Creating a successful exit strategy for you and your business requires thought and planning, but the effort is well worth it for everyone involved.

The Why and How of Exit Planning

When it comes to your exit strategy—sale to employees or a third party, initial public offering (IPO), liquidation or family succession—it is never too early to begin the planning process. In fact, you might say the best time to begin planning your exit is when you draft your initial business plan. But by following five simple steps with the help of your team of internal and external advisors, you can be sure you aren't late to the game.

1. Align your business, personal and financial goals.
2. Consider all possible exit options.
3. Maximize the value of the business.
4. Be aware of the industry and competitive dynamics.
5. Practice due diligence.

The following is a guide to the considerations and basic steps in creating an exit plan for your business. It is not meant to be comprehensive, but it will make you aware of what it takes to create a plan, whom to involve and the risks of not having a plan. Overall, we hope it prompts you to think seriously about the final stages of your involvement with your business so you can create a winning formula for everyone involved.

As always, please consult with legal and accounting professionals, and other trusted advisors to ensure your success.

Aesop, the famous writer of fables, said :

"Affairs are easier of entrance than of exit; and it is but common prudence to see our way out before we venture in."

While that might be true, it does no good to dwell on the past.

When it is time to exit your business, you need a forward-looking strategy—one that addresses your business, personal and financial goals.

GETTING STARTED

Every privately owned business changes hands at least once, representing what is usually the largest single financial transaction in an owner's lifetime. However, many business owners fail to properly plan for this important, risky event. If selling the business is an owner's exit plan, failing to plan can drastically reduce the price a buyer might be willing to pay. An owner should begin planning their exit at least two to five years prior to the actual event as value enhancements and other steps take time to implement and have an effect.

Creating and implementing an effective exit plan involves five key areas:

- Identify and Align Goals
- Evaluate All Potential Options
- Maximize the Value of the Business
- Assess the Environment
- Perform Due Diligence

We will examine each one of these areas in detail and offer insight into why they are important to a successful exit strategy. Planning for a successful exit is complex, involving many decision paths along the way. It all starts with what you want the business to do for you.

IDENTIFY AND ALIGN GOALS

Every business owner will measure the success or failure of an exit differently. For some, a smooth handoff to managers, employees or family members is enough. For others, the sale of their business is the main source of funds for a long, comfortable retirement. Another owner might not need the proceeds from a sale but wants to ensure the business is firmly situated for long-term success.

The first step, therefore, of any exit plan should be for the owner(s) to articulate and align their business, personal and financial goals.

These goals fall into three main categories: business, personal and financial.

BUSINESS GOALS

These could be revenue level, number of locations, or market share. You might want to attain certain business goals before exiting the business or make such goals part of the terms of the transfer.

PERSONAL GOALS

Goals of this type include ideal retirement age, type of sale, and type of buyer: You might want to set a preferred age(s) to retire (subject to change).

You must also consider whether you want to sell all at once or in stages, and determine how much control you want to retain along the way.

Another key consideration is the type of buyer: Are you looking for someone to pay you the highest price or are you willing to give up some dollars in exchange for the plan that best guarantees the legacy you want to create?

FINANCIAL GOALS

Here, you must balance your own long-term financial needs with those of the business—if it will continue operating—other family members, and charitable giving.

Identifying each goal is important, but aligning the goals is a vital step in the exit planning process.

For example, if you want to retire in three years and net $10 million on the sale of your business, does the financial performance of the company imply this level of value? If any of the goals do not align, you will need to prioritize and adjust certain goals.

Some goals, such as long-term personal financial needs can only be adjusted so far. In that case, personal financial needs will drive adjustments in the other goals.

The identification and alignment of the owner's goals are the backbone of any exit plan and will serve as the framework for the entire process.

> *Your goals for retirement, your legacy, the firm's sustainability and the manner in which you step away must all be carefully considered and defined. It takes planning, coordination and soul-searching to balance all these facets of your business and personal life.*
>
> ***The first, and perhaps most important key to a successful exit strategy is aligning your goals.***

EVALUATE ALL POTENTIAL OPTIONS

Depending on an owner's specific situation and the set of goals identified in the first step, exploring the available exit options and determining the most appropriate solution should be the next step in the process. These include:

- Sell the owner's interest in the company to a third party, other shareholders, management or an Employee Stock Ownership Plan (ESOP)
- Transfer ownership to family
- Initial public offering (IPO)
- Wind down and liquidate

An IPO is usually not a viable option for the majority of privately owned businesses. Transferring ownership to family may not be a possibility, and only in rare cases does it make sense to wind down and liquidate a business.

For the majority of business owners, selling their interest in the company is the most appropriate option. Depending on the situation, selling to other owners, management or an ESOP might not be an option, which leaves selling the business to a third party as the best choice. It is with this situation that the other steps become so significant.

One of the best ways to ensure you meet all your goals is to maximize the value of the business. Like most things, it's never too early to get started.

