B.A. BOSS S.L.

A step-by-step approach to

Exit Planning

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B.A. Boss provides Exit Planning information and education to business owners in a number of countries and in Spain in particular.

- Do you sometimes wonder how your business would survive without you?
- Do you find yourself thinking about –how to– getting out of your business?
- Are you wondering how to groom a successor?
- Is passing your company on to your children becoming increasingly unlikely?
- Are you getting tired of fighting the alligators and want a different challenge?
- Does the whole succession idea seem overwhelming?

If you can answer yes to any of these questions, it is time for you to create an Exit Plan. If you don't know how to get started, you are not alone. Few, if any, business owners know how to leave their businesses in style. Leaving in style means leaving your business to the successor you choose, for the price you want at a time you pick. An Exit Plan makes all of this possible.

How do you get started?

Exit Planning: Overview

We like to compare leaving your business successfully to winning a car race. All race plans include careful preparation of the car, driver skill and experience, crew skill and a well-conceived race strategy. Business owners win their ultimate race when they leave their companies on their terms and on their schedules. The process owners use to achieve this victory is known as Exit Planning. In short, Exit Planning is the deliberate, adaptable, and customized process that a business owners use so that they can leave their businesses on their own terms and schedule.

A complete Exit Plan rests on a step-by-step exit planning process. These steps are illustrated in seven simple questions:

1. Do you know your exact retirement goals and what it will take — in cash — to reach them?
2. Do you know how much your business is worth today, in cash?
3. Do you know the best way to maximize the income stream generated by your ownership interest?
4. Do you know how to sell your business to a third party and pay the least possible taxes?
5. Do you know how to transfer your business to family members, co-owners, or employees while paying the least possible taxes and enjoying maximum financial security?
6. Do you have a continuity plan for your business if the unexpected happens to you?
7. Does your family have financial security if the unexpected happens to you?

The Step-by-Step Exit Planning Process:

1. Establishing Owner Objectives
2. Establishing Business Value
3. Building Value and Cash Flow
4. Selling to a Third Party for Top Dollar
5. Transferring to Management or Family Members

6. Developing a Contingency Plan for the Business
7. Family Wealth Preservation Planning

The Bottom Line

Owners face a number of barriers to a successful exit from their businesses:

- Most owners don't know that there is a proven Exit Planning Process.
- Most business advisors are unaware of all that can be done to assist them as they begin to plan for their business exits.
- Without a plan, exiting your business can appear daunting and, as a result, owners wait until it is too late to undertake it.
- What can you do to get started?

The Step-by-Step Exit Planning Process

There are many tools available to help individuals get into business, but few that help them get out. The Exit Planning Process is a customized comprehensive approach to designing and implementing a business owner's successful exit from his or her business. Exit Planning uses an owner's unique personal objectives to convert his or her current reality into the desired outcome. The Exit Planning Process helps maximize the financial return, minimize tax liability, plan for contingencies and increase the likelihood of a successful transfer of the business.

Step 1 *- Owner Objectives*
Each business owner's unique objectives drive the creation of his or her Exit Plan. Step One articulates and tests owner objectives so that the comprehensive Exit Plan focuses on achieving those goals. Key exit objectives that will be identified as part of the Exit Planning Process include: (1) the owner's desired departure date, (2) the value that the owner wants or needs from the business, and (3) the individuals or entities to whom the owner wants to sell/transfer the business.

Step 2 *- Business and Personal Financial Resources*
Step Two determines what owners have — how much the business is worth and how much cash flow the business can generate for Exit Planning. The current value and projected cash flow, along with other non-business assets and income, are used to determine the paths and planning tools available to reach the owner's objectives.

Step 3 *- Maximizing and Protecting Business Value*
The elements that build the value of a business or protect the value the owner has worked so hard to create are called Value Drivers. In Step Three, owners and their advisors identify which Value Drivers are important to meeting the owner's overall exit objectives and devise specific steps to maximize the impact of the Value Drivers.

Step 4 *- Ownership Transfers to Third Parties*
During Step Four, owners who want to sell their business to a third party will work with their advisors to identify ways to do so in the manner that results in the most beneficial sale price and terms. Not all business owners go through Step Four — those who don't either retain their ownership long-term or skip to Step Five.

Step 5 *- Ownership Transfers to Insiders*
Step Five includes a detailed plan to transfer the business to insiders (children, key employees or co-owners). Careful planning in Step Five allows the owner both to receive the desired value from the business and minimize risk, while using the resources of the business should the purchaser have little or no personal capital.

