

How to

EXIT YOUR BUSINESS

The savvy owner's guide to cashing out successfully

continue ▶



FROM THE EDITOR

After years of hard work, business owners deserve to create a successful exit strategy that will maximize their and their financial backers' return on investment. This guide is intended to succinctly help companies with all facets of the challenge.

This is the first edition in a series called Upsize How-to Guides, an edited collection of advice and wisdom drawn from material published in Upsize magazine, its electronic newsletter, podcasts, webinars, seminars and online editions. Upsize Minnesota's mission is to help small-business owners build bigger and more profitable companies: www.upsizemag.com.

Upsize reporter Andrew Tellijohn interviewed many sources to prepare the articles, including business owners who have successfully sold or passed down their businesses, and advisers who have managed multiple such deals in their careers. Contact information for major sources is at the end of the guide.

— Beth Ewen
editor and co-founder
Upsize Minnesota Inc.

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QUOTABLE:

“We often say the store has been an extension of the owner’s living room. It’s a very emotional time. We’re empathetic to that.”

— LEW ZEIDNER, **ApothecaryRx**, on dealing with the selling pharmacist’s family when buying their businesses

Setting a timetable

Don’t wait for outside forces to dictate a sale

Too often retirement, health issues, lack of capitalization, or major family or industry changes creep up on business owners and force them to consider unloading their businesses. With the economy, your own health and other factors affecting what might be the opportune time to sell, it’s important that entrepreneurs not wake up one morning and suddenly decide they want out.

Entrepreneurs should start planning an exit strategy, with some factors such as business structure, the day before they open their doors. They should have a succession plan in place the day they start and if they have partners, they should have a buy-sell agreement, backed with life insurance to finance a buyout. The plans can change over time, but they’re necessary in case something unexpected happens.

Serious planning should begin three to five years in advance of when you plan to put the business on the market. You don’t have to hold yourself to this date; plans

can always change. And be it retirement or another business opportunity, you need a good reason to sell your company.

But planning ahead allows you to control the timing. Giving yourself time will allow you to weather economic up and downturns, set personal and financial objectives and fix any weak points in the business, as potential buyers generally want to see the business on an upswing.

The first thing you want to do is find a broker or other adviser who can help you work through your own goals, walk you through the sale process and ultimately help solicit offers and work through the terms of a deal. Business owners suggest interviewing at least a few and choosing one that convinces you they have your best interests in mind. Discuss your goals for a sale. Your adviser can help ensure that you make as much money on a sale as possible, but also take into account the needs of your family, your partners and your employees.

TO-DO LIST

1. **Begin planning your exit strategy when you start the business.**
2. **Give yourself three to five years of serious planning to fix up aspects of the business that need work before you put it on the market.**
3. **Interview some business brokers and choose one that can help you set goals and solicit offers for your business.**
4. **Solicit advice from an accountant and a mergers and acquisitions attorney to avoid legal and tax-related problems stemming from a deal.**
5. **Sell when the business is on an upswing.**
6. **You need a good reason for selling, one that is dictated by you, not by economic forces or health concerns that are out of your control.**

BOTTOM LINE: IT’S IMPORTANT THAT ENTREPRENEURS NOT WAKE UP ONE MORNING AND SUDDENLY DECIDE THEY WANT OUT.

QUOTABLE:

“Up to 75 percent of the typical business owner’s net worth is tied up in the business. If you are among the 9.5 million owners reaching the age of retirement you may want to ask, ‘What is my exit strategy.’”

— DYANNE ROSS-HANSON, *Exit Planning Strategies*

Structuring to sell

Keep in mind eventual exit when forming company

Consider a scenario under which a business owner receives just under \$4.6 million in net cash from the sale. The company is taxed as a Minnesota C corporation and the seller has depreciated the firm’s assets prior to selling.

Under a stock sale, the business owner could set a sale price of just under \$5.9 million to receive the \$4.6 million payoff. In an asset sale, however, the owner would have to receive a \$10 million sale price in order to achieve the \$4.6 million in net cash.

