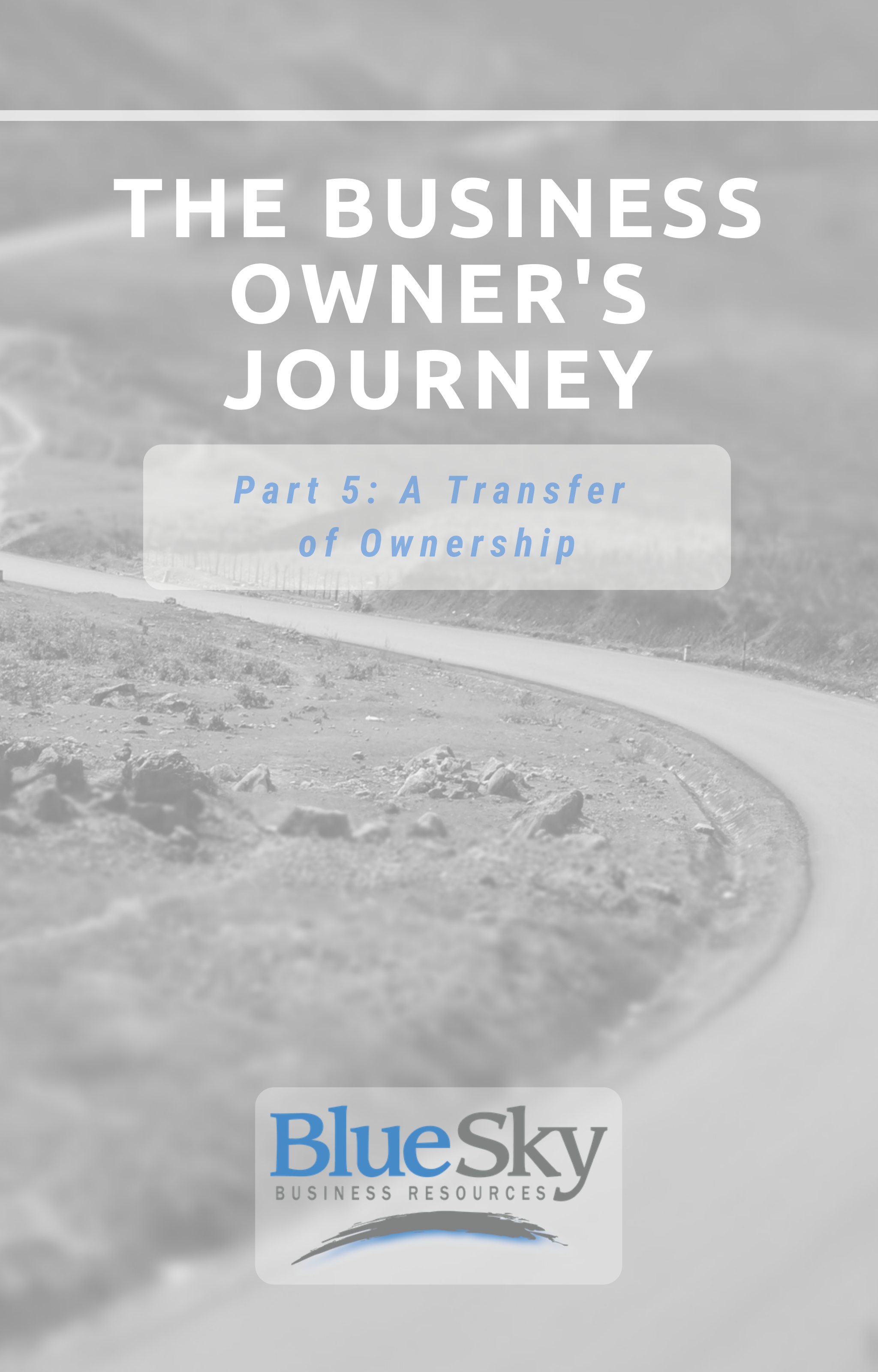


THE BUSINESS OWNER'S JOURNEY

Part 5: A Transfer of Ownership

Every once in a while, we are all prone to bouts of nostalgia and for a business owner considering retirement, there is plenty to be nostalgic about. It can be hard to imagine that so many years have gone by since that first bout of inspiration scribbled passionately on a restaurant napkin. You and your team have been through a lot, closing the first sale, making your first big expansion, weathering down economies, and it has all culminated in a business that has become more a part of your family and extension of yourself than a job. While you know that the time is coming to slow down and enjoy the fruits of decades of hard work, the thought of leaving the business can be hard to consider. This business has been an intrinsic part of your identity for so long that it can be hard to know who you are separate from it.

