Which of 8 ways is best when leaving your firm?

ACCORDING TO Paul Simon, there are 50 ways to leave your lover. Not being as creative as Mr. Simon, I've come up with eight ways for owners to leave their companies.

- Transfer the company to a family member;
- Sell the business to one or more key employees;
- Sell to key employees using an Employee Stock Ownership Plan (ESOP);
- Sell the business to one or more co-owners;
- Sell to an outside third party;
- Engage in an initial public offering;
- Retain ownership but become a passive owner; and
- Liquidate.

Which of these exits do owners, in fact, intend to use? A 2002 survey by National Family Opinion in Northwood, Ohio, indicates that:

- About one-third want to transfer their companies to a family member;
- Eighteen percent want to sell to current employees;
- Another one-third want to sell the business to an outside third party;
- The remaining owners expect to simply close their doors.

While space does not permit a thorough discussion of the advantages and disadvantages of each exit route, a few significant points are worth noting.

With over half of all owners wishing to transfer the business to insiders (family, key employees or co-owners), these options all provide the following non-financial advantages:

- transfers the company to a known entity;
- perpetuates the company's mission or culture;
- allows the owner to remain involved in the company.

Disadvantages of these exit routes include:

- provides little or no cash for retirement;
- increases (and continues) financial risk;
- requires owner involvement in company post-closing.

ESOPS are qualified retirement plans, typically profit-sharing plans, which must invest primarily in the stock of the sponsoring employer. In addition to the advantages mentioned above, the owner who uses an ESOP to transfer a company to key employees enjoys three benefits:

These include cash, beneficial tax treatment and possibility of immediate retirement. Disadvantages include cost and complexity, curtailed growth due to borrowing and owners' assets (post-sale) used as collateral.

[tips] ...for choosing an exit strategy

1 | Figure out objectives, financial and non-financial. For example, if an owner wants cash but doesn't want to sell to an unknown third party, a sale to key employees may be best.

2 | Determine valuation and marketability. This analysis usually eliminates potential exit paths.

3 | Evaluate tax consequences of various paths.

To a new level

Sale to a third party and/or initial public offering (IPO) offer two notable advantages. One is that they usually provide maximum purchase price to the seller. Secondly, with infusion of cash they often facilitate company growth, moving the company to a new level.

Disadvantages with these exit strategies include continued owner involvement beyond the sale. In both cases, the owner is often required to stay on and work for the "new boss" for one to three years. They are both "non-events" from a departure standpoint. They also both involve a degree of continued risk in receiving the sale price.

With a third party sale, receipt of much of the purchase price is subject

to future performance of the company after it is sold. With an IPO, the owner's interest is exchanged for shares of stock in the acquiring entity. By the time the owner is able to liquidate those shares, market price may have significantly changed.

The owner could choose to assume passive ownership. Benefits include ongoing cash flow and the ability to maintain control. The problem with this exit route is that the owner continues to assume risk associated with ownership because the owner has not established continuity for the business.

Liquidation is the final exit route available and is usually only followed in one situation: when the owner needs to (usually for health reasons) leave the company immediately and has no alternative exit strategies in place.

Not surprisingly, the disadvantages to this exit route are enormous. First, liquidation yields much less cash than any other exit route. Secondly, owners who liquidate pay a higher proportion of their proceeds in taxes than owners in any other type of sale or transfer.

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"Structuring the best road map for an owner's inevitable exit from a business requires strategic and early evaluation of the pros and cons of each path."

— Dyanne Ross-Hanson, North Star Resource Group

How to choose

The process of determining exactly which path is best presents an obstacle that too many owners choose to avoid. In order to successfully exit their business, owners must work through a three-step process of selecting their path.

Step One. First, owners need to figure out what their objectives – financial and non financial – are before they can determine who the best buyers for their businesses are.

Internal and external considerations affect an owner's choice of exit path. For example, the owner who wishes to transfer the business for cash, but is unwilling to throw the company's and employees' fates on an unknown third party, may decide that an ESOP or carefully designed sale to key employees is the best exit route.

Likewise, business, market or financial conditions, such as the state of the mergers and acquisitions market, may affect the choice of exit paths. Determining objectives well in advance of departure gives owners and their advisers the time necessary to make their goal a reality.

Step Two. As owners develop consistent objectives and motives, they then must value the company and determine its marketability. This analysis usually provides further direction and can eliminate potential exit paths.

Step Three. The final step in choosing a path is to evaluate the tax consequences of various exit paths. This evaluation will include factors such as form of business entity, sale of assets or stock, timing of payments, etc.

Structuring the best road map for an owner's inevitable exit from a business requires strategic and early evaluation of the pros and cons of each path.

Owners and their advisers must conduct open and frank discussions based on realistic possibilities (rather than conjecture or wishful thinking). Armed with a road map, owners can navigate the most appropriate exit route.

[contact]

Dyanne Ross-Hanson is a senior partner with **North Star Resource Group Inc.** in Minneapolis and a frequent writer and lecturer on financial topics: 612.617.6104; dyanne.rosshanson@northstarfinancial.com; www.northstarfinancial.com