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7. Exit Strategies

Student edition

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Introduction

The issue of selling a business, often referred to as 'harvesting the venture', is one that many entrepreneurs consider at some point in their career. Some entrepreneurs constantly buy and sell businesses in order to make a profit along the way. Others will manage the venture for a long time and then sell their stake in the organisation in order to profit from their years of hard work and effort.

The way in which you exit the business can affect many things such as the value you and other shareholders realise from it, as well as the future success of its products or services. Therefore it is important to think seriously about how you intend to leave. A well-planned exit strategy allows potential investors to clearly understand how you intend to withdraw from the business. Moreover, it will help to define how the company will be marketed to potential buyers or investors, it will ensure that you get the most value out of your company and it will ensure you can end your involvement with the minimum amount of disruption to the business.

This unit discusses some of the factors that affect an entrepreneur's decision to exit the business, as well as some of the exit strategy options available.. When the entrepreneur decides to exit or sell the venture, it is important that all structures and systems in the business are in control. This unit provides useful tips to help with this process. The unit then examines the key stages in the selling process and concludes with a brief discussion and practical tips on effective negotiation strategies.

Learning objectives

When you have successfully completed this unit you will be able to:

- Determine the motivating factors that affect an entrepreneur's decision to exit the venture
- Identify various options available to dispose of the business
- Discuss common factors that affect the disposal process
- Examine the stages in the selling process
- Provide some useful insights on negotiation techniques

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1. Reasons for Exiting the Business

Liquidation of ownership in your business is a very personal decision, and it seems that there is no right or wrong way to exit a business. Clearly there are many reasons why entrepreneurs wish to sell their businesses.

Kaplan and Warren (2007) have undertaken some research in this area and they present personal and business reason for selling. These include:

Personal reasons for leaving the business

- You wish to cash in your chips
- Investors put pressure on you to sell
- Disagreements between you and your team and/or investors
- You receive an attractive unsolicited offer
- You are suffering from exhaustion and are burnt out
- A personal event occurs or you suffer from poor health

Business reasons for leaving the business

- The business requires significant capital for growth
- New competition enters the market
- The market has limited opportunity
- The business is not performing well enough to survive
- The future looks bleak

Many commentators assert that it is not a matter of whether you will sell, or otherwise dispose of, your interest in this business. Your only decisions are when and how this will be done. So, with this in mind, it is important to determine when the right time to exit the venture is. It may be time to think about selling your business when you are losing sleep (or your hair) or because you become conscious of one or more of the following factors:

- Your business is a very valuable asset
- All of your assets are invested in the company
- Some power outside your control (i.e. competitor, government, etc.) could take that away from you.

2. Exit Strategies

It is important to note that your exit strategy will impact many decisions that you make in growing your business. Having an exit strategy in place from the outset will help to create the business model that aligns with your chosen exit option. This will help to maximise the value you get from it.

A well-defined exit strategy can also act as a guide for the appointment of successors in the business. This will ultimately allow you to exit the business at a time of your choosing.

It is always a good idea to plan your exit strategy early so that you do not limit your options in the future.

It is also important that your partners, colleagues and investors agree with it.

Choosing the right exit strategy is a big decision and generally one that is difficult to make. Some of the options available to you include:

Management buyout
The founder can sell the company to existing partners or other key manager s in the business.

Selling to employees
Employee ownership can take several forms such as employee stock ownership plans (ESOPs) which are managed like a pension plan with all company contributions used to buy company stock. Employees can also be given other forms of equity, such as stock options, stock purchase plans and performance based stock bonuses. These plans generally allow the founder to maintain control of the company while his or her shares are diluted by those shares made available to the employees.

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Merger
A merger is where two organisations combine resources to form one larger organisation. It is often used to expand operations in an attempt to increase long-term profitability.

Acquisition
An acquisition, also known as a takeover, is where one company buys another. It usually refers to a purchase of a smaller firm by a larger one. An acquisition may be friendly (i.e. there is consensus between the companies and they cooperate in the negotiation process) or hostile (there is no consensus and the target company is unwilling to be bought).

Outright sale
This is where the founders sells the company to another. It is often seen as the ideal route for an entrepreneur to take as they receive cash in hand for the company.

Public offering
Public offering is the sale of stock by a private company to the public. They are often issued by smaller, younger companies who seek capital to expand, but they can also be done by large privately-owned companies seeking to become publicly traded.

Passing control to your family
Transferring the ownership of a business to your heirs is another common option that should be considered. However, it may not be a feasible option for high-tech entrepreneurs, because such products may have limited life-spans.

