Boardroom Advisors

SCALE UP YOUR BUSINESS:
PLAN YOUR EXIT STRATEGY

Vol. 8 of 8 in the
Complete Guide to Scaling Up Your Business

Why Planning Your Exit is an Important Part of Scaling Up

Your time with your business won't last forever. It can seem rather strange to think about leaving the business as part of scaling up, but it's worth doing.

These things take time to prepare and can involve some time-consuming requirements. You don't want to get caught out when you want to leave by something that'll take a couple of years to implement.

When you're already making big changes to your business, it's easy to add more. Now's a great time to figure out how you want to exit the business and get the ball rolling. That way, your transition out of business won't become stressful.

This eBook looks at the process of exiting a business and available options. In addition, you'll see the work needed to prepare for an exit, so you know where you want to start.

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The Importance of Starting Right

Exiting a business won't be instantaneous. It's not even particularly quick. Yet, that is something that many entrepreneurs have been caught out by.

A certain amount of due diligence is required. Valuations will generally be done by someone independent. And, of course, you have to find and prepare the people you're handing the business over to.

If you're selling externally, you'll need to find a buyer.

So you will have to optimise your business to maximise value, and you can be sure there'll be haggling over your value.

If you're handing the business over to an internal owner, you'll need to ensure they're all prepared to take over leadership responsibilities. Probably, you'll still need to have the business valued, and there'll be investors to appease.

All of these can take time. Sometimes, your exit could be delayed by multiple years while you prepare everything. With this being the case, you can understand why you'd want to start preparing as early as possible.

Investors and Exits

Scaling up your business generally involves seeking investment. Therefore, knowing how you plan to exit your business can be very important to the investors you are looking for.

The value you get for each kind of exit will be different, so the return they'll get on their investment will be too. The less your business sells for, the less they'll get, so they need to be informed of your choices.

If your investor expects a big return only to learn your plan to hand the business to your children without a sale, they won't be happy. But, on the other hand, if they're investing because they believe in your business's mission, they're more likely to be ok with a soft return handover that maintains company culture.

Being clear on your exit strategy will help you find the kinds of investors that best match your vision for the future. Be transparent with them, and you'll avoid any unpleasant revelations.

Exit Strategy Options

This chapter covers some of the owners' most common methods to exit their businesses. Each exit strategy has its benefits and drawbacks. Your choice will depend on what you want from your business and your life after the sale.

For each exit strategy option, there will be an introduction to how they work and an overview of their most important features. There will also be a section on what you must do to prepare for this exit. Some preparations will benefit from being started as soon as possible, so you'll see what you need to start doing.

Employee Ownership Trusts

An Employee Ownership Trust (EOT) is a form of exit that keeps the business in business. As the name suggests, it involves creating a trust in the name of the business's employees that takes over company management. Boardroom Advisors has an eBook that explains the EOT in greater depth, which you can find here.

A board of trustees manages EOTs. A separate management team will run the business. Both aims are to act in the best interest of the business's employees.

An EOT has to own most of a business's shares, so you don't want to relinquish majority control of your business as it grows. In addition, at the time of exit, the business has to be independently valued, as the EOT may not pay more for it than its market value.

Typically, the trust will pay for the shares they've bought in instalments from the business's profits. These payments are exempt from capital gains tax. So your sale won't be in a single lump sum, but it will be tax-free.

EOTs can be great for owners who hold their business's mission and culture to be of high significance. Handing the business over to the employees guarantees that the beliefs of the business will be maintained. It also means you can remain involved to some degree in the business.

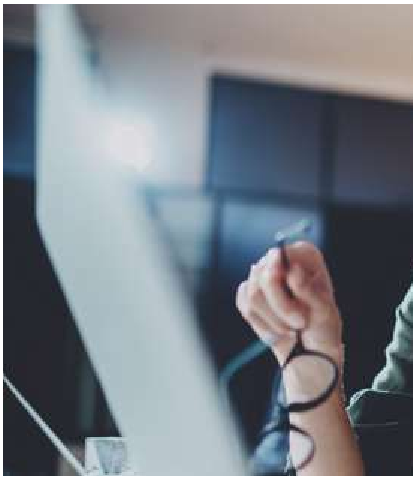
What to Prepare

As the business is sold at no more than market value, and slowly, this will limit the return an investor can receive on their investment. That means you need to find an investor who cares more about the cause of the business than the profit it'll make.

Your senior leadership has to be able to function without you. There won't be a new owner coming in to take control and keep a direction, so your team has to be able to do it for themselves. Training and development should be a core part of the business's culture and operations.

You will need to establish a trust to sell the business to. That doesn't need to be done straight away but needs to be left with enough time to be put in place before you leave.



Trade Sale

A trade sale is conceptually the simplest method of exit. You find a buyer, sell your business to them and then either step away or have an earn-out period. However, that doesn't mean they are an inherently simple process.

