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A **Structured Financial Partners** White Paper

**The Four Phases of Exit Planning**  
*A Brief Overview of the Exit Planning Process*

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## Executive Summary

**Most business plans contain no more than a sentence about the owner's exit strategy. That sentence typically says the owner one day plans an IPO or to sell in an M & A transaction. After the ink on the plan is dry, that is often the last thought of the of exit planning, because the business of running the business is all consuming. As the owner ages, planning for exit becomes important, but is often overlooked until the exit event is breathing down the owner's neck. Pre-exit planning is vital to owners over the age of fifty and the principals we preach in exit planning are valuable to owners of all ages.**

**When we describe the exit planning process to a business owner we often use an analogy that most people have lived through. Who doesn't have an experience with home remodeling? It is this language we use to describe the process of preparing an owner to step away from his business some day.**

## The Four Phases of the exit planning:

- *Phase 1: Framing the issues*
- *Phase 2: Building the Structure—Growing and Protecting Owner Value*
- *Phase 3: Putting the House in Order—Succession, Contingency and Estate Planning*
- *Phase 4: Turning Over the Keys*

By taking business owners through this process, we are able to systematically focus them on the things that are most important to them and will help them to achieve their objectives. This will be particularly important to boomer business owners who have discovered that the economy has eroded their investment portfolios and their business valuations, but aging has not been repealed. As the economy begins to rebound there will be a glut of aging boomers trying to sell their businesses into a shrinking pool of buyers. In this scenario, only the best positioned, best prepared businesses will garner top dollar when it's time to sell.

**Beginning to plan NOW for a sale two, to as many as ten, years from now makes a lot of sense.**

In this article, we will briefly address each of the four phases.

### **Phase One: Framing the Issues**

The first phase of our exit planning process is the most important because it

is this framework on which the rest of the plan is built. Determining the objectives of the business owner might seem like an easy task, but in reality, it is one of the most difficult things we face in our work. We start with three basic objectives: 1.) How long does the owner anticipate working before departing; 2.) How much income does the owner need from the sale of the business and are there other resources to support your post departure lifestyle; and 3.) Who will the business likely be sold to, i.e. co-owner, family member, management team or third parties.

After these questions are answered we can delve into deeper issues. In family transition with multiple children in the business, will all of them be treated equally even if their skills and responsibilities aren't equal? Does Dad want to leave the business to a child who is not interested in or not qualified to take it over?

Does the owner plan on selling to a key employee and that employee really isn't entrepreneurial and isn't interested in taking over? Does the owner expect to sell to a co-owner who really doesn't want to do it alone? Does the owner want to sell to a third party but the business isn't really ready for the M & A market?

In all these cases, we must dig deeper and get the owner to realize what is most important to him or her. We must help them realize that even as objectives are identified, they must remain flexible, because things—like the economy, markets, staffing—change. And then we can begin to build a plan

on the framework we have laid down in Phase One.

## **Phase Two: Building the Structure**

In this phase, we must get the business owner to understand that a prospective buyer doesn't see the current owner's labor of love--his investment of sweat tears and heartache. A buyer is looking primarily for verifiable and sustainable cash flow and value drivers that will keep that cash flow going and growing. During this phase we work on value propositions that can grow your business between today and your departure

Among the things we look at closely are financial statements. If the owner expects that he or she will be selling to third parties, we suggest that they start having **audited financials**. Remember, buyers won't pay top dollar for what they can't understand or don't believe.

If the transition is going to be to insiders (family members or management team) audited statements might be overkill, but having accurate financials, prepared by a credible CPA firm (not your in-house bookkeeper) will be an important step as you begin to disclose information to those insiders considering buying your business.

Another critical area is the value drivers in your business. These are the things you can control that can add value as you approach sale date. Some are accounting-based as mentioned above, for example, does the business have systems in place to control purchasing and invoicing? Is your A/R well

managed? Is your customer base too focused on a single client? These are things that will discount the value of your business. Does your place of business look like a dump? It may not affect the bottom line, but it will affect the psychological value in the mind of a buyer. Straighten it up and slap a coat of paint on it. It will cost very little and it will add value.

