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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

In recent issues of this newsletter, we have described the first three steps of The Seven Step Exit Planning Process. This article will continue with the Seven Step Business Exit Planning Process by focusing on Step 4: Selling the Company to a Third Party, and Step 5: Transferring the Business to Insiders. Many Business Owners either do not have a strong preference for a successor, and/or realize that economic circumstances change over time. Preparing a business for a sale or transfer and completing the transaction take more time, focus, planning, skill and stamina than many owners expect.

Keep in mind that only half of all businesses listed for sale do sell, and that sale prices are influenced by the ups and downs of the marketplace. We truly believe that the best way to ensure the success of a sale or transfer is to get well organized in advance of putting the Company on the market. The Exit Planning Process helps increase the likelihood of a successful sale or transfer of the business, all with a significant role for you as their attorney. Let's discuss…

STEP 4: OWNERSHIP TRANSFERS TO THIRD PARTIES

In preparation for the sale of a business many Business Owners do not realize the complexity and details involved in a Third Party sale until they are well into negotiations. This written planning process will help you to take the appropriate steps *before your client puts their business on the market* so that the sale process can be as organized and as efficient as possible. In doing so, advisors can reduce stress on the client, the client's business and their own practices' while maximizing the likelihood that the transact-tion will achieve the Business Owner client's goals.

Generally, owners are attracted to a Third Party sale (rather than a sale to Insiders—family members, Co-owners or employees) for one or more of the following reasons:

1. When the market is favorable, a sale to a Third Party can yield more cash.
2. A sale to a Third Party usually is less risky than one to Insiders.
3. Sellers can get their money faster than in a transfer to Insiders.
4. Insiders (children, co-owners and employees) often don't have what it takes (usually cash and sometimes desire) to buy the Company.

If these statements apply to the Business Owner Client's situation, the next step is to ask:

- Are they personally, and financially, ready to exit?
- Are they fully prepared for their exit from the business?
- Is the Merger and Acquisition (M&A) marketplace favorable for sellers?

To optimize the likelihood of a successful sale, it is best to begin the sale process only if the client can answer each of these questions with a confident "Yes!" If the Business Owner client has any doubts, now is the time to seek answers and resolution.

Practice Note: Advisors working with their Business Owner clients should seek out the advice of experts. The client should be advised to start to assemble a "Deal Team".

Depending on the size of the company, the transaction intermediary may be an Investment Banker or a Business Broker. The client will need to find an Attorney skilled in transaction work, and if the client's current CPA is skilled in tax minimization techniques, they may be able to play on the Deal Team. The client must understand that several professionals need to be involved for the client to obtain the best advice and counsel.

Working in conjunction, the expertise of this Deal Team helps the client create a plan that:

- Minimizes the tax consequence of the deal;
- Takes into account the Business Owner client's willingness (or unwillingness) to remain active in the Company once the deal closes;
- Determines whether the transaction will best be conducted as a controlled auction or negotiation;
- Specifies what kind of payment the client will accept; and
- Includes a strategy that allows the client to focus on the Company's profitability while the transaction occurs.

POSSIBLE RECOMMENDATIONS TO PREPARE FOR A SALE:

- Begin Pre-Sale Due Diligence
- Reduce Company Debt
- Consider Various Tax Planning Strategies
- Identify Potential Buyers
- Create Stay Bonus Plan for Employees
- Consider Options for Business Real Estate

STEP 5: OWNERSHIP TRANSFERS TO INSIDERS

For circumstances where a Company is too small to attract the notice of a large Third Party Buyer, owners may transfer to an Insider. Such a plan would yield more cash than a Third Party sale, and would allow the Owner to exit sooner. There is a focus on minimizing income tax consequences for both Seller and Buyer, and on acquiring the cash to pay the purchase price. Client's may benefit from ownership transfer to Insiders if: they want to give the business to their children, but believe that taxes will make the transfer impossible; they choose to sell their ownership to an Insider thinking they could get fair value for it; they have promised the business to their Management Team, but realize that they don't have any money!

To transfer the client's ownership interest—success-fully—to insiders (co-owners, family members or key employees) we must:

1. Achieve the client's objectives related to value and timing;
2. Minimize the client's risk, and
3. Keep the client in control of the Company until they have received full payment for the Company.

To accomplish this, one must use individual or Company performance criteria for ownership transfers, business cash flow for the primary source of funding for transfers and/or create plans that unfold over a number of years. Therefore, Exit Planning is an excellent way to actively work with your Business Owner clients.

POSSIBLE RECOMMENDATIONS TO TRANSFER THE BUSINESS TO INSIDERS:

- Create an Ownership Skills Development Plan
- Sale of Ownership Interest (using cash, a note or bank financing)
- Bonus of Ownership Interest
- Gift of Ownership Interest
- Non-Qualified Deferred Compensation Plan
- GRAT (Grantor Retained Annuity Trust)
- Buy-Back Agreement for Minority Owner

IN CONCLUSION

As we discuss our way through the Seven Step Exit Planning Process, practitioners should be able to identify clients within their practices' who need this guidance. Clients want to have a written Exit Plan in place that makes them feel safer as they make what is often the most critical financial decision of their lives: the exit from their business. Given the new Estate & Gift Tax laws, these planning decisions couldn't be any more important or timely. In partner-ship, the Attorney can efficiently work with their Business Owner clients to have a successful exit, and follow the natural work flow to the client's Personal Wealth and Estate Planning.

Until next time, please feel free to contact the authors with any questions, comments or things you would like to talk about…

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