The difference in the two deals is taxation. C corporations are subjected to double taxation. Under the above scenario the owner would pay \$980,000 in state taxes, \$3.2 million in federal taxes and another nearly \$1.3 million in individual taxes, while the stock sale would only be subjected to the individual taxation.

Business owners often don’t realize just how important choosing a corporate structure for their business can be in determining what kind of a deal they can make when they decide to sell. The benefits to a C corporation are that the company can be partially owned by funds and companies.

However, in Minnesota, most businesses are either limited liability corporations (LLC) or S corporations. Under an S corporation, a seller wouldn’t pay taxes at the company level, but the ownership options are more limited.

The various formats all have benefits and disadvantages, however, and that’s why it is important at the time the company is formed that the business owner and his or her advisers keep the eventual exit strategy in mind.

TO-DO LIST

1. **Keep your exit strategy in mind when you are starting the business.**
2. **Consider the tax ramifications of your chosen corporate structure when evaluating sale terms.**
3. **The number and type of shareholders are another consideration, although arrangements don’t typically prevent a sale.**
4. **Seek the advice of accountants and mergers and acquisitions attorneys when evaluating deal terms.**

BOTTOM LINE: CHOOSING THE RIGHT CORPORATE STRUCTURE AT THE BEGINNING MAKES A BIG DIFFERENCE AT THE END.

QUOTABLE:

“Making millions of dollars and being a wreck when you’re 50 is not smart business.”

— DAN BUETTNER, Blue Zones and Quest Network Inc.

Figuring what it’s worth

Valuation methods vary, but all have goal to estimate price tag

Because they are too close to the business and because they are focused on growing their company, owners frequently don’t have a very good hold on what they could get in a sale. That is why it’s important to work with a qualified broker or valuations expert who knows how to evaluate a company’s worth and how to manage a seller’s expectations.

If a seller is looking three to five years in advance of retirement or planned sale there isn’t a need to get a full-blown appraisal — that could cost \$5,000 to \$10,000. But owners might want to get an opinion from a CPA, attorney or broker so they know if a sale would be in the range of what they would be looking for or if they need to take steps to increase the value before pursuing a sale.

There are many methods for evaluating roughly what a business is worth. One is an asset business valuation. That takes into account the value of assets, such as inventory, equipment and real estate.

It works best if you are looking to liquidate an unprofitable business. A market business valuation sets the value based on a multiplier, such as some amount multiplied by sales. Its accuracy is sketchy, however, as it bases the value on industry averages.

Many Web sites, such as www.valuationresources.com, can help small-business owners determine what method is most appropriate for their companies, as can their team of advisers.

Many other factors play into what a business will go for. An owner and his or her team will take a look at what similar competitors have sold for. A broker is likely to put together a confidential package announcing the company is for sale and see how the market reacts.

TO-DO LIST

1. A business is worth what the market will pay for it. This can be hard for business owners to accept.
2. There are several methods for putting a value on a business.
3. Market conditions will also affect a sale price.
4. Business owners often think their company is worth more than it really is.
5. One important rule of thumb is to base the value of the business on the current market conditions. If the market is down generally the business will be worth less.

BOTTOM LINE: THE TRUE VALUE OF A BUSINESS BOILS DOWN TO WHATEVER A BUYER WILL SPEND.

QUOTABLE:

“If you have spent more time planning a recent vacation than planning the exit of your business, you’re not alone. Too often owners make the mistake of not preparing an exit plan and reviewing the value of the business in advance.”

— WAYNE BROWN, Baker Tilly LLP

Sorting the buyers

Best buyer depends on owner’s goals, firm’s condition

Is it important to owners what happens with their employees? Are they seeking the biggest payday possible or are they willing to take a smaller deal to help lighten their tax burden? The answers to these questions will often help determine what type of buyer is sought for your company.

When your broker sends out a package announcing your intent to sell your business he or she will typically approach both financial and strategic buyers. There are differences in the approach and motivation each type of buyer would take to your business. Strategic buyers are those vendors or competitors within your industry that would hope to acquire your company in order to expand their own. Financial buyers are looking to buy your business, grow it to a certain size, then turn around and sell it again at a profit.

