Planning your exit from your business

Many owner-managers put in a lifetime of hard work building their business only to throw away some of the rewards by failing to consider properly how they will exit the business - both financially and as a manager.

It is vital to begin planning an exit at an early stage if it is to be a success. This briefing is aimed primarily at businesses run by a management team, but will also be useful to a sole trader with no employees. It covers:

- Setting your objectives.
- Getting into shape for an exit.
- The different exit routes available.
- Planning for trade sales, management buy-outs and family succession.

1 Plan ahead

1.1 Start planning **early** for your exit.

- In an ideal world, you would have possible exit routes in mind when you first set up the business. But at the very least you should start planning a few years ahead.
- Planning lets you get your business into the best possible shape for an exit.
- Identify a particular year, level of sales or other objective (eg if you plan to retire at 60, you might want to start considering your exit at 55. You can always change your plans later if you need to).

1.2 Think carefully about your **aims**. Consider:

- your objectives as a shareholder (see **2**)
- your objectives for the business (see **3**)
- your objectives as a manager (see **4**)

Even if you are the sole shareholder and manager of your business, analysing the issues from these different perspectives can help you make the right choice. If you have a management team and multiple shareholders, agree objectives from the start to help avoid damaging disputes. Make sure you maintain regular communication with them.

1.3 Be **realistic**.

- Many owner-managers have an inflated idea of the true value of their business. If you cannot think of a good reason why someone would buy your business, you are likely to struggle to sell it.

  Most exits are management buy-outs or family succession, at a modest sale price.

2 Shareholder objectives

2.1 As a shareholder, you may want to exit to gain **financial security** and minimise risks.

This is the goal for many shareholders who want to retire and need a pension.

- The sale must succeed, so you need more than one potential option, and you must be prepared to accept less than the best achievable price.
- You will probably prefer payment in cash, not the shares of a company buying you. This may not always be possible. Deals often involve a combination of the two. You may also get a better theoretical price if you are willing to accept shares.

2.2 You may want to **maximise the price** you get and accept the risk the exit may fail.

2.3 You may want to **pass on the business** to a family member.

2.4 You may prefer to sell it to a **management team** you have worked closely with.

3 Company objectives

Consider how you want the business to develop, and if an exit would help you meet these goals.

3.1 You may need **capital** for growth.

- For example, to allow you to expand your product range or exploit your intellectual property more effectively.

3.2 You may want to improve your **market position** by taking advantage of a better distribution network.

3.3 You may want to enter **new markets** in different sectors or in new countries.

3.4 You may want to draw on **economies of scale** by becoming part of a larger company.

3.5 You may want to give **employees** better job security or career development prospects.

4 Management objectives

4.1 You may want to **end** your management involvement. Some exit routes may require you to remain involved in the business for some time.

- A float usually only provides a partial management exit.
- MBOs may include rollover arrangements that require you to stay involved for a set period.
- If you sell more than 50% of a company, you will no longer control it – so it may be a bad idea to stay involved.

4.2 You may want to **carry on**.

- You may earn a good living from a business which would not be worth much without you. For example, consultancy businesses which can be reliant on an owner's skills.
- Beware of holding on to the business for too long. It may stagnate and lose value, or you could be forced into exiting because you have to, for a bad price.

5 Get the basics right

Sound management over several years will add value to your business and allow you to start an exit relatively quickly when the time is right.

5.1 Aim for a year-on-year **increase in profits**.

- Reducing profits to cut corporation tax liabilities may make short-term sense, but it could harm your business' perceived value.

5.2 Make sure **accounts** are in order and up to date, and give a true picture of the business.

- It pays to be ready for any due diligence you may have to go through later. Be prepared for it to be demanding

5.3 Check you comply with employment, health and safety and other **legislation**.

5.4 Look to expand your range of **customers and suppliers**.

- Over-reliance on a few key customers will undermine your business' value.

5.5 Aim to tie key customers, suppliers, staff and managers to **long-term contracts**.

5.6 Protect your **intellectual property** rights.

"Selling your business can be a very stressful process and can take longer than you had planned. Ensure you maintain focus on your existing business in parallel with any selling process."
Brian Hayden, Hayden Associates

5.7 Look at your business **property**.

5.8 Maximise relief for **capital gains tax** (CGT).

- You may be able to claim entrepreneurs' relief, reducing the effective rate of CGT on up to £10 million of gains.
- Gains made on the sale of an asset will be free of CGT if they are reinvested in qualifying shares in new, small businesses under the SEED Enterprise Investment Scheme (SEIS).
- Substantial holdings in investments could disqualify you from this relief. Avoid investing spare cash in property or the stock market, or leaving it in the bank.
- From April 2016, higher-rate income tax payers are liable to pay CGT at 20%. For those paying the lower income tax rate, CGT is charged at 10%.

6 Possible exit routes

Consider the possible exit routes open to you. These may include:

6.1 Trade sale (see **7**).

6.2 Management buy-out or MBO (see **8**).

6.3 Family succession (see **9**).

6.4 Management buy-in or MBI.

- An external management team, funded by venture capitalists, buys the business. MBIs are rare, can be hard to achieve and often result in failure.

