Viewpoint on Value

Retire at your own risk

How to maximize value when exiting a private business

Can you believe that the oldest Baby Boomers (who were born in 1946) will turn 70 this year? Although a lot of younger Boomers continue to be actively involved in the workforce, many older ones who started their own businesses are finally starting to retire. Removing a key person from daily business operations generally isn't something that can be done overnight, however. It takes time to facilitate a seamless transition to new management that also maximizes cash flow to the retiree.

Identify the options

Too often, private business owners presume that their sons or daughters will take over the reins, only to discover that the next generation isn't qualified (or interested) in running the show. Or the next generation might believe that they'll be given a sweetheart deal — while retiring parents expect their children to pay fair market value for the business. Preventing these types of misunderstandings requires owners to have heart-to-heart conversations with heirs about future plans.

When those plans simply don't jibe, it may be time to consider an alternative strategy, such as:

Strategic sale to an unrelated third party. Competitors, suppliers and customers may be willing to purchase the business for a premium due to cross-selling opportunities and economies of scale. Selling to a third party can be a win-win for everyone. In addition to providing cash flow in retirement, sellers will enjoy the comforts of knowing that 1) their legacies will continue to prosper and 2) loyal employees will continue to have a place to work. And heirs will receive cash (and other assets) that can be used to fund *their* personal interests, rather than settling for their parents' chosen field of interest.

Getting the highest possible selling price may require retirees to sign noncompete agreements or assist with earnouts to minimize risks for the buyers. They may also be asked to enter into consulting agreements to help transition the company to new management. This may require the seller to be of sound body and mind for several more months or even years. So, timing can be critical.

Employee stock ownership plan (ESOP). Sometimes a company's employees are best qualified to take over the business. An ESOP is a type of defined-contribution retirement plan in which employees become owners over time by setting up an employee benefit trust. The current owners typically sell their stock to the trust, effectively creating a "market" for their interests. In turn, the trust usually borrows money to purchase the retiree's stock.

Most ESOPs allow all full-time employees with at least one year of service to participate. Qualifying contributions are a tax-deductible expense for the company. To qualify for such favorable tax treatment, ESOPs can’t discriminate in favor of highly compensated employees or owners. Other complex rules and conditions also apply, necessitating the use of legal, employee benefits and valuation advisors.

Liquidation. This option generally doesn’t provide as much cash flow as the other alternatives. But liquidation may be the only option if the owner is under duress to exit the business, and the current owner hasn’t groomed lower-level managers to operate on their own. In a liquidation scenario, the company closes its doors, sells off its assets (often in an auction), and repays debts, including taxes owed on any gains incurred on asset sales. If time permits, owners may try to boost liquidation proceeds by advertising or approaching competitors about significant assets that are for sale.

Understand business value

Value is in the eye of the beholder. Retiring owners often have unrealistic expectations about how much their businesses are worth. Likewise, potential buyers may attempt to lowball sellers, especially if they seem desperate to sell due to health issues, cash flow needs or other personal circumstances.

An appraisal can help the parties project future cash flows, identify comparable transactions and conduct due diligence. Such guidance is particularly important to an owner who’s cashing in an interest and using it as a “nest egg” to pay expenses during retirement. If they’re engaged early on, valuators can even help retirees drive the value higher through strategic planning.

Sidebar: Exit strategies aren’t just for retirees

Even if retirement is many years down the road, every business owner needs to plan his or her exit strategy. After all, you never know when the unexpected might occur. If you unexpectedly die or become disabled, you don’t want to leave loved ones with insufficient cash to survive.

Buy-sell agreements can eliminate the guesswork when tragedy strikes — or when one owner loses interest in the business but the rest are actively engaged. These agreements are formal contracts in which the other shareholders agree to buy out a departing owner’s interest. When drafting a buy-sell agreement, it’s imperative to work closely with a valuation professional to ensure that all the buyout terms are spelled out in advance. Some buy-sells even call for regular valuation updates to ensure that the shareholders know the current value of the business.

Do you have a **Question?** or want to speak to

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