Exit Strategy...
not the emergency evacuation drill

"Begin with the end in mind." states Stephen Covey in his book, The Seven Habits of Highly Effective People.

As a successful small business owner you probably followed the path of most entrepreneurs: forming your business on a kernel of an idea and then working like a fanatic to realize your dream. You've devoted countless hours to learning how to ride the wave of your success, only to find out that your hard work generally results in more hard work which creates greater growth and then even more hard work. All the while you continue to rise to the occasion until one day you begin to question if there is more to life than this spiral of never ending toil and worry. You begin to think about selling, wondering if you can sell your business, cash out and begin to live like a "normal" person. Of course the answer is yes... you can sell... BUT!

There is an underlying axiom of business that states with hard work, strong management and a little luck all businesses will sell one day! Unfortunately in the owner's haste to form the business and keep on top of the growing enterprise very little thought is given to the end game. **All business start-up guides state that the first step of a strong business plan must be the exit strategy.** A business should be launched with the idea that an exit for the owner is imminent. Eventually the time will come to transition the ownership of the company and pass the mantle of leadership to another individual. The truth is that most owner exits do not have happy endings due to a lack of planning and foresight. Business owners need to plan for their exit whether it will be in the near term or in the distant future. And the best time to begin that plan is today.

Start planning for your departure today by implementing the E-V-A-C-U-A-T-E planning system:

E = Evaluate your personal goals: The process of planning for the eventual departure from your business needs to start with a personal plan for your future!
Evaluate these areas:

• Gain a good understanding of the capital that will be required to sustain the lifestyle that you choose for the future. The profits from the sale of most small businesses do not yield enough capital for the owner to completely retire without the additional resources of retirement plans such as 401k's, SEP's, social security or alternative sources of income. At the beginning of your planning process, it is a good idea to meet with a certified financial planner to design a program that will provide you with the necessary income to support your future life choices.

• If you cannot afford to stop working completely you will need to decide what your next professional undertaking will be. Most business owners have not taken the time to determine their professional and personal aspirations beyond ownership of this particular business. Now is the time to ask yourself, "What type of career/profession will give me the greatest personal and professional satisfaction?" Once you determine a new direction, begin to gather the necessary internal and external resources to support the transition to a new career whether that is further education, skills training or networking within the chosen field.

• Other areas for contemplation and concern should be:

o Solicit the advice and support of friends and relatives to help you design your future. Make sure to swear them to confidentiality BEFORE you say anything about selling.

o If you are planning to retire, will you be leaving the area? If leaving the area is in your future make sure to consider states that have low or no state taxes as an alternative.

o Consider the fall out that will happen as a result of selling your business and transferring the assets. Does the business have a family name that may make others within the family disgruntled to have someone else entrusted with the family moniker? Are your children desirous of owning and operating the business even though they may not have the money necessary to buy you out? Will you miss the standing in the community as a business owner?

o What will be necessary to train and transition a new owner to ensure their success? Are you prepared to stick around and help through the transition period?

Each individual is different and their plans need to be unique and customized by their personal requirements. The key is to take time to plan now when you have the luxury of time on your side.

V = Value of the business: Do you know what your business would sell for in the market today? Oddly, most business owners know the value of their homes, cars and personal possessions, yet they do not have a reliable and realistic idea of what their businesses would sell for in today's market. Most proprietors rely on rumor or unrealistic rules of thumb when it comes to the estimation of the selling price of their businesses and they are shocked by the actual market driven selling price when it is time to sell. It is critical for all business owners to know the real world selling value for their business. Further, it is imperative to understand the dynamics that account for the selling value. Businesses are commonly valued and sold on multiples of cash flow. Cash flow is not solely profit, but all of the cash that is available to a new owner to pay themselves an income, retire debt and have capital left over for emergencies or funding expansion. The multiplier that is applied to the cash flow determines the marketed listing price and eventually the actual selling price. The multiplier is a value that is derived from the overall assessment of the business by a knowledgeable individual. Generally, determining the selling value of a business is not within the preview of the business owner or even the owner's accountant. It is better left to an expert in the field of selling businesses. The market is fluid and dynamic and is influenced by a myriad of factors. Knowing the true value of a given business requires an expert opinion. An expert in the field should be able to place a market value on the business in a short period of time by reviewing historical financial data and interviewing the owner regarding the critical value drivers associated with a particular industry and your specific business. Even if you do not plan to sell your business in the near term it is imperative that you know and understand the probable selling price that you could receive at any given time. The time to know the selling value of your business is today!

