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EXITING YOUR BUSINESS IN STYLE

The Importance of Using a Systematic Process in Business Exit Planning

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THE SEVEN STEP EXIT PLANNING PROCESS

Step 1: Owner Objectives
Step 2: Business and Personal Financial Resources
Step 3: Maximizing and Protecting Business Value
Step 4: Ownership Transfers to Third Parties
Step 5: Ownership Transfers to Insiders
Step 6: Business Continuity Planning
Step 7: Personal Wealth and Estate Planning

This article will continue our discussion of the Seven-Step Business Exit Planning Process by focusing on Step 2: Identifying the Owner's Business and Personal Financial Resources, and Step 3: Building and Preserving the Value of the Company. Readers are encouraged to remember that this systematic process uses the Owner's unique Personal Objectives (identified in Step 1: *WCBA November 2010 Newsletter*, page 8) to convert their current reality into their desired outcome. The Exit Planning Process helps maximize the financial return, minimize tax liability, plan for contingencies and increase the likelihood of a successful transfer of the business, all with a significant role for you as their attorney.

Client's often want all aspects of their planning tied together in one coherent plan. Using a systematic approach allows them to either accomplish this one step at a time or work through an entire Exit Plan, culminating in their Personal Wealth and Estate Planning. If the Business Owner client decides to work through an Exit Plan in stages, the client and advisors can prioritize the steps and complete each component sequentially. Let's discuss…

STEP 2: BUSINESS AND PERSONAL FINANCIAL RESOURCES

Much of an Owner's wealth is often locked up in an illiquid business that must be converted to cash—and taxes paid upon that conversion—in order to exit favorably. In Step 2, we establish: 1) the value of what the Business Owner client has today (i.e. the value of the business), and 2) the potential cash flow of the business over the next few years. We will learn whether there is a shortfall between the amount the client needs or wants from the business (when they exit), and the amount that they have now. Unless we know the value of the Company or the amount of after-tax cash they can expect to receive from the transfer, it is impossible to determine if the financial objectives can be met.

Importantly, the combination of Steps One and Two tells us the extent of value or cash flow increase that is necessary to meet the Business Owner's goals. The starting point for reaching the Exit Objectives begins with: How much is the business worth today? How much cash flow does it currently generate? How much income do the non-business assets produce? We can then project future cash flow, as well as the future value of the business and non-business assets. However, without an initial determination of what the Business Owner client has, both business and personally, we cannot measure our progress toward the stated objectives.

If the financial objectives cannot be met today, a business valuation will tell us how much the Company must grow before the Business Owner client can exit. Therefore, a business valuation determines if a sale can provide needed cash, and it provides a benchmark of what the Owner deserves if the business is to be transferred to a non-cash buyer. If, on the other hand, the client is ready to exit and the

Company will sell for an amount that will make the client financially secure for life, there are significant risks if they choose to delay their exit.

Practice Note: Every attorney has a story about how the client thought their business was worth X, when reality is that it is worth "less than X". A professional business valuation from an objective Appraiser is best when balancing the expectations of the client and the realities of the situation.

When Step 2 is Completed, the Client & Advisor(s) Will Know:

- What the Company is Worth;
- The current and future value of the personal assets the client has in place, and
- What those assets might be worth in the future.

STEP 3: BUILD AND PRESERVE VALUE

The value of the Business will determine not only the quality of the Business Owner Client's life once they leave the business, but how long they will have to stay in the business before they can leave. The simple, but unpleasant fact is that growing business value takes years of concentrated effort. Working to grow and preserve value – well before the date the Owner needs the monetary value – is what Step 3 is all about.

The elements that build the value of a business or preserve the value that the Owner client worked so hard to create and that buyers will pay for are called Value Drivers. In this Component, Value Drivers which are important to meeting the client's objectives are identified, and design strategies are then recommended to protect the tangible and intangible value of the business. Value Drivers include (but are not limited to) a stable and motivated Management Team, a realistic growth strategy and operating systems that improve the sustainability of cash flows. Based on the Company's needs, recommendations may also include installing or updating financial reporting systems, aligning employee performance with the attainment of your profitability goals, or protecting proprietary information through covenants not to compete with key employees.

We utilize a Value Driver Analysis which covers three critical areas: 1) Strategic Objectives: identifying the long-term business and personal goals for the client, 2) Quantify Resources: assessment of the client's business and personal financial landscapes, and 3) Close the Gap: targeting specific areas in the business that can drive up the Value and close the Gap between where the client is today and where they want to be after they leave the business.

STRATEGIC ADVANTAGES OF BUSINESS VALUE DRIVERS:

- To strengthen the Company to better withstand competitive pressure;
- To create a more systematic way to attract, motivate and retain their best employees, and
- To build the Business Value needed to one day sell or transfer the Company for the amount the Business Owner client needs to retire comfortably.

POSSIBLE RECOMMENDATIONS (VALUE DRIVERS) TO BUILD AND PRESERVE VALUE:

- Management Team Development Plan
- Plan to Transition Management Responsibility
- Employee Compensation Review and Analysis
- Qualified Retirement Plan Changes
- Key Person Insurance Planning
- Key Employee Incentive Compensation Plans
- Separation of Business Assets from Business Operations
- Covenants Not to Compete.

IN CONCLUSION

It should be noted that Step 1: Identifying the Owners Objectives and Step 2: Identifying the Business and Personal Financial Resources are always completed in order to provide the fundamental basis for Step 3: Building & Preserving Value. Utilizing the information and objectives from the first two Steps, we make specific recommendations to help grow the business value, protect existing value from the actions of others, and preserve Company value by minimizing income taxes. Once the recommendation details and decisions are finalized, an implementation schedule is created to systematically implement each. At that point, attention can be turned to the next Component of the Exit Planning Process.

In our next article, we will continue to break down and discuss the Seven Step Business Exit Planning Process by focusing on either selling the Company to a Third Party or Transferring the Business to Insiders.

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