What’s more, what can you possibly do to fill all that time? Golf or fish too much, and some of the joy you find in the activity will surely fade. Worse yet is the daunting prospect of actually extricating yourself from the operation. How do you cash out; what can you do ahead of time to protect your team, your legacy, and your nest egg; who and what do you need to know early to ensure peace of mind during retirement? In The Business Owner’s Journey Part V, we will explore the eventual exit of your business and address these considerations in greater detail.

If you have been following the Business Owner’s Journey through the last four phases, you know that we have addresses many of the issues necessary to bring your idea into the market, and to establish and maintain durable strength through the highs and in anticipation of the challenges. The final leg of this journey is the preparation and execution of your eventual exit. A fact of life is that every owner will leave their business, and whether you plan to do so standing up or on your back, someone will need to attend to a transition of leadership. The sooner you begin to prepare for this eventuality, the more control you will have on the timing and outcomes. We will talk about the mechanics of exit planning and walk through the options and the process surrounding an exit, but first we need to talk about the personal and emotional side of exit planning.

Any entrepreneur that has been through the emotional rollercoaster of bring their vision from an idea into maturity as a durable enterprise knows the pride of creation that can only be achieved through this singular endeavor. For those who have not yet experienced it; imagine the magic and profoundness of having a child, the accomplishment of climbing Mt. Everest, the exhilaration of jumping out of an airplane, the financial insecurity of buying your first home in a foreign country, and the mental rigor of taking the Bar Exam. Take all of that pride, emotion, adrenaline, concern, and cognitive strain and multiply it by 1,000 and you'll have a glimpse of what the typical entrepreneur goes through in the first few years of their start-up. It is no small wonder that most business owners love their creation like a child and see their identity and the organization as inseparable. It is hard in many cases for founders to articulate where they end and the organization begins. This parental and individual identification with the organization fosters exactly the level of commitment and perseverance necessary to get through the first critical phases of the business owner's journey. However, it becomes imperative to the lasting success of the organization that the owner begin the process of separation somewhere during the rapid growth and declining growth cycles. This is a critical step for the owner, and some have an easier time with this process than others. It is only after an owner has accepted and internalized their identity as separate from the brand of the organization can the work of exit planning truly

begin. It should also be pointed out that exit planning should begin as soon as the leadership team has an ounce of bandwidth to spare. There are myriad reasons for this urgency. For starters, businesses in the M&A market are valued based on the attributable risk of the organization as an investment. De-risking the operation as an investment vehicle is the same thing as saying that the business is well positioned to sustain long-term growth. In other words, a business that is positioned to achieve a strong value in the market is going to put a good amount of money in the pockets of its owner. Secondly, much of the process of exit planning is focused on mitigating risk by establishing and documenting repeatable processes of operation, succession planning and leadership development, optimizing margins and financial controls, and scrutinizing supply and distribution channels. This all goes hand in hand with the maturation of an organization through the rapid and declining growth cycles. Again, the optimization efforts will drive more cash to the bottom line, and the operational efforts will provide transparency into timing and opportunities for growth while making the organization more adaptable as markets evolve. These are all fundamental principles for a successful organization.

The last critical benefit of developing a robust exit strategy is the ability to implement it quickly when circumstances warrant it. In good circumstances, the organization may find that the market is extremely hot, and an opportunistic exit prior to your original anticipated date could yield substantial financial benefit and get you on the beach sooner than you thought. On the darker side of this consideration, a tragedy or emergency could strike that takes you out of the organization, and the process of transitioning leadership could fall into the hands of a family member or executor. Wouldn't you feel better knowing that the business is in a good position to weather the initial event, and that the trustee had a clear plan to follow?

