TWO (2)CRITICAL THINGS YOU NEED TO DO TO SUCCESSFULLY SELL YOUR BUSINESS TO YOUR CHILDREN OR EMPLOYEES

Transitioning a business from a long-term owner is hard. Really hard. The very qualities of hard headedness and drive that made you successful make it hard to step back and let someone else run your business. When you finance the sale through a loan or earnout, this can be especially difficult as you are relying on someone else's ability to run your company to ensure you get paid. Add the fact that the new owner may be family, a prior employee or someone you know, it is especially important to plan for a smooth transition so that relationship remains intact.

There are two things you need to do to make the transition successful.

- Create the right dealthat fairly represents the value of the business and ensures payouts can reasonably be assured of happening.
- Create a Transition Plan that outlines the specific roles and milestones until the final payment.

Create the Right Deal

The right deal includes the right price and a payment plan that is achievable.

The first step is to get the price right. The right price fairly represents the value of the business based on its industry, performance, the value of fixed assets and any 'special sauce' that has value to a buyer.The actual deal may include cash up front, loans, earnouts or a combination of the three. An earnout is when you receive payments over time based on the company's ability to perform and hit milestones. They can also give you the ability to get paid on the upside if the business does better than expected.

Most business owners have no idea how to establish what their business is worth. The best way to get the right answer is to get an independent valuation.

An independent valuation will accomplish several things. It will establish a price (or price range) based on some combination of cash flow, comparable market deals and the value of assets. That combination will be based on factors like your industry, recent deals in your area, the economy and your location. The actual process of doing a valuation will generate all kinds of information that will be helpful during the transition planning process.

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For example, the valuation process will look at past financial performance and make assumptions about future earnings. This will include the amount of profit generated by the business and the costs associated with the current owner. Why are these helpful?

The amount of profit generated by the business becomes the cash available to make the loan and earnout payments. So, if a business has historically generated $10,000 of profit and your earnout commitment is $11,000, you will clearly be concerned as to how the business will make the required payments. It's also important that the new owner receive some kind of profit during the payoff period or they will have no incentive to be a successful owner.

The cost associated with the current owner (also known as discretionary income) has two important purposes. First, can any of the costs be turned into profit that is now available for payments. This may include things like car leases and memberships that the new owner will not use. Second, if the owner is leaving the business, who will do the work they previously did? The new owner? A new employee? If the company is merging with another company does the role go away? In a transaction where there is a shared risk of success and future payments, these kinds of questions can have significant impact on the success of the transition and the cash you expect the new company to produce.

The valuation will also identify things like the need for new equipment and the impact of interest and lease payments. A new owner must be able to make these payment as well as pay you.

It's important to find the right valuation expert. Ask your accountant or lawyer for a recommendation. The valuation expert should be able to show a history of valuing businesses your size, in your industry and hopefully your area. They should also be someone you are comfortable working with. You are going to be sharing sensitive information. Chances are, you are not an accountant or numbers expert. Your valuation professional should be someone who can help step you through the process.

Make sure you ask for the right kind of valuation. There are different levels of valuations based on what you intend to use the valuation for. There is a summary valuation that is usually used to help a management team make decisions. Then there are more complex valuations that are used for establishing deal prices, tax basis, estate and gift planning and stock transactions. For a transition of your company, you need to get the complex valuation. There are a lot of moving parts in a transition, especially one where you remain attached for some period of time, so it is important to get all the information you can.

When the valuation is done, it's time to set a realisticprice. You may think you need $500,000 to meet your retirement goals but that doesn't mean the company is worth that.

Not only must it be worth the price, but if there are loan payments or earnouts, the company has to be able to generate enough money to replace you, pay the new owner and pay you. The math has to work or the deal will not.

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The fastest way to implode a business is for a new owner to make aggressive decisions to stimulate growth or profitability because they are concerned they won't be able to pay their obligations. This is especially true when the new owner is new to managing a business and when that obligation is to Mom, Dad or a friend.Make your plan achievable.

The deal may include some cash upfront, a loan to you or a bank, an earnout, or a combination of all three. Quick note on loans. A loan must include an interest payment or the IRS will regard it as a gift which has its own tax consequences.

Create a Transition Plan

As you are creating the structure of the deal, you should also create a framework for your Transition Plan. This should be a formal document, written in plain English, with actionable steps, timelines, roles and milestones. It doesn't have to be perfect. It can change over time. But you need to make sure everyone is on the same page. You know what they say about assumptions.

One of the first things you should consider is how you are going to transfer the power to make decisions. Remember, you are the hard headed, driven entrepreneur that is going to have a hard time letting go. How are going to make this happen? Cold turkey? Never?

The answer can be an outsourced consultant that specializes in managing the transition process and coaching the new owner. These can be outsourced Chief Executive Officers (CEO), Chief Financial Officers (CFO) or Chief Operating Officers (COO). Most of these people operate across all three roles. The important thing is to get someone who you feel comfortable working with that is good at both advising and getting things done. Again, ask your accountant or lawyer for a recommendation.

Ideally, your consultant should be engaged early in the Create the Deal stage. This gives them time to get to know you, your business and the buyer. They will also help guide the valuation process and can give you advice on how to structure the transition. You should plan for them to stay on board for some period of time after the deal is complete. Their role may include

- Mentoring/coaching the new owner in running a business
- Providing a channel of communication between you and the new owner so there is a way to manage challenges without you having to fully engage, and
- Provide independent reporting for both parties.

The Transition Plan that you, the new owner and the consultant prepare may include the following topics:

- Financial plans
- Sales plans
- Reporting requirements
- Transition strategy for customers and vendors

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- Employee roles
- Hiring plan to replace the owner
- Potential areas of weakness
- Projected purchases of capital equipment, and
- Conflict resolution plan.

Managing the expectations of the new owner is one of the hardest things to do. If the new owner has been involved with your business, they may be dying to do things their way and eager to put into place all the things they think you should have been doing. These may all be good things, but if they aren't, having a consultant available to coach them, may make the difference between good growth opportunities and taking a wrong turn, which then turns into their inability to pay you.

The role of the consultant is usually a part time position that will ebb and flow through the process. This person will be able to give you peace of mind that the transition will be successful because the new owner has the necessary support in place.

These two steps, Creating the Right Deal and Creating a Transition Plan, will help you achieve a successful sale of your company. You built it. You deserve to get paid. Be hard headed one last time and plan an achievable exit.

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