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MERRILL® PRIVATE WEALTH MANAGEMENT

# The good exit: How company owners sell their business without regrets

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# Introduction

Samuel "Whit" Whitaker[2] has decided that he'd like to sell the highly successful company he spent decades building within the next five years. Although he still enjoys running the company, he's thinking more about what might be next. His wife, Naomi, has also been urging him to slow down so they can travel and enjoy a happy retirement, and the idea of having the freedom to explore the world has always appealed to Whit.

As Whit considers his options, he's clear on a few points. For one, family succession is not in the cards. His children don't have business backgrounds and have no interest in taking over. This means he'll most likely need to sell the company to his employees, a strategic buyer or a private equity fund. But that's where Whit's clarity ends and the pressure begins. This will be the culmination of his life's work. He knows it will set the trajectory for him and his family, possibly for generations, and yet, he's never sold a business before, and he doesn't know what to expect.

During a meeting with Ari, his Merrill Private Wealth Advisor, Whit shares his uncertainty about the future and mentions that he's thinking about selling his business. Ari shares that she's had a number of clients who've gone through a liquidity event — some highly successful and some less so. The main difference is that those who sold well viewed the sale as a longer-term process, almost as though it were a phase of their business life in the same way that starting, growing and consolidating a business are phases. Indeed, in some ways it's the most important phase because it's the one in which the value of the business can be fully realized.

Ari noted that her clients who had treated the sale as simply a transaction were often the ones with the most regret. Their lack of foresight and preparation created personal and business turmoil that led to decreased company valuations.

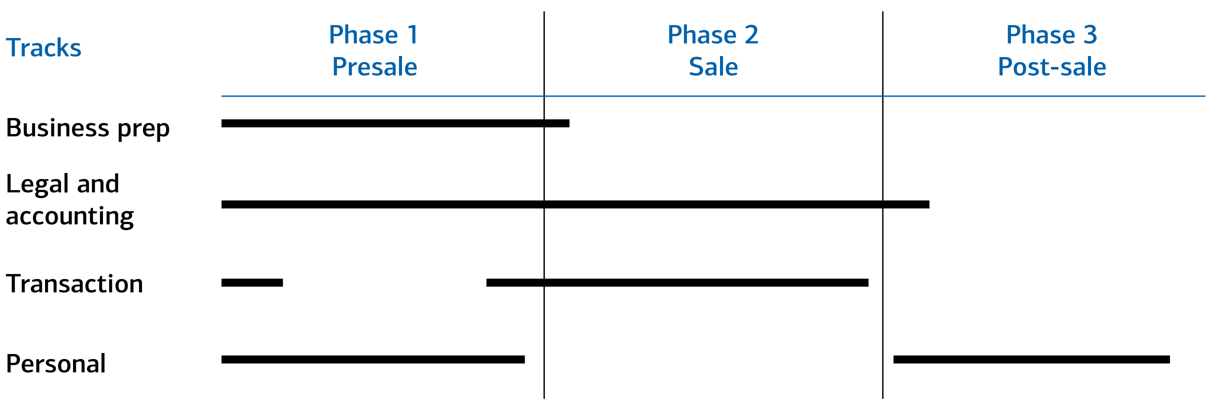
Ari suggests that by thinking ahead, Whit is positioning himself to sell his business on his terms and by his own choice. This will allow him to do the things over time that will maximize the value of his business and leave him in a much better position than someone who has run out of gas, has been defeated by a competitor or is being forced out for various reasons. (For a more complete description of different types of sales and their unique attributes, see the Appendix, page 7.)

Ari offers to give Whit a rundown of what typically transpires during a business sale based on her experience with other clients. Whit accepts the offer, and they arrange a time to go into detail about the exit process.

When they next met, Ari begins to break down what can at first seem like an overwhelming process. Ari tells Whit that she likes to think of selling a business as having three phases: presale, sale and post-sale. Ari draws a diagram that looks like this:

| Phase 1<br>Presale | Phase 2<br>Sale | Phase 3<br>Post-sale |
|---|---|---|
| | | |

Cutting across the three phases are four "tracks," or types of activity: the prepping the business track, the legal and accounting track, the transaction track, and the personal (personal finance and personal development) track.




