



EXIT STRATEGIES FOR YOUR BUSINESS

IF YOU'RE THINKING AHEAD TO THE DAY WHEN YOU'LL NO LONGER RUN YOUR BUSINESS, THINK ABOUT THESE FIVE EXIT STRATEGIES NOW SO YOU'LL BE PREPARED FOR YOUR FUTURE.

BY STEVER ROBBINS

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Entrepreneurs live for the struggle of launching their businesses. But one thing they often forget is that decisions made on day one can have huge implications down the road. You see, it's not enough to build a business worth a fortune; you have to make sure you have an exit strategy, a way to get the money back out. For those of you who like to plan ahead--and for those of you who don't but should--here are the five primary exit strategies available to most entrepreneurs:

The Modified Nike Maneuver: Just Take It. One favorite exit strategy of some forward-thinking business owners is simply to bleed the company dry on a daily basis. I don't mean run it in the red--I mean pay yourself a huge salary, reward yourself with a gigantic bonus regardless of actual company performance, and issue a special class of shares that only you own that gives you ten times the dividends the other shareholders receive. Although we frown upon these practices in public companies, in private companies, this actually isn't such a bad idea. It's called a "lifestyle company."

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Rather than reinvesting money in growing your business, in lifestyle companies, you keep things small, take out a comfortable chunk, and simply live on the income. In one of my most memorable Harvard Business School moments, my fellow classmates and I asked the owner of a small, fabulously profitable manufacturing company why he didn't grow the business bigger and sell it for a gazillion dollars. His response: "Excuse me? You've had way too much schooling. What part of 30-hour work weeks and a \$5 million personal income don't you understand?"

Remember, money in the wallet is no longer money in the business. If you're in a business that must invest to grow, taking out too much money can hurt you down the road. Also, if you have other investors, taking too much can upset them.

Imagine their surprise when investors in a small business I once worked for received the company's internal loan repayment spreadsheet, showing that the business owner was pulling out bucks by paying his family exorbitant interest on loans while investor loans were repaid at rock-bottom rates over as long a time period as possible.

If you think you're in business for the lifestyle, minimize your dependence on other investors and structure the business to allow you to draw out cash as needed.

Pros

- Who doesn't like seven figures of take-home pay?
- Private jets are fun.
- There's no need to think hard about getting out: Just pull out the money when you need it.

Cons

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- The way you pull the money out may have negative tax implications. For example, a high salary is taxed as ordinary income, while an acquisition could bring money in the form of capital gains.
- Without careful long-term planning, you may end up pulling out money now you'll need later.

The Liquidation. Even lifestyle entrepreneurs can decide that enough is enough. One often-overlooked exit strategy is simply to call it quits, close the business doors, and call it a day. I don't know anyone who's founded a business planning to liquidate it someday, but it happens all the time. If you liquidate, however, any proceeds from the assets must be used to repay creditors. The remainder gets divided among the shareholders--if there are other shareholders, you want to make sure they get their due.

Pros

- It's easy and it's natural. Everything comes to an end.
- There's no negotiations involved.
- There's no worrying about transfer of control.

Cons

- Get real; it's a waste! At most, you get the market value of your company's assets.
- Things like client lists, your reputation, and your business relationships may be very valuable, and liquidation just destroys them without an opportunity to recover their value.
- Other shareholders may be less than thrilled at how much you're leaving on the table.

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My favorite piano bar in Boston simply vanished one day when the owner decided he was tired of show tunes. His regular patrons were crushed, but then, he didn't consult with us first....

Selling to a Friendly Buyer. If my neighborhood piano bar owner had asked, we might have wanted to buy the business ourselves. You see, if you've become emotionally attached to what you've built, even easier than liquidating your business is the option of passing ownership to another true believer who will preserve your legacy. Interested parties might include customers, employees, children or other family members.

The fictional Willy Wonka handed off his chocolate empire to a little boy who was a loyal Wonka customer, someone who was chosen with great care through a selection process designed to weed out all but the most dedicated Wonka devotees. Wonka was able to choose his heir apparent and ride off into the sunset a happier entrepreneur.

Of course, the buyer needn't come from outside. You can also sell your business to current employees or managers. Often in this kind of sale, the seller finances the sale and lets the buyer pay it off over time. A hair stylist I knew learned a local salon owner was shutting his doors and decided to propose a low-money-down deal to acquire the salon. The owner still makes more this way than he would by closing, and the stylist gets to earn his way into owning a business. It's a win-win for everyone involved.

The purest friendly buyout occurs when the business is passed down to the family. But remember, the key to "family business" is the word "family." Is yours functional? No sooner than you leave the family business to the kids, it's likely

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they'll end up fighting over who got the larger share, who does or doesn't deserve the ownership they got, and who gets the final word. They'll finger-point for a decade while the business slowly declines into ruin, then blame you for not leaving clearer instructions. If you decide to go this route, you've got a lot of planning to do before getting out.

Pros

- You know them. They know you. There's less due diligence required.
- Your buyer will most likely preserve what's important to you about the business.
- If management buys the business, they have a commitment to making it work.
- Selling to family makes good on that regrettable offhand promise made 30 years ago, "Someday, son/daughter, all this will be yours."

Cons

- You can get so attached to being bought by someone nice that you leave too much money on the table.
- If you sell to a friend, they'll be peeved when they discover they just bought the liability for that decade's worth of taxes you forgot to pay.
- Selling to family can tear the company apart with jealousies and promotions that put emotion way ahead of business needs.

