Walk Away From Everything Without Leaving Anything Behind:

Creating A Business Exit Plan

by MARC J. LEWYN and CHARLES F. GOETZ

Imagine this scenario: After a year of heated negotiations and emotional discussions among family members, mountains of legal and accounting fees, and millions of dollars in taxes, the transaction was complete. Williams Marketing, Inc. had been sold to its largest competitor. Brothers Bob and Sam Williams received large checks, the investment bankers and lawyers were paid their fees, and everyone could go home.

So why did Bob and Sam feel so bad? Their regrets centered on their vague feeling that they did not realize enough money to be financially independent. They also were sorry to have sold their business to their competitor, when they might have been able to keep the business in the family, or sell to their loyal management team. They just could not figure out a way to do either and secure their own financial future, since neither family nor their key employees had much cash. Further, the offer from their competitor came so suddenly they did not have the time to plan for their sons and key employees to keep their jobs. Despite the pats on the back and hearty handshakes from their professional advisors at the closing, they felt they probably did not receive fair value for their business. During the sale process, the buyer found several reasons to lower the offering price. Among many issues, the buyer suggested that since there were no written contracts with two key customers, he felt

Completing The Exit Plan

Marc J. Lewyn, who moderated a presentation on succession planning at *Keystone 2005,* expanded on a number of the points that he and Goetz made in the accompanying article. According to the consultant, there are a number of considerations the manufacturers' representative ought to keep in mind as he ponders his exit or succession planning strategy.

• **Timing** — "How far in advance the succession plan ought to be anticipated and then implemented can depend to a certain extent upon the way the owner plans on leaving the business. If, for instance, he or she is selling to a third party outside the business, then I've seen the process concluded in as little as 12 months. If, on the other hand, the sale is to an employee or a family member, then the process can be lengthened considerably."

• **Gender Considerations** — It was mentioned in one of the other articles in this section that whether the family member inheriting the business is a son or daughter can have an impact on the succession plan. The only bow in the direction of that variable, according to Lewyn, is more the age of the female in the equation than anything else. "For instance, if the female has child-bearing or child-care issues, that can impact what is decided. That's important. I've worked with one company where the female involved would like to work only a three- or four-day week so she can care for children. That sets up a problem with the male who is involved in the succession plan. Her view is that 'I can get more done in three days than he can in six.' Naturally, his view differs."

• **Creating a Team** — When it comes to the advisory team referred to earlier, Lewyn is careful to put the word "great" in front of the various team members that he feels are needed. "Here's how I view it," he says. "You need a 'great':

— Attorney
— CPA
— Banker
— Financial/investment planner
— Business broker
— Valuation specialist"

• When asked to boil down to one word — if possible — his advice for manufacturers' representatives looking for a way to leave their business, Lewyn offered, **"Patience."**

"It's important to take your time and get the process completed using your agenda and on your schedule." He warned that in a perfect world all the advisors you've surrounded yourself with would be completely objective and attuned to your needs and your agenda, but that's not always the case. "Remember, no one gets paid in this process, unless the sale is made. Hence, if the broker is anxious to get your business sold so he can collect his $500,000 commission, that's the agenda he's working on. Your best interests may not necessarily be served. At the same time, some advisors may be more concerned that they're maintaining their relationships with other advisors such as themselves, rather than meeting your needs.

As to where a rep can find these "great" advisors, Lewyn recommends following the tried-and-true referral route. "Chances are someone you're already working with has contacts in all these other areas. That's the best place to start."

And finally, when asked if a rep, or any businessperson for that matter, can achieve a truly successful exit plan without expert advice, Lewyn good-naturedly responds that the question "is a little like asking a lion if he likes red meat." He notes that while he makes his living providing such advice, he likens the situation to working on a house. "Sure, I'm fairly handy around the house, and I can put in the molding and some other things. But when it comes to something major, I can run into a lot of problems if I don't have the right help either from an architect or contractors."

he was in danger of losing a revenue stream. In addition, there was no structure in place to retain a key salesperson who had generated a large percentage of company revenue.