Each track runs through the entire transaction, but the intensity and amount of activity in each track will change depending on the phase. In the presale phase, the business preparation and personal tracks demand the most attention. During the sale, there's little time for the personal track, and almost all effort is focused on the transaction itself, for example, going to market, soliciting offers, due diligence, and associated accounting and legal components. In the post-sale period, the business prep and legal and accounting tracks have simmered down, and a great deal of focus is typically spent on the personal finance and personal development track. Sometimes these tracks overlap, Ari notes. The process is never as neat as it appears on paper.

This breakdown is already helpful, Whit says but he'd like to know in even more detail what will happen in each phase. While every transaction is different, Ari says she's noticed general patterns in how sellers and buyers think and behave. She suggests they work through the stages one by one.

# The presale phase

This phase involves business valuation, identifying the ideal buyer, anticipating buyer questions, preparing answers and tuning up the business. It's also a time to start developing a vision of life after the sale.

### Business preparation

One of the most challenging aspects of selling a business is coming to terms with the market's valuation of the business, Ari tells Whit. Owners almost always think their business is more valuable than it actually is. This belief, Ari says, typically becomes more uncomfortable during the due diligence process, which is designed to drive down the price of the initial offer. Ari suggests that a conversation with an investment banker in the Bank of America Private Sales Referral Network (PSRN) might help Whit get a sense of the market and how to think realistically about the value of his business.[1]

Next, Whit will need to identify which type of buyer he's targeting and tune up the business to be attractive for the kind of exit he's planning to execute. Selling to employees requires one work flow, selling to a strategic buyer another, and to an equity fund yet another. A good bit of this work will have to do with improving business infrastructure and processes.

A serious potential buyer will have a litany of questions that will need to be answered during a due diligence audit: *Is the right management team in place? What are the vulnerabilities of the supply chain? Are there soft spots in operations?* Buyers will look for points of risk that will allow them to come off their initial offer price, while the owner will try to support the initial valuation by having an answer to every possible question and reducing the risk to the buyer. Whit will have to be able to credibly put his best foot forward and answer each question if he's to maximize the buyout.

Ari suggests that many owners will hire a skilled consultant to guide them through this process of improving the business, targeting a seller and establishing an appropriate value. The consultant should have the experience to understand the type of exit Whit is contemplating and the skills to help Whit anticipate and address issues that might be used to try to drive down the price.

### Legal and accounting audits

The company's books and legal affairs, Ari suggests, will also need to be in order. She relates a story of a client who had a profitable and growing company but was beaten down on price because the financials were in disarray. When the client sold her company, her greatest regret as a businessperson was that she had not kept meticulous books from the beginning. Fortunately, Whit has a great accountant who has been with him for years and always pushes Whit to keep impeccable records. However, Whit isn't as sure about the state of his legal documentation. Ari advises him to consider a legal audit from his attorneys.

### Assembling a deal team

Toward the end of the presale phase, Whit will need to meet with people who can position him well within the market. This is another point where the PSRN could be a tremendous resource, as the team comprises fully vetted investment bankers whose job focuses on helping owners take their company to market. The PSRN would pair Whit with someone who knows his industry to help him make a good deal. If the PSRN isn't the right solution for Whit, Ari can work to help connect Whit with people who can help him. Ari notes that, in many cases, she also works closely with owners' existing legal and accounting professionals to help put together the best deal team.

### Personal issues of finance and planning

The personal track is also the time for Whit to think about his after-sale cash flow. He'll need to determine how much money will be required to retire comfortably, factoring in costs that might currently be absorbed by the company, such as car leases, health care, club memberships and the like. Ari says she's happy to help Whit and Naomi with this. Creating a financial model and road map will help Whit and Naomi know that there will be enough to retire well, and the plan can and likely will evolve as they move closer to the transition.

The most overlooked track is usually the personal development track, Ari tells Whit. And yet, one of the most difficult problems for many business owners is envisioning a meaningful life after giving up control of their company. The company has typically been a core source of the owner's identity and has occupied a massive amount of the owner's available head space.

Most clients who've gone through this process with flying colors engaged coaches to help them think through what life will be like after the sale, Ari advises. Spouses or other family members also frequently have their own identity struggles during this transition, and neglecting their needs for support can have harmful effects on marital and family relationships. Ari notes there's a group within Merrill, the Merrill Center for Family Wealth™, that could help Whit and Naomi start the process of mapping out post-retirement goals and objectives.

