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Planning Your Escape

(From Your Business)

09-2012

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INTRODUCTION

Your business is a big part of your life. Running your business is challenging. In fact, most business owners consider getting the day-to-day and year-to-year tasks done a small victory. Making money in business means ultimately showing positive cash flow and a bottom line profit. With this mindset, entrepreneurs often figure they will create and carry out their exit plans at some time in the future. Not all get this opportunity!

It is a fact that none of us can predict the future, but having a plan in place that anticipates future events and scenarios can help gain economic advantages that will predictably come up in the future. This rule holds true for the sale of businesses. If the business owner has an exit plan in place, opportunities might not be overlooked as easily as they could without a plan. The exit plan is intended as a device to get the owner to think about the future and serve as a guide once arriving at the point of exiting. This is why having a written exit plan is always important to have.

It always pays to be proactive in business, especially now! Do you remember the time you saw an item on sale for a large amount off and you did not buy it only to realize a month later you should have made the purchase? Alternatively, have you ever owned an item that was more valuable to a buyer a month or a year ago than today (i.e. stocks, commodities, or real estate)? Most of us can relate to these situations. If only the buyer or seller could have anticipated the situation, they would be better off economically today.

BACKGROUND

There are different types of exit strategies to choose from. Most entrepreneurs who start businesses set their goal with an initial public offering. While this is a respectable and admirable goal, for most it is not likely to happen. Most exits from business involve an acquisition or sale of the business. It is important to make a reasonable goal when creating an exit plan. This does not mean an IPO is unreasonable for everyone, but the business owner should think about possible alternatives to their primary goal or their intended exit. Below is a discussion of the different types of business exits or selling arrangements that can be made:

- 1) Sale of a Business – A business is sold to an individual, group of individuals, or an entity. Doing this, the business owner receives cash or an equivalent for the

business. However, it can be difficult to find a ready, willing, and able buyer to purchase the business.

2) Acquisition – Similar to the “Sale of a Business” exit, but usually involves an outright purchase of another company. You receive cash right away, but you must find a ready, willing, and able buyer that wants to acquire your business and add to their business.

3) Merger – In this type of exit, the business joins with an existing company. As with a sale of a business, you get cash, stock, or a cash equivalent, but you join in with new partners and may suffer a partial or complete loss of control of your business. A Buy-Sell Agreement is used for the future exit strategy

4) Service vs. Inventory - It is also important to note that businesses in some industries are able to exit easier than others. A sale of a business may work better in noncapital intensive industries such as service sector businesses with relatively low values. If the business value is higher, as with capital intensive industries such as manufacturing, retail, etc, it may be better to find a business type buyer.

5) Installment Sale - Most individuals cannot readily come up with a few million dollars to buy a manufacturing plant. However, many individuals can come up with \$50,000 to \$500,000 to buy a business by borrowing from retirement funds, taking a second mortgage, or borrowing from relatives. Installment Sales can work well for any kind of a business. Since cash does not have to exchange hands at closing, installment sales can readily be accomplished by any other willing business.

GETTING STARTED

Since we can't predict the future, it is important for the business owner to adopt a “what if” mentality when thinking of exit plans. It is very simple logic. To follow it ask “What if” or “What should I do if” and then name or state a scenario. Examples: What should I do if my business rapidly expands in the next five years? What if the economy enters a depression? While the form or wording of the thought is not important, this kind of thinking allows the business owner to cover a wide range of contingencies and plan accordingly.

Although it may be useful to list many contingencies, you cannot plan for every contingency that arises. It is more important to select the more important scenarios from the many scenarios considered. Create a plan describing the actions and policies to be followed in the event any contingency comes to pass.