The Acquisition. The acquisition was invented so you can sell your business and leave the kids money, still spoiling them rotten, but at least sparing the business from second-generation ruin. Acquisition is one of the most common exit strategies: You find another business that wants to buy yours and sell, sell, sell.

In an acquisition, you negotiate price. This is good. Public markets value you relative to your industry. Who wants that? In an acquisition, the sky's the limit on your perceived value. You see, the person making the acquisition decision is rarely the owner of the acquiring company, so they don't feel the pain of acquisition cost. Convince them you're worth a billion dollars, and they'll gladly break out their employer's checkbook.

If you choose the right acquirer, your value can far exceed what would be reasonable based on your income. How do you select the right company? Look for strategic fit: Which acquirer can buy you to expand into a new market, or offer a new product to their existing customers? I recently read that a classmate of mine started a company that was acquired during the Internet boom for \$500 million when it was just 18 months old. He commanded a huge price because his acquirer thought the acquisition gave them critical capabilities faster than they could develop those capabilities on their own.

But acquisition has its dark side. If there's a bad fit between the acquirer and acquiree, the combined companies can self-destruct. The acquired management team can end up locked into working for the combined company, and if things head south, they get to watch their baby implode from within. Time Warner recently announced that they're thinking of spinning off AOL, almost exactly five years after the two companies merged. What, exactly, did the merger accomplish? It made two CEOs very wealthy--and destroyed years' worth of work and billions of dollars. I'm sure the AOL employees who stuck it out enjoyed that particular ride!

If you're thinking of acquisition as your exist strategy, make yourself attractive to acquisition candidates, but don't go so far as to you cut off your other options.

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One software company knew exactly whom they wanted to sell to, so they developed their product in a way that meshed perfectly with the prospective suitor's products. Too bad the suitor had no interest in the acquisition. The software company was left with a product so specialized that no one else wanted to buy them either.

Pros

- If you have strategic value to an acquirer, they may pay far more than you're worth to anyone else.
- If you get multiple acquirers involved in a bidding war, you can ratchet your price to the stratosphere.

Cons

- If you organize your company around a specific be-acquired target, that may prevent you from becoming attractive to other acquirers.
- Acquisitions are messy and often difficult when cultures and systems clash in the merged company.
- Acquisitions can come with noncompete agreements and other strings that can make you rich, but make your life unpleasant for a time.

The IPO. I've saved IPOs for last, because they're sexy, they're flashy, and they get all the press. Too bad they make the lottery look good by comparison. There are millions of companies in the U.S., and only about 7,000 of those are public. And many public companies weren't even founded by entrepreneurs but rather were spun out from existing companies. Heck, AT&T and its spin-offs are almost a significant fraction of the listed exchanges!

If you're funded by professional investors with a track record of taking companies public, you might be able to do it. Of course, the professional investors will also have diluted you down to the point where you only own a tiny fraction of your company anyway. The investors will make out great. And maybe, if you're the principle entrepreneur and have done a great job protecting your equity, you'll make some money, too.

But if you're a bootstrapper, believing in a fair IPO is a touchingly naive act of faith. Besides, do you have any idea what's actually involved in an IPO?

You start by spending millions just preparing for the road show, where you grovel to convince investors your stock should be worth as much as possible. (You even do a "reverse split," if necessary, to drive up the share price.) Unlike an acquisition, where you craft a good fit with a single suitor, here you romancing hundreds of Wall Street analysts. If the romance fails, you've blown millions. And if you succeed, you end up married to analysts. You call that a life?

Once public, you bow and scrape to the analysts. These earnest 28-year-olds--who haven't produced anything of value since winning their fifth grade limerick contest--will study your every move, soberly declaring your utter incompetence at running the business you've built over decades. It's one thing to receive this treatment from your loving spouse. It's quite another to receive it from Smith Barney.

We won't even talk about the need to conform to Sarbanes-Oxley, or the 6 percent underwriting fees you'll pay to investment bankers, or lockout periods, or how down markets can tank your wealth despite having a healthy business, or how IPO-raised funds distort your income statement, or ...

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In short, IPOs are not only rare, they're a pain in the backside. They make the headlines in the very, very rare cases that they produce 20-year-old billionaires. But when you're founding your company, consider them just one of many exit strategies. Realize that there are a lot of ways to skin a cat, and just as many ways to get value out of your company. Think ahead, surely, but do it with sanity and gravitas. And if you find yourself tempted to start looking for more office space in preparation for your IPO in 18 months, call me first. I'll talk you down until the paramedics arrive.

Pros

- You'll be on the cover of *Newsweek*.
- Your stock will be worth in the tens--or maybe even hundreds--of millions of dollars.
- Your VCs will finally stop bugging you as they frantically try to insure their shares will retain value even when the lockout period expires (Warning: they won't necessarily be looking out for your shares, too.)

Cons

- Only a very few number of small businesses actually have this option available to them since there are very few IPOs completed annually in the United States.
- You need financial and accounting rigor from day one far above what many entrepreneurs generally put in place.
- Some forms of corporation--S-corps, for example--will require a reorganization before they can be taken public.
- You'll spend your time selling the company, not running it.
- Investment bankers take 6 percent off the top, and the transaction costs on an IPO can run in the millions.

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- When your lockout restrictions expire, your stock will be worth as much as a third world hovel.

Stever Robbins is a veteran of nine startups over 25 years and is the author It Takes a Lot More than Attitude to Lead a Stellar Organization. He co-designed the "Foundations" segment of Harvard's MBA program and has appeared on CNN-fn and in the Wall Street Journal, Investors Business Daily and Harvard Business Review. Stever and his monthly newsletter can be found at <http://SteverRobbins.com> .

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