Guide to Exit Planning

COASTAL VIRGINIA SMALL BUSINESS RESILIENCE SELF-ASSESSMENT AND GUIDE

CCRFR Report 12 | June 2021

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COASTAL VIRGINIA SMALL BUSINESS RESILIENCE SELF-ASSESSMENT AND GUIDE

This guide is part of the Coastal Virginia Small Business Resilience Self-Assessment and Guide and was developed by Dr. Wie Yusuf of the ODU Institute for Coastal Adaptation and Resilience for The RAFT (Resilience Adaptation Feasibility Tool) and the Commonwealth Center for Recurrent Flooding Resiliency. Questions? Need more information? Contact Dr. Wie Yusuf via e-mail: jyusuf@odu.edu.

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GUIDE TO EXIT PLANNING

For most businesses, the "exit" phase may seem very far off, and while you're busy enjoying running the business, you may not particularly want to exit. However, it's important that you develop and plan an exit strategy.

The very first step in exit planning involves preparing an accurate account of your finances both personally and professionally.

- It helps others prepare. For example, your managers and employees want to know about the future of the business, so they can feel secure in their jobs and understand their roles. Your investors and lenders want to know how you will pay them back if you exit the business.
- It gives you a way out. You may need to leave the business for a number of reasons (e.g., retirement, burnout, or a medical emergency that leaves you unable to run the business). No matter what you're facing, an exit strategy will give you a planned path out.
- It allows you to better plan your business. When you have an exit strategy, you'll be better able to direct the business. You'll have more time to prepare for the end.

STEP 1

The very first step in exit planning involves preparing an accurate account of your finances both personally and professionally. Looking at how much you owe investors or lenders is important, and how they can best be paid back. Undertake valuation of your business (See this quick introduction to business valuation).

STEP 2

Planning an exit strategy involves deciding whether you plan to transfer your business (to family, employees, friends), sell the business, or close your business completely (liquidate your assets). There are pros and cons to all three options, but it is important to be certain about your decision before proceeding. For most businesses, the most realistic and common options are management buyouts, family succession, selling the business to outsiders, or liquidating and closing the business.

In deciding your exit options, consider the following:

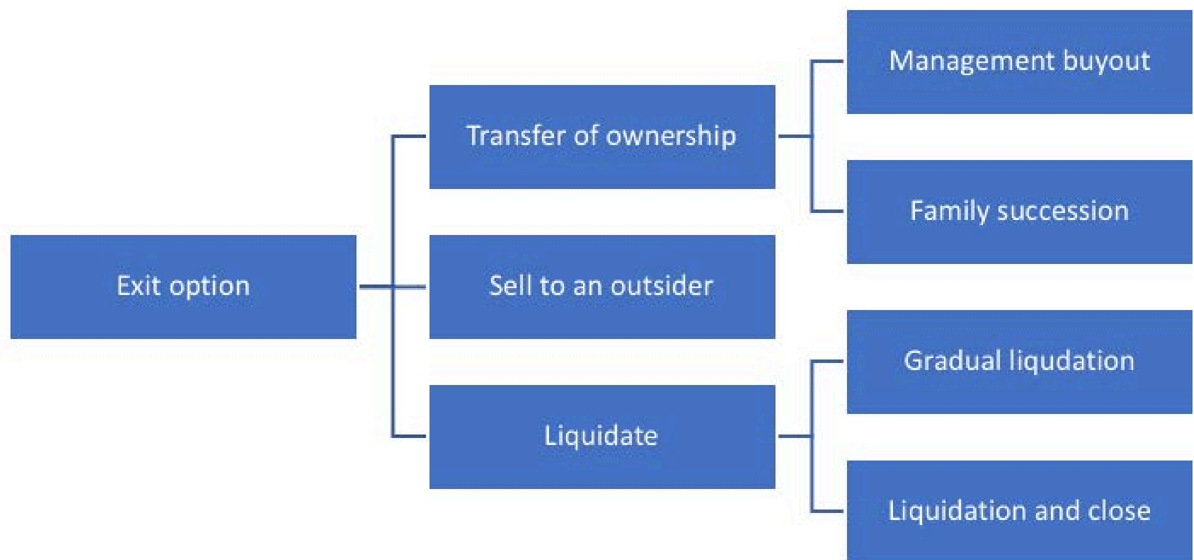
1. What are your priorities? What do you want to achieve? Would you rather keep things simple, even if it means losing some money, or are you willing to go a complex route to maximize profitability? Are you concerned with protecting your employees and managers?
2. What are your financial goals?
3. What is your business currently like? What is your business structure? Is it big or small? Flush with cash or in debt? Simple or complicated?
4. How much time do you have? When do you plan to retire?
5. How long do you want to stay involved in the business?

