THE GOOD AND THE BAD OF BUSINESS TRANSITION OPTIONS

WRITTEN BY

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"You've got to be very careful if you don't know where you are going because you might not get there."

Yogi Berra


Roads to Exit:

There are many options available for business owners to successfully exit his or her business. Most owners don't realize that there are many roads that lead to a successful transaction.

Exit strategies fall into three main categories:

- internal transitions
- external transitions
- other transitions

This eBook provides a little information about each type of exit so you can start to narrow your focus on the types of plans that best suits your needs. There is one way to guarantee that a business owner won't be able to exit successfully and that is to fail to plan for it. #exitstrategy

48% **of business owners do not have exit strategies for their business**

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Transition to Insiders

Typically about a third of business owners are interested in a sale to insiders. A transfer to insiders is arguably the most successful transition available to business owners today, primarily because it reduces risk and provides significant benefits to the insiders who take on the business. There are three primary types of insider transitions - a sale to family members, a sale to current management, or a sale to employees or ESOP.

- **TRANSITION TO FAMILY**

89%

of family members are not interested in taking over the family business

Despite the challenges inherent to a family transfer, there are many offsetting rewards and benefits, all which stem from careful planning.

PROS

- Usually family members have been involved in the business already
- Great way to leave a family legacy
- Favorable way to transfer family|generational wealth

CONS

- Many times the "buying" generation wants to do things differently to leave their mark - which sometimes rubs the "selling" generation the wrong way
- Family communication issues
- Family members not inside the company may feel slighted
- Typically lower value transaction to the seller

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- **TRANSITION TO MANAGEMENT**

This type of transition is commonly referred to as a Management Buy-Out or MBO. In an MBO, the current management secures funding from a bank, investment partner or the current owner.

PROS

- Security of having well-seasoned management who already know the business.
- Secures your legacy as well as future payments to you or new investors
- Business is no longer dependent on owner involvement

CONS

- Need to secure funding and usually, the current management does not have the ability to do so without help from the current owner
- Possibly still involved in business

- **EMPLOYEE STOCK PURCHASE**

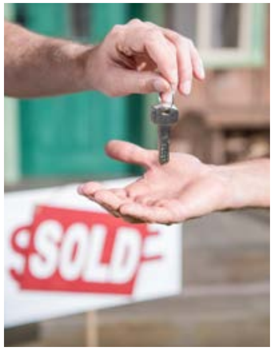
A small percentage of business owners consider an ESOP exit strategy. This path is particularly appealing to those who wish to transfer their companies to known entities, perpetuate their current mission or culture, and keep their companies in their community.

PROS

- Rewards your current employees and management by providing ownership in the company
- Typically allows the owner to stay involved in the business post-transaction
- Allows the owner to continue his long relationship with employees, vendors, and customers
- Retains the business owners sense of belonging

CONS

- Somewhat complicated to navigate
- The business owner and employees will need to seek outside help which can be costly
- The business has to be able to borrow or find investors to pay the owner at closing
- Many times, the owner carries a long term note from the company, even though he's typically no longer involved in the day to day operations of the business.



Sale to a Third Party:

The majority of business owners (close to two-thirds) are interested in this Exit Path, which is often the first or second choice for many business owners. A third-party sale is often the easiest and most rewarding option for business owners.

82%

of business owners would rather have cash than the business

- **SALE TO INDIVIDUAL BUYERS**

For very small businesses, the most likely buyer is an individual, sometimes with industry experience or specific interest in the market served by the business.

58%

of business owners have never had their business appraised.

PROS

- Individual buyers might keep the business owner's legacy alive.The individual may have industry experience allowing for a smooth transition
- The owner may be able to stay on for a long term consulting agreement providing additional cash flow as they transition to the Third Act.
- Individual buyers may have a shorter due diligence process than other types of buyers.

CONS

- Individuals may not have the ability to pay cash or be able to finance a transaction therefore potentially requiring owner financing.
- The individual may not have industry experience typically causing a longer transition period whether the owner wants to stay or not.

