

Exiting Your Business

Avoiding a Retirement Crisis and
Maximising the Sale Value of Your Business

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Introduction

At some stage every business owner must sell, pass on or move on from their business.

They must transition.

Many will have predicated their post exit plans on having a nice nest egg from the sale of their business.

But are you going to get the returns you expect from your years of investment of time, energy and money? And there is often an emotional strain for the long-term business owner – sometimes it is like the loss of a loved one. For others it is relief from removing the ‘Sword of Damocles’ that has been hanging over them as they fought to survive.

Irrespective of the reasons for exiting your business and the strategy you choose, seeking professional advice along the way will no doubt improve the outcome – with an estimated 80% of baby boomer business owners planning an exit over the next 5 years, you should look to get all the help you can.

Regardless of why you will be choosing to move on, there are several ways in which you could exit your business and these include:

- Selling the business as a going concern,
- Planned succession – passing on the business to family, staff or other stakeholders,
- Merger with another (similar) business,
- Simply closing the doors – liquidate the business, sell the assets and stop trading,
- Forced exit

How you exit the business is an important decision and is hopefully one that has been considered and planned well in advance.

1. Selling the business as a going concern

Selling the business is one of the most important things most business owners will undertake in the time that have been ‘in the business’. Unlike other decisions where you will be around to see the success or failure of that decision, this one is final and your “afterlife” will depend on how successful the decision and subsequent business transaction is. There are many issues that you will need to address when you have made the decision to sell including:

- Business valuation – what the business is ultimately worth is what someone will pay for it, but you have to have a starting point.
- Where are the buyers? – is the sale likely to be attractive to a like business looking to expand or take greater control of the market (trade sale) an investment sale?
- Sales planning – when to sell, what is sold, post-sales support etc
- What does the deal look like and how is it financed? – the immediate cash needs and tax implications for both parties will have an impact on how the deal is structured. Will it be a straight sale or a “work out”? Will vendor finance be involved?
- “Finessing” the sale – from initial “agreement” to closure of contract, the process must be well managed to avoid misinterpretation or any “nasty surprises”.

Valuing the Business

Not surprisingly, this is where the buyer and the seller will usually have totally different objectives. You, as the seller will want the best possible return. The buyer will want to minimize the price they pay. So how do you know what the business is worth?

People will buy your business for its profit making potential. This can be calculated on historical figures, projected revenue and profitability (used mainly for start-up businesses) or the synergistic effect the business may have on an existing operation (eg economies of scale, increased customer base).

There are many different methods for valuing a business, with some better suited to a specific type of business than others. It is important to select the most appropriate method for valuing a particular business. The method chosen should provide a reasonable estimate of value, be suitable for the intended purpose and be able to face challenges by the opposing parties.

As a part of the process, a valuation specialist will often employ several different methods and average the results to arrive at a "ballpark" estimate. Because each method has strengths and weaknesses, business owners and their advisors should be familiar with the most commonly used valuation techniques.

Some of the recognised methods are:

- Net Asset Value (Based on a sale at fair market value of the firm's assets on an on-going concern basis);
- Discounted Future Earnings (Based on the capital required to produce income equal to the projected future income stream from continuing operations of the firm);
- Excess Earnings or Treasury Method (Adding the estimated market value of its tangible assets to the capitalized value of projected income resulting from goodwill);
- Capitalisation of Earnings (Capital required to generate an income equal to an average of the firm's recent, historical results).

Regardless of the rules for calculating the worth of a business, as previously stated, the worth of your business is what someone is prepared to pay for it and with sellers outnumbering buyers you need to make sure your business stands out from the crowd.

What Needs to Be Prepared for the Sale?

At the risk of stating the obvious, the business needs to be in the best possible shape – a bit like detailing a car before it is sold. It is wise to engage an experienced advisor to help you prepare for what the potential buyer will analyse. These will almost definitely include:

- Business plan and your performance against the plan
- Financial records
- Staff
- Customers
- Contracts
- Intellectual property and its protection
- Outstanding litigation of other legal issues
- Insurances, leases, agreements etc

- Inventory
- Assets
- Sales and marketing procedures
- Policies and procedures
- And most importantly, the ability for the business to run without you

Marketing the Business

To start the sales process you need to have a plan and that plan needs to consider why someone would want to buy your business. You need to promote the business as you would any of the products or services that business has been providing over the years. What are the strengths of the business? Do you have unique features that will make the business more attractive or more valuable to potential buyers - points to be highlighted in negotiations?

And you need to be prepared for the obvious. Potential buyers will want to know why the business is on the market. Positive reasons that buyers will expect to hear may include:

- Retirement – age or health reasons
- Looking for other opportunities/challenges
- Inability to maintain the pace required to keep up with the business' growth or changes in the industry

The due-diligence of a well prepared buyer will uncover negative causes for the sale such as declining revenue, increased competition, poor reputation etc, so be genuine.