Whit should also consider updating any needed estate planning during the presale phase. When left to the last minute, tax savings opportunities are lost. When the time is right, Ari offers to put Whit in touch with one of Merrill's wealth strategists, who can help him plan appropriately.

Ari notes that unexpected challenges will come into play during this presale transition. The important thing for Whit to know is that close collaboration between key advisors will be critical to the success of the transaction. Ari, Whit's lawyer and Whit's accountant are all experienced in this work and can help Whit assemble the right team to optimize the value of his business and help him make the transition financially and personally successful.

# The sale phase

This is the hectic period where all the preparation in the presale phase bears fruit.

When the business is ready to go to market, Ari cautions that things will heat up quickly and Whit may feel like he has two jobs — running the business and running the deal. After the company is listed, offers will be solicited. Once a legitimate offer comes in, due diligence will occur and negotiations will ensue. This flurry of activity is one of the reasons it's so important to take care of financial planning, personal planning, family alignment and estate planning early. Ari has seen too many people who neglected these preliminary matters and regretted it post-sale. This is also the period where being prepared through the business tuneup will pay big dividends. There's nothing pleasant about business owners trying to backfill and scramble to try to retain the highest price they can get for their business, Ari says. Conversely, a thoroughly prepared owner can sit back and confidently oversee the negotiations while holding as many cards as possible. No matter how well prepared, however, Ari warns Whit that this phase will likely be exhausting, and there will be surprises along the way.

# The post-sale phase

After the sale, the business owner and the owner's family make a major transition into a newly created life.

After the sale, life will change dramatically. Whit will find much more time on his hands. What people do in retirement varies greatly. A few simply kick back, play golf, take up hobbies and travel the world. Some have dreamed of becoming a teacher and use this as an opportunity to fulfill that desire. Others become involved in nonprofits and giving back to the community. Still others want to become a mentor to younger business owners. Or they may make investments and even start a new business. Where early in their career they had been looking for investors, some now enjoy being the "money person" in deals. There are lots of avenues for a fulfilling life. Ari says that after a short period of adjustment, almost all business owners she's worked with are glad to be free of what they came to view as the crushing weight of running a business. They feel lighter and liberated.

One often unexpected challenge for a business owner in retirement is understanding the risks of financial markets. Ari says that a large part of her job is understanding the levers and dials for managing these risks, and that she'll help Whit understand how these work. In addition, there are classes and other opportunities, such as the Merrill Wealth Creators Financial Boot Camp, that can help him gain comfort in the complex world of investments and engage with peers in a neutral environment.

As a note of caution, Ari mentions that business owners often hope to spend more time with their family after the sale. However, they find that while they've been running their business, their spouse and children developed their own lives, with their own time commitments, activities and ways of doing things. Ari shares a story where the husband, who no longer had hundreds of people to manage, tried to manage his wife's time and how she was running the household. He quickly found out that this was a suboptimal approach. Wise former business owners recognize the realities of their family's existing pursuits and work with them, not against them.

Finally, Ari says, one of the great opportunities that emerges upon coming into wealth is its benefit to the family. While initially exhilarating, this will also come with complexity. Without careful planning and education, large sums of money could do damage in the lives of heirs. For that reason, it'll be important for Whit to focus on the development of the capacities and capabilities of his family members to secure the promise of the wealth he's created. He notes that the Merrill Center for Family Wealth will help him and his family define the purpose of their wealth and help his children gain the skills and acumen to lay the foundation for managing wealth wisely for generations.

# Afterword

Ari and Whit went on the journey of selling Whit's business together. They worked closely with a team of professionals who helped Whit maximize the value of this business. Whit resisted doing a legal audit, as it was going to be expensive and create delays. In retrospect, he wished he'd invested in the audit, as the buyer was able to negotiate the price down slightly because of some of his contracting practices. Still, Whit was thorough in all other areas of his preparation. He engaged various resources that Ari introduced from Merrill and Bank of America, and also drew upon outside advisors and coaches. Whit feels he put together an excellent, well-qualified team who helped him optimize his business exit.

