14 Tips to Help Business Owners Successfully Exit Their Business

FAMILY OFFICE AND HIGH NET WORTH

Selling a business can be one of the most transformative moments in the life of an individual or family. The transaction can set the framework for legacy-building and bringing levels of financial security to current and future generations—or it can be part of a strategy for managing a challenging situation that needed to be done sooner rather than later.

Every business owner will eventually exit from their business, either voluntarily or involuntarily, and proper planning is essential for making sure that this exit will be completed in a seamless, tax-efficient and economically favorable manner.

For privately held businesses that have not yet designed and implemented exit and succession plans, the ever-changing economic environment should serve as a wakeup call to complete this critical task. Businesses that already have exit and succession plans in place are encouraged to re-examine them to ensure that the structure and terms of the plans will still accomplish their intended objectives.

At the top of their risk management strategy, business owners should consult with legal counsel who have the expertise and experience in designing and implementing exit and succession plans to ensure that the business owners adopt well-conceived plans that carry out their business, financial and personal goals.

The time-sensitive nature and importance of exit and succession plans

A business owner cannot predict with certainty the date on which they will exit from their business. The exit event may be in the form of an unanticipated offer from a third-party buyer or an involuntary event such as death or disability. As the due date for a business owner's exit and succession plans could arrive as early as tomorrow, it is critical that a business owner not delay the creation and implementation of these plans.

Failure to do so may result in the business owner:

1. Losing control over the timing and terms of the exit from their business (e.g., a fire sale of the business);
2. Overpaying income taxes and estate taxes;
3. Not realizing their personal, financial and business goals during the exit process;

4. Imposing significant burdens on family members, customers, partners and employees; and
5. Restricting the options they have for exiting from their business.

A business owner's implementation of well-conceived and thorough exit and succession plans will eliminate the potential for the business owner to experience one or more of the devastating consequences of poor planning above, and enable the business owner to have a seamless and tax efficient exit (i.e., in which key business, financial and personal goals are achieved) from their business.

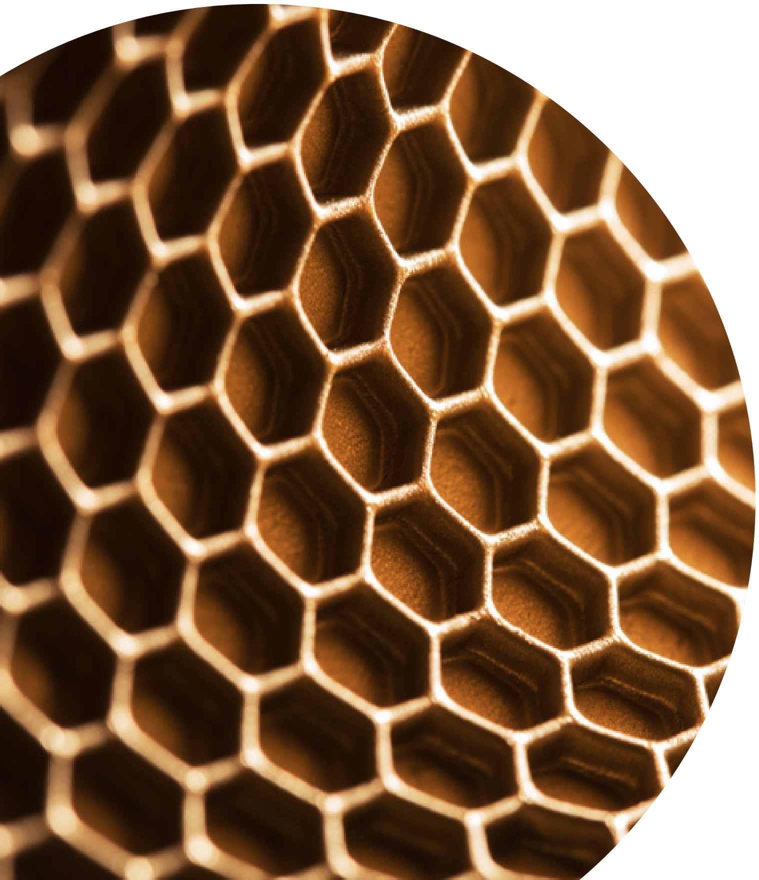
14 key areas to consider when selling your business

A business owner and their legal counsel need to complete the following action steps in connection with designing exit and succession plans:

