

Planning your exit strategy

At some stage, most owners will want to sell their business – either to capitalise on their investment, or to retire. John Hawkey looks at how to plan your exit strategy.

Recent research has shown that 40% of all small business owners would like to exit their business immediately – but that only 25% have any sort of plan for doing so.

A mere 7% have a formal written exit plan in place – so although the desire is at the forefront of many owners' minds, there is no strategy to make it happen.

When you consider that the sale of a business is probably one of the most significant events in the life of a business owner, it is surprising that so little organised thought goes into it.

One problem is that business owners view the disposal of their business as an event somewhat out of their control that will happen one day, whereas they *should* consider exit as a process over which they can exercise considerable control.

Another problem is that many business owners know very little about the process of exit strategy planning and how it can be applied to their businesses.

This month and next month I will take you through how to plan the process of exiting in a simple step-by-step way so that you can optimise your exit proceeds and your personal satisfaction. But first, we need to look at some technical issues regarding business structures.

The right structure

It is important that the structure of your business (with regard to how it is owned and what it does) and the relationships with any co-owners (and, perhaps, also your family) are properly organised so that you:

- Don't limit your exit opportunities;
- Don't become liable to pay more tax on the sale proceeds than is legally necessary.

Ideally, you should address structural issues from start-up, thus ensuring that when you come to exit you are not hindered or disadvantaged; the point being you never know when you might be forced to sell.

Where you have not already addressed these matters, you should do so immediately. But, even then you might not be able to achieve a perfect result, depending on how quickly you wish to exit and the attitude of your co-owners at the time.

Specifically, the issues you should address are as follows.

Ownership structure

The ability to claim relief from capital gains tax (CGT) and inheritance tax in business disposals or transfers depends on who owns the business and for how long they have owned it.

For example, business asset taper relief (BATR) from CGT is available to individuals, but not to companies, so if you own your business through a holding company you will not qualify for BATR if you sell it at a profit.

As another example, if you have owned the business personally, but for less than two full years before you dispose of it, you will not get the maximum BATR relief available under the legislation.

You can see that with regard to ownership issues alone you might have to start an exit plan at least two years ahead of your desired exit date to ensure maximum tax relief.

Business activities

BATR is available to 'qualifying companies', which are, essentially, 'trading' companies. Trade is deemed by the Inland Revenue to be anything that is considered to be trade for the purpose of income tax, and a 'trading company' is a company substantially engaged in trade.

This can be a tricky area. For example, even if your company is obviously engaged in trade, but more than 25% of its assets comprise non-trading undertakings (such as investment property), the Inland Revenue could deem it a non-trading company for BATR purposes.

Shareholders' agreements

Where you have co-owners in your business (co-owners being either partners or fellow shareholders) and even if a co-shareholder only owns one share, it is necessary for your exit strategy planning to have a formal shareholders' or partners' agreement in place.

There are two common misconceptions held by shareholders of companies.

The first is they believe the Memorandum and Articles of Association adequately cover the sale of shares between themselves.

The second is they believe majority shareholders have the power (through the Companies Act) to coerce minority



'I told my son "One day this will all be yours" and he hasn't spoken to me since'

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NEXT MONTH:

How to choose your optimum exit option and implement your exit strategy plan

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shareholders to sell their shares, just as the shareholder with more than 50% of the shares is able to elect and remove fellow directors.

Neither of these beliefs is correct, and without a shareholders' agreement (that, for example, compels minority shareholders to sell their shares when you wish to sell to a buyer who wants to buy 100% of the company), your exit plans could be scuppered.

Key exit points

The principles of shareholders' and partners' agreements are broadly the same, but for convenience sake I will refer to shareholders' agreement only.

The key exit points that must be included in the agreement are as follows.

Pre-emptive rights

This part of the agreement prevents shareholders or their personal representatives (either because they have died or for any other reason) from selling their shares to outsiders without first offering them to fellow shareholders.

It should also address how the shares are to be valued and, consequently, at what price they have to be offered to other shareholders.

This clause prevents shares from falling into hostile hands or into the hands of people who might not wish to sell when you wish to exit. It also prevents disputes about what value should be placed on the shares at the time of sale.

'Drag-along' clause

This clause compels minority shareholders to sell their shares (usually at the same offer price per share) when the majority shareholder wishes to sell his shares to a bona fide third party, thus facilitating the majority shareholder's exit.

'Piggy-back' clause

This clause protects minority shareholders from being abandoned to a potentially hostile buyer by stating that the majority shareholder cannot sell his shares unless the buyer offers the same price per share to the minority shareholders (who, under the drag-along clause, would be compelled to sell if the buyer so chose).

Not all majority shareholders insist on the inclusion of this clause.

You can see why it is necessary to have a proper shareholders' agreement in place as soon as possible. The advantage of completing it at start-up is that people usually agree to these sorts of things at the beginning of a venture – and refusal could provide a good

reason for not going ahead. If you have not already addressed this at start-up, the sooner you address it – and the further you are from your actual exit date when you do so – the better.

The last thing you want when you have a keen buyer knocking on your door is to be desperately trying to get an agreement to sell from fellow shareholders.

Also, as we shall see when we look at 'impediments to sale' later, not having an agreement in place could mean that potential buyers are deterred from investigating your business further.

Other foundation matters

A well-constructed exit strategy plan should address the usual risks involved with running a business, including insurance of your assets and your key personnel.

Also, if you are married and intend to leave your business to a child rather than your spouse, then you must have a current will in place that indicates your wishes.

If your child is married and you are concerned about their marital relationship (and do not wish a part of the business to go to the their spouse), you might consider setting up a trust in favour of them rather than a transfer directly into their name.

Exit options

Having dealt with these aspects, we can now get down to the personal and operational issues of planning your exit strategy.

Firstly, although every private business owner will have to exit their business one day, there are different reasons for exiting, and these could affect both the time you have to plan as well as the choice of your exit option.

For example, if you are ill and need to exit in the very short term, you can embark only on a short-term exit plan, which will probably not be as successful as a longer-term plan.

Alternatively, if you are in your early 40s, in good health and planning to exit at a normal retirement age of 60 or 65, you can embark on a long-term plan that should enable you to achieve most of your aims to maximise your net sale proceeds.

The time available to plan might also determine the choice of exit option. For example, with only a limited time to plan it could be impossible to embark on an effective family succession plan, because the grooming of a successor could take ten years.

Of course, although you might plan to exit over the longer term, events might dictate that you are not afforded this luxury. The production of an operational business plan should be undertaken as a matter of urgency whatever your plans and ambitions ❖

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Contact

John Hawkey is the author of *Exit Strategy Planning: Growing Your Business for Sale or Succession*, published by Gower, £49.50. ISBN 0566084988

John Hawkey
Exit Strategies Ltd
Dove Cottage, Church Lane,
Millington
York YO42 1TX
☎ 01759 305248
Fax: 01759 301412
www.exitstrategyplanning.com