3. Factors that Affect the Disposal Process

There are common factors which affect the disposal process and ultimately impact on the potential return to the seller. You should identify the key drivers that make your business attractive to potential purchasers and you will need to focus your energy on ensuring that these are maximised prior to the sale.

n example of this could be where a business generates recurring income on an annual basis. The income should be attractive to potential acquirers, so the vendor should ensure that the basis for the recurring income is documented and, if possible, is the subject of a long-term contract, thus ensuring the income stream for a reasonable period. Other examples of good practice include:

Maximise profitability
Quite often an owner managed business will carry unnecessary costs purely as a matter of convenience to the owners. In addition, a business may generate various sources of wealth for the owners, which understate the underlying profitability of the operation. If your business can generate higher profits by eliminating unnecessary costs, then this should be done. A potential purchaser will not pay for ‘potential’ that you say can be achieved, but only for what you have achieved.

Resolve all problems
Potential purchasers prefer to buy cleanly run, efficient companies. If you have contentious issues attaching to your business, make every effort to get these resolved prior to entry into the disposal process. If there are contingent issues such as industrial relations disputes or potential legal actions attaching to your business, buyers will generally take a worst case scenario view and discount the potential price accordingly.

Streamline all procedures
It is likely that any potential purchaser will want to carry out a level of due diligence on your business. The cleaner and clearer your records are, the easier that process becomes. This in turn will facilitate a smooth and quick transaction. It is important that the information underlying the profits generated is clear, concise and easily accessible. It is also important that your balance sheet is clean and all major control accounts are reconciled.

Keep your eye on the ball
The disposal process can become a long and drawn-out process. It often happens that the business owner’s attention to the business wanes while the owner gets caught up in the negotiation process. This can lead to a renegotiation on price at a later stage if there is a reduction in performance.

4. The Selling Process

There are many factors that affect the selling process. These include preparing prudently for the business sale, maximising the price obtained for the business and arriving at a suitable sale mechanism that meets both the vendor's and purchaser's obligations.

The selling process is illustrated in figure 1.

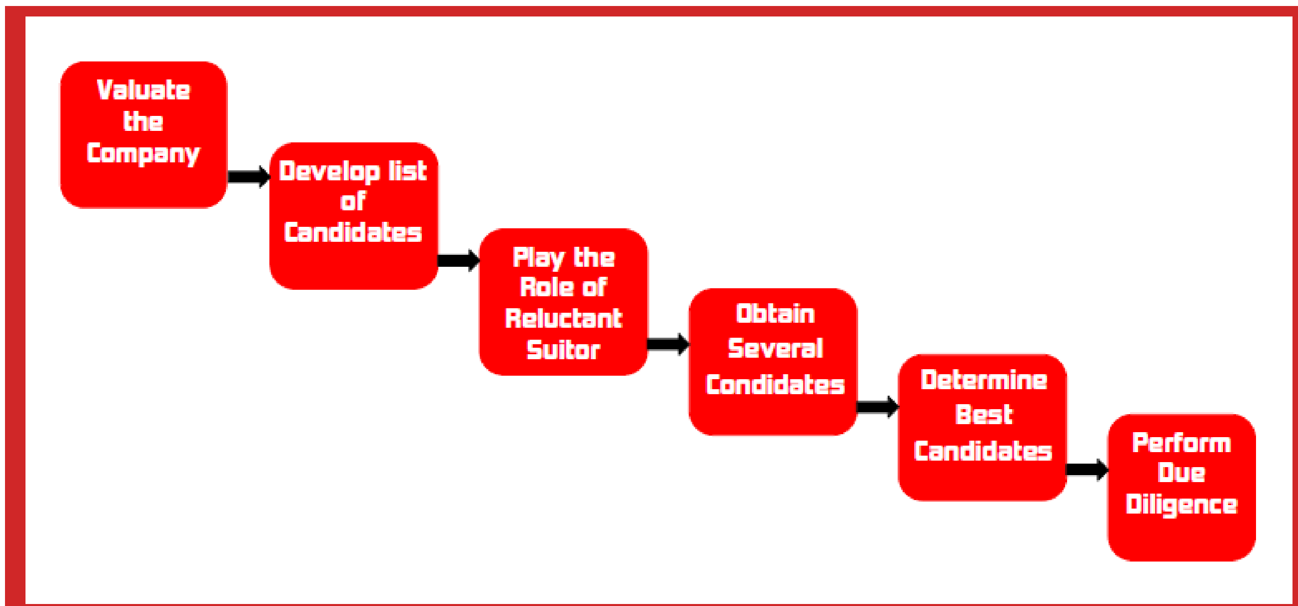

Figure 1: The selling process

The table on the next page discusses the six steps of the selling process in more detail.