Your broker or other adviser can use government documents and SIC codes to identify potential strategic buyers and can also identify areas in which your company might be of the most benefit to a competitor. The

disadvantages of selling to a strategic buyer might include goals that differ from yours and a willingness to shake up the existing management team after a sale. For sellers that want to stay involved a strategic buyer might also not care about your perspective once a sale is completed.

If a business owner is looking to maximize financial return, a private industry fund looking to enter a specific industry might provide the best return. They’re typically looking for firms that are larger but might add smaller businesses to increase ownership in a given industry in their fund. The advantage to financial buyers is that there is money available. They’ll often leave existing management in place, but they also are in it to make a profit, and could shake up the business with a second sale.

Other options include selling to employees through stock option plans and finding individual buyers that are interested in diversifying an existing business they already own or in running a company while in between executive positions.

TO-DO LIST

1. Consider both strategic and financial buyers.
2. Initial public offerings are less common now for small businesses.
3. Consider your goals for what a post-sale company will look like.
4. In the last few years financial buyers have been aggressively pursuing and paying good prices for well-run businesses and winning many deals. There’s a lot of capital available from private equity firms.
5. But they’re also selective. They’re looking for businesses they can buy at a premium and for sufficient cash flow to service debt financing.

BOTTOM LINE: THERE ARE DIFFERENCES IN THE APPROACH EACH TYPE OF BUYER WOULD TAKE TO YOUR BUSINESS.

QUOTABLE:

“Unique businesses with predictable, growing profits continue to be few and far between. These businesses are very desirable to prospective buyers, and because they are rare, command a premium.”

— GREG LOESCHKE, Lingate Financial Group

Maximizing your price

Audited financials, solid management lead to higher price

There are many steps a business owner can take to maximize the price they will ultimately receive for their company.

One of the most important factors is the uniqueness of the company. An undifferentiated product is going to bring a lower-end return, but if you stand out in some way you'll be able to command a greater price.

Business experts suggest small-business owners focus on finding ways to maximize their profit potential as opposed to increasing revenue. High revenue with low margins is less attractive to potential buyers than a company with bottom line growth and stability.

A strong business will have assets in excess of liabilities. Try to reduce the liabilities as much as possible. The buyer is going to be practicing risk management and having good records that show

past success and indicate that greater future success is attainable will increase your sale price.

Other records and documents, such as minutes from business meetings and an up-to-date business plan, also can be important. Keep in mind the buyer also will be checking into customer satisfaction, employee productivity and market competition to determine its worth.

It also helps convince buyers they are making a good deal if the business has top-notch management in place. And make sure those executives and managers are actually involved in the company's day-to-day dealings. You want to make yourself expendable. If the seller is the only person keeping the business alive it will be less attractive to buyers because it will have less chance of succeeding once the owner leaves.

TO-DO LIST

1. Be flexible on terms.
2. Maximize your customer base.
3. Update financial statements.
4. Have an active, robust management team that is actually doing work.
5. Make yourself expendable.

BOTTOM LINE: ANYTHING YOU CAN DO TO MAKE A POTENTIAL BUYER MORE COMFORTABLE WITH THE FUTURE OF THE COMPANY GIVES YOU A CHANCE TO INCREASE THE EVENTUAL PURCHASE PRICE.

QUOTABLE:

“If both owners wish to be involved with the ongoing business, a merger makes the most sense because it legally combines the two companies. If one business is struggling or its owner wants to bow out, an asset or stock purchase or an exchange might be best.”

— TODD TAYLOR and KERRY TRAPP, Leonard, O’Brien, Spencer, Gayle

Minimizing your taxes

Work with team to sort complex issues

One of the reasons it’s important to utilize an accountant when selling a business is the tax ramifications. First, a seller wants to maximize the amount of the sale that will be treated as capital gains because that tax has the lowest rate available.

Sellers must think about how they are going to get the money. If they sell their ownership interest they’ll have to pay capital gains tax on the difference between the original investment and what the business is worth now. Sometimes they can consider spreading out the payments over five to 10 years, which would allow them to spread out the tax payments as well.