Step 6 *- Business Continuity*
Step Six prepares the owner for the contingencies that affect the business and its owners. A complete Exit Plan incorporates potential changes, such as death or permanent disability of an owner so that the owner's objectives can still be achieved if circumstances change.

Step 7 *- Personal Wealth and Estate Planning*
The sale of a business generates cash for owners, their families and the IRS. During Step Seven, owners and their advisors create a plan that not only preserves wealth, but minimizes taxes using both lifetime and estate planning tools.

Components of the step-by-step Exit Planning process

The step-by-step Exit Planning process is comprehensive enough to address all of the key elements required to create a successful Exit Plan, and flexible enough to work with each business owner's planning style. Although some business owners prefer to develop their Exit Plan as part of one multi-facetted process, others prefer to work through the Exit Planning process in stages.
For those who want a staged approach, the owner and his or her advisors can prioritize the elements of the Exit Plan and complete each component sequentially, rather than all at once. In these situations the owner and advisors identify each Component of the Exit Plan to be addressed and create a schedule for addressing and completing that Component before moving on to the next.

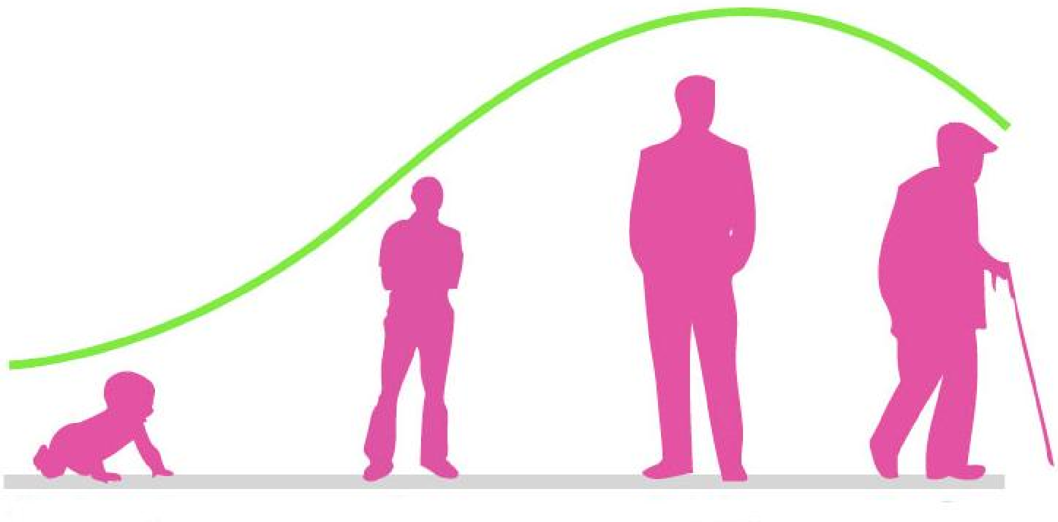
Components:

- Maximizing and Protecting Business Value
- Ownership Transfers to Third Parties
- Ownership Transfers to Insiders
- Business Continuity
- Personal Wealth and Estate Planning

Step One: Establishing Owner Objectives

When a driver enters a race, he or she has one objective: to win. To do so, he or she must know what type of race it is: a sprint or an endurance race? So too must business owners know what their objectives are. For example, is the objective to transfer the company to a child or is it to leave with the biggest pile of cash possible? A winning Exit Plan differs from owner to owner depending upon the three primary exit goals that every owner must establish. Establishing these goals determines the owner's race strategy or Exit Plan. To establish your goals, we suggest that you ask yourself three questions that, once answered, enable you to move forward decisively.

- When do I want to sell my business?
- What is the annual after-tax income I want after I sell my business?
- To whom do I want to transfer the business?



Owners also have secondary objectives that impact their Exit Planning choices. For example, one owner may want his or her exit to benefit certain key employees while another may wish to pass wealth (with minimal tax consequences) to family members.
Selling your business starts with a definition of what you want and need from the Exit Planning process or, in other words, what a successful exit from the business means to you. Determining what you want is the most important step of the entire process. Be thoughtful. Take time to weigh various objectives. Work with your advisors. Your financial or insurance advisor can easily provide computer projections (based on your financial statement) of your financial needs after you exit your business. Your attorney or CPA may be helpful in developing your objectives with you. But most of the effort expended in this step will be yours — after all; these are your exit objectives.

