Private Company Services
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Making the decision to sell

Exit Focus Series
Part One of Five

Part One of the series explores the framework for developing an effective exit strategy – setting the appropriate objectives and understanding the importance of effective and early planning.

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Introduction to the series

Change of ownership and succession of management are among the most difficult challenges business owners encounter. The decisions surrounding these issues determine what becomes of the entity to which owners have devoted their lives, and impacts the return on a valuable financial asset.

Yet, ironically, these critical – and complex – decisions are among those for which owners are often least prepared, since they are often faced just once in a lifetime. Owners may have decades of experience managing their business, but little or no experience with the monumental task surrounding their exit.

Our experience helping privately-held business owners develop and implement effective exit strategies shows that every situation is unique. The optimal solution for one owner may be undesirable for another. But there is one golden rule: optimizing the outcome depends on a carefully thought-out and well-planned exit strategy.

We have created this Exit Focus series to guide business owners in the development and execution of an effective exit strategy.

Overview of the series

Part One of the series explores the framework for developing an effective exit strategy – setting the appropriate objectives and understanding the importance of effective and early planning.

Subsequent installments will address:

- **Part Two:** Finding the right buyer
- **Part Three:** Preparing the business for sale
- **Part Four:** The deal process
- **Part Five:** Preparing for life after the deal

Need to talk?

Whatever stage of your transition your company is at, we can help you make the complex decisions that need to be made, understand the process and choose the right option to help you realize the value of your business and achieve your long-term vision.

To find out more, please contact:

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Executive summary

Time for a transition: why now?

Sooner or later you will have to let go and transfer or sell your business.

To maximize value you need to be in control of the process from start to finish, which requires detailed thought and planning. The earlier you start the succession planning process, the better your chances of getting more value.

Defining objectives: the mission critical step

You need a clear view of the ultimate direction of the business. Whatever your decision, it is only through a clear understanding of your personal and business priorities that you can control the exit option that suits you.

Family considerations

The emotional and personal issues around family business succession are more often difficult to resolve than business or financial issues. You need to address these sensitive issues before you look at other business challenges.

What drives value: where are you now?

What are the real and perceived aspects that enhance the value of your business? You need to assess their strengths and take actions to enhance them. Be honest with yourself and your business. Look at the company and its operations through the eyes of a prospective buyer.

Employees and the decision to sell

Your exit strategy should consider the impact of a sale on current employees. Concerns can range from the desire to retain key management to providing security for a valued long-term employee.

Structuring the deal

Effective deal structuring often helps to maximize deal value. The sooner you can begin to understand the implications and importance of effectively structuring transactions, the better positioned you are to lay the groundwork for future success.

Timing: early planning is essential

Many companies are reactive when it comes to planning succession. At best, this can mean failure to maximize value and, at worst, can see your life's work flounder in transition. Don't delay planning because you are caught up in day-to-day demands, or because it's tough to admit that the time may soon come to think about letting go.

Position your business now

Effective planning will enhance value, even as negotiations for an actual transaction occur. It will give you relevant information to make an informed decision whether to accept an offer – or walk away.

Time for a transition: why now?

The earlier you start the succession planning process, the better your chances are of getting more value.

Ownership transfers are initiated for many reasons, most commonly:

- Retirement of the primary shareholder
- Competitive pressures
- Death or illness of the owner
- Financial difficulties
- Readiness of heirs to take control of the business
- Desire for liquidity and asset diversification on the part of the primary shareholder

Retirement, illness or death of the owner

Retirement is the most frequently stated reason for ownership transfer. Because they are emotionally as well as financially connected with their organizations, many private business owners are unwilling to seriously investigate opportunities to transition ownership before they are 'forced' by age or illness.

Competitive pressures and financial difficulties

The second most frequently stated reason for ownership transfer is intensified competition or financial difficulties. For many owners, competitive pressures have increased as a result of consolidation or a fall in demand due to the economy. Many industries that in the past have experienced only local or regional competition have become global, and with the availability of credit decreasing in the recession owners may decide to sell sooner rather than later.

The link to these situations is that they are both reactive, so are likely to yield suboptimal results. To maximize value you need to be in control of the process from start to finish, which requires detailed thought and planning. The earlier you start the succession planning process, the better your chances are of getting more value.

Defining your objectives: the mission-critical step

Deciding what you want to do and then getting the best value for your business starts with a clear statement of your goals. Objectives will be both financial (return, sale price, tax, estate, and wealth planning) and nonfinancial (succession, legacy and reputation, employee and stakeholder concerns, family dynamics, and so on).