Trade sales tend to give the largest return, so may be the preferred route for investment who just want profits. On the other hand, if you want a large lump sum to walk away with, this may be a good route for you, although you should be aware that the sale may be subject to taxes eg capital gains tax.

Owners who exit via a trade sale tend to cut ties with the business entirely. But even if there is a period of earn-out the business has a new owner and a new identity.

The new owner has free reign to run the business, so this method may not maintain the vision you had for your business. However, changes will likely occur, so you have to be content that the business has entered a new phase of its life.

When the business is valued, a lot of due diligence will be needed. You want to maximise the business value, while they will want to chip the price down. Everything has to be accounted for and in order, which can take time.

You also need to find the buyer before you can make a sale. But, of course, that can be easier said than done. Securing an interested party for a sale can take a lot of time by itself, so you don't want to add even more sale preparations than necessary.

What to Prepare

If you want to get the best value out of your business, it has to be worth as much as possible. A trade sale exit means you'll need to prioritise growing value during your scale-up.

A business reliant on its owner will be valued for much less than an independent one. If a lot of your business's current success is derived from you, it won't be maintained after you leave. A buyer will need to be confident that the business will continue to function without them needing to save it.

A business preparing for a sale will need a rigid and resilient management structure. Every link in the chain should understand what they're doing and why so they can keep doing it without your oversight.

Management Buyout

A management buyout sits somewhere between an EOT and a trade sale. You sell the business fully instead of a trust, but the buyers already work there.

In a management buyout, the existing management team buys the business from you using their assets. As they're buying as private individuals, the sale isn't as limited by regulations as an EOT. That can make the process somewhat more adversarial, however.

They're using their assets and will likely need to raise the finances for it, so they will want to reduce the costs. As this usually involves debt, they'll want to minimise the amount they borrow at your expense
.
However, they're all current business employees, so they understand your mission. A management buyout is more likely to maintain your established legacy but with a single payment to take away.

As with an EOT, owners can maintain a relationship with a business after a management buyout. You don't have to sell all your shares; you can take on a different role, such as an advisor.

If you take this route, remember that you have sold the business to them. It's theirs now, and you need to respect that even if you're still around. It's also worth noting that pressure due to debt can force them to move away from your legacy for growth.

What to Prepare

They must be on board if you want to exit your business with a management buyout. You can't force them to buy you out if they don't want to.

The management team needs time to decide if this is what they want and to raise funds for this purpose. The due diligence will be less thorough but is still necessary.

You need to ensure the management team is sufficiently trained and practised in running the business without you. If they don't have what it takes to keep the business growing in your absence, you should rethink if they're the right people to sell to.

Succession

Succession is very different to the other exit methods. It's common in family businesses, where ownership is passed from generation to generation.

Instead of selling the business, the controlling shares are given to a chosen successor or successors. Of course, that can be your child/children, but it can also be an heir from within the business, so you feel comfortable trusting its future to.

With no, or only a nominal, sales price, neither you nor your investors will see a return from this exit. Your investors have to be ok with not seeing any money come from the business's handover. Philanthropic or non-equity investment can be useful if this is your end goal.

What to do

The main requirement for succession is the successor. They need to be mentored and prepared to take on their role when it comes.

You may also need to smooth things out with your investors. If they aren't happy about the handover, they may become a problem. That could involve agreeing on a revenue-based buy-out scheme or you buying back their shares from them.

Otherwise, with no sale, there's no oversight to consider. Fair market value and due diligence aren't important when no one's buying anything.

Who do You Need to Involve?

Across many of the exit strategies, you will have seen some common occurrences. Some people must be involved, no matter what exit strategy you choose.

Your strategy of choice will affect the people you bring into your business as it grows. It will also affect your operational structure and development needs. That is the main reason you should start planning your exit.

"Start early. Exit takes time firstly to make sure the business is attractive to acquirers, and then to find a buyer."

- Eian, Non-Executve Director

Involving Your Investors

If you already have some investment, such as seed funding as a start-up, you will need to have this discussion with your investor. You can be selective about future investments but can't change the past.

Understanding what they're ok with can help you build your plan. They'll be happier with an internal handover if they don't care about their return compared to the business's cause. If they want a return, you may need to figure out how you'll still provide them with what they're owed.

You may be able to agree on a payment scheme with them to buy them out before the exit. You may agree to split your instalments from an EOT until they're paid back. Be open and honest to find the best option for you.

Going forward, your strategy of choice should inform your investment options. For example, if you want to sell the business, you likely won't have any issues with a traditional VC. VCs have a duty to their clients but can't give money out knowing it won't see a return.

If you want to give your business to your child or something similar, you may need to use alternative finance methods. Equity-based finance isn't the only option; you may benefit more from crowdfunding or debt finance.

