

EXIT STRATEGIES FOR ENTREPRENEURS

This article discusses how different exit strategies can be used to smooth a transition out of your business

Your exit strategy may be one of the most important, yet least thought-out, elements of your business plan. Among the important decisions — what you might want to do after you leave the business, what the ongoing roles of your children or other family members might be, and how the sale proceeds will be deployed. The development of an exit strategy also opens the door for a wide range of tax management, philanthropic, and estate planning activities and opportunities. However, since effective strategies balance complex legal, financial, tax planning, and contractual issues, cross-disciplinary professional advice is virtually required.

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If you are like many of your peers, the road into your business was more clearly laid out than your exit route from involvement. However, a well-drawn roadmap for the endgame can be the difference between achieving success and missing the target on important life goals. As a result, preparing an effective exit plan should be a central part of your overall game plan.

Laying the Groundwork

A viable entrepreneurial exit strategy must take account of where you are today or where you would like to be in the future and provide for contingencies in the event of unforeseen circumstances. As a result, your exit planning should start with a comprehensive appraisal of your business and personal finances. Many entrepreneurs have found it valuable to start by developing a comprehensive net-worth assessment with their financial advisor. This not only helps to identify all available resources, but also to help match those resources against specific goals.

Perhaps less objective but no less key to a successful exit strategy is values clarification. For example, if some or all of your children are involved in the business, do you want them to continue in their current roles or expect that all will move on when the business is sold? You might have a clear choice for successor, and so might wish to consider how that choice will impact other family relationships. Keep in mind that many exit plans have foundered because of internecine conflicts. A related area of concern that will form a backdrop for the exit strategy is your vision for life after the event. Are you planning to retire? To remain involved as a consultant or part-time executive? To start a new venture in another field? Also, what might happen to your business if you were to suffer an untimely disability or even death? How each of these questions is addressed will direct the practical thrust of the nascent exit strategy.

Finally, a successful exit process should be based on a sound understanding of existing business relationships and provisions. You should identify the key professional and executive talent in your firm and then formulate appropriate reward and retention strategies for them.

Potential Deal Forms to Consider

The various choices of deal structure each offer unique cost/benefit trade-offs. Here is an overview of the options:

Buy-Sell agreement -- This arrangement is designed to permit business co-owners to terminate their business relationship by setting the parameters for some participants to buy out others. It enables one or more associates to maintain involvement in a business when others might wish to sever their ties to it. It can also provide funding for a buyout in the event of the disability or death of a co-owner. A buy-sell agreement requires careful design to ensure that its execution does not work at cross-purposes with other estate and succession planning tools.

Cash sale to a third party -- A pure cash transaction may create the greatest immediate liquidity for the seller, but other financing structures may have the potential to generate greater net yield over time. A cash sale may also be the simplest means to execute a complete and immediate separation from the business. However, keep in mind that one of the challenges of seeking a third-party buyer is that quite often there is no ready market to sell a small business. Simply put, it can take time and money to find the most profitable deal.

Buyout or recapitalization -- In leveraged transactions partners, managers, or the business as a corporate entity borrow the funds to purchase the stock of the exiting entrepreneur. These deals may be especially useful for dissolving a multiple ownership arrangement while otherwise maintaining the business as a going concern. They are also often used for transferring business responsibility to children or other heirs while creating financial independence from them. Recapitalizations can also be used to finance an annuity for a business owner who might wish to combine financial independence with limited business involvement.

Employee Stock Ownership Plan -- An ESOP is a form of leveraged buyout designed specifically

to give control of the business to a broad base of its current employees. ESOPs may have higher transaction costs than ordinary cash sales, but in many cases these costs are not out of line with the costs of other more complex deals. There are also specific tax benefits for ESOP transactions that may improve their net value significantly.

Managing the Proceeds

A key part of any exit strategy is the financial plan for managing the proceeds of the deal in a manner consistent with the client's post-sale goals. Such plans typically include a blueprint for investing sale proceeds in a diversified portfolio. They also typically include an estate plan crafted to take advantage of the trust structures and tax-code features that allow you to preserve wealth and protect the future interests of heirs. Among the favored devices may be family limited partnerships and grantor retained annuity trusts, which can reduce the estate value of shares passed on to heirs. In addition, many entrepreneurs are interested in charitable remainder trusts. These may be used to fund philanthropic programs that realize specific charitable goals while maximizing tax benefits, minimizing costs, and creating an income stream.

Professional Guidance a Must

Just as you likely rely on key advisors when making significant business decisions, you'll need to assemble a team of legal, tax and finance professionals to help you analyze your current and future objectives and planning needs.

Points to Remember

1. The sale of a business is only one small transaction at the center of a larger plan often referred to as an exit strategy.
2. The most successful exit strategies are those that give the business owners the greatest probability of comfort with the results as seen in their financial security, family dynamics and long-range goals.
3. There are many options for structuring the sale of the business, and each had different implications for other elements of the broader strategy. Buy-sell agreements can help maintain continuity for remaining owners in a wide range of circumstances. Pure cash transactions typically yield the greatest immediate liquidity. Leveraged transactions may enable managers, partners or family to take over and maintain continuity for the business. ESOPs can provide tax benefits and empower employees.
4. Trusts can be valuable tools for managing the income tax and estate planning implications of the wealth derived from a business sale.

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