Before you start, you need to answer some tough questions:

- What is really important to me?
- Why would I want to keep the business in the family?
- What are my financial needs?
- How important is it to maximize the value I receive, relative to other considerations?
- What kind of ongoing management role, if any, would I like to have in the business? For how long?
- How do I decide whether to retain a financial stake in the business?
- Who do I want to sell or transfer the business to? How do I choose among family members, employees, financial investors, competitors, or others? Why would I care?
- What managerial expertise is required for my business to continue to be successful? Who is willing and able to run the business? What preparation do they need to take on that role?
- What can I do to protect, reward, and retain my employees or others with a stake in the business?
- What other motivating factors might affect my decision? How do I feel about the business keeping its name and identity following my exit?
- How important is it that my business retains its independence?
- How should the business be structured and financed to take advantage of future opportunities?

Answering these questions needs a clear view of the strategic direction of the business. Whatever your decision, it is only through a clear understanding of your personal and business priorities that you can choose the exit option that suits you.

Family considerations

Apart from the financial considerations, one of the first things you need to decide is whether to keep the business in the family. Frequently, the emotional and personal issues around family business succession are more difficult to resolve than business or financial issues. You need to address these sensitive issues before you look at the business challenges.

Many owners start out with the intention of transferring their business to their immediate family, but ultimately that may not be a viable, realistic or optimal solution. Many factors come into play.

You need to think about the age of your family, their wishes and skill sets, management experience, potential sibling rivalries, and reactions of key non-family employees. To increase the odds of a successful transition, you need the input and buy-in of everyone who will be directly affected by your decision.

Whatever you decide, it is only through a clear understanding of your personal and business priorities that you can choose the best exit options for you, your family members and key staff. In our experience, the passion and emotional involvement you need to run your business sometimes gets in the way of the choices you make to exit from it. The perspective of an external advisor can help you stay on track.

Once your goals are set, planning for your exit will be much simpler. The next step is to find out what drives the value in your business.

What are your key value drivers?

Value drivers are the real and perceived aspects that enhance the value.

Common value drivers include:

- Synergies expected from a merger/acquisition
- Quality and reputation of your business
- Cash flow and profitability
- Customer relationships
- Supplier relationships
- Growth trends for key products and services
- Distribution network
- Intellectual property, such as patents, trademarks and brand
- Quality and depth of your management team
- Technology
- People and intellectual capital

Once you've identified your value drivers, you need to assess their strengths and take actions to enhance them. For example, systems may need to be upgraded to support growth; the business may need to move to offshore manufacturing to increase margins. The balance sheet and cash flow may need to be improved, perhaps through cost-cutting or debt restructuring. The management team may need to be upgraded, and so on.

You need to be honest with yourself and your business. Look at the business and its operations through the eyes of a prospective buyer or ask a third party to do an assessment for you.

Employees and the decision to sell

Your exit strategy should consider the impact of a sale on current employees. Concerns can range from the desire to retain key management to providing security for a valued long-term employee. An effective strategy also identifies and implements needed management changes long before an actual transaction is on the horizon. Having an established managerial record gives confidence to potential buyers or investors, and increases the overall value of the enterprise.

Effective communications

Even in the early stages of formulating an exit plan, communication issues are important. From the outset, it's important to identify key individuals you need to involve in the process. This is important for several reasons. First, it avoids unnecessary or premature concern to other employees. Second, it's easier to manage the consistency of the message to potential investors when working with a smaller group. Third, the people who are critical to preparing for a potential transaction are likely to be the same individuals who are most responsible for the success of the business, and the resulting value to a buyer.

As a specific transaction unfolds, communication needs will shift and a larger circle of employees may need to be involved in due diligence work. But again, knowledge should be limited to the smallest possible number of people.

The impact of ownership succession on an organization can be positive or negative, depending on how the transition is managed. Sometimes performance deteriorates as a result of uncertainty and fear of change. However, business succession can also improve employee performance if the planned changes are quickly and effectively communicated. Employees often work harder to prove themselves to new management. In addition, new internal or external managers are sometimes more willing to address certain personnel issues (e.g. dealing with 'dead wood') than the prior management, resulting in improved efficiency and morale.

Performance management

The business succession process provides an unprecedented opportunity for the owner to take a fresh look at where the company is headed, establish new goals, identify any missing talent, and take action steps to secure appropriately skilled outside talent.

Having an established strong managerial track record provides confidence to potential buyers or investors, thus increasing the overall value of the business.

Structuring the deal

Effective deal structuring can help maximize deal value. The sooner you can begin to understand the implications and importance of effectively structuring transactions, the better positioned you are to lay the groundwork for future success.

Selling/transferring ownership

Although there are many ways to transfer ownership, the most common are sales/transfers of ownership within the current family or employee group and sales to a third party. Other options include minority sales and recapitalizations, variations that can allow for retention of partial ownership or management control, as well as IPOs (initial public offerings) and MBOs (management buy-outs). Each arrangement comes with a unique set of concerns.

