Choosing the right exit option

At some stage, most owners will want to sell their business. John Hawkey looks at the various exit options available, and how to go about choosing the right one.

A vital part of exit strategy planning is choosing the exit option that will maximise your financial and personal outcome.

For most small business owners, an exit is synonymous with either a sale to a third party (a trade sale) or a family succession.

While these are the main routes for most small business disposals, it is also helpful to consider other options.

This is particularly true for very small businesses, where disposal at a good price is difficult – mainly because management and business knowledge is in the mind of the owner (who will usually be leaving the business soon after it is sold).

Family succession

If you have a suitable heir, your first choice of exit option will probably be a family succession.

The key to successful family succession (besides grooming the business for transfer, which is common to all exit options) is to allow plenty of time to train your successor. There are five stages to this training, namely:

Learning

Usually, the heir will have joined the family business at an early stage, and the learning process will involve experience (perhaps only superficial) in as many aspects of the business operations as possible.

Outside experience

At some stage, to widen their experience of the wider world, the successor should gain business experience outside the family business. Ideally, this would be after the initial learning experience.

Doing

After a wide involvement in all the business's operations, the heir should be assigned more responsible roles in specific tasks, when their strengths and weaknesses can be assessed. This should include sales and accounting roles.

Managing

An extensive period of managing particular operations or activities should now be undertaken. The heir should be given greater freedom now to make decisions, and their performance as a manager should be closely monitored.

Leading/owning

Finally, the heir needs leadership and ownership experience. Although leadership is largely an inherent ability, team leadership and decision-making can be taught to most competent managers. By the time of the hand-over, the heir should be capable of making the strategic decisions necessary to own a business.

Trade sales

We will deal with trade sales more fully in a future issue of *Better Business*, but here the grooming, and in particular the identification and removal of impediments to sale, are the key issues. (I will deal with impediments to sale later in this article.)

There are two other exit options, however, that are suitable for small businesses, and which are too often ignored by owners when they are planning their exits – namely management (or employee) buy-outs, and the sole trader merger.

Management buy-outs

Most small business owners believe that management buy-outs are reserved for big business and involve venture capitalists. This is not so, as a management buy-out is no more than a sale to your management or employees, and need not be funded by outside financiers.

When you think about it, your management and employees could be the most obvious buyers for your business for many reasons. They include:

- Your managers are familiar with the business, its clients, suppliers, bankers and other employees;
- They are aware of the potential of the business and should have the knowledge to achieve this;
- You know the managers well, and should trust them;
- You should be able to structure a deal with your managers to suit your personal financial or retirement needs;
- They will likely be driven by personal and emotional reasons to buy your business and, therefore, be willing to pay more for it;
- You could derive a great deal of personal satisfaction from selling your business to people you know and have worked with.

Pre-requisites of a management buy-out are usually that:

- The management has the ability to run the business;

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- If management is borrowing money to buy the business, the business has a strong enough cashflow to service the borrowings.

When planning for a management buy-out, the grooming of the management for take-over will be similar to the later stages of grooming a successor.

The sole trader merger

A sole trader merger is of particular interest to those who own small businesses or professional practices on their own, or who have no senior management in place and who wish to retire.

Sole trader businesses are notoriously difficult to sell because of their lack of management continuity and because of the particularly personal nature of the business.

A sole trader merger is usually completed in four stages, namely:

- **Stage one.** The retiring owner, within five years of retirement, seeks out a (usually) younger owner with a similar business and business philosophy who has long-term ambitions to expand and does not plan to retire for at least five to ten years.
- **Stage two.** The two businesses merge, with perhaps some consideration paid by the younger owner to the retiring owner to equalise their shareholding in the merged business.
- **Stage three.** After a number of years, the younger owner buys out the balance of retiring owner's interests in the merged business.
- **Stage four.** The owner either retires, or remains for some time as an employee of the new business to ensure continuity, and then retires.

The ultimate choice of option will depend on various circumstances within the business. In some cases the choice will be obvious, in others it will be less so. It is probably worthwhile obtaining expert advice before embarking on this process.

Planning the exit plan

Having chosen the optimum exit option, the time has come to put together the exit plan itself. From an overall perspective a typical exit strategy plan will consist of the following three main parts.

Structural issues

These were dealt with in last month's issue of *Better Business*. The addressing of structural and ownership issues is also known by some as business continuity planning. If you have not addressed these previously, you should do so as soon as possible.

Business plan

A business plan is the basis of all exit strategy planning, and every business plan should include an element of exit strategy.

You could say that a business plan without an exit strategy plan is like planning a journey without choosing a destination.

A business plan, having identified the strengths, weaknesses, opportunities and threats of a business (through what is known a 'SWOT' analysis) should focus on doing those things of an operational nature that will improve business value. These are fed into the master exit strategy plan.

The master exit strategy plan

This brings together the business continuity plan, the business plan and the exit strategy plan components.

This should include a timescale for exit, the choice of exit option, the identification and removal of impediments to sale, and the training (or grooming) of management and/or successor and the disposal plans.