6.5 Stock-market flotation.

- Few small businesses have the secure earning streams and significant growth prospects needed to float successfully.
- The exit is partial. Selling your shares too soon after floatation could be interpreted as a warning sign by other investors – and you may not be permitted to do so.

6.6 Merger. This will not really give you an exit – though you may be able to retire later.

- Mergers are more common with people businesses, such as lawyers and consultants with complementary strengths (eg geographic or sector coverage). Be careful this does not become a takeover.
- Apart from getting your business into a good market position, it can be difficult to plan for a merger as you will not know how your company might fit with a potential suitor until the chance arises.

6.7 Liquidation. This may be the only option if you cannot find a buyer.

- You do not have to be in distress. Simply sell your assets, surrender your lease and stop trading.
- Businesses with limited earning potential are likely to have net assets as a value benchmark.

Get the timing right

From a financial perspective, the best time to exit is when you are in a position of strength.

A Aim to exit when **profits are increasing** and are likely to grow further.

- Static profits are not a good sign.

B Look for general confidence in the **economy** and particularly in your sector.

C Consider the impact of any cycles or **seasonal changes** in your business.

- Do you have higher sales or fuller order books at a particular time of year?

7 Planning a trade sale

A trade sale is usually the best way to get a good financial exit from a small firm, particularly if you have several competing buyers.

7.1 Identify possible buyers who might benefit from acquiring your business.

- Your market knowledge should mean you have a fair idea of who they might be.
- A corporate finance adviser will have a database of possible buyers and may be able to spot less obvious ones prepared to pay a premium price.
- Look in trade magazines and directories, and the financial press.

  The more possible buyers you can identify, the better the potential price is likely to be.

7.2 Work to develop characteristics buyers will really **want**. They may be seeking to:

- Gain access to a new market. For example, an overseas business might want to get a foothold in the UK.
- Get rid of a competitor.

“Good planning is essential if you want to exit on your own terms, from a position of strength, rather than being forced into it because you need the money or can no longer continue your management involvement.”
Peter Gray, Cavendish Corporate Finance

- Get hold of a particular product, portfolio or contract you have. Will any of your contracts be nullified by a change-of-ownership clause in them?
- Get access to your staff and skills.
- Obtain synergies and cost-savings (eg through discounts or reduced overheads).
- Cross-sell their existing products or services to your customer base.

7.3 Put a good **management team** in place.

- If the business is too reliant on your own skills, its value to a trade buyer could be damaged. Or you may have to stay involved longer than you might wish.

8 Planning an MBO

8.1 **Sound out** your management team.

- Avoid raising their expectations too much.

8.2 **Train** your management team.

- Their skills will be a key issue for venture capitalists or banks funding a deal.

8.3 Put a **value** on the company.

8.4 Give the management team time to **raise the money** - they will probably have to approach banks and venture capitalists.

8.5 Talk to management about how you might **structure** any deal.

- Consider allowing them to acquire the business in stages, buying part of it each year for a number of years out of their share of the profits.
- You continue to take your own share of the profits until the deal is complete.
- Get a legal agreement committing the management to buy the whole business, so they can't change their minds.
  Use this agreement to make sure you pay tax on any capital gain at the end of each year, rather than paying it all at the start.
  Make sure that any agreement is discussed with your tax adviser prior to signing.

9 A family succession

Family successions can be fraught with problems and emotions. A third party - such as a non-executive director or business adviser - can be useful in providing impartial guidance and asking awkward questions.

9.1 **Identify** a potential successor or successors and plan their development.

- Talk openly with possible successors. Conduct the discussions in the workplace.
- There may be only one realistic candidate, but you still need to be sure this person has the necessary skills and commitment.
  You might let them experience different roles, or get them to work elsewhere.
- It will be more difficult if there is more than one possible successor.
  Giving more than one person equal standing in the business could be a bad idea. If you do, make sure they share the same agenda and establish clear areas of responsibility from the start.
- Your children will expect equal treatment. This does not mean they should all take an active role in the business.
  You could split the company's share capital into two types: one with full voting rights for children active in the business, the other with restricted or no voting rights.

9.2 Keep **other employees** fully informed.

- Inform long-serving staff about key decisions.

  Your best staff are likely to be the first to jump ship if things turn sour.

9.3 Discuss your **future expectations** with your successor.

- Aim to resolve any differences regarding the aims of the business.
  This will make it easier to step back when you retire – which can be difficult if you are relying on the business for a pension.

9.4 Consider your **tax position** at the earliest possible stage.

- You may be able to claim business-property relief from inheritance tax (IHT) on shares you give to your relatives. This should allow you to transfer shares held for at least two years free of IHT, even if you do not live for more than seven years.
  But you could lose some of this relief if your company holds investments.
- You may be able to defer (hold over) CGT, meaning your successor will pay it if and when the gain is released in future.
- Putting some shares in a trust for your children, from which you are excluded as a beneficiary, may help you cut your tax bill.

9.5 Put an **alternative plan** in place in case family successors are not interested.

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