If the parties do an asset purchase, which is more common in deals involving small businesses, it’s generally better for the buyer, who can pick and choose the items he or she wants to acquire and then depreciate those assets based on the purchase price. That kind of a deal would typically be harder on the seller as those assets have typically already been depreciated. They would then have to report ordinary income on

that portion of the sale. Conversely, a stock sale entails the purchase of all assets and liabilities. Unless the seller wants to retain certain assets, such as real estate, he or she is typically going to be more interested in a stock sale, for multiple reasons.

Often parties will meet in the middle and do transactions involving both cash and stock. Those are complicated in that if 50 percent or less of the transaction is done in cash the Internal Revenue Service will delay taxing the stock until it is sold. But if the deal is for more than 50 percent cash the IRS taxes the entire amount upfront, meaning that the seller ends up using more cash from the transaction to pay the tax.

A good CPA, certified public accountant, will know of other outlets for minimizing proceeds allocated to taxes as well. In addition to structuring a deal that is palatable tax-wise for both the buyer and seller, the deal structure will impact how the seller’s estate planning is set up.

TO-DO LIST

1. A CPA can help sort through the countless tax ramifications of different types of deals.
2. Pay attention to capital gains taxes, and try to consider a sale when they’re low.
3. Asset sales of C corporation businesses cause a double-taxation scenario.
4. Stock sales are generally less onerous from a tax perspective for sellers.
5. Dual stock/asset sales have unique IRS ramifications as well.

BOTTOM LINE: THERE ARE FEW MORE COMPLICATED ASPECTS TO SELLING A BUSINESS THAN THE TAX IMPLICATIONS SO TALK TO YOUR TEAM EARLY.

QUOTABLE:

“It can take six months to more than a year to finalize a business transaction. Entrepreneurs can’t afford to take their eyes off the bottom line during this time or they risk business erosion.”

— JOHN CAMERON, Cameron Law Office

Selecting and negotiating

Advisers can counteract owner’s emotional attachment to business

If your selling efforts have worked well you’ve now received several offers structured in a variety of ways. The best thing to do, again, is to seek the advice of your broker or other advisers. That adviser realizes you have a childlike attachment to the business and that selling it is an emotional decision. He or she can stay the adult and help you sift through the offers.

Many times these days businesses don’t have multiple offers to choose from. For businesses that are making money and have a promising future, however, it is still a seller’s market. And if you are lucky enough to have multiple offers, the first thing your broker will do when the deals come in is create some sort of spreadsheet to track all the information, as it’s rare that any of the offers will contain exactly the same terms.

Once the offers are in front of your advisers they’ll start conducting some due diligence. They’ll sift through several years of the potential buyers’ tax returns to ensure that their offers are valid, research their history of past transactions, and the legal and business representation

on their sides of the prospective deals to ensure they are legitimate, and determine the progress they have made on financing. Some buyers will likely fall out of the process through this vetting alone. As some experts say, if you have a bad feeling there is probably some reason for it.

After performing due diligence the broker will begin comparing the actual terms of the deal, which will quickly start to narrow the field. For example if one firm offers to pay cash upfront while another wants to pay in installments over 10 years you’ll discuss the ramifications. It’s more secure to get the money upfront, but you can defer taxes by taking the installment deal.

There are going to be non-financial factors at play, too. For example, it’s not uncommon for a seller to include among his or her pre-set goals consideration for the well-being of the company’s employees. So some sellers will take a lower price for the business if the potential buyer will take customer and employee needs into account.

TO-DO LIST

1. Set your goals upfront to make sorting through offers easier.
2. Keep non-financial goals such as the well-being of current employees in mind.
3. Have your broker create a spreadsheet outlining terms of all the offers.
4. Perform due diligence to ensure that the terms of each offer can be met.
5. Following due diligence one of the offers will generally surface as a clear favorite.

BOTTOM LINE: THERE ARE THREE CRITERIA THAT WILL BE USED TO JUDGE A DEAL: PRICE, TERMS, CREDIBILITY.

QUOTABLE:

“If you’re retired, you can either play shuffleboard or play cards or you can play business. The worst way to punish me would be to say, ‘If you don’t reach this goal, you have to go out and play 18 holes of golf,’ and then I’d work my butt off.”