Importantly, it should also integrate the owner's personal financial (or retirement) planning with the financial planning of the business.

Impediments to sale

Impediments to sale are those aspects of a business that will either reduce its sale price or make it difficult to sell; or, in the most extreme cases, make the business impossible to sell.

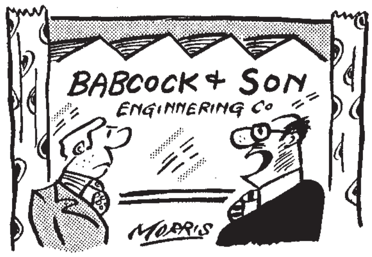
Effective identification and removal of impediments to sale make the difference between a successful exit strategy plan and an unsuccessful one.

Some impediments are obvious – for example, with no management in place to provide continuity and facilitate the transfer of business knowledge, there can be no transfer of goodwill value to a new owner.

Some are less so. For example, subtle shifts in consumer demand for formerly highly desirable goods could destroy profitability and sale value. But, even though an impediment might be obvious to identify, it might not be so easy to rectify.

Amongst the most common impediments to sale in small businesses are:

- Setting an unrealistic selling price;
- The business is unprofitable, or is less profitable than the average in its sector, or its gross margins are too low;
- Goodwill value (in the nature of business knowledge) cannot be transferred to the new owners, because knowledge is all in the mind of the seller;



'I'd sack you if it didn't mean a row with your mother when we get home'

- The business has no senior management that will transfer to the new owner;
- ‘Small business’ accounting methods distort profitability, and potential purchasers are put off by re-calculated profit and loss accounts littered with ‘add-backs’;
- There is no credible business plan in place and, where there are co-owners, no shareholders’ agreement. The lack of a shareholders’ agreement could also mean that minority shareholders are not bound to the sale, and the purchaser is unwilling to commit time and costs unless he is certain that all shareholders are bound to sell.
- The business is run down and looks it – the owners have lost their zest and enthusiasm.

Implementing the plan

A master exit strategy plan should be reduced to a detailed diagram with an exit date that summarises the steps to be completed, together with time targets and the name of the person who will tackle the task.

Major tasks will vary depending on the size and type of business and the exit option being followed, but will usually include the following:

- Identifying and removing major impediments to sale;
- Strengthening management and employees training and abilities;
- Grooming of management and/or successor for take-over;
- Improvements to the look of the business premises (perhaps cosmetic) and upgrading of IT systems;
- Appointment of suitable advisers to assist in disposal itself;
- Last-minute planning for disposal (including production of memorandum of offer documents);
- The disposal itself.

The disposal

The disposal of your business after the effective execution of your exit strategy plan could be relatively straightforward, but it is still the ultimate test of the strategies employed.

You will now come face to face with the reality that whatever the extent of your planning, your business is only worth what someone is willing to pay you for it.

It is important, therefore, to make the right choices regarding expert assistance at this stage.

The rewards of successful exit strategy planning can be great, not only in direct financial terms, but also in terms of your personal satisfaction.

So make a plan and execute it, don’t leave it to gather dust on your desk ❖

It’s a wireless wonder!

Microsoft Wireless Optical Desktop Mac/PC USB £59 +VAT

It’s surprising what a small difference makes in something you take for granted, and in ways you wouldn’t imagine.

We all use a keyboard and mouse without much thought. Only when you use another computer do you notice any difference in feel or usability.

We were recently sent a Microsoft wireless desktop keyboard and optical mouse to review, and I admit to being a bit sceptical of what appeared just gimmicks – no wires, no ball. But they were simple to install and the benefits immediate (the only downside being that they consume batteries every couple of weeks).

The mouse felt comfortable, and so effortless to move without dragging a wire around. With no ball collecting dust it traversed smoothly and accurately, and you don’t have to keep cleaning gunge off the pads

underneath. Even the wheel was lighter to use for scrolling.

The keyboard was quiet and with just the right ‘feel’ to the keys. The one we tried was a Natural Keyboard, which is split at an angle in the middle to allow a more comfortable stance – a normal version is also available (pictured above).

There is also an extra row of keys, the most useful of which give instant control when playing CDs.

The real treat comes when you’ve finished typing and want your desk space back. You just pick up the keyboard and dump it elsewhere – there are no wires to tether it. Little things add up to a big convenience ❖

Andrew James

Label printing made easy

DYMO LabelWriter 300 series Mac/PC from £99 +VAT

Label printing can be a bugbear for any small business.

Putting a sheet of labels through a laser, and selecting the correct lay-out for the ones that haven’t been used, is a fiddly operation at the best of times.

So the latest label printer from DYMO is a real revelation. Using pre-supplied templates, this little wonder can print anything from address labels to name badges or bar codes.

It is a thermal printer, which means that there is no ink cartridge to replace – you simply buy a roll of labels (there is a variety of sizes available), pop it into the machine, and away you go.

The quality is clear and sharp – a far cry from the fuzzy output of thermal printers from years gone by, if not quite good enough for product labelling ❖

Richard Reed