THIS WAY OUT!

STRATEGIES FOR SUCCESSFUL EXIT PLANNING

EDITORIAL | GEORGE NAPOLI

Exit planning is a modern-day business strategy and the most effective process for learning to work **on** your business while you work **in** your business — even if you're not quite ready to leave.

GEORGE NAPOLI

George Napoli is a director member of BEI's network of exit planning advisors. For for more exit planning information and training resources, or to sign up for a free monthly e-newsletter on exit planning, visit **nextgenerationep.com**.

A review of the market and exit planning stakeholders shows that:

✓ **The exit planning market is approximately 10 trillion dollars.**

✓ **7.2 million business owners 50 years and older own more than 9 million businesses.**

✓ **4.2 million businesses are successful.**

The typical exit planning candidate has been in business for 10 years, has one or more key employees and does in excess of one million dollars *plus*, in profit annually. Many cases exist for the smaller enterprise where profits are approximately a half-million dollars annually.

Why is Exit Planning Critical?

- A majority of closely-held businesses will change hands within the next five years.
- The balance of those businesses are ready to change hands now.
- Forty percent of all businesses deal with ownership transfers each year.

Most business owners have not taken active steps to transfer out of their business, and for most owners, the business itself is their single largest asset.

Here are two scenarios that illustrate the importance of exit planning:

- Years ago I met with Bill and Paul McGrath, owners of a thriving construction company. What I assumed would be a business planning meeting turned into a "We're-getting-out-of-business-how-do-we-do-it?" meeting. As successful as they were, they were tired of changing tax codes, government regulation and the day-to-day grind.

  A sale to a third party was not an option because they were not willing to stay on after the sale — and they had failed to develop a management team, which any savvy advisor would require as a condition of purchase. Neither had children and transferring ownership to employees was out of the question.

  Bill and Paul's thriving business was worth no more than the value of their tangible assets. After the sale of those assets, dozens of employees lost their jobs, the business disappeared, and Bill and Paul left millions on the table.

- Franklin Taft was understandably a bit neurotic. He was increasingly anxious to begin planning for his eventual departure from his sales rep business, but his concerns prevented him from proceeding. "I'm too busy working in my business to think about how to leave. Besides, I don't know what to do and neither do my advisors. Worse yet is that I know what happens if my competitors find out or my principals learn about it."

Sound familiar? Experience tells us the primary reasons owners fail to plan are:

- You are too busy fighting alligators to drain the swamp.
- Most advisors don't know how to effectively work together to help you leave your business.
- You fear the unknown.

Exit Planning Team

No one person has all the skills or knowledge needed or required to create a comprehensive exit plan. You already have a team of advisors that are trusted. Your exit plan-

Experience tells us the primary reason owners fail to plan is:
you are too busy fighting alligators to drain the swamp.

"How many exit paths really exist for business owners? I've heard as many as 50, but we can only really come up with eight ways for owners to leave their business."

ning advisor works with selected members of that team and creates the blueprint, recommendations and action list to a successful exit.

Your Exit Planning Team includes:
- Exit Planner
- CPA
- Attorney
- Financial Planner
- Business Broker
- Insurance Agent
- Wealth Manager

Some of your Advisors serve more than one role and can fill multiple roles. You may not need every discipline to support your exit plan.

Knowing Your Company's Worth
The critical elements of an exit plan and the single most important element of them all are:

- Owners must pick at least a tentative departure date so advisors can put all planning efforts in context.
- The preliminary financial needs analysis. You must assess your post-retirement financial needs, because meeting them is a key measure of your exit planning success.
- Choosing a successor is similar to the first element in that your choice is not immutable, but does give structure to the exit plan. Keep in mind, it is not uncommon for an owner's sale to key employees to be pre-empted by an offer from a third party.
- An estimate of future cash flow, since "cash is king"!!!
- Know what your company is worth. This is the single most important element of all. To accomplish this, you should consider hiring a certified value specialist to provide your advisors an idea of what your company is worth. Some CPA firms provide this service as well.