As he looks back, Whit sees the transaction as the high point of his career and feels as though he won the lottery. At the same time, his new life is filled with challenges and opportunities he never dreamed possible. He's sought out by younger business owners who want his advice, and he's serving in nonprofits that are giving at-risk youth a real shot at long-term success. Whit has also focused on leadership in his own family — he's seeking to use the wealth to do wonderful things in the lives of his children and grandchildren. He and Naomi also spend time traveling. Naomi is grateful that Whit got out from under the pressures of running his company and is thrilled that, together, they built a new life that satisfies them both. They joke that life didn't slow down for them as they thought it would, but that it's more rewarding without, what looks to be in retrospect, the overwhelming responsibility of running a business. Whit has no regrets.

# Conclusion

The process of business transition is obviously more complex and involved than what this scenario describes. That said, the framework it sets forth has been helpful to many as they worked through the inevitable twists and turns of successfully selling a thriving business. Your Merrill Private Wealth Advisor — together with your team of other trusted advisors — can help to surround you with the right people, at the right time, in the right way, to get the right results. Your process will not be Whit's, but, hopefully, his story has given you some insights into your own possible future.

If you have questions or would like to start a conversation, please contact your Private Wealth Advisor.

# Appendix

### Five types of exit

While this is not an exhaustive list of the reasons people sell their business, these are the most common scenarios we see. Each of these situations involves different timelines and different workflows. The Merrill Center for Family Wealth is familiar with all of these and has designed processes (together with our advisor teams) to address the concerns in each scenario and to tailor these approaches to fit the specifics of each.

#### New horizons

The owner is electing to leave the business to enjoy retirement, pursue other opportunities or to establish another business.

| | |
|---|---|
| **Timeline** | Relaxed |
| **Key needs** | • Relaxed time frame allows for the owner to embark on value-development work to improve the quality of the company and related third-party valuation<br>• Owner must calibrate personal and professional risk tolerance to embark on a new venture<br>• All exit alternatives are ostensibly in play depending on the owner's exit-decision criteria<br>• Carefully orchestrated communications are needed to prevent unplanned employee or customer attrition |

#### Too good to pass

The owner receives offers in a "hot" market that reflect high to exceptional valuations and sells due to concern that these favorable conditions are either unique or won't recur within an acceptable time frame.

| | |
|---|---|
| **Timeline** | Pressed |
| **Key needs** | • Owner assesses the condition of the company to embark on a prescribed transition timetable and receives counsel as to the best exit options<br>• Company communication quality is at a premium<br>• Mobilize company resources under a change-management rubric to efficiently manage through the effect of the owner's decision<br>• Methodological, yet truncated, value-development plan is established and followed to completion<br>• Owner exits the company on prescribed terms |

| Can't keep up<br>The business is floundering due to poor leadership, untoward market conditions, internal and external disruption, and imploding business culture. | |
|---|---|
| **Timeline** | Urgent |
| **Key needs** | • Owner assesses the condition of the company to embark on an accelerated transition timetable and receives counsel as to the best exit options<br>• Company leadership will be tested for competency to prevent unwanted employee and/or customer attrition<br>• Time is of the essence, requiring company leadership to mobilize company resources under a potentially rapid change-management rubric to efficiently manage through the effect of the owner's decision |

| Out of gas<br>The owner is tired or burned out and cannot muster the personal energy required to keep the business competitive. | |
|---|---|
| **Timeline** | Critical |
| **Key needs** | • Understand the best exit options immediately available<br>• Mitigate negative business effects of the sale as it goes public<br>• Gain support through lifestyle and/or executive coaching<br>• Create rapid response change-management process |

| Force out<br>The owner is forced out due to personal or business reasons such as health, litigation or economic downturn. | |
|---|---|
| **Timeline** | Imminent |
| **Key needs** | • Institute support systems for personal issues<br>• Put a communication strategy in place for stakeholder groups<br>• Initiate a legal salvage operation to preserve as much value as possible<br>• Install replacement management for short turnaround or transition<br>• Use a conflict-management approach to mitigate disruption |

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[1] Samuel Whitaker is a fictional person based on a composite of clients with whom we have worked. Facts in this case are hypothetical and designed to be as realistic and comprehensive as possible.

[2] The Bank of America Private Sales Referral Network provides initial consultation and education with business owners to help them gauge what is possible for their business and give them a clearer sense of how their business would be viewed and priced by potential buyers. This is a no-obligation service for Bank of America and Merrill clients.

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