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1	**Determine the company's valuation** • The valuation may be based on financial evaluation. If so, you should have all profit and loss, cash flow and balance sheet statements up to date. • The valuation may be based on strategic market value. Therefore you should have all appropriate figures prepared. These may include actual and projected accounts, actual and projected product sales
2	**Develop a list of candidates** • Consider a group of strategic buyers. These may include competitors, related businesses, manufacturers of related products, companies with announced acquisition plans • Consider a group of financial buyers. These may include management or employees, related businesses, high net worth individuals
3	**Try to play the role of a 'reluctant suitor'** • Have others (i.e. investment bankers, consultants, brokers, etc.) make initial contacts with potential buyers
4	**Obtain more than one serious candidate** • Use competitive negotiation strategies • Let all candidates know others are interested • Negotiate an equitable sales price and related issues
5	**Determine best candidates** • Determine the criteria for assessment • Develop a letter of intent
6	**Carry out due diligence** • It may take some time (15 to 60 days) • Negotiate a definitive agreement of sale • Close the sale

Table1: Six steps of the selling process (Cormican 2008)

It is important to note that the average time from beginning the selling process to closing the sale is around one year — so be patient!

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5. Negotiation Strategies

Negotiation can be defined as a discussion between two or more parties who are trying to work out a solution to a problem.

When you negotiate, you try to use your influence to get a better deal, rather than simply taking what the other side will voluntarily give you. You should always seek to agree rather than fight openly, give in, or break off contact. When you negotiate, you should expect some give and take.

There have been numerous articles, books and guidelines written on the topic of negotiation strategies and techniques. Harvey Mackay is a business coach and motivational speaker who has synthesised many of the best practices in this area. He provides some very practical tips that should be considered when engaging in this process. These strategies and tips are listed on table 2

TIP 1	Never accept any proposal immediately, no matter how good it sounds.
TIP 2	Never negotiate with yourself. Once you've made an offer, if the other party doesn't accept it, don't make another offer. Get a counter offer. It's a sign of weakness when you lower your own demands without getting your opponent to lower theirs.
TIP 3	Never cut a deal with someone who has to 'go back and get the boss's approval.' That gives the other side two bites of the apple to your one. They can take any deal you are willing to make and renegotiate it.
TIP 4	If you can't say yes, it's no. Just because a deal can be done, doesn't mean it should be done. No one ever went broke saying 'no' too often.

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TIP 5	Just because it may look nonnegotiable, doesn't mean it is. Take that beautifully printed 'standard contract' you've just been handed. Many a smart negotiator has been able to name a term and get away with it by making it appear to be chiseled in granite, when they will deal if their bluff is called.
TIP 6	Do your homework before you deal. Learn as much as you can about the other side. Instincts are no match for information.
TIP 7	Rehearse. Practice. Get someone to play the other side. Then switch roles. Instincts are no match for preparation.
TIP 8	Beware the late dealer. Feigning indifference or casually disregarding timetables is often just a negotiator's way of trying to make you believe he/she doesn't care if you make the deal or not.
TIP 9	Be nice, but if you can't be nice, go away and let someone else do the deal. You'll blow it.
TIP 10	A deal can always be made when both parties see their own benefit in making it.
TIP 11	A dream is a bargain no matter what you pay for it. Set the scene. Tell the tale. Generate excitement. Help the other side visualize the benefits, and they'll sell themselves.
TIP 12	Watch the game films. Top players in any game, including negotiating, debrief themselves immediately after every major session. They always keep a book on themselves and the other side.
TIP 13	No one is going to show you their whole card. You have to figure out what they really want. Clue: Since the given reason is never the real reason, you can eliminate the given reason.
TIP 14	Always let the other side talk first. Their first offer could surprise you and be better than you ever expected.

Table 2: Harvey Mackay's Negotiation strategies (Mackay 1996)

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Review

An exit strategy has become an almost *de facto* consideration in business plans as it allows potential investors to clearly understand how you ultimately intend to withdraw from the business, and outlines the stages and targets you envisage for achieving this.

This unit focused on some of these issues. It began by identifying some of the factors that stimulate an entrepreneur's decision to exit or leave the venture. It examined some disposal options that should be considered and discussed various factors that affect the disposal process. The unit also highlighted the stages in the selling process and provided some useful insights on negotiation techniques to help optimise the return to the seller.

Self-Assessment Questions

1. What are the motivating factors that affect an entrepreneur's decision to exit the venture?
2. Identify various options available to an entrepreneur to dispose of the business.
3. List some factors that affect the disposal process.
4. What are the key stages in the selling process?
5. Identify some good practices that may help to negotiate a deal.

References

Kaplan, J.M. and Warren, A.C. (2007) *Patterns of Entrepreneurship*, 2nd ed., Wiley.

Mackay, H. (1996) *Swim with the Sharks Without Being Eaten Alive: Outsell, Outmanage, Outmotivate, and Outnegotiate your Competition*, Ballantine Books.