THE EXIT PLANNING REVIEW™

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# Exit Planning Pays Long-Term Dividends

When we talk to business owners about the value of Exit Planning, we are talking about orchestrating a business exit that fulfills their unique financial and personal goals. Since tackling a task of this magnitude can be daunting, owners sometimes ask whether devoting the necessary time and money to this project is really worthwhile.

To answer that question, we've asked Kevin Short, an investment banker who works every day with owners of small and mid-sized companies, about the value of Exit Planning.

"Good exit planning can be the difference between a successful closing and a complete derailment of the sale process," says Short.

When asked to explain, Short focuses on Steps 1, 2 and 3. "When an owner sets his objectives in an Exit Planning context (Step 1), he or she does so methodically and proactively. Owners who wait until entering the M&A arena to decide how much cash they want and need from their companies do so reactively and often are blinded by attractive bait held out by less-than scrupulous buyers."

In Step 2 of the Exit Planning Process, owners and their advisors place a value on the owner's company. "When an owner's first valuation experience happens in my office, and that owner is primed and ready to sell last Friday, learning that the company is not worth what he or she had hoped is a painful experience. Even more painful is the subsequent rededication of effort to building the value of the company."

In Short's opinion, "The element of Exit Planning that gives an owner the biggest bang for the buck is, without a doubt, Step 3 of The Exit Planning Process (Build and Preserve Value)."

One technique that exit planners use to motivate managers to remain with a company post-closing (a vital Value Driver) is the Stay Bonus. An effective Stay Bonus accomplishes three tasks: 1) it gives the key managers a reason to stay; 2) it is structured so that it increases the value of the company, and 3) it includes a penalty (usually in the form of a covenant not to compete) that prevents key managers from taking key clients, vendors or trade secrets with them should they leave before or after the sale.

Short can rattle off far too many horror stories about owners who, believing that their loyal employees were happy and already well compensated, were held hostage by those same employees.

In one, Kevin describes an owner who was a week away from the sale of his company for $10 million. "At this very late stage of the game, the buyer met with each of the key managers to reassure them that they'd be retained by the new owners at their existing compensation levels. At its meeting with my client's top salesperson, it was lavish in its praise about her performance and about how important her continued success was to the company's future success. When the buyer asked her to sign a covenant not to compete before the closing date, the salesperson asked for a break and headed straight for my client's office. She proceeded to remind my client that she'd helped build the company to its current value during her tenure, and ever-so-generously consented to wait until the closing date to collect her $1 million bonus."

"My client paid the ransom. He understood that if the salesperson servicing his top four clients left the company, the buyer would likely scrap the deal. If the buyer did come to the closing table, it would reduce its purchase offer

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by far more than $1 million."

As a result of this and many similar experiences, "We recommend that owners get very aggressive implementing Stay Bonuses with anyone who has a significant impact on a company's performance." Short elaborates, "The Stay Bonus should apply to anyone—and that might be the janitor—whose cousin is your biggest client—who has leverage against the company." And, of course, tie the stay bonus to a covenant not to compete (or similar agreement), first checking with your attorney about how to best create enforceable agreements.

In Step 3, advisors also work with owners to protect business value. One method is to clean up shareholder agreements (again, well in advance of any contemplated sale or transfer). "If a shareholder agreement does not force a minority shareholder to sell when the majority shareholder does, majority owners can (and often do) find themselves unable to sell, or held hostage by minority shareholders."

"By and large," adds Short, "entrepreneurs ignore both Stay Bonus Plans and shareholder agreements because they believe that other shareholders or employees will 'come along' on closing day." Short observes, "What owners forget is that every shareholder and every employee figures out leverage and most intend to use it."

From these and many other examples from his practice, Short believes that Exit Planning is indeed well worth the time and money owners devote to it. If you'd like to learn how exit planning might save you time and money, please contact us.

*Subsequent issues of The Exit Planning Review™ provide balanced and advertising-free information about all aspects of Exit Planning. We have newsletter articles and detailed White Papers related to this and other Exit Planning topics. If you have any questions or want additional Exit Planning information, please contact us.*