Involving Your Management

Whether you're preparing them for a takeover or doing it to improve your business's value, your management team needs to be ready for your exit.

A business that can't function without its leader isn't scalable, so it isn't as valuable.

If your business needs you there every day, it isn't ready. So you have to prepare your business for your absence.

Following a common thought experiment, if you were to disappear from your business for the next week suddenly, what would happen? If you don't think they'd handle that week, can they really handle your exit?

Preparing your business for your exit will mostly consist of exactly this. Once your senior leadership team can keep working without you, and there's nothing that cannot happen if you're absent, then they're ready.

As the business's leader, you should be there to approve the big things and provide the business's strategic direction. So you don't want to step away while running the business completely. You also don't want them to be unable to process payments because you're on holiday, and it can't be done without your authorisation.

Outside Bodies

Many exit strategies will need some independent interaction. For example, value is generally done by an outside agency. You may also need help to establish a trust like in an EOT.

It's always a good idea to get advice from experts on what will be necessary. If there are legally mandated steps, you will need to make sure you can complete them, for example.

That is also why it's such a good idea to have someone who has exited a business before on your board. They'll be able to provide this advice from experience and direct you to the people you need where they're not enough.

What Does Your Business Need To Do?

Anything that can be done ahead of your exit should be. What can be made part of the company culture will be easier to include.

You can build the management structure your business needs from the start with your scale-up. Making training and development opportunities a normal part of operations will help you identify promising candidates.

You likely aren't the only one needing replacing on your exit. If someone is stepping up to take over a CEO role, their job will still need to be filled. But, again, establishing succession planning as the norm will help with management shifts.

If those who will be exiting the business identifies and develops their successors, it'll be easier for your business to adapt. That shows your business is prepared, which can also improve its value.

One thing to consider is estate planning. Like succession planning, this is about what will happen after you leave the business. However, unlike succession, this is for unexpected events such as your death.

If there's a clear plan for what will happen when you pass away, then there's a clear plan for what'll happen when you leave. It makes your business stronger and will improve buyer confidence.

Exit Your Business On Time and Capitalise

When planning your exit, you must decide which route is best for you. Once you have, you know where you can start.

As always, research and discuss your decisions with your key players. If you want to give business to someone else to run, the recipient needs to be on board and properly supported.

Talk to the experts. Build your business's independence. Get it, and yourself, ready for living apart.

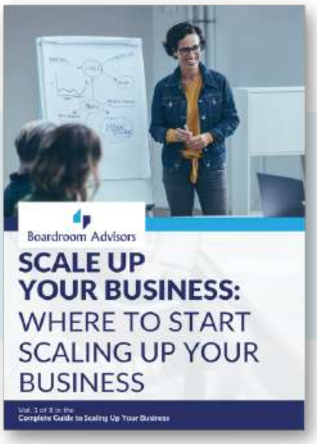
Exiting your business is rarely an easy time. After everything you've put into it, it's completely understandable to be emotional. Doing the work in advance will help make the process easier for you.

If you are not sure how to best prepare for the exit you want consider enlisting the support of an experienced part-time director. All our Advisors have successfully scaled businesses and you could work with someone who has been through the exact same process many times.

The Scale-Up Series

1

START



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BUILD

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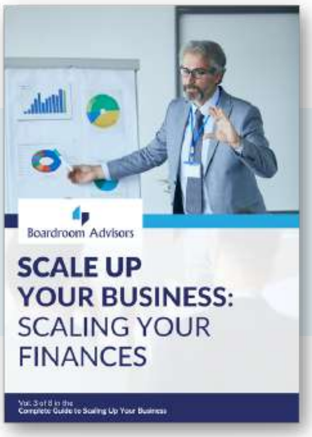
SCALE



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EXPAND

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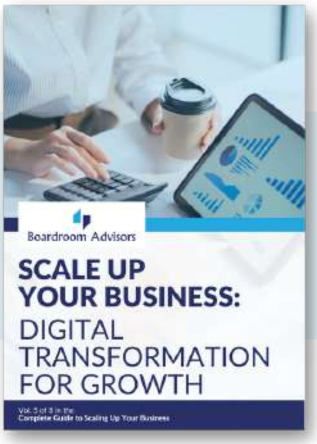
GROW



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MARKET

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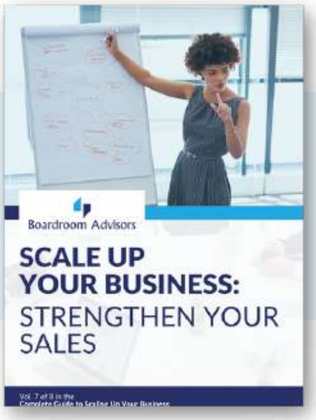

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EXIT