The exit planning process should be owner-based. Its foundation is made up of your goals — one of the most important of which is how much money you want when you leave your company. The other part is in knowing what type of vehicle you will drive to your destination. You and your advisors need to know if your company is a dependable, high-performance road warrior or a temperamental vehicle prone to periodic breakdowns. If it is the latter, incorporate that knowledge into the exit plan. Part of the necessary planning includes minimizing or eliminating any weaknesses, making your company more desirable to buyers — thus, more valuable.

Since nothing can begin without a valuation, it's important we discuss it in further detail. Would you put your home on the market without knowing its value? Your business is likely far more valuable, and the conversion of that value is far more important to your financial future. For all these reasons, determining a reliable value is essential before planning your exit can truly begin.

A valuation can occur in two phases. You can always start with a less expensive preliminary valuation. They range between $4,000 and $10,000. Secure a final valuation at a later time in the exit planning process. The preliminary valuation:

- Consumes about 40-60% of the total valuation fee,
- Is the basis for the complete valuation, but
- Lacks the supporting information contained in a written opinion value.

You need an accurate valuation, since a solid valuation becomes the cornerstone and foundation to your exit plan. It's also used to support recommendations such as key employee incentives, business continuity, ESOP'S, stock bonus and non-qualified deferred compensation plans and stock appreciation (SAR) rights as a few examples determined from past projects.

Planning for Your Business Exit
Inevitably, everyone will exit their business, now or some time in the future, willingly or through sickness or death. Owners begin to learn about exiting their business when three streams converge:

- The first is when you realize you want to do something different each day besides going to work. Either you would like to be someplace else, do something else, or no longer get a kick out of doing what you do.

- The second is when you become aware that you are either approaching financial independence, or making significant strides toward reaching that goal, or you can reach it by exiting your business. Hopefully, when that happens, your exit plan is in place and you can actually leave the business when you want to.
- The third stream is when you learn of a possible health problem or other family issue.

That, in a nutshell, is the purpose of exit planning — to leave your business on your terms and on your schedule, and just as important, be prepared in the event of an untimely death, sickness or accident.

How to Leave the Business

How many exit paths really exist for business owners? I've heard as many as 50, but we can only really come up with eight ways for owners to leave their business:

- Transfer the company to a family member.
- Sell the business to one or more key employees.
- Sell to key employees using an ESOP.
- Sell the business to one or more co-owners.
- Sell to an outside third party.
- Engage in an Initial Public Offering.
- Retain ownership but become a passive owner.
- Liquidate.

Choosing a Path

First, you and your advisor team need to identify your most important objectives; second, consider the most important element — value — along with the internal and external considerations that impact your decision and third, evaluate the tax consequences.

Learn what value drivers buyers are most interested in and will pay the greatest amount for. Have you ever wondered why one business has buyers lined up willing to pay top dollar, while another sits on the market for months, even years?

The items common to all industries combined with items specific to your business that drive up value are called — "value drivers." They include:

- A stable, motivated management team.
- Operating systems that improve sustainability of cash flow.
- A solid, diversified customer base.
- Facility appearance consistent with asking price.
- A realistic growth strategy.
- Effective financial controls.
- Good and improving cash flow.

The reason a buyer is willing to pay a premium price centers on his or her perceptions of risk and return. If the characteristics of what buyers find valuable — characteristics that both reduce risk and improve returns are present — a buyer will be willing to pay top dollar.

If you would like to learn more about how to prepare your EP, here are some of Napoli's resources:

How To Run Your Business So You Can Leave It In Style — Request a copy via the author's website (**nextgenerationep.com**). Supporting workbooks are also available.

Consulting Services — There is a defined exit planning process that provides templates showing owners and advisors what they need to know to successfully leave their business on their terms and on their conditions. Exit plans are component-driven and are meant to stand alone as preliminary plans or combined to create a comprehensive exit plan. Inquire via the website.

A free archived newsletter is available on request — *Former Owners Express No Regrets.* Simply email your request to **gnapoli@nextgenerationep.com.**