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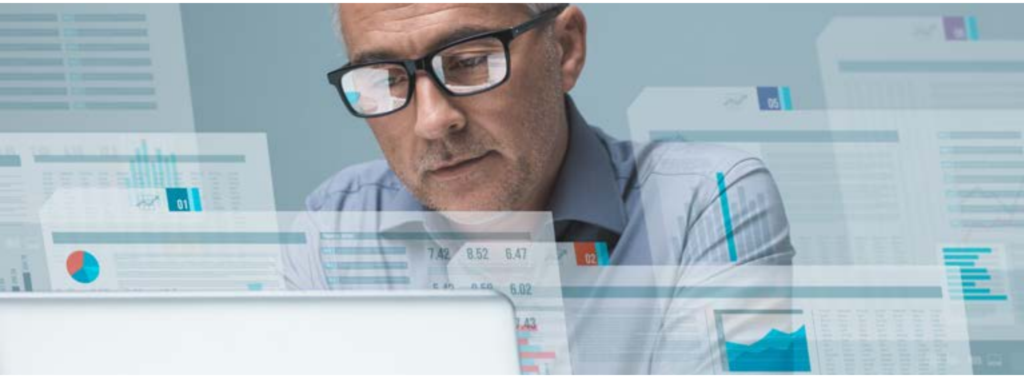
• SALE TO FINANCIAL BUYERS

There are several types of financial buyers such as private equity firms, venture capitalists and family offices. These buyers typically have the cash to invest but don't always have industry experience



PROS

- Financial buyers of all types are experienced at business transactions and so for the most part, they will know what they are doing.
- Financial buyers will typically ask the owner to stay on and retain some ownership so that they can have a "second bite of the apple" when the business sells again
- Many times, financial buyers will pay the highest price for a business, mostly because they have committed capital that needs to be deployed and put to work for their investors.

CONS

- Financial buyers almost never have specific industry experience, and therefore are not particularly helpful with operational issues and challenges. Sometimes they do have a panel of experts that can help but make no mistake, they are about driving higher revenue and profits.
- Financial buyers will have a higher level of scrutiny on the financial performance of the business, even if the owner stays on in a key role.
- Financial buyers will almost always require the owner to stay on with the company. Although they rarely disclose it during the purchase process, financial buyers always have an investment thesis, and the owner will have to conform to the new business strategy or they will be forced out. By the way, the average tenure of a former owner of a business that sells to a financial buyer is about 2 years.

- **SALE TO STRATEGIC BUYERS**

A strategic buyer is usually a larger company that has some reason they want to buy another company - typically technology, product or customer base. They also usually are entrenched in the same industry as the company, but may also be in a related industry and looking to expand into the company's market.

PROS

- Because by definition, strategic buyers have a specific strategy in mind when they complete an acquisition, they are frequently the highest offer for the business netting the owner a higher value outcome.
- In most circumstances, strategic buyers know a great deal about the business and are buying it for strategic reasons. Therefore, they have great industry experience and can contribute really meaningful input.
- Many times, a strategic buyer is also interested in the owner of the business and therefore may offer a short or long term employment agreement providing additional income and security.
- For owners looking to walk away quickly, strategic buyers are a great option because they already know the business and market.

CONS

- Because strategic buyers are likely in the same or a very similar business, they may not need all of the former overhead, so some of the employees may lose their jobs and facilities may be closed.
- For business owners that personally own their real estate, if the buyer decides to vacate the property, the former owner may not be able to find another tenant for the space, thus reducing future income potential.
- If a transaction with a strategic buyer falls apart, that buyer will have tons of information about the acquisition target that could negatively impact the business.

PROS

- Capital infusion to the company for new stock issued that can used for R&D, growth, debt reduction, etc.
- Financial benefit to the business owner and early investors who can liquidate their formerly illiquid asset.
- Often generates publicity by making the company and products known to a wider potential swath of customers.

• INITIAL PUBLIC OFFERING

An IPO is a sale to the public markets typically through one of the stock exchanges, or more rarely by purchasing a "shell" that is already public. IPOs are typically reserved only for fast-growing businesses that have reached at least $100M in revenue, or for disruptive businesses that have raised significant investments already and have attracted lots of attention. Therefore only a tiny percentage of business owners consider it a viable exit option.

CONS

- IPOs are really expensive and business owners will need lots of help from experienced service providers and professionals
- Increased reporting requirements, not to mention added scrutiny of the Securities and Exchange Commission
- Companies going public have to invest in things they may not have previously considered - like the generation of financial reporting documents, audit fees, investor relation departments, and accounting oversight committees.

