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Overcoming Exit Planning Obstacles

Robert Avery at Cornell University estimates that $10.4 Trillion of business wealth will be transferred by "Baby Boomers" by the year 2040. *M&A Today* published these business owner statistics: a) 75% of their total net worth is tied up in their businesses; b) 65% of business owners do not know what their company is worth, and c) 85% of business owners have no exit strategy.

This issue addresses three obstacles in developing an *Exit Plan* and how these obstacles might be overcome.

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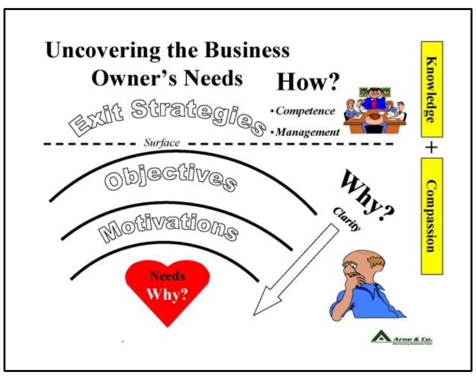
Obstacle: Emotional Issues



The business owner coming to grips with the realities of "letting go" of the business, plus trying to meet the varying needs, through some level of consensus, amongst other stakeholders.

In 1943, Andrew Maslow published a paper in *Psychological Review* titled "A Theory of Human Motivation". That paper led to what has been commonly referred to as *Maslow's Hierarchy of Needs*, portrayed in the shape of a pyramid. The theory is that humans are motivated by unsatisfied needs in order to achieve happiness. Those needs are (from lower to higher needs): 1) *physiological needs*, 2) *safety needs*, 3) *belonging needs*, 4) *esteem needs* and 5) *being needs*.

With this in mind, it's easy to see how emotional it is for a business owner to let go of his/her Company, because the business satisfies many of these human needs: *safety needs*: job security for the owner, family and other stakeholders; *belonging needs*: companionship and a sense of community; and *esteem needs*: status and a feeling of independence.

Many believe that a person's truth and authenticity lies in one's heart, not in the mind. The schematic on "Uncovering the Business Owner's Needs" shows that understanding a business owner's needs – his/her "WHY" – is the place to begin the *Exit Planning* process. Finding the WHY brings to the surface a business owner's true motivations and objectives – before specific Exit Strategies are implemented.

Ten (10) questions in helping to discover a business owner's needs (their WHY):

1. What is the most important thing in your life right now?
2. What do you love about your Company?
3. What do you love to do outside the running of your business?
4. How do you feel about taking your business to the next level (i.e. growth)?
5. How much longer do you feel that you want to work in the business?
6. How do you feel about selling/transferring the business to family, employees or to a third party?
7. How does your spouse feel about selling/transferring the Company?
8. How would family working in the business, along with key managers, feel about you selling the business?
9. How important is the business to achieving your financial security upon retirement?
10. Who are your trusted advisers that you would call upon for advice about selling/transferring the business?

Obstacle: Valuation Expectations

One of the primary reasons for a business not being sold is the seller's unreasonable valuation expectations.

Overcoming unreasonable valuation expectations is a matter of education. Here are three things to help educate the business owner concerning valuation:

I. Explain the difference between *Value* and *Price*
   a. The saying goes . . . "*you determine value, and negotiate price"*
   b. Fair Market Value (*Value*) refers to a hypothetical willing buyer (see Article)
   c. Investment Value (*Price*) refers to a specific buyer (see Article)
   d. Here's how the *value* vs. *price* distinction is made within our Firm's valuation reports:

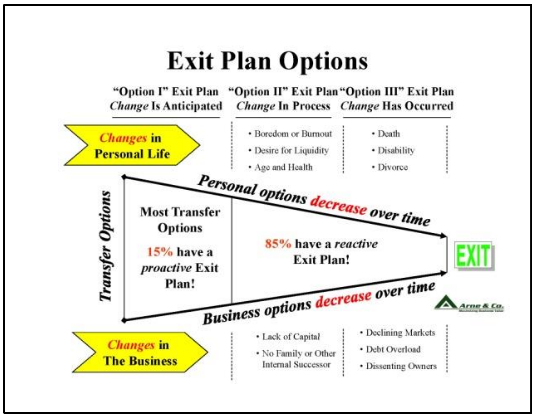
> *The estimate of value expressed within this appraisal report is fair market value, the definition of which is shown on Appendix D. Fair market value presumes a hypothetical sale under terms common in the marketplace. A price that a specific buyer pays is termed investment value, and may be concluded at a price that is higher or lower than fair market value, depending upon the circumstances of an actual transaction.*
>
> *Such circumstances may include, but not be limited to, changes in economic and industry conditions, leveraging, cost of capital, the parties' individual perception of risk, knowledge, changes to existing organizational and management structures, synergism, motivation, negotiating skills, quality of counsel, income tax consequences, and other individual and interrelated factors*

II. Explain that Buyers are essentially purchasing the Company's *operating cash flows*
   a. Objectively, operating cash flows must satisfy the Buyer's claimholders to those cash flows: a) Uncle Sam (income taxes); b) Lenders (P&I); c) the Company (CapEx & Working Capital); and d) Equity Investor(s) (ROI) (see Article)
   b. Common sense would say that if the *operating cash flows* cannot support these claimholders, the price is too high

III. Explain how Deal Structuring and the Controlled Auction Process help control valuation expectations
   a. Implement Inventive Deal Structuring Options that address: a) consideration options, b) buyer's financing options, and c) tax structuring options (see Article)
   b. Bridge the valuation gap using earn outs (see Article)
   c. If the business meets the appropriate size and marketability criteria, market the business without a price under a controlled auction process (see Article)

Obstacle: One-Sided Role

The business owner is too busy in the role of manager of the day-to-day operations of the business, leaving little time to address the dual role as the business owner, and the eventual exit from the business.



The Exit Plan Options schematic shows that the business owner has three choices in deciding what action to take. One is to be proactive, with more options to exiting. For example, tranfers to family, other owners (see Article), management, ESOPs (see Article) or to a third party (see Article). The other two options are reactive, where transfer options become limited, along with the business owner incurring the direct, indirect and opportunity costs of doing nothing.

Final Thoughts on Exit Planning

- *Exit Planning* is largerly an emotional decision on the part of the business owner.
- Communication is essential because each stakeholder's emotional and financial needs will differ.
- Patience. *Exit Planning* is a time consuming process occuring before, during, and after the transfer.
- Compassionate attitudes help alliviate the human distress associated with change in business ownership.