ESG
EQUITY STRATEGIES GROUP

White Paper

Exit Planning – Inside and Out

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The question of "**Should I sell my business internally or to an outside buyer**?" comes up all the time.

If you think that transferring your business to your management team is inherently risky, you may be right. Inside transfers are risky because:

- Insiders typically have no money.
- Successors' management / ownership skills and commitment to ownership may be untested.
- You lose control of the business if you make the transfer before you are completely cashed out.

On the other hand, the *possible* **benefits** to this type of transfer include:

- Extending your legacy through your hand-picked management group.
- Motivating, retaining and rewarding key employees.
- Retaining control until all, or most, of the purchase price is received.
- Remaining active in the business while gradually reducing your day-to-day responsibilities.
- Providing time for you to build up personal assets (via receipt of cash payments) before your exit.

It is key to design a plan that minimizes each risk so you can reap all of the potential benefits. Let's address each of these risks:

- **Insiders have no money, therefore it is too risky to sell to them -** That's true if you don't design a transfer strategy that puts money in their pockets as they increase the value of your company. Years in advance of the transfer, you will have to work steadily and effectively to build cash flow (the source for all cash out) through the installation of various Value Drivers to increase the value of your business and through careful planning to minimize taxation.

  Unless you carefully plan to avoid it, cash flow can be taxed twice. This double tax (often totaling more than 50%) can spell disaster for many internal transfers. Through effective tax planning, however, some of this tax burden can be legally avoided.

Finally, you should use a modest, but defensible valuation for the company when transferring internally. Because a lower value is used for the purchase price, the size of the tax bite is correspondingly reduced. The difference between what you will receive from the sale of your business, at a lower price, and what you want to be paid after you leave the business is "made good" through a number of different techniques to extract cash from the company after you exit.

- **Successor's management/ownership skills are untested -** If that's the case, train your successors and create a written plan to systematically transition management and ownership responsibilities. During the transition period, you can test your assumptions and your successors' skills. This usually takes several years to complete.

- **You lose control before being cashed out.** This is only true if you fail to implement a transfer strategy designed to maintain control. In such a plan, you keep control through a well-designed and incremental sale of the company, over time, based upon improving company cash flow.

In summary, the keys to reduce the risks of an insider transfer are:

1. Plan the transfer well in advance of your desired exit date. Executing an insider transfer takes longer than executing a sale to a third party.
2. Value building activities are just as, if not more, important to an insider transfer as they are to a sale to a third party.
3. Plan design must be tax-sensitive.
4. The Plan must be in writing and make successors accountable.

How can ESG help?

We can assess which exit path – internal or external – is more appropriate for your client, based on his/her objectives. Our network of approved Investment Bankers may be able to raise capital to enable the company or key employee group to buy out the current owner(s). Other alternatives, such as an ESOP, partial ESOP, or external sale may also be explored.

Let us know how we can support you.

For more information on how ESG and its national platform of M&A firms and Investment Bankers can help sell your business, please call us at 201-556-4618 or 1-866-807-0325, or email us at DPrisciotta@equitystrategiesgroup.com.

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