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Selling your business to your managers



Selling your business to your managers -- a good option?

Between the credit crunch, inflation roaring back and a change in the business cycle, private business owners today may find it more difficult to sell the business to outsiders. More and more often we're also finding the children of private business owners aren't interested in taking over the business or their parents aren't interested in having their children take over the business.

This leaves the owner with three options. You can continue operating the business, you can liquidate, or you can sell the business to your managers. If your business is hard to sell or it is getting slammed by the current economic environment, selling to your managers might be your best option.

Preparing your managers

The number one mistake we see business owners make is lack of preparation. You need to have a conversation at least two years in advance with your managers about the possibility of purchasing the business if and when the time comes. Managers are rarely prepared to take over a business. They often have misconceptions about what it takes to run a business. And if the owner wants to sell the business quickly, managers' misconceptions often cause major problems in putting together a transaction.

If you think you might want to give your managers the opportunity to purchase your business, we suggest that you start early to engage them in what it really takes to run the business from the owner's perspective. You also want them to learn about the world of debt. Even if you are prepared to be their bank, you want them to understand financing alternatives so that they value what you are willing to do.

Your managers need to understand that it's rational for you to expect the same sort of security arrangements as any lender your managers would borrow money from. Remember, if you sell your business to your managers, there is a very good chance that you will be the bank for at least the first three to five years. It is a major commitment on your part, and your managers need to be educated that they will likely need to guarantee debt personally.

Your managers' advisors

The second error we often see is that managers choose lawyers, business advisors and CPA's who don't understand internal transfers. The goal for you and your managers is to transfer the business at the lowest tax cost for the managers

We believe that a successful wealth management relationship starts with clarity of purpose.

Before embarking on any plans or strategies with our Client, we first seek to develop a clear understanding of your personal and financial goals.

We then work with you to select and implement strategies that will help you move toward your goals.

and the highest after-tax return for you, the selling owner. This often requires that creative thinking be employed. If your manager's advisors don't understand how internal sales are made tax effective, you will get less than you deserve. We think it's a good idea to help your managers choose their advisors at least one year in advance of your transaction. Since your managers may not have capital of their own, it might even be worthwhile for you to front money for them to interview and choose advisors that will help your future deal go through in an effective and efficient manner.

Helping your managers choose appropriate advisors is something you can do ethically as long as you're not in the throes of putting together a deal. If your managers are just shopping you can meet with these advisors and help your managers understand whether they will help the deal move forward or not. Giving your managers a year to get comfortable with their team will help them understand that you aren't trying to force your managers to use an advisor who is friendly to you.

Understand how a transaction could be done well in advance

The third mistake we see occurs when owners don't understand the transaction that is being proposed. You are an expert at running your business. Doing an effective internal sale will require you to learn new terms and financing techniques that you likely have not seen before.

If you take time to learn about a proposed transaction structure-again, we recommend starting two years in advance-you will make a more informed decision about what's best for you, your managers, your employees and the other stakeholders that are important to your business. If you're trying to learn at the same time you are putting together a deal, you may miss some of the options and variation that can provide true value for everyone involved.

We at Stage 2 Planning specialize in helping our Clients understand the internal transaction. We would be glad to spend time with you helping you understand the options you have available. Give us a call and we will be glad to provide a complimentary initial conversation.

Warmest Regards,

Stage 2 Planning Partners

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