Key Considerations for Succession and Exit Planning

Business owners inevitably confront the need to transition ownership and management of the business to others. Whatever form this transition takes—to the next generation in a family business, to a management team buying out the owner, or to a third-party buyer—it involves a new set of risks and opportunities that differ from those encountered in normal operations. Owners must prepare themselves and the business for what lies ahead. Here are some key considerations:

Know yourself. Many owners embark on a sale process, only to discover they really don't want to sell. The business is their baby and their life's work. Who are you if you are not the president of XYZ Corp.? Take the time to think through these soft issues.

Know your objectives. As with most things in life, you won't get there if you don't know where you are going. Define your objectives. Realize that there will be inherent conflicts among these objectives. You can't have maximum liquidity and minimum risk while also keeping the business in the family. Determine priorities and make compromises to resolve these conflicts.

Integrate your plans. For an owner, the business is an asset, yet many owners don't view it sitting alongside stock, bonds and CDs in an investment portfolio. Start to think like an owner-investor and be certain to integrate your business succession plan with your personal financial and estate plans.

Plan ahead – way ahead. No business is perfect and each will require work to get ready for succession or exit. Maybe you need to diversify the customer base, beef up the management team or improve your financial reporting systems. Planning takes time and in many cases, may be driven by factors beyond your control – health issues, conditions in the capital markets, availability of capital, performance of the stock market. Start developing your plan 3–5 years ahead of when you think you will implement it.

Know when to say when. There are lots of reasons to sell a business. Most of the *good* reasons require the owner to take initiative to capitalize on favorable opportunities. You don't want to try to exit when margins are declining due to obsolete products, new competitors or the loss of key customers. You want a transition, not a turnaround.

Understand value. The value of a business derives from various factors specific to the business (internal) or affecting the market or the economy as a whole (external). Understand the key value drivers for your business and how they are affected under various circumstances.

Make yourself less essential. In many private companies, the owner maintains the key relationships—with customers, suppliers, bankers and others—that make the business run. Bring members of your team into these relationships so they can keep things on track in your absence.

Build a team. Succession and exit planning presents issues and requires strategies that are quite different from normal business operations. Many of the steps involved will be new to business owners, even seasoned owners who have "seen it all." Make sure your transition team includes experienced individuals with the right expertise and an ability to work together for your benefit.

Get your house in order. Risk—real or perceived—reduces valuation, and the succession or sale process will spotlight every risk in the business. Assess and address these risks, with a particular focus on quality financial information. If a buyer can't trust the financials, a good result is unlikely.

Prepare for your new full-time job. Business owners focused on maintaining good operating results will be astounded by the amount of time, effort and attention required to implement a successful exit process. Make sure the business can run well when you are away for several days meeting with potential buyers. You will need to delegate, which is a good thing.

Be ready for non-business issues. Particularly in a family business, some of the most vexing issues have nothing to do with the business and everything to do with the people involved. What if the heir apparent to a family business doesn't want to run the business, or is incapable of doing so? What if your CFO always thought he would take over the business, and leaves just when he becomes most important? Anticipate and prepare for these non-business issues.

Maintain confidentiality. If the market learns that your business is in transition, customers and suppliers will be uncertain about their relationship with your company and competitors will seize the opportunity. Experienced advisors can help design a process to reduce this risk, which can be particularly acute when dealing with a potential strategic buyer.

Know your buyer. Few business owners walk away with a bag of money and no other concerns. Most will have an ongoing relationship with the buyer and it's important to know something about them. How do they handle the issues that inevitably arise? What about your earn-out, or your employees? Do your own due diligence. Talk to others who have sold businesses to your buyer and learn from their experiences.

Diversify your risk. Owners tend to reinvest profits so a business is prepared for the future. This is a sound practice, but if you can take some value out along the way, you will reduce the "bet the ranch" nature of a transition. Remember, capital can be loaned back to the business if needed.

Change is never easy, nor is it avoidable. Systematically addressing these issues with a team of competent advisors, a business owner will be well positioned for success. Regardless of succession or exit considerations, these actions will result in a stronger business.

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