A = Accounting: Businesses are valued and sold on a basis of provable historical cash flows and as such a buyer will pay more for a business that has accurate detailed financial records. In terms of maximizing the selling price of your business, the best investment that you as an owner can make is to install an accounting/bookkeeping system such as QuickBooks and use it religiously to account for the activity of the enterprise. Secondly, secure the assistance of a good accountant that is familiar with your industry and have them prepare quarterly financial statements (operating statements and balance sheets) as well as year end statements and tax returns. It is not enough to have the accountant's involvement only at tax preparation time. It is well known throughout the business brokerage industry that accurate detailed financial statements will raise the multiplier by a factor of 0.25 to 0.75 over a business that lacks good financial records. Raising the multiplier by a factor of 0.25 to 0.75 has an astounding impact on the selling price. For instance; if your business has $100,000 of cash flow you would realize $25,000 to $75,000 in additional selling proceeds over a business that has poor financial documentation. The next "must do" item is to make sure that you are reporting all of the revenue of the business on your tax returns. Again, it is important to realize that every dollar that is reported as provable cash flow will raise the selling price by the factor of the multiplier. Most small businesses sell for a multiplier of 2.0 to 3.0, so therefore every provable cash flow dollar should be worth $2.00 to $3.00 at time of sale. Larger businesses often sell for even greater multiples, making the benefits exponentially greater. These additional dollars at time of sale far outweigh the tax savings you may realize by under reporting your revenue and/or profits. Finally the key watch word in maximizing the proceeds from the sale of your business is provable cash flow. Your financial documentation must stand up to a buyer's rigorous due diligence efforts. Make sure that all elements of the accounting cycle tie out and there aren't any magically appearing cash flow dollars that skew the true picture. Buyers are very weary of financial documentation that does not ring true when put to the test accounting principles. On the other hand, a buyer generally is willing to pay a premium price if they feel assured that the cash flow will actually be there once they own the business. So invest in your financial reporting and accounting to make certain that it is complete and accurate. The pay back on the investment will be big!

C = Correct: A good business leader constantly strives to recognize operational flaws and then takes corrective action to eliminate identified weaknesses. The same activity needs to occur when thinking about getting your business ready for sale. But in this case, the business owner needs to identify the areas of weakness that will negatively affect the selling value multiplier, (thereby reducing the selling price) and then take the steps necessary to rectify those conditions. The multiplier is made up of a set of value drivers. Value drivers are the tangible and intangible elements of a business that a buyer assigns value to. Value drivers cover the full operational spectrum of an enterprise and can include 25 to 30 areas of concern. Areas such as the transferability of tangible and intangible assets, availability of key management, competition, capital investment requirements, competency & longevity of the employee base, age of operating assets, customer sales concentration, documented processes and procedures, operational technology, intellectual property such as patents, contracts, franchise rights, leases, operating capital requirements, value of the business name within the marketplace, and much more blend together to determine the multiplier. It is important for a business owner to identify and inventory all of the value drivers pertaining to their operation and implement a program that will enhance the multiplier's characteristics in order to maximize the selling price. Often times the value drivers can either be put into practice or improved upon without much capital investment on the part of the ownership. The activity of correcting value driver deficiencies will give you a big bang for your buck when it comes to selling your business. If you do not have a good grasp on all of the value drivers for your business, contact a business sales expert that can help you determine the operational elements that will be used to establish the multiplier. As Ed Pendarvis, founder of Sunbelt Business Brokers, is fond of saying; "A business is made of multiple chapters just like a book, and each chapter contributes to the overall value of the business. A buyer wants to read the whole book, examining all of the chapters word by word in order to discern the true worth of the enterprise." Make sure that the book for your business is all inclusive and as such will be highly valued by perspective buyers.

U = Understand: Most business sellers and buyers equate the activity associated with the sale or acquisition of a business to the purchase of real estate, such as a home or a commercial building. Comparatively, selling a business is unlike the sale or purchase of real estate and is probably very different than any undertaking that you have engaged in previously. A business owner must be generally acquainted with the processes and procedures pertaining to the orderly transition of ownership in order to protect the business and themselves from the dire consequences that can occur if mistakes are made. Planning and knowledge will help you avoid the many pitfalls that are inherent with this complicated undertaking. First and foremost your decision to sell (or even if you are thinking of selling) must be handled in a strict confidential manner. If word gets out that you are considering selling your business, regardless of your reasons, the general public perception will be that the business is on the verge of bankruptcy. Your business could be damaged by a breach of confidentiality. Employees and management may seek a new employer, vendors could seek alternative outlets and competitors will make sure that your customers know that you may not be in business in the near future. Be very careful who you trust with the idea that you may be selling and make certain that they sign a confidentiality and non-disclosure agreement before relating any information. Secondly, an owner needs to understand the flow and process of the business selling cycle to maximize selling price and mitigate liability. Selling a business is not as simple as placing an ad in the classified newspaper section of the Sunday paper and then sitting back to review the multiple offers that you receive. Placing the business for sale involves; placing a salable value on the enterprise, reviewing and implementing tax mitigation tactics, strategic marketing, confidential prospective buyer qualification review, facilitating multiple operational buyer-seller meetings, extracting an offer for purchase from the buyer, negotiating the offer to maximize seller value, supporting the buyer's due diligence, negotiating transition of leases and contracts, drawing up binding legal closing documents and much more. Each phase of the process needs to be handled in an exact order with great care and diligence to maximize the results for all parties while mitigating post transaction liability. Gaining a reasonable understanding of all of the intricacies of the business selling process will pay big dividends by reducing the problems and risk associated with selling a business.