1. **Due diligence review of the owner's business.** As a precursor to a business owner's design of an exit plan from their business, the owner needs to complete a comprehensive due diligence review of their business operations (the "Business Operations"). This review will identify problems, issues and areas of exposure to liability for the Business Operations, and will include:
    - A thorough evaluation of the corporate governance and structure for the Business Operations'
    - A detailed review of all the corporate records, benefit plans and employee handbooks, incentive compensation plans, current and historical tax filings, and material agreements (including lease agreements, franchise agreements, and employment agreements with key employees) for the Business Operations;
    - A review of the intellectual property protection in place for the intangible assets of the Business Operations;
    - A SWOT analysis, identifying the strengths, weaknesses, opportunities and threats facing the business owner and the business, and how these factors should be addressed in the exit and succession plans;
    - An evaluation of all relevant legal compliance issues for the Business Operations; and
    - A review of the insurance coverage that is in place for the Business Operations. This evaluation of the Business Operations enables a business owner to develop a list of action items that need to be completed to make his business as "airtight as possible."
2. **Planning to achieve growth in business value.** An important part of the planning process is to determine how the business owner (i) has grown the value of their business to this point and (ii) will grow the value of the business going forward. In this regard, the business owner needs to work with legal counsel to:
    - Identify the intangible assets of the business that give the business a competitive advantage (e.g., a talented management team, unique business processes, proprietary information);

- Ensure that the valuable intangible assets of the business are properly protected (intellectual property protection, restrictive covenants in employment agreements with key employees that protect the business' goodwill and confidential information, etc.); and
- Implement compensation plans for key employees (e.g., a phantom stock plan or a stock appreciation rights plan) that incentivize them to think and act like owners of the business (and assist with its growth).

3. **Value and transferability of the business.** The income of a business does not create or represent value for the business if such income is dependent upon the owner (rather than the business itself). As part of the planning process, one needs to create owner independence so that:
    - The business generates income and value regardless of whether the owner participates in its operations; and
    - The unique intangible assets of the business (i.e., the value of the business) can be easily transferred by the business owner to a third party (as they are not dependent on or tied to the business owner).



4. **The five "D's."** In designing the exit and succession plans for a business, the business owner needs to account for the five "D's": death, disability, divorce, distress and disagreement.
5. **Define the goals and concerns of the business owner.** As part of the planning process, the business owner and legal counsel need to:
    - Identify and address the concerns of the business owner: What is my business worth? Will I have enough money to retire? Who will run my business in the future? How do I protect and increase the value of my business?
    - Define the personal, financial and business goals of the business owner and incorporate such goals in the design of the exit and succession plans.
6. **Valuation of the business, estate and personal financial planning.** The business owner, together with legal counsel, an accountant and a financial planner, need to:
    - Conduct a valuation of the business, and develop a net proceeds analysis for a current sale of the business (i.e., calculate the net proceeds that the business owner would realize from a current sale of the business after taxes and transactional expenses).
    - Develop a financial plan and a "retirement number" for the business owner, and compare the "retirement number" to the amount derived from the net proceeds analysis for a current sale of the business.
    - If the retirement number is less than the amount derived from the net proceeds analysis, determine the amount of growth in the value of the business that needs to be achieved (through the growth-planning process described above) to enable the business owner to achieve their financial goals.
    - Design and implement an estate plan for the business owner that is in sync with the exit and succession plans.

7. **Identify current market trends.** The business owner, with assistance of legal counsel and advisors, needs to identify current market trends in the business owner's industry. Is the market growing? Is the industry consolidating? Is there the possibility of a market disruption that will impact the value of the business?

8. **Identify the key employees in the business and establish their goals.** The key employees of a business are critical to the successful implementation of a business' exit and succession plans. In this regard, the business owner and legal counsel need to:

   - Identify the personal and financial goals of the key employees, and then design exit plans for the key employees that enable them to achieve such goals;

   - Grant ownership interests in the business to key employees or cause the key employees to be covered by an incentive compensation plan (e.g., a phantom stock plan or a stock appreciation rights plan) that will (i) cause the key employees to think and act like owners of the business and (ii) incentivize the key employees to increase the revenue, profitability and value of the business (which, in turn, will enable the business owner and the key employees to achieve their financial goals); and

   - Protect the goodwill and confidential information of the business by causing the non-owner key employees of the business to execute employment agreements that contain restrictive covenants (i.e., a confidentiality agreement and agreements to not compete with the business or solicit customers or employees of the business). Consider the value of personal goodwill of owners and the business and tax implications of converting such personal good will to goodwill of the business.