— DOUG HUSEBY, Becker Furniture World and Common Sense Wellness

Exiting partially or gradually

How to take some money off table while keeping hand in

If a business owner is looking to ease into retirement or if a company needs some cash to get through a down time one option would be a partial sale. It’s not an uncommon transaction and the structures are as broad as the buyer and seller want to be creative.

The benefit to the business of additional capital and new leadership can help push the company into unexplored business segments and new heights and some observers see such a move as selfless and a testament to the seller. Such a transaction can provide a business owner transitioning toward retirement a way to start backing away without diving into a work-free life.

However, sometimes business owners get more than they bargained for from giving up total control of their company. They need to recognize that it’s hard to find partial buyers that will come in for less than a majority ownership interest. The risk is that when new majority ownership takes control, especially if they are on-site, they might be less or not at all interested in how the

seller has run things in the past, a scenario that could cause power struggles and other problems.

While they aren’t common, a growing number of private equity funds or venture capitalists these days are showing some willingness to provide their expertise and capital while purchasing a minority business interest in exchange for a preferred stock offering or some greater-than-normal rights. These situations are being driven by the large amount of undeployed capital available in the market.

One scenario in which a gradual exit might make sense is transitioning the business to children or other family members. Under this situation it’s difficult for a parent to pass the business on right away, especially if the family’s entire net worth is wrapped up in the company. Under a partial exit the parent will still want to be involved in the day-to-day operations until they can find a way to cash out and step aside completely.

TO-DO LIST

1. An abundance of capital has led some venture capitalists and equity funds to consider buying minority interests in companies.
2. Early preparation can provide a greater number of options.
3. Be prepared after a partial exit to have a lesser role in day-to-day business dealings.
4. Partial exits can be useful for recapitalizations as well as for business owners or partners looking to take on a lesser role.

BOTTOM LINE: A PARTIAL BUYOUT OR RECAPITALIZATION CAN PROVIDE A SECOND CHANCE FOR FIRMS THAT HAVE BEEN SHORT ON CAPITAL TO ACHIEVE NEW PERFORMANCE GOALS.

QUOTABLE:

“Transitioning the business and transitioning the individual are two separate processes and difficult to do simultaneously.”

— JACK MACBEAN, Ostbye & Anderson

Handling family matters

When children inherit business, complications multiply

One of the most difficult decisions a business owner has to make is whether or not to pass the company down to related heirs. There is a significantly higher failure rate with second- and third-generation business owners. The biggest factors that sink the next generation are failing to plan ahead and not dealing with small issues when they arise, allowing them to grow into big problems.

It can be especially tricky if multiple children are involved. First, if some want in on the company and others have no interest how do you treat them fairly? Oftentimes owners will find ways to try and be fair, such as buying life insurance policies for the family members outside the business in an amount near or equal to the equity stake taken on by the siblings that stayed in the business. It's also important that kids realize that fair does not always mean equal.

After the succession takes place it's important that communication not end. One of the biggest areas in which family members struggle is addressing small issues that

are bothering them. Often those small items could be resolved easily, but if the offended party keeps quiet, it allows the small wound to fester.

While family meetings are important it is probably best that some larger issues facing the business be handled by a board of directors. Outsiders that still have the company's best interests at heart are better at separating emotions from issues and they can prevent potential problems from getting out of hand.

Business owners should definitely check with children or other relatives to see if they are interested in taking over or buying the business. But sometimes, experts say, it's just not meant to be. The owner might be better off selling for the maximum value of the business and splitting the proceeds among the heirs before they blow it all running the company into the ground.

TO-DO LIST

1. Sometimes it's not in the best interests of the business owners or their children for the business to be passed on within in the family.
2. Create a succession plan far in advance of when the transition will take place.
3. Help children that don't take part in the next generation of ownership realize that you will try to be fair, but that doesn't always mean being equal.
4. Don't let small issues grow into big issues by not communicating.
5. Once the founder has passed the business on to heirs it's important that the seller doesn't second-guess the new owners' business decisions.
6. Existing employees are frequently suspicious of the next generation so the buyers will have to work harder to earn their trust.

