THE icehouse INSIGHTS

EXIT STRATEGY AND PLANNING

What are the key components of a value-laden exit strategy?

How can you successfully exit a business?

Icehouse Insights

A regular series that introduces many of the major challenges facing SMEs today, Icehouse Insights provides a stepping-stone to kick-start the conversation, solve some common queries and win.

This edition:

Perfectly planning and executing an exit strategy is arguably the most important process any business owner will ever undertake. It's the culmination of (often decades' worth of) toil, sleepless nights, long days and much stress.

However, 75% of private business owners 'profoundly regret' exiting their business (Snider, 2016), so something isn't right. Icehouse Insights attempts to provide some clarity to some very important questions, build some advantages and identify the pitfalls.

INTRODUCTION

Through their State of Owner Readiness Survey, The Exit Planning Institute estimates 60% of owners strongly agreed that having an exit strategy was 'important to their future and the future of their business'.

An exit strategy is the plan for how an owner will eventually leave the business, it is critical they take good advice from the outset. Who will they sell to? When will they sell? What kind of exit plan will they choose? How can they add value to the business before they sell? There's plenty to consider, so let's read on...

Acknowledgement: Thanks to Andrew Martin (Marty) at Strategic Specialists Group for advice, consultancy, and background information.
www.strategicspecialists.co.nz

THE BIG ALTERNATIVE... AND THE BIG QUESTION

There is a further option to consider before embarking on the process of selling a business. That's asking yourself if you really want, or need, to sell?

Of the owners who do build something worth selling, ‘1 in 4 will go through a lengthy sale process only to find the deal fall apart before the closing' and '51% of the time they fail to close due to seller misrepresentation or an unreasonable seller or buyer demand,’ according to the Private Capital Markets Report, 2017.

Does that indicate that the sale lacked the required due diligence or that the seller wasn't committed to the deal? Or both? Further, while a mere 5% of business owners are content with their net proceeds from selling – they may also underestimate the non-fiscal or non-material loses; a sense of purpose, a daily routine or a creative outlet.

Is there an argument for postponing an exit strategy for another five to ten years?

Will the business look very different by that time? Are you missing an opportunity to reward the people who have stuck by you if you sell too early (or sell at all)? Is there a chance to grow your business to an exceptional size, create opportunities for your people, teams, the wider community, and then benefit from the tangible rewards of five-to-ten years of phenomenal growth?

Is your industry growing? What are your industry colleagues and competitors doing? Is there an industry trend for consolidation?

To successfully sell a business is to ask 'what outcome do I want to achieve?', and then work backwards. Ultimately, if there is more to harvest from the business, then owners need to think very carefully if they want to sell.

THE FIVE TYPES OF EXIT STRATEGY

Sell to family or friend

As a significant percentage of SMEs are family-owned, the temptation to sell to someone you know and 'trust' to keep going the 'good name' of the business makes sense. In this exit strategy, many choose to bring those people into the business well before they leave, so they can learn the ropes and ensure a smooth succession.

Sell to Management or Employees

Selling to existing employees, management, partners, or investors, takes out the emotional aspect of selling to family and friends, keeps the outgoing owner more objective and, as the incoming individual or team already know the challenges and opportunities of the business, they are perfectly skilled to take over.

Mergers and Acquisitions

Possibly a more lucrative option but if planning to stay in the business, there's a challenge around finding a buyer who is a good strategic fit and meets existing goals and values, leaning towards more of a merger style set-up.

Initial Public Offering (IPO)

The most profitable and an almighty achievement and quite rare. Many start-ups develop their business with the goal of eventually listing themselves on the stock market. A public company enjoys higher growth but has higher compliance and reporting standards.

Liquidation

Either orderly or forced. If a business is not profitable and in debt, liquidation is a simple and fast option and usually involves selling assets and ending operations. An orderly liquidation can also be a sensible option for profitable businesses by liquidating assets over time and drawing a larger salary or dividends over several years until funds dry up.

Source: Sloan Partners

SELLING THE FAMILY BUSINESS

'Most family businesses are small and local. This can pose a challenge when placing a value on the business and finding suitable buyers. Liquidating some of the expensive assets and planning a partial exit, where you stay on board for some time and help the new owner get acclimated, is one strategy that can accelerate the sale.' (Smallbusiness.chron)

It is vital to detach any sentiment, emotion and loyalty from the objectivity required in selling a family business – even when it's to another family member. Here are five things to consider:

Liquidate expensive assets

Many family businesses have substantial assets in the form of land and equipment, and are worth more than can be justified by the operating profits.

Estimate net worth

Once you decide what to sell, try to estimate what the business is worth. Start by adding up all assets and subtracting debt. The result is called the book value and your asking price should be significantly higher than this number, representing the intangible assets built into the ongoing business.

Spread the word

Once you have a sales price, contact acquaintances as well as local business broker, who tend to have wide-ranging contacts and know the sector and region.

Work with the buyer

A family business may be relatively hard to take over and run smoothly at first. Your customers may be doing business there because they trust you and suddenly seeing a new face may come as a shock.

SELLING THE FAMILY BUSINESS 2

Put it on paper

Once you find a seller and agree on the details, have a qualified attorney put everything on paper. Everything that has been agreed upon must be written down.