The Bottom Line
Helping owners and their advisors to structure the Exit Plan is at the heart of what B.A. Boss is all about and it begins with this step. Step one answers the question "what do I want?" The next step, Business Valuation and Cash Flow (step two), answers the question "what do I have?" Failing to answer these questions before proceeding with the Exit Planning process causes delay and confusion because your planning has no direction (your exit goals and objectives), and no grounding in reality (what do I have to attain my goals?)

Yogi Berra said: "You've got to be very careful if you don't know where you are going because you might not get there."
Think about it.

Step Two: Establishing Business Value and Cash Flow

Step one establishes what you want (or need) in order to leave your business in style. Step two determines what you have — how much is your business worth? If you're selling to a family member, key employee or co-owner, future cash flow (for reasons you will learn) of the business after you leave it, is even more important than value. Step two is a critical step in the Exit Planning process. It cannot be ignored nor can it be skipped while you go on to other parts of the process. You must value your business and you must do it at the inception of the Exit Planning Process. The reason for emphasizing valuation at the outset is simple.
The fundamental Exit Objective questions are:

- When can you leave the business?
- How much money do you want or need?
- Who can you transfer the business to and how can you get paid what you need?

Each exit objective question can only be answered in light of "how much money can I expect upon leaving the business?" This interplay between establishing Exit objectives and obtaining a business valuation is not static. Selling your business to an outside third party for cash is a very different Exit objective than is selling or transferring your business to a family member, employee or co-owner (an "insider"). The reason is simple. An outside third party has cash, the insider does not. The valuation approaches used for inside vs. an outside sale are dramatically different.

The valuation approach for a third party sale is to value the company at three points during the Sale Process:

- A preliminary (or "ballpark") estimate of what the business is worth. This is used to help owners decide if the business can potentially be sold for sufficient cash to meet their exit criteria.
- A formal valuation. This in-depth valuation documents and confirms (or adjusts) the original ballpark estimate. This is a critical undertaking that should be completed before you begin the actual Sale Process. This valuation should normally be performed by the business broker, investment banker (or other transaction advisor) who conducts the sale of your business.
- A marketability and pricing analysis. This analysis is performed during both the preliminary and formal valuations and again as the business goes to market. It must be performed by your transaction advisor: 1) to gauge existing market conditions; 2) to assess what the market will likely pay; and 3) to determine if now is the best time to market your particular business.

At each of these valuation points, the owner seeks to obtain the highest possible valuation. On the other hand, an owner seeking a valuation because he or she wants to pass the ownership to children or sell stock to employees and will, for tax reasons, seek the lowest defensible value for his or her ownership interest. Those performing the valuation usually use historical information to establish an "as-is" valuation. Often a CPA or valuation appraisal firm is the most appropriate choice for performing a valuation.

Owners who wish to transfer their companies to insiders (children or employees) must craft a plan to reap their sale proceeds in a tax-sensitive manner. Remember, in a transfer of this kind, the buyer must look to the future cash flow of the business to pay the departing owner. Consequently, the tax consequences to the buyer as he/she pays for the business are critical. Too high of a business value means that the tax consequences — to the buyer —may prevent the buyer from acquiring the business. Techniques exist to minimize this tax impact while likely still providing you, the owner, with 100% of the cash you would have received from a sale to a third party for full market value.

To learn more about this not-so-obvious, yet critical, aspect of transfers to insiders, please see step five. This brief overview of valuation illustrates how step two is influenced by, and in turn influences, the rest of the planning process.

The Bottom Line
If you wish to sell your business to an outside party, a professional valuation of your company is essential at the inception of the Exit Planning process. It is critical in the development of an accurate and comprehensive Exit Plan. We have affiliates who can perform a business valuation at the outset of the Exit Planning process to determine what the business is worth (based upon recent market activity in your industry) in today's Merger & Acquisition marketplace. This valuation also includes a determination of your company's marketability. This approach differs significantly from standard valuations based on historical information because it gives you the information you need: your company's market price and its marketability. This approach differs significantly from standard valuations based on historical information because it gives you the information you need: your company's market price and its marketability.

On the other hand, if you wish to sell the business to employees or perhaps a child, a less market-driven valuation is usually more appropriate. Again, if your advisors are unable to help with this type of evaluation, we encourage you to click here to request information about advisors in your community who can help you.