### **Phase Three: Putting the House in Order**

To review what we've done so far in the process, in phase one, by framing the issues, we have dug deep and built a foundation based on the owners objectives. She has told us how much longer she would like to work in the business. We have done some analysis to determine how much income she needs from the sale of the business to meet her income needs in retirement. And we have an idea as to whether she wants to sell to third parties or insiders. In phase two, we have focused on the systems strategies, procedures and people that will make the business more valuable in the eyes of the buyer.

Now in phase three, we must look to protect the value of the business and do some planning to coordinate this exit plan with the owner's personal estate plan.

In phase two we talked about how important the CPA is. In phase three, the estate and/or business attorney becomes critical. If the owner has already done some estate planning, that existing planning will need to be reviewed in light of impending sale of

the business. Certain planning steps may be taken prior to sale for income OR estate tax shifting.

Other things that need review during this phase are shareholder (buy-sell) agreements for co-owned business. A well written buy-sell covers not only death of a shareholder, but other triggering events such as: divorce, irreconcilable differences between shareholders, retirement. It also must have a valid valuation formula.

Likewise, leases, contracts and other legal obligations should be reviewed and deemed clear of any possible obstructions to sale.

An often overlooked asset is the key employee group. As the owner ages and prepares for exit these key people are an important part of what the business has to offer—no matter who the buyer is. To a third party buyer, if they are buying a "well-run company" what are they buying? The owner is leaving. They are buying the people the owner is leaving behind, especially the management team. If the owner is selling **to** the key people they need to be well enough trained to run the business after the sale, because those buyers will be paying for it out of the profits of the company as we will discuss briefly below.

### **Phase Four: Turning Over the Keys**

The final phase is what all the fuss and hard work was about. For most **smaller** middle market companies there are three potential markets for your company:

- Third party buyer
- Insider—co-owner, key employee (or group ) or family member,
- ESOP—a special retirement plan that creates a market for employer stock

We will focus here on insider and third party sales. When we work with our clients, we make it clear that we are unbiased as to which type of sale they wish to make, since we are **process** oriented not **transaction** oriented...

Sales to third parties can be rewarding...They generally yield more cash more quickly than insider sales. But markets are fickle as this current economic climate has reminded us. Our investment banker friends have told us that the number of transactions will be way down this year, but companies in certain hot niches are still selling at attractive multiples.

In down markets, the only businesses to sell for top dollar will be those in “hot” niches and those that are incredibly well run with value drivers that make them stand out in a crowd.

Insider sales can meet a number of needs for a business owner. First, the inside buyers are likely to be less demanding than outsiders are far as due diligence. Since the owner doesn’t have to find a buyer, he won’t have to pay an investment banker...Perhaps the owner has always wanted to pass the baton—whether to a family member, younger co-owner or a key employee.

These insiders, however, tend to have one thing in common. They don’t have the cash to buy the business, nor do they typically have the collateral to satisfy the bank. This leads to the departing owner being the bank, by carrying paper to fund the buyout. In these situations, installment payout arrangements need to be carefully designed so that they are tax-wise for all parties. What departing owner wants to be pulled out of retirement to repossess a failing business?

### Wrapping up

The four phase exit planning process is designed to assist business owners in designing and implementing a plan of attack two to ten years before any planned transition. Taking these steps will add value, smooth the transition and prepare the business for unplanned bumps in the road. The principals we use in this process can be started far in advance of the owner’s exit to provide the owner a more orderly and profitable company that is ready for sale should an unexpected opportunity arise.

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Armed with her MBA from UCLA and her investment banking experience Susan took over the reins of a family-owned business and prepared her first exit plan for her parents. She can be reached at [susan@sfpartners.net](mailto:susan@sfpartners.net)