Selling or passing control within your family

It's not surprising that many owners would like to see family members or other heirs enjoy the fruits of their labour. But, non-family managers and employees can be suspicious of plans to transfer management control to a family member, and often family members who are not actively involved in the business will voice objections as well. Key employees and family members alike may have concerns about who controls the business. The earlier and more openly you consider these issues, the greater the likelihood of a satisfactory resolution.

Selling to a partner or co-owner

When partners or co-owners buy or start a business, ownership agreements usually include restrictions regarding the circumstances of transfer (e.g., only by gift or at death); the potential transferees (e.g., only the entity itself, family members or other existing owners of the business); the transfer price (e.g., usually of formula approach or independent expert valuation). The restrictions are often coupled with a right of first refusal in the hands of the co-owners or the company.

Selling to employees, management buy-out (MBOs)

Sometimes the logical successor is an existing employee or group of employees. Where certain employees are key to the business or closely involved in day-to-day operations, you must take steps to ensure that these people want to remain in the business after you've gone. If they leave, the value could be significantly affected.

Sale to a third party

The simplest way to transfer ownership is through a sale to an outside party. Sales to larger companies are common as are sales to private equity buyers. This option creates an opportunity to diversify a concentration of wealth in the business. However, the outside sale of assets or stock can have complications and unintended consequences. In the context of a family business, the family may lose its identity or be unable to find a career path for family members associated with the business. A sale to an outsider may also change relationships with key employees, vendors and customers.

Initial public offerings (IPOs)

The expression 'going public' describes the process of offering securities (common or preferred stock or bonds) of a private company to the general public. This is often considered when the funding required to meet business growth has exceeded its debt capacity. Under the right circumstances, going public can be very attractive, but the costs are significant, and there is often a misperception about the amount of control that can be retained. The decision to list requires in-depth analysis, and its advantages and disadvantages must be weighed carefully.

Timing: early planning is essential

Effective succession begins long before an actual exit.

In our experience, many owners delay planning because they are caught up in day-to-day operational demands, or because they find it difficult to acknowledge that the time has come to think about letting go of their business. As a result, many companies are reactive when it comes to planning succession. At best, this can mean failure to maximize value and, at worst, can see businesses fail in transition.

Effective succession begins long before an actual exit. You need to give yourself time to:

- Demonstrate you have long-term relationships with customers and vendors.
- Develop an effective management team which alleviates concerns that the business value is dependent on the owner.
- Review your strategy (e.g. choice of clients, markets) and focus on creating an attractive asset for sale down the road.
- Get your finances in order. Any potential buyer will pay a great deal of attention to your financial results from the past few years. They will scrutinize historical performance to get an understanding of the risks and rewards associated with their potential investment.
- Create and organize regular management reports to help buyers understand the key metrics and performance indicators used to manage the business.
- Develop a message around quality of earnings and performance, and anticipate the questions and concerns of potential buyers.
- Start considering 'the ideal buyer' and the concept of subjective value. By understanding your optimal potential buyer's view about what drives value, you can position your business to highlight those points.
- Realistically understand the strengths and weaknesses of your business. The better understanding you have, the better prepared you will be to talk to a potential buyer. This understanding can be used to shore up relevant weaknesses and highlight key value drivers and investment considerations.
- Formulate and implement a comprehensive sell-side due diligence process that will prepare you for buyer skepticism, rigorous analysis and negotiations.
- Identify, quantify and amplify upside sale value opportunities such as property and other surplus assets.

Regardless of a particular investment or economic climate, early and thorough planning will optimize value. You need time to invest in developing a strategy, building your team, and managing the process.

Each of these steps will be discussed in detail in later installments of this series.

Position your business now

The amount of leverage you have is determined long before any negotiations with a buyer. Proper timing helps you invest in building your strategy, building your team, and managing the process. Early planning gives time to understand the strengths of your business and identify and shore up any weaknesses. Ultimately it lets you embed value in the organization and move it away from individuals, including yourself.

Early and effective planning provides the knowledge that will help you drive your exit process rather than letting potential buyers or others gain control.

Effective planning enhances value in yet another way, even as negotiations for an actual transaction occur. It gives you the best available information to make an informed decision whether to accept an offer – or walk away.

About PwC's Private Company Services

More than 65% of PwC Canada's clients are private companies, ranging from high net worth individuals to owner-managed family businesses and large, professionally-managed businesses. PwC's Private Company Services (PCS) group is a dedicated team of business advisors who help private company owners resolve day-to-day business issues and achieve long-term success. PCS offers the perspective of a third party with professional industry knowledge, business consulting, tax and accounting expertise.

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