BOTTOM LINE: PARENTS SHOULD START WORKING ON THEIR SUCCESSION PLANS, WHETHER THEY ANTICIPATE SELLING TO THEIR CHILDREN OR TO ANOTHER COMPANY, WELL BEFORE THEIR RETIREMENT.

QUOTABLE:

“I wanted to shake up the paradigm of my life.”

— DIANE NETTIFEE, on why she left her corporate job to found Magis

Deciding what's next

Retirees with plan fare better after business sells

Retirement used to mean spending a few years on the golf course, having nice dinners with friends, spending some time with the grandchildren, and maybe some travel. But today's baby boomers are living longer than ever and they're often pushing retirement further into the future as well.

Some recent business sellers say it's important to take some time - up to a year - to decompress after a sale. It's okay to back away for a while. But business brokers and other financial advisers also suggest that these quasi-retirees at least have a plan. Entrepreneurs should talk with their families, friends and advisers about what retirement means to them before selling their business.

Some sellers are actually looking to retire. But many will stay on with the company after selling it, enjoying the opportunity to stay involved in less of a leadership role with more opportunities to spend time with their families. That can come with some downsides, however. Many times the new owners don't bother picking the

seller's brains, feeling they can take over and do a better job. Many advisers say buy-out deals are almost always bought out early.

Some sellers do so in order to start tinkering with another business idea or to move south and take the business concept they just sold to their new residence. For some it means volunteering or becoming a community activist.

These days it's not uncommon for business brokers and other advisers to do some coaching for their clients to make sure they think about these issues ahead of time. Studies have recently shown that business owners who head into retirement with a plan have greater self worth and longer life expectancies than those who don't.

TO-DO LIST

1. Don't wait until you've sold the business to have a plan for what you are going to do next.
2. Even if you stay on with your company for awhile realize that the buyers might feel they have better plans than you.
3. Many sellers end up starting or buying different businesses because running a company is in their blood.
4. If you plan to retire discuss your finances with a planner.
5. Having nothing to do can be a considerable culture shock.

BOTTOM LINE: MANY PEOPLE, ESPECIALLY THOSE WHO HAVE SPENT YEARS WRAPPING THEIR IDENTITY AROUND BUSINESS OWNERSHIP, OFTEN FIND THEY CAN PLAY ONLY SO MUCH GOLF.

Major sources for this guide**Justin Besekof, Lurie Besikof Lapidus Private Investment Banking LLC:**

612.381.8879; jbesikof@lblco.com; www.lblco.com

Sandra Broekema, Bostwick LLC: 612.709.6066;

Sandra.broekema@ebostwick.com; www.ebostwick.com

John Edson, Blanski Peter Kronlage & Zoch PA: 763.546.6211;

jedson@bpkz.com; www.bpkz.com.

Tom Hubler, Hubler Family Business Consultants: 612.375.0640;

tomh@thehublergroup.com; www.hublerfamilybusiness.com

Terri Krivosha, Maslon Edelman Borman & Brand LLP: 612.672.8340;

terri.krivosha@maslon.com; www.maslon.com

Greg Loeschke, Ligate Financial Group: 763.546.8201;

gloeschke@ligate.com; www.ligate.com

Thomas Lyons, Faelon Business Brokers Inc.: 763.231.4200;

lyons@faelon.com; www.faelon.com

Myrna Marofsky, Redbook LLC: 612.991.5427;

myrnamarofsky@mac.com; www.redbookllc.com.

Scott Nelson, Lommen, Abdo: 612.336.9320;

scott@lommen.com; www.lommen.com

Karen Oman, Certes Financial Pros (retired): 612.554.2896;

karenoman@clpropertiesinc.com; www.certespros.com

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Wes Bergstrom, publisher**Beth Ewen**, editor**Jonathan Hankin**, design director**Georgene Bergstrom**, circulation manager**Andrew Tellijohn**, contributing writer**Upsize Minnesota**

3033 Excelsior Boulevard, Suite 10

Minneapolis, MN 55416

Tel: 612.920.0701

Fax: 952.890.3786

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