Without knowing the value of your company or the amount of after-tax cash you can expect to receive from its transfer, it is impossible to determine if your financial objectives can be met. If your objectives cannot be met at present, the valuation will tell you how much your company must grow before you can exit. This assessment naturally leads to step three.

Step Three: Promoting Value

For a moment, think of your company as a race car. If, like a race car engineer, you could design your business from the tires up, what would you include to attract buyers (or professional buyout funds) to look at your company? What features, or characteristics, would be necessary to make your business saleable and valuable? We call these features "Value Drivers." They are characteristics that either reduce the risk associated with owning the business or enhance the prospect that the business will grow significantly in the future. These same characteristics are equally important if your exit objective is to transfer the business to "insiders" — your children or key employees. You will want these Value Drivers to be in place as you exit the business to ensure that the business can continue and that you will receive the income stream you need to reach your financial objective.

Value Drivers include:

- Management Team
- Operating Systems
- Established and Diverse Customer Base
- Appearance of Facility Consistent with Asking Price
- Realistic Growth Strategy
- Effective Financial Controls
- Stable and Increasing Cash Flow
- Tax Efficient Business Structure

These value drivers are not dreamed up by a business school professor but are what professional, sophisticated buyers seek in closely held businesses. For those owners seeking to sell to insiders, Value Drivers are equally important. Working with your advisors to develop and enhance these Value Drivers before the sale process begins will position you to get top dollar for your business. Again, having these value drivers in place, before the transfer to insider begins, will help ensure you meet your financial exit objectives should you decide to transfer the business to an "insider" rather to sell to an outside third party.

Likewise, creating a tax-efficient business structure before the sale process begins can reduce the tax bite by a considerable percentage. If your company is now a certain legal entity, it could be that you must consider the possibility and appropriateness of converting your company into a corporation of another legal structure. The difference between the after-tax proceeds from the asset sale of one legal entity and from that of another can be considerable. There can be significant after-tax differences even in stock sales. Finally, one legal entity, as opposed to another form, can be much easier to transfer to "insiders." For more information on this subject, we suggest you discuss this vital issue with your tax advisors.

The Bottom Line
Part of the valuation process includes an assessment of the condition of your company's value drivers. Strong value drivers equate to a strong interest on the part of buyers to acquire your business and willingness to pay top dollar for your business. You need to know what must be done to increase your company's value. Should your exit objective be to sell to an insider — a group of employees or co-owner — these value drivers are no less important for they ensure the continued viability of the business after you have left — but before you've been paid the money due you.

Step Four: Sale to a Third Party for Top Dollar

Once an owner has fixed his or her exit goals and objectives, determined a market value for the company, and created any needed additional value, the business is finally ready to be sold for top dollar. This is where the rubber meets the road. The best tactic for middle market businesses to reach the checkered flag first is to orchestrate a controlled auction. In a controlled auction, your company is introduced to a pre-selected list of qualified buyers. The buyers, as a condition of participating in the auction, agree to comply with the bidding procedures and timing requirements prescribed by the investment banker conducting the auction. Multiple buyers, bidding for your company at the same time, each having identical information and each being financially qualified to acquire your company, will compete against each other for the opportunity to purchase your company.

An alternative to a controlled auction is the Negotiated Sale. In this method, an owner has identified a single buyer (or one has identified him or her) and has decided to transfer the company to that buyer.

If you are ready to proceed with a sale to a third party, consider the use of an Investment Banker as well as other team members, like a Transaction Attorney.
Smaller companies also require an experienced set of transaction advisors. If your business is worth less than $5 million, you will likely substitute the Investment Banker for a Business Broker.

When you sell your business taxes will take its share of the purchase price. The size of its share, however, depends on both tax structure and tax planning. Without proper planning, the tax bite can be twice as large as with planning and the total tax bill may exceed 30-40 percent of the sale price.

The Bottom Line

Income Tax Planning
It is imperative that you work with your advisors to design an exit strategy that minimizes and avoids, to the extent legally permissible, the payment of income taxes upon the transfer of your business. Timely tax planning saves business owners millions of euros. Develop your Advisory Team early in the Exit Planning Process and give your team the time it needs to design and implement tax saving strategies.