As with any sale, you need to make potential buyers aware of the opportunity – you need to market.

There are many ways you can 'beat the drum'. And you need to be mindful of how, when and where you announce the sale of your business. Do you need to advise clients, staff and suppliers before the news becomes public? What effect will news of the pending sale have on the business? How you promote the sale of the business is something to be considered seriously as it can have a major impact not just on the potential return, but also on the ongoing profitability of the business. That said, here are some common ways business sales are promoted;

- Business brokers – the use of a broker has a cost associated with it the same way the use of a real estate agent does in selling property, but it can relieve a lot of the stress and allow the revelation of the pending sale to be delayed.
- Advertising – obvious of course, but where and when to advertise should be given serious consideration. The type of business and public awareness you want of the sale may well dictate the type of advertising you undertake. Are local papers appropriate? Local, community or national? Trade journals?
- 'Word of Mouth' – customers, suppliers, distributors can help spread the word and may well be a likely to unearth the possible industry/merger buyer.

Once you have the message out that the business is on the market, you need to be prepared to manage the enquiries and, ultimately, close the deal. In no particular order, you must consider:

- The legal, financial and tax implications of the sale – make sure you consult your appropriate advisors.

- Are all business records up-to-date, easily accessible and easy to review?
- What outstanding leases, contracts, agreements etc need to be finalized or transferred to the new owner?
Can existing leases, memberships, certifications etc be transferred to the new owner?
- The 'legitimacy' of the potential buyer – are they serious or just 'tyre-kicking'? If they are serious, can they complete the purchase?
- How will the deal be financed? Are you considering vendor-finance?
- Be prepared to close the deal – have draft contracts drawn up by a solicitor experienced in the sale of businesses.

Due Diligence

In its simplest form due diligence is a comprehensive process that investigates a business to assure the intending purchaser that all facts and financial figures are as stated by the vendor and that there are no unpleasant and unwanted surprises that have been concealed.

This process of due diligence is usually conducted by the purchaser's accountant, business advisors and legal advisors, who may also call in specialists for matters relating to stock or capital equipment, among other possible areas under examination.

Sellers may also look to perform a due diligence analysis on the purchaser. This is a way to ensure the buyer is 'legitimate'. Items that may be considered are the buyer's ability to purchase, as well as other items that would affect the purchased entity or the seller after the sale has been completed.

Due diligence is a part of every business sale or purchase, regardless of the size of the enterprise. The more complex the business is, the longer the due diligence is likely to take, but today's purchasers shouldn't even contemplate buying a business until due diligence has been completed.

Finalising the Sale

Once agreement 'in principal' has been reached with a potential buyer, the serious negotiations will begin. As stated above, the seller will want the best return for their years of hard work and investment. The buyer on the other hand will (generally) only be interested in what the future holds and want to minimize the purchase price. As a seller, you must be prepared for these negotiations and also understand the negotiations may involve more than just monetary considerations – there may be a need for the seller to remain involved in the business. Conversely, the buyer may want to limit the sellers' ability to start up in direct competition or 'poach' key employees.

All of these issues must be addressed in the sales/purchase agreement. Such an agreement is not dissimilar to that used in the purchase of real estate and should include the following key points:

- Definition of what is being sold
- Price
- Terms of payment
- Buyers and sellers responsibilities
- Covenants
- Time, place and process for 'sign off'

2. Planned succession

Heard about the guy who was asked how he got to have a million dollar business at such a young age? His father left him a \$5 million dollar business!! It's meant to be a joke, but it is an all too familiar reality. Here's the proof.

- Over 95% per cent businesses are family owned
- Of these only about 30% survive the second generation.
- Only 10% survive the third generation.
- RMIT University research suggests just 25% of Australian business have a succession plan

Passing on your business to a family member or staff can be one of the most self-satisfying things you do in your business life, but these figures reinforce the need for this succession to be planned and for the planning to start early. To quote Dr Steven Covey from his classic "The 7 Habits of Highly Successful People" - *'begin with the end in mind'*.

Business owners who don't start planning this well in advance of retirement are potentially creating unnecessary stress and chaos for themselves, their family and their staff, and neglect of the situation might well damage the business.

A long-term plan is necessary for the family and the owner alike to achieve their lifestyle, financial and business aims. A plan should be in place years before the owner wishes to retire, reduce their workload or dispose of the business.

If family members are involved in the business and understand the owner's aims, it is much more likely business momentum will be maintained. Any plan must involve all members of the family, not just those involved in the running of the business.

Selecting and grooming the successor – options include family members, committee of family members, promoting a key/loyal employee of long-standing, recruiting and external executive to manage the family business. From a practical perspective, a single successor usually minimises conflict and confusion.