A = Assets: One of the biggest areas of confusion surrounding the selling value of a business is what constitutes salable assets and what value should be placed on those assets. From an accounting perspective, the value of an asset is its acquired cost less the amount of depreciation taken over a set period of time. This is generally known as the book value of the asset. However, in the case of valuing assets as they relate to the sales price of a business, an asset is defined as anything that brings value to the operation. Generally the assets are divided into tangible and intangible groupings. The tangible assets are the furniture fixture and equipment known as the FF & E. The intangible assets are often referred to as blue sky or "goodwill" and are made up of items such as business name, location, phone and fax numbers, customer lists, vendor relationships, contracts, etc. Generally, sellers have a large misunderstanding as to the worth of tangible operating assets. Most sellers view the value of their FF & E on a replacement cost basis when it comes to attempting to determine a sales price. However, this is not accurate when it comes to the selling price of a business. The FF & E needs to be valued as assets in place making money in order to fall within the underlying math of valuing and selling businesses (cash flow times a multiplier). For example, a business may have operating assets that have a replacement value of $500,000; and the operations are producing $100,000 of cash flow. Let's assume that this business has a selling multiple of 3.5 times cash flow, so the expected real world selling price would be $350,000 which is $150,000 less than the replacement value of the tangible assets. Unfortunately the cash flow from operations does not justify a selling price for the assets based on replacement value. This can be a bitter pill for most business owners to swallow. However, from a taxable liability mitigation stand point this can be a bonus to the seller. If the seller sells the FF & E for an amount greater than the book value (acquired cost less accumulated depreciation) than the amount of gain from the sale will be taxed at ordinary income and must be paid in the year of the sale. The FF & E of the business should be generally valued at an arbitrary value that nearly matches the book value. Essentially if you sell your assets for more than their stated book value you are going to pay a large tax bill. If you are in the unenviable position of having tangible asset (FF & E) holdings far in excess of the selling value of your business based on cash flow from operations, it would seem that you have surplus equipment capacity and you need to either find more work and/or liquidate the underutilized equipment.

T = Taxes: If you are fortunate enough to sell your business you will have an uninvited third party at the closing table! Uncle Sam will be there with his hand out. The sale of your business will more than likely constitute a taxable event, which could take a substantial bite out of the sale proceeds. However, with some research and advanced planning you may be able to lower your Uncle's take and walk away from the table with more of your hard earned money. Business owners need to meet with their accountants to research the taxable consequences of selling their businesses in order to understand the tax laws governing the sale of a business. Unfortunately, most small business owners wait until they put the business up for sale before they investigate the taxable issues surrounding the transaction. This is way too late and the delay will cost you in real dollars. The taxable consequences are intricate and variable and are dependent on the formation of the legal entity and the past tax history of each business; much too intricate for discussion here. There are general rules of the thumb that can be applied, but in this area you need the help of an expert that knows your business and has been through multiple sales. Make sure that you start today to gain a thorough understanding of tax laws pertaining to your business and how they will affect the sale of the business. Remember, the selling price is of secondary importance to the actual after-tax proceeds that you will receive from the sale.

E = Engage: Any good plan ends with an action step. If you believe that your business will sell one day you must start preparing immediately in order maximize price and minimize liability. Whether you are planning on selling in the near term or in the future the best first step is to meet with a qualified professional business sales agent. The agent will get you started in the right direction by helping you understand the value of your business, the corrective steps that you can implement to create greater value and familiarize you with the process of successfully marketing and selling your business.

The next steps are to enlist the aid and support of qualified individuals in the areas of personal financial planning and accounting and tax mitigation. Of course, the rest is up to you. Maximizing your selling price through proper planning and timing can result in large difference in the cash that you finally get to take home at the end of your tenure of ownership. Don't delay, get proactive and get going. Time is money and the clock is moving fast.