MAXIMIZE THE VALUE OF THE BUSINESS

The first step to maximize the value of your business is to look at it from the buyer's perspective. Or better yet, bring in an independent third party who is experienced in mergers and acquisitions, and who can point out potential roadblocks or pitfalls. Many business owners started their company from the ground up so they tend to overlook potential issues as it is just the way they have always done something.

A buyer, however, will look at the company from their perspective and how they would run the business, which might reveal issues that often leads to a decrease in purchase price. The good thing is, many of these items can be addressed and improved prior to marketing the company, which will not only add value, but create a much smoother sales process.

Some of the items that need to be addressed prior to marketing the business include:

OWNER'S DUTIES

Many times, the owner of the company becomes so involved in all aspects of the business that the individual becomes the largest component of value. No owner. No value. Take steps as early as possible to train capable management and delegate duties. This will assure the buyer that the value of the company—in the form of intellectual capital, employee relationships, and operational knowledge—doesn't walk out the door after the sale.

FINANCIALS

It's no secret that business owners tend to run non-business-related expenses through the company to minimize taxes or have not put in place a proper accounting system. There's nothing wrong with that, but as you get closer to implementing your exit strategy, these practices should be changed, by increasing your salary, paying dividends, installing a good accounting system, and more.

Don't make a buyer wade through your personal expenses to figure out what your business is really worth. Having financials that are understandable, relevant and justifiable are vital to a smooth process. And remember, it's not just the direct buyer who will be looking at them. Due diligence on the buyer's side will involve lawyers, banks, investors and accountants on their end.

CAPITAL EXPENDITURES

It's easy to think that putting off certain capital expenditures will help the bottom line of the business and thus increase the price, but this might not be the case. Depending on the type of asset, its age and other factors, you might be better off replacing or repairing it to give both a physical and financial impression of a higher business valuation.

Many times, when a buyer must commit significant resources updating the facility or equipment, their valuation of the business will be even lower. Your consultant and CPA can help you decide if it makes more sense to upgrade or stick with what is there now.

CUSTOMER CONCENTRATION

Many business owners have significant customer concentration and aren't too worried about it as they've done business with these same companies for years. But a buyer doesn't have the same relationship with your customers, and they'll be greatly concerned that after the transaction, one or more of these significant customers will go away.

While you certainly don't want to turn away sales to reduce concentration, every attempt should be made to bring in other key customers or having your existing ones sign sales agreements that will offer some assurance to the buyer that the business won't walk out the door.

ASSESS THE ENVIRONMENT

If selling your business is an option, it is important to be aware of what is going on in your industry with respect to mergers and acquisitions. This includes not only the overall pace and type of activity—consolidation, fragmentation, diversification—but what price is being paid for comparable companies.

Many business owners have a targeted retirement age, but this might need to be modified in order to better time the market. Selling an average company in an up market is typically much easier than selling a great firm in a down market.

It is important to meet regularly with a merger and acquisition advisor to be aware of pricing trends in your industry and other factors that may signify a time to sell or possibly hold onto the company a little longer than expected. Timing can be the single-most-important factor to consider when selling a business.

PERFORM DUE DILIGENCE

After all the strategy and improvements to the business have been implemented, the last step of the exit plan is to begin the marketing process. Several important key pieces remain.

Sell-Side Due Diligence

Just as the buyer will perform extensive due diligence on the seller prior to closing, the seller should conduct the same intensive review prior to marketing the business. This step provides two important benefits to the seller.

First, it speeds up the process because you will have already compiled the information the buyer needs to see. Second, it eliminates the possibility of the buyer finding "skeletons in the closet" that they can use as leverage against you.

By doing your own due diligence, negative issues are discovered prior to selling the business and can either be fixed or disclosed to potential buyers early in the process.

Competitive Negotiations

As experienced merger and acquisition professionals always say, one buyer is no buyer.

The chosen sales/marketing approach should create a competitive market for your company. There are two basic approaches available to middle market companies; a negotiated sale and a controlled auction.

In a negotiated sale, the seller's advisor contacts only a few, targeted buyers. Often the list is limited to buyers who have expressed interest in the company previously and other known interested parties in your industry.

This approach limits the possibility of the sale leaking out to competitors or employees. On the downside, you could miss qualified buyers who might have been the best partner in a transaction.

A controlled auction involves soliciting interest from a wide variety of potential buyers so as not to exclude a qualified buyer from the process. This approach results in the greatest number of buyers being contacted and gives the highest likelihood of completing a transaction on your own terms.

NEXT STEPS

These are certainly not all the steps that can be taken in developing an exit plan as each company is unique and the plan should be developed recognizing this fact. These are, however, some of the more important components of any exit plan.

If you have any questions on how exit planning might benefit your organization, please contact us and we'll be glad to go over the process in more detail.

A STRATEGY FOR TODAY AND TOMORROW

For exit strategy, mergers and acquisition, and other transaction advice, contact Jim Rein at 970.685.3500 or rein@kcoe.com**.**

A sound exit strategy leads to peace of mind and all-around benefits for you and your business. Follow these steps:

1. Identify and Align Goals
2. Evaluate All Options
3. Maximize the Value
4. Assess the Environment
5. Perform Due Diligence