6. Do you have investors or creditors to pay off before exiting?

7. Do you have entrepreneurial family members or friends, or competitors that may be interested in the business?

8. Are you willing to list your business for sale?

There are different options to choose from, each with their own strengths and weaknesses. There isn't a single "right" exit strategy, so consider your options carefully, keeping in mind the answers to the questions just posed. You should also talk with your employees, partners, investors, and advisors to find the option that will serve you best. The best exit strategy for your business is the one that best fits your goals, expectations, and business. If you want your legacy to continue after you leave, selling it to an employee, customer or family member may be the best option. Alternatively, if your goal is to exit quickly while receiving the best purchase price, targeting an acquisition by a competitor or another business or liquidating the company might instead be optimal routes to consider.



Transfer of Ownership (management buyout or family succession)

Transferring ownership of the business such as to employees via management buyout or through family succession to a family member offers a way to transition out of the day-to-day operations of your business.

Management Buyout	Family succession
If you built a business that you want to continue, you can consider turning to your co-owners or employees. They have a good idea of how things are run already, but they will have intimate knowledge regarding company culture, corporate goals, and a pre-existing determination to make it work. This form of exit strategy is a good idea if you want to keep your legacy alive.	If your family members are quite knowledgeable about your business, then they may be the best people to pass it to. If you would like to pass on your business to your children or any other family member, you should make sure that they have the prerequisite skills, are competent and have the success and future of the business at heart. This will make it a lot easier to retire.

PROS:	CONS:
• The new owner will already share your passion for the business and continue your legacy. • You get to see your business continue to thrive in the hands of people you trust. • You may also be able to continue serving an advisory role. • The transition for your employees and customers will be a smooth one, since the new owner likely already has a stake in the business. • You can undertake significant advanced planning to ensure successful exit.	• Selling to a co-owner, employee or family member can be problematic in terms of money and tensions that may leak into the workplace. • Family members inheriting the business may not understand or have interest in the business. • If you are selling to someone you know, you may be tempted to sell the business for less and lose money. • You may jeopardize personal relationships over your business (e.g., passing the business to a relative may cause familial tension).

Management and family succession planning allows you to plan ahead for your exit by working with the potential new owners and take actions to prepare them and the business for the transfer of ownership. The more time you have to prepare all parties impacted, the smoother the transition. Use the 'Succession Planning Worksheet' (Appendix C) to help you work through key planning aspects for a management buyout or family succession.

Also consider the following advice:

- Start as early as possible
- Set up your business so that it can run without you. Create processes that ensure you aren't the only one with important information for running the business (e.g., accounts, passwords, supplier information, etc.). Identify staff who can assume your duties should you be unavailable for any length of time.
- Determine a time frame for exit.
- Open a dialogue with potential successors/ owners - start talking about succession planning with employees and family members and emphasize how important it is to the future of your business. Making your own succession plan and then announcing it is the surest way to sow family discord or tension among employees. Discussing the plan helps to identify who might want to be involved directly and who is focused elsewhere. It also might help some family members find interest in the business they didn't know they had.
- Dedicate focused resources and time to the selection, training and development of the successor. How can you expect your successors to take over and run your business successfully if you haven't spent any time training them? Your succession planning will have a much better chance of success if you work with your successors for at least a year or two before you hand over the reins. Read more: Developing the next generation of leaders in your family business.
- Treat management and ownership as separate entities and allocate according to what's best for the business, rather than what is perceived fair and equitable among family members and employees. In recognizing that management and ownership are not the same, you may decide, for instance, to transfer management of your business to a key employee or one of your children, but transfer equal shares of ownership to all your children, whether they're actively involved in operating the business or not.
- Seek advice from experts and trusted advisors. Lawyers, accountants, financial advisers, and others can help you put together a successful succession plan. Accountants and lawyers who specialize in business succession planning can provide advice about strategies to minimize taxes when the transfer takes place. Transferring ownership may have legal impacts, such as estate and gift tax obligations imposed by the IRS. A transfer of property would also likely have tax implications. You may want to consult with a lawyer to see which additional rules could apply depending on your business type. There are companies that specialize in family business succession planning that will facilitate the process of working through issues.
- Read more: 25 best family business success planning strategies and tips.

Buy-Sell Agreement

A buy-sell agreement is a sort of prenup that spells out how the business transfers to co-owners if one

of the partners/owners dies, becomes disabled, or retires. A buy-sell agreement is a legally binding contract between two or more business owners outlining how the assets and equity in a business will be divided if an owner becomes disabled or dies. (More information about buy-sell agreements).

The buy-sell agreement can include purchasing life insurance policies for each owner to provide funding to purchase the business in the event of disability or death. Business partners buy life insurance on each other and name themselves as beneficiaries. If one dies, the surviving partner can use the life insurance payout to buy the late partner's share of the business. The business pays for the monthly premiums and is always both the beneficiary and the owner of each buy-sell life insurance policy.

- Term life insurance typically payouts in the event of death.
- Permanent insurance has a cash value component that can also be used in the event of disability or retirement.

Determine the following as part of your exit plan:

- Who will purchase the policy?
- Who will be the beneficiary?
- Permanent or term policy?
- What will be the death benefit?
- For term insurance, what will be the term length?

Sell the Business to an Outsider

Alternatively, you may decide to sell your business to an outsider or another business. Selling the business is a way to potentially make more money off of the business, and if selling to a competing or complementary business, can also create a merging of businesses.

PROS:	CONS:
• You may make more money when there is strong interest in your business. • There may be less tension among employees or family members vying for ownership of the business.	• If the business is bought by another, the merging of two the two can create imbalances and your employee could be laid off in the transition. • You might have to list your business for sale publicly. • Provides an option if you do not have any clear family successors or successors from among employees.

After careful consideration, you may decide to sell your business. Sound planning can help ensure you cover all your bases. Use the 'Succession Plan Template' to help you work through key planning aspects for selling your business.

Also, review the following resources:

- 5 mistakes to avoid when selling your small business
- How to value a small business if you're looking to sell - or buy

Liquidate the Business

It's hard to shut down the business you worked so hard to build, but it may be the best option to repay investors and lenders and still make money. If you liquidate your business, however, you lose your business concept, reputation, and your customers. Your business will not live on like in other exit strategy options.

Liquidating your business over time allows you to pay yourself until your business funds run dry, and then closing up shop. You are taking funds out of the business instead of reinvesting them back into the business

PROS:	CONS:
• You will still get a paycheck to maintain your lifestyle (until assets run out or business funds run dry).	• Stunts business's growth, which makes it less valuable if you change your mind and decide to sell. • This may upset investors and your employees who are not benefitting from business reinvestment.

The second option is to close up shop and sell assets as quickly as possible. While this method is simple and can happen very quickly, the money you make only comes from the assets you are able to sell. These may include real estate, inventory and equipment. Additionally, if you have any creditors, the money you generate must pay them before you can pay yourself.

PROS:	CONS:
• Relatively simple exit method. • Depending on the type of assets, the closure can occur quickly.	• Money you make only comes from the assets you are able to sell such as real estate, inventory and equipment. • If you have creditors, these people must be paid off before you can pay yourself.

