



The Great Escape: Developing an Exit Strategy

By Thomas E. Houck

There's a common question on the minds of entrepreneurs when they think about retirement: "How can I eventually get out of my business and not lose my shirt?" The answer is simple: develop an exit strategy a few years before your desired retirement, and simply execute it.



Take the case of Chuck, a 65-year-old-going-on-21 life-of-the-party type of guy. He always sported a big smile and joked with everyone. But he was plagued by a gnawing question: "In 10 years, I want to exit my business, take care of my employees, have enough money to live out my retirement

dreams, and guarantee that my daughter inherits everything if something happens to me. Some people may want to get every dime they can when they sell, but these are the most important things to me. How do I pull this off?"

Chuck had been an entrepreneur all his life, and had started his current business from scratch 20 years prior. Due to his insatiable appetite for improvement, his business blossomed into one of the largest in southeast Florida.

Chuck felt a great deal of loyalty to his employees, and wanted to develop a plan to sell the business to his General Manager, Carlos. Since Carlos was a young guy with a family, he didn't have many financial assets. Chuck needed to develop a plan that would make the buyout process affordable for Carlos, while simultaneously assuring that his daughter would get a fair value if anything happened to him.

To develop a quality exit strategy, business owners like Chuck need to follow these important steps:

Step One: Create a financial plan.

Chuck first decided how much income he would need after retirement to fulfill his dreams. This determined how much money he would need in his retirement savings and from the sale of the business when he retires.

Step Two: Maximize retirement savings now.

Chuck consulted with his financial advisors and developed a comprehensive financial plan. A thorough analysis revealed that Chuck needed to put \$5,000 per month into a retirement

savings plan. Since IRAs and 401(k)s allow limited funding, a defined benefit pension plan was a good choice for him. This type of plan is ideal for an older owner with younger employees. The plan he chose allowed Chuck to put \$60,000 a year into savings, all of which was tax deductible. The tax savings alone helped fund a portion of the plan. A true win-win!

Step 3: Determine the company's worth.

Chuck didn't want the expense of hiring a valuation analyst to compute his company's worth. To come up with an approximate value, Chuck and his financial advisors estimated the net amount of money Chuck's business earned the previous year. A good rule of thumb is that a company is worth about three to five times that value.

Step 4: Establish a strategy to transfer the business to the buyer.

Because Carlos didn't have much money or assets, he wasn't going to be able to simply go to the bank and get a loan to pay for the business. Instead, Chuck and his advisers created annual performance incentives for the company. If the business earnings at the end of each year met certain requirements, Carlos, as General Manager, would receive 5 percent of the company in stock at the end of each year, until he reached 49 percent ownership after 10 years. At that point, Carlos would be a 49 percent owner with a 10-year track record, and a bank would likely be willing to loan him half of the business' value to complete the buyout of Chuck's interest.

Step 5: Get it in writing.

After establishing a strategy, Chuck sat down with an attorney and get it all in writing. Since his advisors had done most of the legwork already, they were able to tell the attorney exactly what was needed, which saved a considerable sum in legal fees. The attorney drafted a stock purchase agreement for Chuck and Carlos. The agreement



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laid out the performance incentives, where the stock would be held, stipulated that the shares would be non voting, and required Carlos to buy Chuck out at the end of the 10-year period. The attorney also created a trust, which laid out the transfer of Chuck's assets to his daughter, in case he died.

This type of buyout strategy is useful when an owner wants to sell to an employee or family member. The key element that allows these plans to succeed is *time*. The more time the business owner plans for the exit of his business, the greater his chance of success. If Chuck simply woke up one day and said, "I can't take it anymore," there's no way that Carlos could buy him out. Everyone knows a business owner who's had health problems or unexpectedly passed away, causing the business and all its value to go down the tubes. This could have been avoided in almost every case by taking the time to create an exit plan.



Another key element in making your exit strategy succeed is to work with advisors who have extensive experience with this type of planning. Many good CPAs and attorneys don't fall into this category, but they're smart enough to bring in an outside

advisor who does. Also, it's important that the advisors work as a team so that everyone is on the same page and working toward the business owner's goals.

Chuck's plan was enacted five years ago, and all has gone exactly as planned. Chuck's still the life of the party, and loves seeing his vision turned into reality. Financial peace of mind hasn't changed him one bit — when his friends get together, they all smile, shake their heads, and marvel at the character everyone knows as Chuck.

About the Author

Thomas E. Houck, CPA, CFP®, is a speaker, author, and consultant whose program, "Your CFO Advantage™" has helped numerous business owners grow their businesses, reduce their taxes, and lower their stress level. His book, *The Top 10 Mistakes Business Owners Make (and How to Fix Them)*, helps business owners develop strategies to lead a better life by running a better business. For more information, you can visit Tom's website at www.heritagebusinesssolutions.com.

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