FEDERAL DEPOSIT INSURANCE CORPORATION

Small Business Exit Strategy

How to get out, when its time to get out

Learning Objectives

At the end of this module, you will be able to:

- Identify business exit strategy options, including various selling options or liquidation, and advantages and disadvantages of each option.
- Identify ways to make your small business more marketable to potential buyers.
- Identify additional considerations in selling or closing your small business.

About FDIC Small Business Resource Effort

- The Federal Deposit Insurance Corporation ("FDIC") recognizes the important contributions made by small, veteran, and minority and women-owned businesses to our economy. For that reason, we strive to provide small businesses with opportunities to contract with the FDIC. In furtherance of this goal, the FDIC has initiated the FDIC Small Business Resource Effort to assist the small vendors that provide products, services, and solutions to the FDIC.
- The objective of the Small Business Resource Effort is to provide information and the tools small vendors need to become better positioned to compete for contracts and subcontracts at the FDIC. To achieve this objective, the Small Business Resource Effort references outside resources critical for qualified vendors, leverages technology to provide education according to perceived needs, and offers connectivity through resourcing, accessibility, counseling, coaching, and guidance where applicable.
- This product was developed by the FDIC Office of Minority and Women Inclusion (OMWI). OMWI has responsibility for oversight of the Small Business Resource Effort.

Executive Summary

- Planning how to exit your business is just as important as how you start it. The goal is to maximize the value of your company before converting it to cash, and to minimize the amount of time consumed.
- The business plan needs to include alternative exit strategies. Examples include selling to family member(s), selling to partner(s), or liquidation.

Business Plan Exit Strategy

- A typical business plan lays out a course of action to start a venture and keep it running. A comprehensive business plan also includes an exit strategy.
- A proper exit strategy places you and your business in the best possible position to maximize the financial return on your company.
- The function of a viable exit strategy in a business plan is to maximize the worth of the business enterprise in advance of commencing the final process of converting your investment or ownership interests into cash.

Deciding To Sell

- Selling the business you've worked so hard to grow is rarely an easy decision. Selling may be the right option if:
  - You're ready to retire and have no heir to continue the company.
  - Partners who own the business decide to dissolve their partnership.
  - One of the owners dies or becomes disabled.
  - You or another owner get divorced and need cash for a settlement.
  - You want to do something more challenging, more fun or less stressful.
  - You don't have enough working capital to keep going.
  - The company needs new skills, a new approach or resources you can't provide.

Selling Your Business *(Slide 1 of 8)*

- Small business owners have options to consider in closing down. Selling or liquidating are common choices:
  - Sell to an existing partner
  - Sell to family member(s)
  - Sell to key employee(s)
  - Sell to an individual in an arm's length transaction
  - Sell to a competitor or another business
  - Sell to employees
  - Liquidate

Selling Your Business *(Slide 2 of 8)*

- Sell to an existing partner
  – Most business partnerships begin with a legal agreement outlining the process for selling a partnership stake to the remaining partner(s). When this document exists, the details of the process (often including the buyout price) are already established.
  – One key benefit to selling to an existing partner is that pre-defined partner exit strategies result in the least disruption to the business, clients and employees.

Selling Your Business *(Slide 3 of 8)*

- Sell to family member(s)
  - Usually this option is anticipated in advance.
  - Consult attorneys, accountants and family successors to determine best transition. Valuation, business transfer and related estate planning issues can be complicated.
  - Family sale rarely results in top dollar sale. However, it does provide flexibility in determining future involvement in the business and typically creates a smooth transition for customers and employees.

Selling Your Business *(Slide 4 of 8)*

- Sell to a key employee
  - This may be an option when a trusted employee has the desire and financial resources to take over the business. Consult an attorney to structure a partnership and buy-sell agreement.
  - Affords many of the same advantages of selling to family member(s) including flexibility and smooth transition.

Selling Your Business *(Slide 5 of 8)*

- Sell to an individual in an arm's length transaction
  - Individuals buy businesses to become an entrepreneur while avoiding the risk of starting a business from scratch.
  - Seller financing allows new owners to finance a purchase easier than it would be to finance a startup through investment or commercial financing.
  - Purchasing an established business offers buyers many benefits including an existing stream of sales and cash flow, established systems, current clients and reputable brand name.
  - If your business is in strong financial condition, selling to an individual often offers the best opportunity to achieve business plan exit goals.