For more details, head to: smallbusiness.chron.com/sell-family-business-43668.html

And taking over a family business...

Whether a member of the same family, someone already immersed in the business, or an outside entity, the perfect situation involves negotiating any potential challenges before they arise.

'If you're preparing to take over the family business, you'll want to achieve as seamless a transition as possible.'

This is Allbusiness.com's seven point plan:

- Use the succession plan
- Be patient
- Assess your skills
- Take care of company culture
- Maintain your credibility
- Keep the peace
- Consider the advice of your peers

For more details, head to: www.allbusiness.com/taking-over-the-family-business-the-basics-2975869-1.html

HOW TO GET VALUE...

Just because you make the decision to sell a business it doesn't mean it's going to be a formality or a smooth process. Selling a business is not a done deal, with so many variables involved, and it takes much hard work behind-the-scenes to put you and your business in the best possible situation to get the best outcome.

The Exit Planning Institute has produced an excellent document on the intangible four capitals, or the four Cs, which make your business more valuable to prospective buyers.

The four Cs... What makes your business valuable?

It is likely that 80% of your company's value lies within the four Intangible Capitals or 4Cs. These Intangible Capitals consist of Human, Social, Customer, and Structural Capital. Exit Planning Institute President, Scott Snider, shares his insights into the 4 Cs and how strong intangible capital builds value in your business.

Human Capital

People are everything. Scott Snider says, "I don't care how good your product or processes are, if you don't have the right people – you're screwed." The Human Capital in your business is one of the most difficult to navigate and one of the most important. Human Capital is the measure of talent on your team.

> "Our role with clients thinking about exit is to help them build their intangible capital and make them transferable."
>
> Andrew Martin (Marty) – Certified Exit Planning Advisor, Strategic Specialists Group - www.strategicspecialists.co.nz

HOW TO GET VALUE 2...

According to Walking to Destiny, "62% of owners indicated that finding and retaining top talent is the biggest challenge they face."

When working on your employee development plans, follow a series of steps that encourage growth in your employees and your business.

All the Value Advisors we interviewed mentioned that some owners come to them stating that they want to exit their business because of operational issues that make them unhappy.

However, after working with the Value Advisors on building value in their company, the owners ultimately decide to stay in the business either in their same role or in a more supervisory capacity until they are ready to harvest the value in their business during an exit.

Social Capital

This Social Capital, or company culture, embraces the people. How they communicate, what they believe in, and how they operate internally and externally are key components of a company's culture. Scott Snider refers to social capital as, "the heartbeat of the organization. Culture is what pulls people together and draws them to the organization as an employee or a customer."

Social Capital represents your brand, how your team works, the rhythm of the day-to-day operations, and the way you interact with customers. Developing strong Social Capital in your business can take years. For that reason, Scott Snider says Social Capital is one of the hardest capitals to transition to a new owner.

HOW TO GET VALUE 3...

He says, "If you have a 'Google-like' culture of slides in the lobby, sleeping stations, stand up desks, whiteboard walls, and cafes – it wouldn't necessarily transition well into what I would consider the traditional corporate culture of suit and ties, cubicles, formalities, and restrictions." Ask yourself when working on your exit plan, though your culture may fit your business, does it fit the business of the organisation acquiring you?

Customer Capital

Without customers, you have no business, for obvious reasons. As small to lower middle-market companies, we face the dreaded customer concentration factor. Scott shares, "I think the biggest challenge here is moving our customers from engaged to entangled. What do we do so well with our customers that they couldn't possibly think about doing business without us? What makes us indispensable to them. That is entanglement."

One of the most effective ways to build value in your business is through strong Customer Capital.

It is important to view your business from the eyes of your customer. This allows you to see where your business excels and your organisation's areas for growth.

What are three things a customer would say your business does well and what would they say you should stop doing as an organisation? By seeing your business through your customer's eyes, you can address their pain points and meet their needs.

HOW TO GET VALUE 4...

Structural Capital

Finally, the most robust of all intangible capitals is Structural Capital. It encompasses everything that makes your company work efficiently. The process, documentation, training programs, technology, tools, equipment, and real estate. Scott says, “Bottom line, I don’t think there is a more important intangible capital than the processes that make your business.”

When a business has strong structural capital, the success of the company does not depend on any individual person’s ability to perform a specific task. Christopher Snider writes in Walking to Destiny, “Your knowledge needs to be documented and transferable, such that someone else can learn from you and apply it. Making this knowledge company property ensures that when your talent walks out the door at night, the knowledge doesn’t walk out the door with them.”

Source: Exit Planning Institute, Five Things Every Business Owner Must Know About Exit Planning 5-4-3-2-1

CONCLUSION

There are so many things to consider when it comes to selling your business, but the fundamental questions remain the same.

Do you really want to sell? When is the right time to sell? If not yet, how are you going to bridge the gap between then and now? Do you have something else lined up for afterwards? Are your current employees moving on with you or not? Have you explored all possible scenarios?

If you do plan to sell, be prepared. Do remember that selling a business can be a hugely stressful time and is a very specialised undertaking, so make sure you seek the very best advice you can.

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