OTHER TYPES OF TRANSITIONS:

Although technically other options might be considered either internal or external transitions - there are a few that just don't fit neatly into one of the other categories. They include often overlooked exit strategies that could be viable options for business owners.

37%

of business owners have no structures in place to shield sale proceeds

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- **ROLE TRANSITION**

Perhaps one of the most overlooked exit strategies might be considered no exit at all. A role transition from Owner/Operator to Owner/Investor is where business owners retain management and ownership of the business - but stop working in the business day-to-day. This is an excellent option for businesses that produce high cash flow and for owners that can genuinely hand over the reins and learn to manage like an owner rather than an operator. It's also a great option if both the company and the business owner are in great health.

PROS

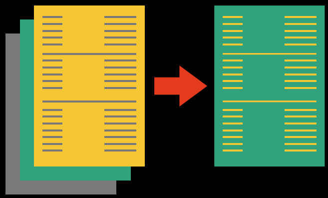
- The business owner retains the benefit of the high cash flow.
- The owner can potentially keep or add significant fringe benefits.
- If great second-tier management already exists in the company, the transition can be easy and seamless.
- The business owner ultimately has control of the asset they started or built.

CONS

- Many times this transition is hard for business owners that have been heavily involved in the business for a long time.
- If internal management candidates are not available, the business owner will have to recruit and train new managers to run the business.
- Some of that high cash flow will need to be invested in the new management for compensation and incentives

- **LIQUIDATION**

Fewer than one in five business owners view liquidation as a viable exit strategy. Except in rare occasions, liquidation is preferable only to death as a means of getting money out of the business. Without any planning, liquidation may become the owner's only option.



41%

of business owners are looking to exit their business in the next 5 years

PROS

- You stay in control of the process
- You can sell assets over time or at a planned time to close the business

CONS

- The business owner may not be able to find buyers for all of the assets
- Liquidation can be a long and laborious process

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- **DEATH**

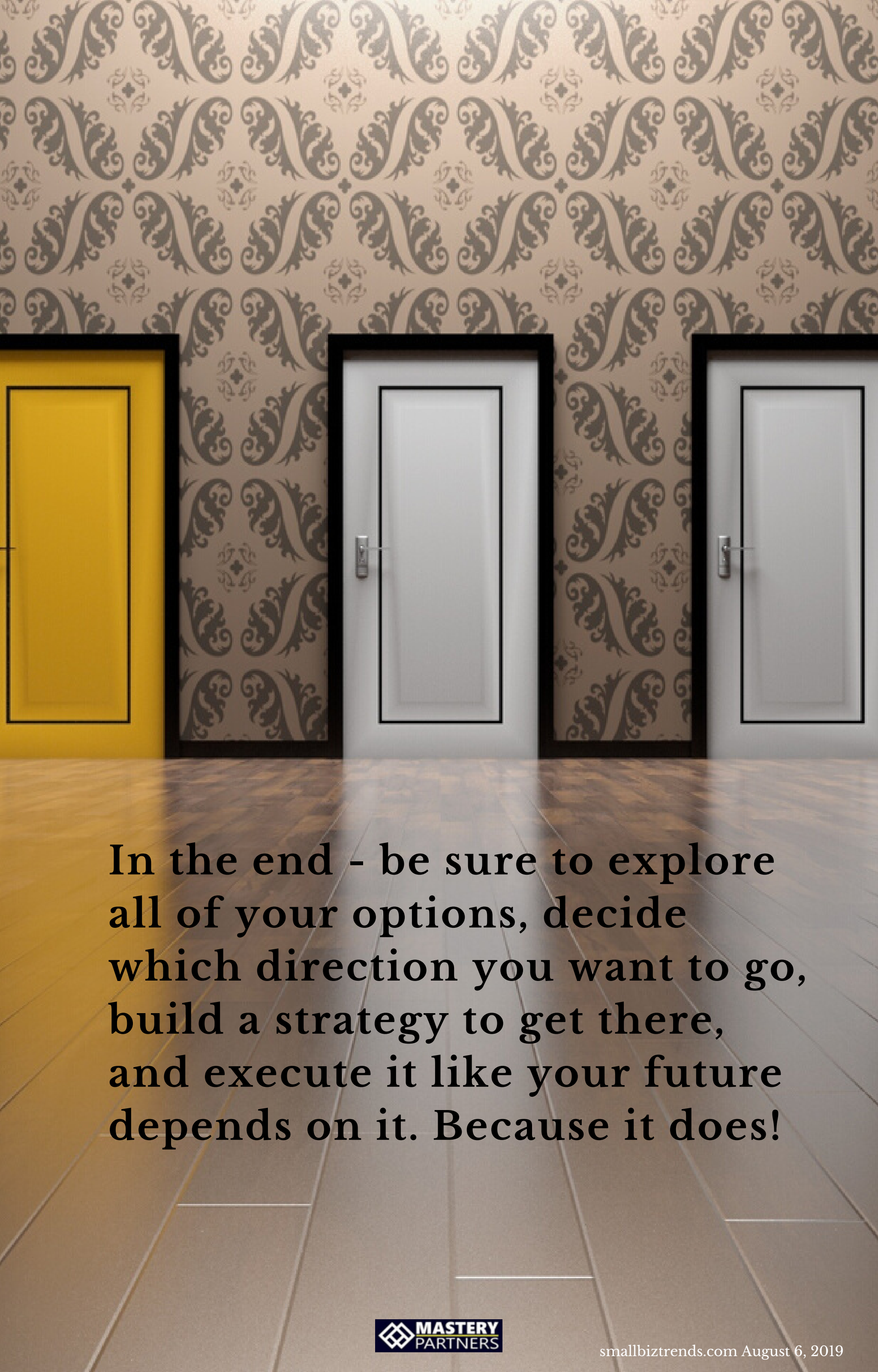
OK - don't laugh. I hated to add this one to the list - but unfortunately death becomes the default exit option for too many business owners. It is almost always the worst possible outcome because the business is left to the typically inexperienced hands of the heirs and employees - with no plan for what to do to keep the business viable.