For the owner, they need to consider:

- Meeting financial needs
- Estate planning
- Tax issues
- Any ongoing share ownership
- Family relationships
- Business relationships and contracts (novation?)

3. Merger with another business

Simply defined a merger is the bringing together the assets and operations of separate business entities into a single unit.

Mergers may be considered for many reasons, including:

- Increased efficiencies through economies of scale
- Increase market share
- Access to valuable resources
- Ability to compete more effectively in aggressive markets
- Protection from closure
- Increased ability to invest in R&D and market development
- Diversification

While the decision to merge is usually mutual, the merger may be the result of the takeover of one company by another (referred to as a takeover or acquisition). As a result, there are a number of ways deals can be structured including the outright purchase of one company by another or offering the stockholders of one company's securities in the acquiring company in exchange for the surrender of their stock.

Regardless of how the merger is initiated, negotiated and concluded, for the business owner the considerations need to be what deliver the best outcome for them. Consideration must be given to the value gained from the merger (immediate if exiting the business or longer term if this is being used as part of a planned exit strategy), ongoing involvement of the owner, management and staff, and the impact on suppliers.

4. Closing the doors

In the 2000 movie by the same name, the meteorological planets aligned to create the 'Perfect Storm' – it a scary thought but for the Baby Boomer business owners, the economic and biological planets are now aligning to create a perfect storm for those choosing to exit their businesses.

In fact, the Federal Government has estimated that 80% of all businesses that are exited over the next 10 years will be simple cessations – the owner will simply close the doors and walk away. Sadly, there will be times when this is a forced closure through bankruptcy or liquidation.

If the decision has been made to close the doors and walk away, there are still commercial, governance and compliance obligations you need to address. And no doubt you will want to walk away with as much as possible, so planning for this exit and executing the plan effectively are critical.

In summary, as the business owner you need to liquidate your assets, pay off your debts, meet any legal obligations and take the balance. The roadmap for business closure will often look like this:

- Make the decision to close the business and walk away
- Set a date and arrange for termination of supply and contracts from this date.
- If the business operates from leased premises, it is advisable where possible to synchronise closure with lease termination. If this is not possible, suitable arrangements must be made with the landlord
- Advise all customers prior to the closure and where possible provide them some guidance to alternate suppliers (remember, you may need them again in future business opportunities, so look after them)
- Advise all suppliers
- Complete and submit all necessary documentation, returns and accounts (seek guidance on this to ensure nothing is missed)
- Close the doors, take the balance of money (hopefully there is some) and take a break

5. Forced exit

This is the least desirable outcome for the business owner who has devoted his life to building what he had hoped would be his legacy.

Where the closure is forced, the business owner will need to liquidate (in the case of a company) or declare bankruptcy (in the case of an individual eg sole trader).

In general terms a business is placed in liquidation when it is unable to meet its trading commitments. This usually occurs after a period of time where the business has been run by an Administrator – a person or group of people experienced in working with businesses in trouble who endeavor to salvage what can be salvaged from the business, or get it back on its feet. ASIC defines liquidation as:

The orderly winding up of a company's affairs. It involves realising the company's assets, cessation or sale of its operations, distributing the proceeds of realisation among its creditors and distributing any surplus among its shareholders. The three types of liquidation are:

- court
- creditors' voluntary, and
- members' voluntary.

A creditors' voluntary liquidation is a liquidation initiated by the company. A court liquidation starts as a result of a court order, made after an application to the court, usually by a creditor of the company.

The liquidator has a duty to all creditors and their responsibilities are defined by ASIC. The role of the liquidator is to:

- Collect, protect and realise the company's assets
- Investigate and report to creditors about the company's affairs, including any unfair preferences which may be recoverable, any uncommercial transactions which may be set aside, and any possible claims against the company's officers
- Enquire into the failure of the company and possible offences by people involved with the company and report to ASIC
- After payment of the costs of the liquidation, and subject to the rights of any secured creditor, distribute the proceeds of realisation - first to priority creditors, including employees, and then to unsecured creditors, and
- Apply for deregistration of the company on completion of the liquidation.

Payment of the liquidator is from company assets. Where there are insufficient funds or assets the liquidator may remain unpaid unless the creditors agree to meet the fees. This is an unlikely scenario as most liquidators would ensure they were protected prior to commencing the project.

Conclusion

In developing and implementing your succession plan, consider it a management process:

1. Evaluate your position
2. Set your goals
3. Plan your strategy
4. Manage your plan
 - a. Timeframes
 - b. Stakeholder identification, communication and management
 - c. Estate Planning
 - d. Risk management
 - e. Documentation

- f. Project management
- 5. Change leadership
- 6. Exit from Ownership (may be concurrent with 6.4)
- 7. Fund your retirement
- 8. And most importantly...ENJOY

Succession planning is critical. Every owner will exit their business and a good succession plan will enable a smooth transition with less likelihood of disruption to operations, or the need to exit in undesirable circumstances. By planning your exit well in advance you can maximise the value of your business and increase the chances of you achieving your personal, business and financial goals.