Selling Your Business *(Slide 6 of 8)*

- Sell to a competitor or another business
  - May be an option if your business is in a hot market.
  - Acquisition typically allows the business owner to take a position with the newly merged company, and is an attractive option for sellers who want to stay in the industry and are comfortable relinquishing ownership in exchange for a financial payoff and the satisfaction of being part of a larger business with additional capabilities, market reach, competitiveness and profitability.
  - Be certain you are comfortable with your new role, if any, in the newly merged company. Fully understand the culture and other dynamics in the acquiring company.
  - Consult with an attorney to structure the acquisition agreement.

Selling Your Business *(Slide 7 of 8)*

- Sell to employees
  - A sale to employees involves a tax-qualified, defined employee benefit plan called an "Employee Stock Ownership Plan."
  - Employees of the business buy shares either immediately upon owner's exit or over a period of time, depending on how the transition is structured.
  - Requires significant legal planning and a combination of business factors that are rare in small businesses. Can be tax-advantageous, however, since proceeds from employee sale may be tax-free. Also allows a phase-out of the owner's involvement and affords continuity to customers and employees.

Selling Your Business *(Slide 8 of 8)*

- Liquidate
  – Option of last resort and most common for small businesses with significant weaknesses or solvency issues requiring an immediate exit.
  – Liquidation may allow quickest and easiest exit allowing owner to recover some value while avoiding investing additional funds before leaving the business.
  – Consult liquidation experts to ensure proper procedures are followed including selling assets, collecting outstanding receivables, paying off debts, addressing contractual commitments, releasing employees, and finalizing legal and financial obligations before closing the business.

Making Your Small Business Marketable *(Slide 1 of 2)*

- Business owners considering selling in a tough or recovering economy should consider ways to make their businesses most marketable. Some considerations include:
  - **Potential for profitability:** purchasers will want to feel confident in the ability of the business to continue to make money in the future. Evidence of reliable cash flow and revenues, and profitability through challenging economic times greatly encourages potential buyers.
  - **Potential to grow:** evidence the business can continue to make profit and thrive in the future. Sellers who can offer buyers a focused plan for growth, which might include strategies such as acquiring competitors or expanding a product or service, will have an easier time selling the business.

Making Your Small Business Marketable *(Slide 2 of 2)*

- **Seller financing:** a seller willing to finance part of the sale price and allow the buyer to pay back with interest later may have an advantage.
- **Physical Assets for Debt Financing:** because banks may be more cautious about business financing in challenging economic times, businesses with greater amounts of tangible assets – such as capital equipment or owned real estate – may have more success in securing purchase loans.
- **Strong Brand or Loyal Customers:** strong brand equity or a loyal customer base can be very appealing to potential buyers, depending on the industry.

Customer Relations When Selling your Business

- A business sale is a often a difficult transition. As the seller, it is often best to help guide customers through that transition and to provide reasons for them to stay with the business.
- Exiting the business while maintaining positive customer relations is the right thing to do for the customers, for the new owner(s), and for your business reputation.
  - Coordinate release of information with the new owner(s).
  - Contact key customers first.
  - Address specific customer concerns regarding new ownership, management, or products.
  - Be positive and enthusiastic when communicating with customers about the business sale.

Tax Considerations in Closing Your Business

- Be sure to consult an accountant or tax professional when contemplating your business exit strategy.
  - You must file an annual tax return for the year you go out of business.
  - If you have employees you must file final employment tax returns, in addition to making final federal tax return deposits of these taxes.
  - You will also need to file returns to report disposing of business property, reporting the exchange of like-kind property, and/or changing the form of your business.

Key Takeaways from This Module

- A comprehensive business plan will include desirable exit strategies.
- Selling the business or liquidation are options in leaving your business.
- Additional exit strategy considerations include ensuring your small business is a marketable as possible, aiding customers in a smooth transition to the new business owner(s), and complying with tax rules in closing or selling your small business.

Sources and Citations

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