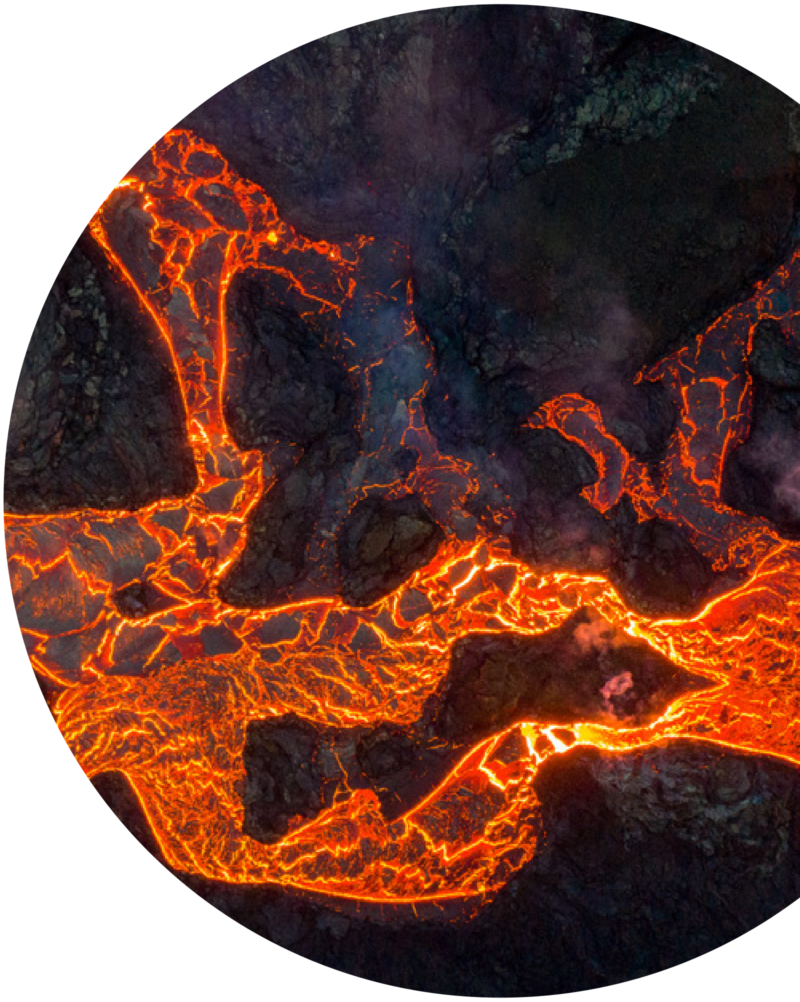
9. **Develop and implement a succession plan.** The business owner and legal counsel need to develop a succession plan for the business in which:

   - The organization chart for all important employees of the business is critically analyzed to (i) define (in writing) the functions and roles of the key employees, (ii) determine whether there are redundancies in the roles of the key employees that should be eliminated or additional functions that the key employees need to perform in the future, and (iii) identify internal and/or external successors to the key employees, and determine whether internal successors need training; and

- The business owner delegates the day-to-day responsibility for the operation of the business to the key employees and the business becomes a turnkey operation that operates independent of the business owner and can be easily transferred to a third-party buyer. Proper programs to incentivize employees to think and act like an owner assist in the filling the gap and allow the business owner to separate from the business after an exit.