Hopefully, by now you are embracing the value of exit planning, both personally and organizationally. Now, let's get into the fundamentals of how to establish and manage an exit strategy. While there are details and nuances that are dependent on the team, the industry, and the size of the organization; much of what we discuss here is universally applicable. At the very least, it will provide you with a jumping-off point and a reasonable framework. We strongly advise that you do not take on this effort internally. It is valuable and important to have your advisory team on your exit planning team.

- M&A Transaction Advisor
- Accounting/Tax Team
- Legal Council
- Personal Financial Advisor

They will each provide unique perspectives based on their expertise, and having them all onboard early will ensure that they are all advising you consistently based on a clear understanding of your objectives.

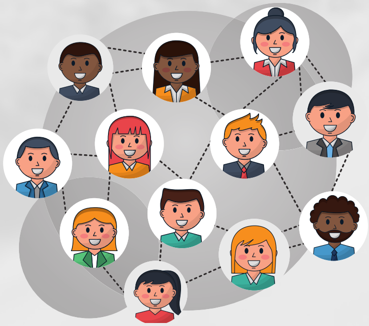
You should start by establishing two benchmarks, where you are and where you want to be. We recommend employing a business valuation and industry benchmarking to establish your current state. As for where you would like to end up, don’t be afraid to stretch beyond your comfort zone on this. You can use the external threat mitigation and strategic planning processes to help guide your team to achieving your goals. Again, the more time you have before you want to be retired, the further you can push your goal from where your business is today. Also keep in mind that this should be at the very least an annual process, so you can always update your objective as the business evolves.

The next thing you will want to do is to assess your organizational opportunities and prioritize them compared to impact and objectives. Some core areas

Some core areas that you will want to be sure you are attending to are as follows (this is far from an exhaustive list):

- Financial engineering
  - Is your working capital in line with your industry?
    - Are you making good use of AP terms?
    - Are you collecting AR consistently and timely?
    - How frequently are you turning your inventory, and is there an opportunity to go lean or achieve quantity discounts?
  - How are your margins?
    - Cost of Goods Sold (COGS)
    - Labor (direct and indirect)
    - Gross Profit Margin
    - Sales, General, and Administrative (SG&A)
    - Net Profit Margin
    - Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)
  - Capital Expenditure Management and Fixed Asset Depreciation
  - Managing against a Pro-Forma Budget

- Supply Chain and Distribution
    - Is a risk assessment regularly undertaken regarding supply chain and logistics?
    - Does the organization have secondary sourcing options established for all critical resources?
    - Are there concentration issues (greater than 15% overall impact) with clients or suppliers?
- HR
    - Is there a working process for employee recruitment?
    - Is there an established onboarding process? Does it work?
    - Is there an established development and internal promotion system Is it working?
    - Does the company know its turnover and cost of capture for new employees?



Even this very short list of considerations can keep an organization strategically and tactically very busy for many years. This should serve to reinforce the imperative of getting going as soon as possible. Furthermore, the more you and your team dig into this form of thinking about the company, the more it will become imperative just how much this work is strengthening the operation. This is a virtuous cycle that will build upon itself as long as you are all paying attention. You will also be able to see the impact that this work has on the value of your organization, building equity as you reap greater profits.

Ultimately, the decision to exit your business should be a decision made with confidence and contentment. If properly planned for, you will be able to leave your business knowing that you have done everything in your power to prepare it to thrive long after you moved on, and this is the greatest legacy any entrepreneur could strive for. What’s more, you will be able to rest easy knowing that your equity will deliver a nest egg that will carry you and your family comfortably through retirement.

Food for Thought

- What things are most important outcomes from the sale?
  - Receiving top dollar
  - Brand Legacy
  - Shortest possible transition period
  - Employee welfare
- Have you considered all your exit options?
  - ESOP
  - Recapitalization
  - 100% Sale
  - Handoff to family or management team
- What does life look life after the exit from your business?
- Who is on your deal team and what M&A experience do they have?
- Have you performed a valuation so you know what value to expect in the open market?
- How. much time do you have before you want to be retired?
- Are there any industry players you can see taking over your business?

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