Following are the two most important contingencies and should definitely be considered. They are: 1) When should I sell my business? and 2) What should I do if forced to stop working? Examples of an emergency include illness, death, bankruptcy, etc. These two contingencies fall at opposite ends of the logic spectrum. One contingency is on a best-case scenario where you have time to plan and achieve the best result. The other, potentially a worst-case scenario, involving exit planning by crisis. Every other plan is in between these two. Without best and worst case scenarios being covered, the plan is incomplete.

Every exit plan should take into account different factors such as the industry, competition, the owner's resources and goals, and any other relevant intangibles. The best plans take into account all of the affected persons' goals.

THE HOMEWORK

Now that the scenarios in which to sell a business have been outlined, some homework and basic research must be done. This is important, because it is important to thoroughly know your business and what is in place before you make a plan that may be redundant, ineffective, or void in light of existing agreements. You may want to call in an advisor for legal, accounting, and tax issues that arise so they can interpret them for you.

It is probably best to think of potential scenarios and then eliminate them at this stage, because the previous stage defines what is important to YOU, not what is important to EVERYONE ELSE. Doing the process this way will not lead you astray into what others believe is important.

The homework consists of reviewing any existing agreements you have with partners, shareholders, and others who are involved in the organization. The agreement may consist of articles of incorporation, by-laws, and buy/sell agreements. The exit plan must conform to the existing agreements or it could defeat the plan. If you

don't have any existing agreements between shareholders and partners, now may be the best time to create one in conformity with the plan you want to follow. REMEMBER, A BUY/SELL AGREEMENT IS THE MOST IMPORTANT LEGAL DOCUMENT A BUSINESS CAN HAVE THAT COVERS EXIT STRATEGIES.

WRITING THE PLAN

After doing the homework, the rest of the plan should be written. The plan does not necessarily have to be complicated or even well written to be effective when the scenarios arise. The most effective plans are the plans that are most thoroughly thought out, so it pays to think at this stage.

The Goal - It is important to define a goal. Obviously the main goal in any exit plan is to achieve the best results. These results may include reviewing the biggest monetary gain, the smoothest transition into the next generation, paying the least taxes, or to create a retirement plan. The individual goals in the plan are not as important as the intent and the overall effect of the plan itself.

The People - Next it is important to choose the players to be involved in the exit plan. Decide what partners or key people will handle what or what you would like them to do. When the time comes, the people named may not be willing to do the task, so be wary of this situation and always keep your plan up to date and current.

To prevent an unexpected withdrawal or nonperformance by a team member, these people should be people you have known for a while and are trustworthy. While you don't have to be an expert on personal character, it is generally best to choose people with interest in conformity to yours, people without incidents of mistrust or fraud in their past, and generally people that anyone would think is trustworthy.

It is also important to decide who will represent you in your exit. An experienced professional accountant or attorney with a tax background complemented with an understanding of legal implications is probably your best bet here.

The Valuation - Valuation of the company is also important. It is important to identify a company or professional that has expertise in this specialized area. A poor valuation can lead to selling the business for a price short of what it should be. An entire lifetime of hard work and sacrifice should not be devalued by means of a shoddy

valuation; it would not be fair to you or those around you. A valuation of a company should take place every year, because the results and value-added drivers of operation are important to the overall value of the business.

Due Diligence - Potential due diligence issues then need to be addressed. Due diligence is the process of ensuring the accuracy and completeness of assertions. It is best to address the issues now rather than wait until the exit. Items such as obsolete inventory, family members on the payroll, and real estate all need to be dealt with and thought of before the business is put it for sale. An issue in due diligence can result in a deal breaker when your exit plan is put in action.

CONCLUSION

Being proactive in business pays. It especially pays when you are dealing with an exit strategy. Dealing with the issues that come up now can eliminate lost opportunity, headaches, and problems that may not be able to be solved when the exit occurs. Therefore, it is important to have an exit plan at all stages of a business. If you like, please contact the professionals at the Center for further assistance in your business and tax needs. The professionals at the Center specialize in exit strategies for private companies. Financial, legal, and tax advice is provided in developing exit strategies.