EXIT PLANNING - DO YOU HAVE A STRATEGY?

"Nothing in life is certain but death and taxes." As a small business owner, you will face yet a third certainty – no longer owning your business. Fortunately, proper planning will help you leave your business at the best time for you, your family, your employees, and your investors.

What is an exit from a business? It can be as emotionally disturbing as bankruptcy or as quiet as a simple closing with all debts paid. You may get an offer you can't refuse, one that will set you up for life or help you craft a new business venture. You can plan to sell at a good time, take the money, and run. You could also pass the business on to your heirs. An exit strategy simply means that you have planned for the transition and are ready to take advantage of new opportunities.

What is your business worth? An uninformed person would say it's only worth what a buyer would pay you for it. Ask yourself the following – *what do I want it to be worth?* A business owner often assumes the buyer knows more about the value of the business than the owner does. Your business exit plan is the strategy that helps you understand the value of your business and when to cash out.

It takes time and dedication to build a profitable business, especially if you want it to grow quickly. New business owners can usually sustain 80-90 hour work weeks for a couple of years. Still, most function best with no more than 55-60 hour work weeks. Beyond that, they aren't nearly as productive as they should be.

Once you've built your business to a certain point, you will want to continually add value. How? Begin by making the necessary changes to sustain growth and increase business value, but do so without dedicating every hour of your day to the company.

As a business owner, you want to receive a fair value for your business. A successful exit ensures that your business brings a top price. Small business owners looking to exit often allow the value of the business to decrease.

For example, Joe the Barber just turned 55 and is thinking of getting out of his business. He has run a successful hair salon for over 25 years and employs six other barbers and stylists. Joe is tired of coming to work each day and lets his employees run the shop. Joe never approached any of his experienced employees to see if they were interested in buying his business. Two more years pass and two of Joe's key employees leave the shop and start their own salon. In doing so, they take many of Joe's long-term customers with them. These customers prefer services from Joe's prior employees because Joe hasn't had any direct contact with them for some time.

By allowing this to happen, Joe has significantly reduced the value of his business.

Joe does not have the inclination or energy to work the long hours he did when he developed the business. If Joe sells, he will likely have to settle on a sale price less than he had planned on.

If you’re thinking of transitioning your business, keep the following points in mind:

1) Start delegating responsibilities to someone who may have an interest in purchasing your business in the near future. Typically, the planning process should start three to five years prior to when you want to leave. The actual business transaction can take twelve to eighteen months to close.
2) Increase business revenues and improve your profit margins.
3) Reduce expenditures by deferring capital expenditures. Additionally, if you can, reduce training, business travel, entertainment, and other discretionary expenses.
4) Use a reputable accounting firm, even if you haven’t before, to audit, review, or compile financial statements. The purchase price for a small businesses is often less if there is a chance that that the financial information is inaccurate.

Exit Strategies to Consider

Sell

Sell to someone who intimately understands the operations and value of your company. In a small business, you may have employees and/or company managers who may be interested in buying your business. Offering part ownership to start, then selling them a larger interest – and later, perhaps a controlling interest – is not uncommon. The purchase can be financed in a number of ways. If you are comfortable with the buyer(s), you may consider carrying the financing for the purchase. With experienced company managers and a company with a solid track record and assets, financing may be obtained from your local bank. A good attorney is recommended to help you draft the purchase agreement. This can protect you from unanticipated future problems.

Owning and operating a successful small business generally is reflective of the sweat equity you incurred, and thus, selling can often be an emotional experience. As the old saying goes, “Don’t give up your power until you have your money.” To get paid in full the day you sell the business is almost always preferable. It rids a business owner of the worry as to whether or not he or she will eventually receive the full value for the business.

However, if you plan to continue working in some part-time capacity for the company, you should know who is going to end up with the responsibility for running the business and who will get the benefit for owning it. If this is a family member(s), can they be trusted to run the business profitably? If the new owners lack experience, can you, as the former owner, successfully work with them to keep the business prosperous and profitable so that you get paid off?

Close

Sometimes, hopefully not often, it makes more sense to exit by closing the business. Is the business more valuable dead than alive? For example, your business in real estate may provide a greater return if leased to an outside party versus owning and operating your own business. Capital-equipment intensive companies, such as building contractors, may dissolve because the market value of the equipment does not give them a return on the assets great enough to continue to be profitable. A well planned business closing can be a profitable transaction.

Merge

An often overlooked exit strategy for very small businesses is to develop close relationships with similar businesses that may be interested in acquiring or merging. A word of caution: make sure that the business cultures mesh. For example, companies that have adopted more efficient technological methods of operations or have a younger employee group often do not successfully merge with companies that are antiquated in day-to-day operational functions. Designate a period of time – perhaps two to three years – toward developing a working relationship before formally merging. The closer the relationship, the better the chance for a successful, strategic fit.

Go Public

If you are a larger business, you can consider an IPO (initial prospectus offering.) This is a very expensive and involved process that allows your company to sell stock to the public. In recent years, many internet firms were brought to market well before being established businesses. An IPO is a very valid strategy to use if you need to raise a lot of money and have access to the capital markets on a continuing basis. IPO's require following stringent rules and reporting of the Securities and Exchange Commission.

File Bankruptcy

In some cases, bankruptcy is a viable exit from your business. A bankruptcy can be used to reorganize the business and allow you to continue operating. It can also work to salvage the business and allow someone else, such as a creditor, to operate and sell it. Bankruptcy can be a clean break from your old debts and obligations.

Pass to Heirs

If you intend to leave a profitable business to your heirs, it is a good idea to transfer ownership to them in an orderly way that will minimize your tax liabilities. A good estate attorney, accountant, and financial planner should be used to help you structure the transfer so that taxes and other liabilities will be minimized. These resources will also help ensure you retire with an adequate future income stream.

To learn more about exit planning strategies and other services offered by our firm, please visit www.rukkilanegro.com.

Original Author:
Bruce A. Rukkila, CPA, MA
CVA (Certifited Valuation Analyst)
CEPA (Certified Exit Planning Adviser)