Make sure your succession plan is attainable - set a realistic timetable and measurable milestones along the way and stick to them.

And remember...

This is only a plan...unless you DO IT nothing will happen.

There is help available from many quarters, you just need to ask.

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Succession Planning Check List

| Stage | Consideration | Status | Action | Who | When |
|-------|-------------------------------------------------------------------------------------------------------------------------|--------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|--------|
| | Business "Health Check" | | Undertake complete Business Diagnosis including Financial Report to determine true "health" of business. This will assist in determining business value and readiness for sale or other migration. Last 3 years Financials should be considered | | Annual |
| | Is there a Business Plan in place? | | Develop and maintain a Business Plan that reflects the business direction and necessary actions to meet objectives. | | |
| | Determine expected transition timeframe | | This need not be definitive, but having a date in mind will start to focus necessary activities. | | |
| | What do the owners want from the business immediately and on-going? | | If business is sold, what sale model is under consideration? Full and final price, or part payment and on-going percentage of profits? If passed to family members, will there be any up front payments? | | |
| | Succession Type | | Will you be completely removed from the business or only partially? If it is a partial succession, what will be your future involvement in the business? | | |
| | Change of Business Structure | | Do you need to change your business structure? For example, if the business was a partnership and the new structure will be a company or sole trader. | | |
| | Transfers <ul style="list-style-type: none"> • Registration • Leases • Memberships etc | | What needs to be transferred, ABN, GST, IP, domain names, permits Are there leases, memberships or other items in your name that require to be transferred? | | |

| | | | | | |
|--|---------------------------------------------------------------------------|--|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|
| | Proposed Org Structure | | Briefly outline what the organisation might look like once you leave. For example, who is your successor? If they are internal also outline who will fill their current position. Outline any positions that will be vacant after the reshuffle. | | |
| | Key Person Retention &/or Development | | <p>List all of the positions in the organisation and the people that are expected to fill the position in the event of a succession. For each position outline:</p> <ul style="list-style-type: none"> ▪ Job title: Position title ▪ Name: If known, the name of the employee expected to fill the position. If unknown, add 'Vacant'. ▪ Skills required: Relevant qualifications and/or experience. <p>Training requirements: What particular training will this person require to fulfil their new role?</p> | | |
| | Financing. If a transition to a family member, how will this be financed? | | Review with Accountant and Financial Planner | | |
| | Contracts & Legal Documents | | Is there a legal document that dictates the terms of the succession? If so, what are the terms? Are there any contracts that need to be modified in the event of the succession, e.g. partnership contract? Are there any new contracts that need to be drawn up? | | |
| | Buy/sell Agreement | | If you are in a partnership do you have a buy-sell agreement in place? What are the terms? Will the remaining partner(s) buy your partnership share or will it be open to external partners/family members? Does this arrangement apply to all partners in the organisation? | | |

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|--|-------------------------------------------------------------------------------------------|--|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|
| | If a family succession, are other family members in agreement? | | Depending of stage of transition. Initially determine what are the expectations of family members. Will the be acceptance of planned transition? Will there be a need for non-executive family members to be represented in the business? | | |
| | Are non-executive family members fairly compensated in transition? | | | | |
| | On-going representation in company management? | | Consider what involvement you want, if any, in the future business. This will help identify the exit strategy. | | |
| | Are wills in place for key stakeholders? | | Review with family members. In consultation with Financial Planner and Legal representative. | | |
| | Are key stakeholders and family insured? Life, Trauma, Income Protection? | | Review position with trusted Business Advisor and Insurance Broker. Determine appropriate levels of cover and purchase suitable policies. Discuss most efficient way to purchase with Accountant and/or Financial Planner. | | |
| | How will profits or on-going revenues be dispersed among stakeholders and family members? | | | | |
| | Risk Assessment | | <p>Detail the risks to the succession and any contingencies. For example: If the sale price you expected is not met, what will happen? For each risk list:</p> <ul style="list-style-type: none"> ▪ Succession risk: What can go wrong while the succession plan is being implemented? What is the potential impact to your business? ▪ Likelihood: Highly Unlikely, Unlikely, Likely or Highly Likely. | | |

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|--|--------------------------------------------------------|--|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|
| | | | <ul style="list-style-type: none"> ▪ Impact: High, Medium or Low. <p>Contingency: What is your contingency/alternative plan in the event that this risk happens?</p> | | |
| | Has post-ownership financial planning been considered? | | Review with trusted Financial Planner. Develop individual Financial Plans to deliver required lifestyle. | | |

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