Because Bob and Sam were not aware of how much these issues would impact value, they failed to take any early action that would have addressed these concerns. The Williams' financial advisor had mentioned something years earlier about adding a valuation specialist into the mix of their professional advisors. Although Bob and Sam thought it made sense at the time, they ended up putting that idea on the shelf to be addressed later.

Another nagging concern was that they were not certain whether they had minimized both the income tax burden resulting from the sale and the potential tax issues their families faced down the road. Their financial advisor and CPA did say something about avoiding capital gains taxes had they had the time to plan, and their attorney made the offhand comment that they could have taken control of the money they now had to send to the government in taxes. They realized too late that this money could have gone instead to their family or favorite charity.

Do You Have an Exit Plan?

This cautionary tale for many business owners illustrates that your ultimate success depends upon having an exit plan. Just as so many other processes within a business, planning for your inevitable exit pays off. Exit planning helps you create higher value for your business, as well as legal and tax structures at least a year ahead of a sale to lower your income-tax liability. It also enables you to objectively consider several possible options, none of which may be a sale to a third party.

Consider the following process for creating a business exit plan:

• ***Establish your objectives.*** This can be compared to a three-legged stool.

1. When do you want to leave?
2. How much money will you want when you leave?
3. Who will own the business after you?

Without answering these threshold questions, it is impossible to plan. As the old saying goes, "If you don't know where you are going, any road will take you there."

• ***Determine what you have.*** That is, how much is your business really worth? If you are selling to a family member, key employee or co-owner, future cash flow of the business after you leave is even more important than its current value.

• ***Promote the business value.*** What features are necessary to make the business saleable and valuable? Among the many questions to ask is whether all legal documents and contracts are in great shape so that a buyer would not be scared away. Also, are all financial controls in place and well-documented? Do you have documentation that operating profit margins are at least as good as industry averages?

These "value drivers" either reduce the risk associated with your business or enhance the prospects that the business will grow significantly in the future. Find out what they are by involving an objective third party (often a valuation specialist) who can identify and implement them.

• ***Clarify whether the goal is to sell to an insider or an outsider.*** This allows you to determine whether the business needs to sell for its highest possible value or for its lowest defensible value. The reasons to sell to a third party for its highest possible value are obvious. The decision to sell for the lowest defensible value may have a huge impact on the taxes you and the insider would pay, as well as whether both of you reach your financial independence goals.

• ***If the goal is to sell to an insider, determine how the buyer can generate the cash necessary to make the transaction happen.*** How can this be done without

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depriving the company of operating cash flow and compromising your own financial goals? One technique is to create the lowest defensible valuation coupled with a deferred compensation plan for you. This minimizes the amount of cash the buyer needs while generating a similar after-tax result for you. Note also that a sale to an insider often does not end with the closing. By creating a back-up plan if the payment stretches out a year or longer, both you and the company will survive if something goes wrong.

• ***Develop a contingency plan for the business.*** Business continuity is much more than making sure there is a new owner. If the buyer becomes disabled before the exit is complete and still owes you money on a multi-year buyout, your financial security may be compromised. There are a variety of techniques that can address this, like creating a buy-sell agreement funded by insurance to allow the seller to be paid in the event of a catastrophe. A second idea might be the creation of a "stay bonus" plan, whereby a key employee has the incentive to stay on after the new owner's disability or death.

• ***Rely on a great advisory team.*** This is critical to keeping the IRS from taking a significant amount of the cash generated by the sale. In the end, this step must rank high on your priority list. If you create a valuable business but lose much of it in income and estate taxes, what have you really accomplished? Your team should be in place at the beginning of the process and should have extensive experience in all the elements of exit planning — especially the tax planning.

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Looking Back With No Regrets

Had Bob and Sam followed these steps, they possibly could have generated a greater sum at the closing, sold their business to the right buyer and paid less in taxes, and they would have been able to look back on their career with greater satisfaction.

Like many things in life, a failure to consider the important, but not urgent, elements of our business lives often leads to disappointments and regrets. By contrast, a proactive focus on these critical elements can leave you with a sense of achievement and financial security. ❐