10. **Develop and implement an exit plan.** A business owner's exit from their business may be voluntary or involuntary, and may occur sooner than desired or anticipated. The business owner needs to design and implement an exit plan that, regardless of when and how the exit event occurs, enables him/her to have a seamless, economically favorable and tax-efficient exit from their business; one in which all of their business, financial, and personal goals are achieved. In this regard, the business owner and legal counsel need to:
    - Define the personal, financial and business goals that the business owner wants to realize from the exit process.
    - Define the structure for the exit process and consider the form of such exit process. Conduct a review and analysis of which exit will be most favorable to the business owner. Should it be a sale of the business to a strategic buyer (including a competitor), a financial buyer, customer, supplier, an ESOP, the management team for the business, or family members? Or a gift of the business to family members during life or at death? A sales or gift of the business assets or a sale or gift of the business equity?
    - Structure the governing agreements at the outset to assist in dealing with minority equity holders, including family members.
    - Create and structure an incentive program for employees so that they will assist and "buy in" to the exit.
11. **Develop and implement a contingency plan.** The business owner needs to develop a contingency plan that covers an owner or key employee's involuntary exit from the business due to death or disability. In this regard, prudent planning involves:
    - The company's purchase of disability insurance and life insurance that covers the key employees. The proceeds of this insurance will enable the business to stabilize itself following the death or disability of a key employee;
    - The company's purchase of disability insurance and life insurance that covers the owner of the business. The proceeds of this insurance will enable the business to stabilize itself following the death or disability of an owner and to purchase their ownership interests without having to deplete or leverage the balance sheet of the business; and
    - The business owner having a comprehensive personal estate plan that includes transfer of ownership of the business.
12. **Prevent your business assets from going into probate.** Work with your legal team to create a tax efficient way to transfer your assets that avoids probate. If your business assets go into probate, it can take an additional year or more before the assets go to the person(s) you name. Proper estate planning allows for your business assets to quickly transfer to the new owners, minimizing disruption to the company.

13. **Communicate your plan with stakeholders and employees.** Once you have established your succession plan and begun its implementation, share this with employees so they can be reassured that the business will continue after your departure.
14. **Life after the Exit.** Many business owners' entire identity is tied to their business and without proper planning, life after the exit can be challenging. It is important that the business owner plan for life after the exit, including financial planning, philanthropy, family interests, etc.



How disruptive events can impact your exit and succession plans

Most businesses will experience challenges (e.g., COVID-19, supply chain disruptions, loss of key customers, etc.) that impact planning and cause a sudden and immediate impact on their operations, suppliers, sales and workforce. As a result, you should re-evaluate your exit and succession plans and the events that could potentially impact your business and your existing exit and succession plans.

- **How recently was your business valued?** A valuation date greater than 12 months old very well might not capture recent events and their impact on the value of your business. An updated valuation may be necessary; one that will take into account such matters as any stimulus benefits the company received, current cash flow and any company specific-risks that may have arisen due to recent events, such as COVID-19.
- **Has your timeline for exit changed?** The current challenges may have caused you to consider exiting sooner than you otherwise planned. For some businesses, valuations may be higher as a result of recent changes in the economy. On the other hand, you may decide that you want to delay the operation of your exit and succession plans so you can oversee the business through its current challenges. And if your business was negatively impacted by recent events, waiting to implement your plan may also allow for time for the company's valuation to rise.
- **Is your chosen successor still the best to lead the company?** Recent challenges to your business may have reinforced that your chosen successor has the skills and ability to lead your company through any challenge—including another unforeseen pandemic. It is also possible that someone else rose to the top during this fraught time, keeping operations running or boosting employee morale, and he/she should be considered for successorship.
- **Is your leadership development hitting the mark?** Business owners sometimes need to make difficult decisions around pay cuts, furloughing staff and pausing or ceasing operations, even temporarily. If your current leadership development plan is not preparing your successor to make these types of difficult decisions in a high-pressure environment (such as global pandemic), it's time to provide this type of training so you set your next leader up for success.

- **A lower valuation could minimize estate and gift taxes.** While no business wants to see its valuation drop, there are planning opportunities that arise with a lower valuation. Several estate-planning techniques, such as grantor retained annuity trusts (GRATs), are more effective when interest rates are lower. When your business value is lower, it may be beneficial to give stock or ownership interests now, because you likely will be able to give more stock or ownership interests at a lower tax cost compared to when your business valuation was higher.

The need for business continuity

While it is essential that privately held businesses have exit and succession plans in place, it is also important that operations be able to continue if the owner or owners were to suddenly become unable to run the business. Without proper planning via a business continuity plan, an abrupt change in leadership can negatively impact business operations, employee morale and, ultimately, the business value.

While COVID-19 reinforced the need for businesses to have a continuity plan in place, we recognize that an owner could, at any time, receive a significant medical diagnosis or be involved in an accident that renders him or her incapacitated and possibly leads to death.

Business stakeholders should work with their outside legal counsel to identify who, internally, could temporarily run the business in the event the owner(s) are suddenly unavailable. It would also be prudent for the company to identify a backup to the temporary leader in the event that this individual is unable, unwilling or incapable of assuming the reins.

It is vital that privately held businesses take steps today to ensure that the business can continue long after the current owner or owners have left. This includes creating exit, succession and business continuity plans. Legal counsel with expertise and experience in exit and succession planning can be a great help in crafting these essential documents.

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