PROS

- The business owner is no longer burdened with the business - because he's dead.
- I don't know any other pros on this one!

CONS

- The heirs probably need the cash that the business formerly generated in order to survive. (Notice I said formerly because, without the owner, the business almost always declines rapidly.)
- The business is left to the heirs to decide what to do, and most of the time they have no experience in the business.
- The business will have to be sold in a fire sale or liquidation - which will generate far less value for the heirs.


In the end - be sure to explore all of your options, decide which direction you want to go, build a strategy to get there, and execute it like your future depends on it. Because it does!
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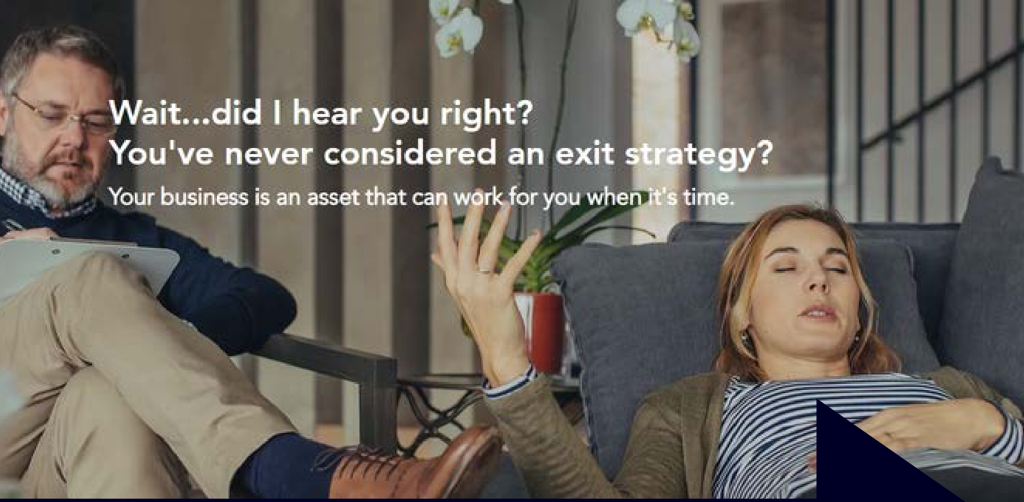

Are you stuck?

We take the mystery out of **EXIT strategies with our 4-Step Process.**

1. Transaction Readiness Assessment
2. Roadmap for Value Acceleration
3. Strategy Execution
4. Transition on Your Terms

Our proven process helps business owners maximize business value, design an exit strategy, and transition their business on their terms

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REACH OUT TO US TODAY!

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