Before liquidating your business, you should make sure you're following the right procedure for selling your assets, paying back all debts, letting go of employees, and finalizing all legal and financial commitments.

- Read more: 7 legal and financial steps to closing your business

Your exit plan should address both asset liquidation and closing the business. As part of the asset liquidation component, the plan should include the steps below:

1. **Preparing an inventory and determining assets for sale**

   Make a list of the physical property your business owns, as well as any money owed to the business in the form of rent, security deposits, and unpaid bills (accounts receivable) you still expect to collect. Your list should include:

   - business equipment, such as computers, phones, cash registers, and credit card machines
   - office furniture, art, and supplies
   - vehicles
   - real estate
   - security deposits with landlords, utilities, or taxing agencies, and
   - prepaid insurance premiums you can get refunded to you.

   For physical property, write down a description of each item or category of property, the condition of the property, and who technically owns it (what money was used to purchase the property—your personal funds, a partner's personal funds, or business funds). In addition to tangible property, you may be able to sell intangible property that your business owns, such as:

   - contracts with suppliers at below-market rates
   - works in progress that could have some value
   - your customer list and your company name (essentially, the goodwill your company has built up)
   - intellectual property such as copyrights, patents, and trademarks, and
   - remaining accounts receivable (accounts receivables will be much less valuable after your business closes, so put early effort to collect them now. Alternatively, you can sell them to a factor or debt buyer, who will either buy your accounts receivable at a fraction of their worth or, for a fee, pay you a certain percentage of the debt up front and the rest when they collect it).

2. **Securing physical property and other assets.**

3. **Selling property and assets, by considering the following:**

   - Set liquidation value of assets with a qualified appraiser
   - Use different sale options: negotiated, consignment, internet, sealed bid, retail, etc.

- Hire an auctioneer, dealer, broker, or other expert to conduct the sale
- Use a non-recourse bill of sale so buyer accepts the associated risk
- You'll likely get no more than 80% of an assets value, at most. If you have items that will be hard to sell, consider donating them to charity for a tax deduction.
- Cast a wide net for buyers. Use your business contacts, including appropriate suppliers and competitors, to find buyers. Competitors may also be interested in buying your intangible assets (trademarks, copyrights, customer lists, company name, product name, etc.) and any works or jobs in progress. You might find buyers for fixtures, furniture, and equipment by listing them on websites like eBay, craigslist, or bid4assets.com. Also search for websites that specialize in auctions for your industry (some sites specialize in restaurant equipment, industrial machinery, high-tech equipment, construction equipment, etc.). If you have numerous assets with significant value, contacting a business broker or professional auctioneer or liquidator might be a good idea.

4. **Keeping good records.**

   As you liquidate your assets, you'll want to record how you tried to sell each piece of property (save copies of ads or Web listings), who ended up buying it, and the amount you received. Keeping good records of your property and what happens to it will protect you in case a creditor later questions your liquidation of assets or in case you have to file for bankruptcy. You will also need this information for your tax returns.

Include the following steps in your exit plan under the business closing component (Read more from https://www.sba.gov/business-guide/manage-your-business/close-or-sell-your-business):

1. If you have partners or co-owners, formally document the decision to close the business via a written agreement signed by all co-owners.
2. File dissolution documents if needed. Failure to legally dissolve a partnership, LLC, or corporation with the state will expose you to continued taxes and filing requirements. (You can find appropriate dissolution documents from the Virginia State Corporation Commission).
3. Cancel registrations, permits, licenses, and business names. Protect your finances and reputation by canceling any of these that you no longer need, including your trade name.
4. Resolve financial obligations. Handle final returns for income tax and sales tax. Follow this checklist from the IRS and follow appropriate processes with the Virginia Department of Taxation.
5. Maintain records. You may be legally required to maintain tax and employment records, among other files. Common guidelines advise keeping records for anywhere from three to seven years.

STEP 3

Execute the exit plan.

