Why Is Exit Planning So Difficult?

For private company owners who have built significant value in their businesses, preparing an exit plan seems like an obvious step that most would be eager to take. Yet, this seldom happens. Although comprehensive statistics are not available, many practitioners who deal with private company owners would conclude that relatively few achieve their major goals in exiting their company.

To appreciate the odds against a successful exit, consider first *external* market challenges. M&A advisors disqualify roughly 65 to 75 percent of prospective sellers and, according to a U.S. Chamber of Commerce Study, only 20 percent of the businesses that are for sale will successfully transfer hands to another owner. This implies that only 5 to 7 percent of companies actually get sold!

Although less commonly recognized, *internal* company and owner circumstances commonly create even larger impediments to a successful exit. Owners frequently are conflicted over issues and goals surrounding their exit. Beyond a sale of their company, they seldom recognize the range of exit options from which they have to choose. And just because an owner wants to make a change does not mean he or the company is immediately ready to successfully execute that change.

Clearly, the answer to why exit planning is so difficult begins with the realization that the exit decision is usually highly complex, and this challenge is made even more difficult because most owners and their advisors see this decision as primarily financial. The decision about whether or not to exit a company, and if so how, typically involves four distinct but related considerations. Each may require careful planning and present obstacles to achieving the owner's desired result. In addition, as needs and goals are identified, some likely will conflict with others causing owners to have to compromise. As the years pass, an owner's life circumstances, and thus his needs and goals, change. In the meantime, business conditions change as well. So, what may be a sound plan in one year under one set of circumstances may prove unworkable at a different time. When a company has multiple owners, these variables often multiply, making identification of a strategy that fits everyone's needs even more difficult.

Sound planning clearly begins with recognition of the primary issues involved so that owners can identify their needs and goals and set priorities in accordance with them. The issues owners must address in planning to exit include:

- **Strategic Business Issues.** The conditions of a company will clearly affect its value, its relative level of attractiveness to other potential owners and what the company needs to succeed going forward. Many companies may need several years of pre-exit preparation to enable any sort of exit to be feasible. The size of the company, its dependence on key executives or customers and general economic and industry conditions all can have a major impact on exit strategy and timing.

  So the first component of the owner's exit decision centers on strategic assessment of the company and what must be done to it to enable successful transition. For some owners, this assessment is particularly difficult because it requires an evaluation of their leadership and performance, identification of any shortcomings or gaps in their skill set and management team and consideration of how the company they are accustomed to leading must change.

- **Financial Issues.** For many if not most owners, an exit can have a major effect on their wealth, annual income or cash flow, the riskiness of their overall portfolio of investments and the liquidity of their investments. The exit plan may involve the owner leaving the company and having no continuing stream of income from it, or staying with the company in some capacity with a commensurate level of compensation and benefits continuing from the business.

Before an exit, many private company owners have much or virtually all of their wealth concentrated in their single private company investment. Depending on the magnitude of that wealth, the other investments the owner may have and the owner's age, this may constitute anything from a sound to a highly risky investment strategy. Also, depending on the owner's age, lifestyle, standard of living, and tolerance for risk, the exit plan he chooses may entail making major or minor changes in his income and overall financial security.

Private company exit plans frequently involve transaction structures that include contingent compensation in future years or assumption of buyer debt. These decisions can also have a material effect on the owner's income and risk profile. Just ask any owner who sold a company in a transaction that involved an earnout that was not achieved or an owner who financed the sale of his business to a buyer and several years later had to foreclose on the loan and assume control of what had by then become a crippled company.

- **Professional or Career Issues.** Many private company owners struggle to distinguish between their ownership or *investment* in their company and their *employment* in their company. As the owner considers exit planning, he may choose to end his employment in the company, but continue in some capacity as an owner, or end his ownership in the company, but continue in some capacity as an employee.

For many owners, building their company was one of the major events in their life and their involvement in it may be something they want to continue. An owner may consider a change in duties or responsibilities, but his desire to work may actually be the most important priority in his overall exit plan. Consequently, assessment of an owner's professional goals and objectives is a critical step in the exit process. In doing so, he must assess what kind of work he wants to do and not do, how much he wants to work, and for approximately how long he intends to work. In addition, he must assess whether he can and wants to work with or for others and the compensation he would require for whatever level of work he does.

It is easy for some owners to underestimate the importance of their work and what work matters most to them. For example, some owners want to shed administrative duties or the responsibility of "being the boss," while others may want most to remain in control. Making these decisions often requires significant introspection and perhaps recognition by an owner that he is no longer able to perform certain roles in the company.

- **Personal Issues.** In addition to strategic, financial, and professional concerns, private company owners commonly have personal issues that have a substantial bearing on their exit decision. Some of these relate to their individual circumstances, while others involve people who are important to them.

On an individual basis, the decision to exit a company may be driven by the owner's age or health, interests he has outside of the company, his personal stature and identity that he sees coming from his position with the company and the long-term legacy of the company itself. For the owner who has put much of his life effort into building a business, he will identify with it and may experience a significant sense of loss in any type of exit from the company. Thus, he needs to explore these personal issues to identify what is most important to him to ensure that his exit plan includes accommodating these needs.

Private company owners frequently have other people in their life – most commonly family members, employees or fellow owners – whose circumstances (e.g., income and financial security) would be materially impacted by an exit decision. Some might lose their job or see their employment status and compensation change dramatically if an exit occurs. Depending on the way the exit is structured, other people's status as owners of the company could change and they could view these changes as either a positive or a negative. So the private company owner must identify those stakeholders who are of most concern, assess how the various exit choices would affect them, and then weigh this against his various other priorities.

Once these four issues in the exit decision – strategic, financial, professional, and personal – are identified, they must be prioritized. That is, the owner needs to identify his most important financial and non-financial needs and goals related to his exit decisions. While some of his goals may make sound financial sense, others may not. For many owners, a successful exit decision cannot be measured strictly in dollars and cents. As addressed later in this chapter in step 2 of the six-step exit planning process, owner readiness is defined in terms of *both* financial *and* mental readiness. Some of the owner's goals may reduce his income or wealth, but give him peace of mind. This is clearly how the decision about a private company investment differs so much from the typical decision to sell public company stock. While the former is most commonly an intensely personal decision, the latter is purely financial.

Identifying a sound exit plan that accommodates these four issues is a major challenge for individuals who own 100 percent of their company. When a private company has multiple owners, each will have his own needs and goals, and when owners have differences in age, wealth, liquidity, appetite for risk, desire to work and standard of living, deriving an exit plan that meets their mutual needs can be a significant challenge.

The lesson here is that exit planning is essential for sound private company owner decisions because these decisions entail an unusually complex combination of strategic, financial, professional, and personal issues. There is a distinct advantage to recognizing these issues and establishing priorities well in advance of any intended exit date. Particularly when there are multiple owners involved, the added time should enable the greatest flexibility to accommodate conflicting needs and goals.

For guidance to help owners identify and prioritize their private company financial and non-financial goals, visit www.evansandassociates.net to obtain a complimentary copy of the Private Company Owner Assessment. It is a great first step to take in the exit planning process.