Transfer of Ownership Interest
The decision whether to sell your business to an outside third party or to transfer it internally to one or more employees is often deferred until you have completed the first three steps (establishing exit objectives, valuation, promoting value). A major goal of the Exit Planning process is, in fact, to determine the best or most appropriate buyer for your company. No matter what type of buyer you choose, the Exit Planning process positions you to implement your decision. Consider choosing an Investment Banker or Business Broker appropriate to your exit objectives, the size of your company and your choice of buyer.

Step Five: Transfer to Management or Family Members

If a sale to a third party is equivalent to a sprint to the finish line, then a sale to insiders is a marathon. Why? A sale to insiders does not end with the closing. It only ends when you get paid. Those brave owners who define winning as a business transfer to family or employees, must do so in a way that keeps the new owner from crashing the car (your company) until the final payment is made.

In Exit Planning, that means addressing two fundamental conditions present in this type of a transfer.

- First, the income tax consequences of the transfer must be minimized for both the seller and the buyer.
- Second, the departing owner must concentrate on acquiring maximum security for payment of the purchase price.

The reason for the emphasis on these two conditions is based on one overriding concern: The future drivers of your company — children or key employees — have no cash. With cash at a premium, effective Exit Planning means designing methods to guarantee you the company's future cash flow at the lowest possible tax cost — to you and to the buyer.

Owners must design and implement an exit strategy that creates the greatest likelihood that they will ultimately receive their purchase price. We urge owners to design exit plans to include an "out." If a transfer to children or key employees doesn't work, an owner needs the ability to sell his or her business to an outside party in order to achieve his or her original exit objectives.

Successful business owners often wrestle with the issue of how to pass wealth to children in a way that minimizes — legitimately — their tax bills. An Exit Plan provides owners with an explanation how such a transfer can be designed, as well as why fixing their own financial objective precedes any transfer, and how to determine the amount (and if that amount is too much) to be transferred.

Owners wishing to sell their businesses to management (key employees) face one unpleasant fact: their employees have no money. Nor can they borrow any - at least not in sufficient quantity to cash out the owner. An Exit Plan provides methods of how to employ a long-term installment buyout of the owner or use someone else's money to affect the buyout.

ESOP (Employee Stock Option Plan) Opportunities – this program provides an owner with the possibility how he can three ownership objectives:

1. to cash out at fair market value;
2. to pay no taxes on the sale; and
3. to transfer the company to key employees. While examining how ESOPs work, their advantages and disadvantages, readers need to learn that ESOPs do not work for all owners or for every company in any country. They do, however, provide opportunity for some owners to leave their businesses in style.

The Bottom Line

If you choose to transfer your company to key employees or to family members, you must design specific tools to use in conjunction with a low purchase price to make sure you will get the cash you need for financial security. Tools include:

- Non-Qualified Deferred Compensation Plans
- Licenses and Royalty Agreements
- Indemnification Fees
- ESOPs

There also are similar methods all designed to distribute a company's cash flow to a departing owner at the lowest possible tax cost. Developing these tools is a team effort. Seek the input and cooperation of your advisors

Step Six: Developing a Contingency Plan for the Business

Death. Permanent Incapacity...

Generally, owners have more pleasant endings in mind when they think of exiting their businesses. Unlike car racing, owning a business is not commonly perceived as dangerous or life threatening. But we all know many more owners who died owning their businesses than racers who died at the wheels of their cars. The point is this; it is easy to overlook or to avoid this part of the Exit Planning process. Without continuity of ownership, the business hits the wall. If ownership transition is uncertain, business continuity is not only uncertain — it's doubtful. But business continuity is much more than simply making sure there is a new owner.

Failure to be aware of all of the dire consequences upon a business of the owner's death can mean the unintended demise of the business along with its owner. Our Exit Planning Process requires you to re-examine your existing contingency plan and, at the very least, update it for current values and current exit plans.

Consideration should be given to the consequences of an owner's death upon the business's ability to maintain its bonding status, its financing capability, its relationship with key customers, vendors, and other parties important to the ongoing success of the business.
A business poised for sale is most vulnerable. It has peaked in value, but the event creating liquidity (the finish line) is often a year or more away; and, for many owners, several years away. Work with your legal and insurance advisors to make certain the business is protected in the event you depart from the business instead of the business departing from you. Providing business continuity planning is a necessary element of the overall strategic Exit Plan.

The Bottom Line
Your Exit Plan must ensure that the business continues if you don't. Few owners have an updated business continuity plan that reflects the true market value (as determined in Step 2) of their ownership interest. This plan includes a buy-sell agreement when the business has multiple owners or a "stay bonus" plan for employees in single-owner companies.