- **Speak with your investors and creditors.** Approach your investors, creditors, and other stakeholders to share your intent to exit the business. Create a strategy that advises investors and creditors on how they will be repaid.
- **Choose new leadership.** Once you've decided to exit your business, start transferring some of your responsibilities to new leadership while you finalize your plans.
- **Tell your employees.** When your succession plans are in place, share the news with employees and be prepared to answer their questions.
- **Inform your customers**. Finally, tell your clients and customers. If your business will continue with a new owner, introduce them to your clients. If you are closing your business for good, give your customers alternative options.

Planning Resources

There are three common business valuation methods to help you determine how much your business is worth.

1. **Income Approach**: Looks at projected revenue and accounts for potential risks. The income method looks at your business's financial history and uses your books to show buyers your business is a low-risk and profitable investment. For a buyer that will take out a small business loan to buy your business, you need to show that your business can generate enough profit to pay the loan.
    - The income method looks at past profits and cash flow to project the future profits and debts of the business. Using the projections, you can determine how you're your business is worth.
    - For example, you project your business will earn net profits of $100,000 in the near future (based on averaging net profits from previous years). With the income method, you might sell the business for $100,000.
2. **Assets Approach**: Subtracts total business liabilities from the total value of all assets. The asset-based method looks at your business's assets and liabilities, and calculates the business' worth by finding the difference between assets and liabilities.
    - When you use the asset-based method, you look at your business as being made up of smaller parts. Some parts add value to your company. Items that add value are assets.
    - Other parts add debts to your business. Liabilities are debts your company owes to creditors. To find the value of your business, subtract liabilities from the assets.
    - For example, if you have $150,000 in assets and $50,000 in liabilities, the value of your business is $100,000 ($150,000 – $50,000 = $100,000).

- With the asset-based method, you can find the book value of your business. Your book value is the owner's equity on the balance sheet. The book value should be the lowest price you are willing to sell your company.
- Consider using the asset-based method if you need to sell your business fast. If you are selling to pay debts, you may save time and money by offering book value.
- If you are selling a healthy business, you may not want to price it at book value. A healthy business could be sold for more than the book value.

3. **Market Approach**: Compares your business to other similar businesses that have recently sold. The value of your business depends on the market.
    - Look at data from comparable businesses' sale prices. Value your business at a similar amount to businesses that are like yours.
    - For example, if you own a nail salon, you would consider that nail salons in your area are selling for an average of $50,000. Using the market method, you would sell your salon for about $50,000.
    - The market method offers an amount closer to the fair market value or what buyers are willing to pay. You might need to increase or decrease your business's price, depending on what buyers will pay.

Most small business owners can conduct their own business valuations. However, you should also consult an appraiser for a professional business valuation. An appraiser can offer you valuable advice and help you get the most out of your sale.

- This simple business valuation calculator that may be helpful as a starting point for determining the value of your business.
- This guide offers examples, worksheets, and more in-depth discussion of business valuation.

Three primary options are available for **transferring ownership rights or selling your business** to another person or entity.

1. **Outright Sale** - By selling a business in full, you will transfer ownership immediately and receive payment right away. This allows for quick exit and quick cash.
2. **Graduated Sale** - This option often benefits sellers whose successors/future owners cannot afford an outright sale, but instead are able to finance a long-term payment plan. A gradual sale is a flexible option for transferring a business. The seller receives a monthly income and may still be involved in the business if desired.When you use the asset-based method, you look at your business as being made up of smaller parts. Some parts add value to your company. Items that add value are assets.
3. **Lease** - Transferring business ownership through a lease (for a specific time period) is a contractual commitment that provides the seller payments for the temporary rights to the business. This might be a feasible short-term option if

unplanned events occur or the business owner is temporarily unable to run the business.

You must prepare a **sales agreement** to sell your business officially. This document allows for the purchase of your business.

- List all inventory in the sale along with names of the seller, buyer, and business.
- Fill in background details of the business.
- Determine how the business will be run prior to close and the level of access the buyer will have to your information.
- Note all adjustments, broker fees, and any other aspects relevant to the terms of agreement.
- Don't leave out any assets and liabilities, or this can create problems even after the sale has been finalized.

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