Step Seven: Wealth Preservation Planning

The sale of a business, like winning a race, generates cash — cash for the now former owner, his family and (to a limited degree, at least with planning) the IRS. Few owners have much tolerance for the share the IRS takes from sale proceeds. That's why thousands of business owners preserve wealth for themselves and their families through the proactive design and implementation of wealth preservation strategies before they transfer ownership. You too should design and implement these strategies well before the actual transfer of the business. It is far easier to transfer wealth under our gift and estate tax system in the form of a business interest than when that wealth has been converted to cash via a lifetime sale, or valued as if it were cash — at an owner's death.

How does this affect you?

Running a business, like racing, can be hazardous to your health. If you hit the wall, will your loved ones be protected? Owners who ignore this step of the Exit Planning process are the favorites of the tax authorities. Proper planning may permit the transfer of millions of euros of wealth from an owner to his or her children by taking advantage of existing estate planning tools and techniques. In fact, this is the easiest step of the Exit Planning process — the transfer of millions of euros of wealth to a younger generation, provided the owner takes action before the business is converted to cash. The ability to take the necessary action is also contingent upon your other exit objectives (Step 1) and obtaining an appropriate value for the ownership interest (Step 2).

This is the type of planning that owners need but don't usually do. While the natural focus is transferring your business for top value while you are alive and kicking, we are also interested in retaining as much money as possible for your loved ones — a group we do not assume includes the national tax authorities.

The Bottom Line

Your estate plan must be consistent with your business and personal exit plan. Most estate plans are relatively straightforward, standard documents that ignore the particular needs of an owner contemplating the transfer of his or her business. Work with your existing legal counsel as well as your financial and insurance advisors to make certain your estate plan addresses your personal and business objectives.

Succession Plan Framework and Checklist

This guide outlines what a basic plan would include.

- Please place a check mark (?) beside each of the succession planning components that you have completed to date.
- Examine all the statements where you did not place a check mark.
- Based on your situation, place these statements in order of priority.
- Proceed to the **How to Develop Your Business Succession Plan** section of this guide for more information on continuing to develop your plan.
- Gather information and write your plan.

Goals and objectives

Identified the stakeholders of my business
Established the need for a succession plan
Developed a business vision
Established business goals
Established personal goals
Established retirement goals
Contacted an exit planning professional

Exit strategy

Understand the need and process of building a succession plan
Reviewed options for my exit from the business
Made exit strategy decision based on identified options

Business valuation

Obtained professional advice about the value of my business
Determined the value of my business
Determined current value of business assets and liabilities
Determined the goodwill value of the business
Estimated the liquidating value of the business

Business structure and organization

Paid business debt
Hired and retained productive staff
Structured business to maximize value
Documented key processes and procedures

Tax and legal considerations

Tax considerations

Developed financial objectives
Aware of tax implications of current business situation
Planned and implemented tax strategies to minimize taxes

Legal considerations

Developed shareholders agreement
Developed current buy-sell agreement

Estate plan

Made arrangements to provide for my spouse and children
Completed my will, power of attorney and personal directive
Minimized inheritance taxes, probate costs and other legal fees
Selected a trusted advisor to settle the state

Successor Selection

Developed successor criteria
Developed questionnaire to assess candidates for succession
Selected a successor
Communicated with successor
Advised key stakeholders of successor

Successor training

Assessed skills needed by successor
Developed plan for successor training
Developed mentoring program for successor
Established timelines

Contingency Plan

Developed a contingency plan
Obtained disability insurance
Obtained personal life insurance
Obtained critical illness insurance
Obtained business insurance
Obtained key person insurance
Obtained overhead business insurance
Trained a key employee to take over in the case of an unforeseen event
Communicated the plan to family
Communicated the plan to key employees/ stakeholders
Communicated the plan to my advisors

Conflict resolution

Documented the roles, responsibilities and expectations concerning the transition
Identified a facilitator who knows my wishes and will work with the stakeholders through the process of succession

Timelines

Determined timeline for transition of management of the business
Determined timeline for transition of ownership of the business
Determined timeline for full exit from the business

Communications plan

Documented succession intentions
Documented how to proceed with succession should an unforeseen event, such as an accident or illness, occur
Documented the business transition or exit strategy to inform family, employees, clients, suppliers and community

Notes: