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Discerning the Strategies for Exiting Your Business

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Abstract

For many business owners, strategies for operations are well thought out, whereas strategies for exit are not. Exiting a business does not need to occur due to a challenge or disaster. It is possible to plan and exit for the purposes of business growth, retirement, mergers and more. An exit affects the business owner, as it means that they are no longer involved in running or operations of the organization. The aim of this chapter is to identify common exit strategies and understand how they are of benefit to both the business owner or manager and the individual taking over the business. Secondary qualitative research is the research method used, with analysis of strategies and structures used across countries. These findings include differentiation between exit strategies with an understanding of their impact or influence on the business. These include the process of creating and exit strategy and the benefits for having one in place. The expectations of the investor and how they are to be paid back are taken into consideration. The chapter concludes with a solution for any business owner, including how to work with a qualified team to create a logical, well thought out exit plan.

Keywords: Exit Strategies, Business Owner, Investor, Next Generation Entrepreneurs, Succession

1. Introduction

Business owners work hard to build up their businesses in a bid to attain success. They experience incredible excitement and enthusiasm to get a business going right from the start. However, business owners need to think about what would happen if they were no longer able to be part of the business [1]. Numerous circumstances may occur which drive a business owner to exit their business. Exiting a business is not always negative. For this reason, the exit strategy should be in place as part of the long-term plan for the business. This will ensure that any future exit is well planned for, with a smooth transition or continuity where necessary. Also, a business exit may be an excellent option for a business owner seeking to make a significant return on their investment.

Certain circumstances precede the need to exit a business. These include the following: -

- A non – profitable business could require the business to be closed down entirely, or the business owner could consider exiting and allowing the next generation with fresh ideas to run the business and lead it to success.

- Changes in market conditions – The economic climate makes it challenging for the business owner to run and manage their business.
- Reduce business ownership – A business owner may be willing to reduce their ownership and also give up some control in the business to a family member or employee, if they can get financial value by doing so.
- Opportunity to sell – There are times when things fall into place and open up the opportunity for the business owner to sell their business, even if it was not their initial plan.

Other circumstances could precede an exit, with those mentioned above being the most recurrent.

The exit strategy is a plan more than a statement as several factors need consideration. They include clarity on the benefits of having the exit strategy in place, aligning the exit strategy with business goals and objectives, and determining the impact an exit will have on investors and successors. With a business exit strategy in place, it becomes clear what direction the business should take if or when a transition is necessary.

2. Understanding the scope of the exit strategy

In business, the exit strategy document is often a basic document that may only be referred to in the event of a change in business. For the most part, it is not well thought out unless there is an urgent need for it as a tool. For these reasons, businesses require education that explains how the exit strategy directly links with the health of a business.

Existing research touches on individual touchpoints of the exit strategy, without painting a full picture that will enable applicability in long term planning. From the research, it is clear that the following approaches have been explored in relation to exit strategies: -

- How the exit strategy affects the business owner
- Reasons and benefits of having an exit strategy
- The implications of the exit strategy on investors and other stakeholders
- The different types of exit strategies, and their potential influence on the business
- Key financial concerns for revenue continuation following an exit strategy

With exit strategies being shallow documents in most organizations, each of these approaches requires in in-depth review to determine how they fit into the overall picture of the organization. This information is particularly important for upper-level management who are tasked with decision making during an exit. This paper seeks to connect the dots of exit strategy, allowing any manager to craft a comprehensive exit strategy that evaluates present success and a potentially thriving future. Using analysis of qualitative research, key insights are revealed, as is how these insights affect the bigger picture for the business.

2.1 Key benefits of putting an exit strategy in place

An exit strategy is a positive tool that can be beneficial to the overall health of the business [2]. Here are a few reasons why: -

1. The exit strategy can help a business better define what success looks like and clarifies the goal that the company is working towards achieving. It also offers a timeline that can help with measuring progress.
2. The exit strategy also ensures that business leaders can create and execute insightful strategic decision making. Rather than getting stuck in the day to day running of the business, the plan focuses on achieving long term plans and objectives.
3. As a potential blueprint for business, the exit strategy indicates what should happen if certain events occur. These could include the sudden death of a business owner, or even an acquisition decision. When transitions are necessary, they are smoother and more efficient, saving both time and money when an exit strategy is in place.
4. The value of the business is flexible as it can change from one year to the next based on the business activities. With an exit strategy, it becomes possible to determine the current value and plan for future value. For the individual taking over, having a plan for the future increases the value of the business as it indicates there is guidance being used to meet goals.

2.2 The business owner and exit strategy

Businesses differ in terms of their size and operations, which means there are different factors business owners will consider for an exit strategy. The key elements that will affect the type of exit strategy chosen include the following: -.

- Time Frame

The exit strategy needs to be guided in terms of when it will take effect. Although not set in stone, it enables the business owner to negotiate where necessary and also ensures that adequate time is taken for a smooth transition. This information is especially important for the next generation investing in the business, who want to understand how long their investment will be giving them a return, and what factors could affect that return [3].

- Business Intention

As part of the exit strategy, it should be understood whether the business operations are meant to continue, or if the business will be dissolved to make way for a new entity. Understanding this will ensure that the successor of the business meets the intention and overall goal. This also gives all stakeholders an understanding of what to expect in the event of an exit.

- Business Objectives

The business owner needs to evaluate the objectives for starting the business and their individual goals. With these in mind, during the process of exit, it becomes clear if particular business objectives are a priority.

- Triggers

The business owner needs to understand triggers to determine what could happen to cause an exit or any conditions which may preclude an exit. This way, it will be clear what response should be taken.

- Next course of action

The business owner needs to clearly define what their intentions are after they exit the business. If they plan to open up a new business that provides the same product or services, a non-compete clause may be necessary for the exit strategy agreement. If the intention is to simply take the proceeds from the sale and go into retirement, this should be clear as well. The more comprehensive the exit strategy, the better for both the business owner and the investors [4].

As a business owner, several questions need thinking through when putting together the exit strategy [5]. Answers to these questions will help to ensure that plans within the business are aligned with business goals and objectives. These include the following: -

1. Would you like to remain involved in the business after exit?

This question may seem ironic considering exit means leaving the business. However, it is worth answering to determine which would be the best exit strategy to use, particularly if a younger member of the family is taking over. Remaining involved may require a seat on the board, a management position, offering advice, or even staying in business as an employee. As the business continues to grow, it is worth reviewing this question at least once a year.

2. When exiting the business, will you make money?

Answering this question will determine whether the exit strategy is based on going through tough times in business or exiting when experiencing growth and success. This requires looking at the long-term financial plan for the business and placing milestones that help measure their achievement. At the end of this process, the business owner will have a threshold to guide whether exit will mean some money received.

3. How much money would you like to make when you exit?

This ties up with the purpose of the exit. Some business owners begin ventures with the sole purpose of selling the business at the point that it achieves a particular goal. Others are motivated to grow the business until it can qualify for an IPO, and they can make a massive return. For some, the exit strategy is the route to retirement, and the payoff they are seeking should help them cater to the rest of their lives. When clear about the amount of money expected, the time needed for the exit strategy to be effective becomes more apparent.

4. Should the business continue under new ownership?

This question addresses the type of exit strategy that will be chosen. In the event of a merger or acquisition, the business will be altered to create a new entity. This means that it will not continue in the same way when under new ownership. When the business is being transitioned to family members or

employees, it is possible to put in a clause that the business should continue in the same spirit.

5. How much time is needed to go through the exit process?

The time taken to exit the business is highly dependent on the type of exit that is planned. Ideally, the minimum time required for proper exit is one year. Within this year, the business owner can ensure that the successors have been chosen, informed, and are ready to take on the business once the owner exits. Furthermore, this time is necessary to ensure a smooth transition, particularly with the employees that will remain in the business. The main reason that it should take at least a year is financial. This time is needed for all finances to be evaluated and for clarity on how much the business owner should receive upon their exit. Where finances are concerned, business owners also need the year to ensure that they go through all the required legal channels and sort out any taxes.

6. Is there a need to train staff members for a smooth transition?

Yes, there is a need for training. A business owner exiting the business does not necessarily mean that the business is grinding to a total halt. It is typically just the business owner who is mandated to leave, while the other employees stay on to ensure the operations of the business continue. With new owners, updated systems and ways of working are likely to be put in place. To ensure that they can manage these situations, training should be done and evaluated so that there are no gaps in running the business.

2.3 Understanding the expectations of the investor

A business owner's decision to exit the business impacts the stakeholders, especially the investors of the business. Investors may end up making a profit or a loss, depending on how the business owner chooses to exit the business. Even when a family member or employee is taking over, they must know the business owner understands that they want to get their money back from the investment that they make [6]. In the event the business owner chooses to exit, the potential new owner will have the option to move on as well and remain unscathed in the process.

To meet the expectations of the chosen successor, there are several actions a business owner must take. These include the following: -

1. Profit monitoring – This should be done on an annual basis over several years, with three years being ideal. The main aim is to ensure that there is an increase in profits each year. With this monitoring, the value of the business can increase significantly. Also, keeping excellent financial books that reveal an accurate picture of what is happening within the business is essential.
2. Long-standing contracts – Even as the business owner is changing, some things should remain the same to ensure the continuity and stability of the business. This requires long term contracts to be in place. Those who receive these contracts should be critical suppliers, the best and most qualified staff members, top customers, and management staff.
3. Legal compliance – This is concerning legislation that touches on all aspects of the business. It is vital that the business is fully compliant and is not facing any

legal challenges. Legal compliance applies to all the different business licenses and certifications. With finances, ensuring that current audited accounts are available for scrutiny is necessary.

If the business is transitioning into the hands of a successor who wants to keep the business running, the business owner may have the option of keeping their shares. With this, the value of their shares may change, and it will be necessary to educate the successor on the new venture and its goals.

2.4 How do you pay back the successors?

Within the exit strategy plan, it is worth considering the motivations that drove the next generation, or employees to put their funds or even expertise into the business. Most new owners are looking for a way to get a good return. The return may be realized in the event the business being sold, recapitalization, or going public through an IPO. A new owner is interested in knowing the exit strategy for the business owner so that they can be clear on how they will realize a return [7].

To build confidence in the new owner, it is essential to share the plans for the future of the company, especially when it comes to value. It is expected that the value of the company will grow over time, meaning that new owners can look forward to increased returns.

Within the exit strategy, one needs to share the possible time frame for the exit to ensure the new owners can determine whether they will meet their return on the investment. One trap to avoid falling into as a business owner is to forecast what the rate of return will be. The new owner should work on making the calculations on their own based on their understanding and experience. As a business owner, you can support them by sharing financial documents and comprehensive projections.

It is also possible that as a part of the exit strategy, mainly if a deal is in place with another business, shareholders are offered the shares of the other company. The terms and conditions of such an agreement should be hashed out when planning an exit strategy.

2.5 The different types of exit strategies

It is now clear that there is more than one way to exit a business, and the exit strategy chosen is affected by the goals and intentions of the business owner [8]. Here are some of the strategies to choose from when exiting a business.

Transition to family members or employees

Many entrepreneurs visualize their business is still running if they may have to exit, passing it forward to family members or trusted employees. With this strategy, the business owner can take several years to train and groom their successors so that the transition is seamless. The challenge with this strategy is making sure that the person intended to take over the business can adequately manage the pressure of business operations. One advantage is that though the business owner exits and stops being part of the daily operations, they are often available after the transition in an advisory capacity [9].

- Selling with a broker, or employees

Employees of the business may share their interest in purchasing the business and keeping it running. This often happens when the business owner is retiring and seeking a way to exit the business and get a good return. As an exit strategy, a

business owner can plan a long-term buyout, allowing the employees to purchase shares and increase their control over several years. This option can even be tied to their benefits or bonuses, which can be a fantastic motivator to ensure that the business attains success. This is referred to as an ESOP (Employee Share Ownership Plan), which clarifies how current employees can purchase stock. Business owners may also seek permission to remain with the business and support the working team from an advisory capacity [10].

- Mergers and acquisitions

Businesses go through ups and downs, and when a business is losing money, mergers and acquisitions can help bring stability to the business. A merger brings together companies that have complementary abilities so that they can create a new entity. Mergers offer incredible flexibility for a business owner, as the owner may choose to sell their stake in the business or remain involved with business management.

An acquisition involves the entrepreneur finding another business willing to purchase the entire entity from the business owner. It offers some flexibility in getting a good return as there are keen buyers and a willing seller. This opens up the opportunity for negotiation based on the value of the business. If the business is perceived to have high value, various acquirers can begin bidding to own, giving the business owner the chance to benefit significantly. These are a better option than simply closing the entire business by stopping operations.

- Private equity buyout

Private equity buyouts are an excellent option for young companies experiencing challenges in scaling their operations. They work by a private entity acquiring stakes in these young businesses either with financial injections or offering value in expertise. The private equity buyout aims to help the business scale up, thus increasing its value and to own the business while building their potential eventually. The equity bought is in small quantities over time, and there are often some operational conditions included within the agreement. The benefit for the investor is they purchase the company and can realize a good return as the value increases over time.

- Initial public offer (IPO)

Rapid business growth is excellent, though, in the process, the business owner may realize that they do not have adequate funds to take the business to the next level and maintain consistent growth. This issue occurs with a business that is several years old and appears to have achieved a peak in success. At this point, a key consideration is taking in public investors through an IPO. IPO stands for initial public offering, indicating the first time the shares of the company are available to the public, often at a low price that is bound to increase in value.

The business will need to have achieved a pre-determined minimum amount in pre-tax earnings over at least three years. Also, planning for an IPO is expensive, so the company should be stable enough to go through the entire process unscathed. Once the shares are sold, they will then be traded on the stock exchange, and a pool of numerous investors will become a part of the business. The entrepreneur may choose to sell all their shares, giving the business to the control of a management team and board, and therefore ending involvement with the business and getting a good return.

Any business owner who chooses an IPO as an exit strategy should be ready for scrutiny from business analysts who are determined to define the value of the company. Financial documents need to be clear and up to date, going back as far as the company has been in existence.

- Liquidation

This should be a last resort option as it is equivalent to simply closing the business down. When this is the option, there are often challenges around debt, revenue, and profit. Liquidation requires the sale of all the assets so that creditors can be repaid the amount they are owed. If there are any funds left once this is done, the balance is divided between different shareholders to return for their investment. With so many ways to keep a viable business operational, this is one exit strategy that should not be considered unless necessary, and there is no alternative.

2.6 How the exit plan influences the business

- Legal Structure

An effective exit strategy requires a legal agreement that outlines the terms and conditions of the potential exit. During the crafting of the legal agreement, an exit advisory team must go through all the parts of the agreement in detail. With the support of this team, the exit strategy agreement may be drafted several times before a final one that meets all criteria is done [11].

Within the exit strategy agreement, five essential documents should be included. These are: -

1. Letter of Intent

This is a letter prepared by the successor to formally express their interest in making an offer for the business. It often requires specific information, including how the transition will be done to fit the structure of the business. This letter of intent becomes particularly important if the next generation owner intends to purchase the business from an exiting business owner. This is to allow for fair negotiation and can ensure there is a focus on the expectations of the business owner to reach an agreement.

2. Purchase and Sale Agreement

This document is also referred to as the Definitive Purchase Agreement. It includes the final agreement between the parties and acts as a legally binding document for the ownership exchange. Within it, the shares and how they will be divided is outlined. Also, there will be details on how stocks and assets are to be purchased. This agreement should be drafted by an attorney who is well-versed in all the requirements and payments necessary. Furthermore, the attorney can support the exit strategy advisory team with their expertise. With the Definitive purchase agreement, the tax implications for each transaction are captured.

3. Earn-Out Agreement

One aspect of an exit strategy is offering the successor a guarantee that the business will continue to grow and thrive even after the business owner has

made their exit. For most business owners, getting a one-time cash payment to close the deal is the best strategy. This may not be ideal for the buyer. With the earn-out agreement, the buyer offers to make payments to the exiting owner after the exit for some time. This is highly risky for the business owner, as once they exit the business, they have little control over the operations and real success of the entity. If this agreement is used, it needs to have precise and careful wording that offers the exiting business owner some protection.

4. Non-Compete Agreement

When a business owner chooses an exit strategy, there is one highly valuable asset that they take away with them. That is their expertise and knowledge on how to run the business. This can be of concern to the business successor who will want to take all the necessary steps to protect their new investment in the business. This is where the non-compete agreement is essential. This is a formal agreement that outlines that the exiting business owner will not create a competing business or be employed within the same industry in a competing organization for some time. Typically, the non-compete agreement will cover three years.

To ensure that the full legal process is followed, some documents need to be updated continuously for ease of transition. These include all intellectual property licenses, patents, trademarks, and copyrights. The same applies to any software that may hold sensitive or confidential information. These types of documents have an impact on royalties and the way they are collected.

Also, contracts with vendors and clients need filing and updating as they tie into the value of the business. They also provide information on the length of time these stakeholder relationships are valid.

2.7 Types of revenue models

Money and how to get a good return are top of mind when creating an exit strategy. From a financial standpoint, it is necessary to understand financial risks, any barriers to entry due to a change in the business owner, and also if there is any advantage that remains sustainable.

In financial reporting, it is ideal the business seeking to exit can reveal multiple income streams allowing for flexibility when it comes to beating the competition and being able to meet new goals. These income streams include: -

- Transactional Revenue Models
 - With this revenue model, it is easy to transition as part of the exit strategy. This is because, for the most part, the business will remain as usual, which is the most ideal scenario for a next generation successor. Revenue is earned through the company offering a product or service, and the customer making payments for it.
- Subscription Revenue Models
 - With this revenue model, customers pay a subscription fee to gain access to the product or service. It could also be a subscription model where customers pay for a product in installments over some time. For an exit strategy, it is crucial to determine whether this model is in place as it has a high risk.

Customers may not finish their payment or choose to unsubscribe in the event of a change of the business owner. It remains an attractive option for next generation successors due to generating recurring revenue.

2.8 Trade-offs between long vs. short term exit strategy

When considering a long term or short-term exit strategy, the goals, as well as the sustainability of the company, can more easily be aligned. Consider the following example. A business wants to work towards an IPO option within five years. To meet this long-term goal, there are specific steps that will be taken with a short-term strategy. These could include the product or service offering and even pricing and competition. In effect, the long-term goal for investment is the primary consideration, while everything in the short term is viewed as a tactic towards meeting this goal.

The type of exit strategy that you choose, whether long term or short term, will also affect the value you can receive. This is why a business owner needs to select their preferred exit strategy. Exiting can take as little as one year, and even up to ten years to accomplish well.

3. Research methods

The research method that was used to collect data for analysis and discussion is secondary qualitative research. This data was collated from a range of journals, all of which were addressing a different touchpoint of exit strategies. The aim of seeking for information across different platforms was to identify joining factors as well as identify any patterns in approaching exit strategies. Therefore, the review and analysis have been carried out on existing literature, including literature that offers comparisons of exit strategy situations in different countries.

The data collected was non-numeric. The journals and other content sources that were referred to were based on small studies that offer insight into a business or section of industry. For this reason, this paper focuses on analysis of their conclusions, more so than their data sets. This allows for deductive reason, though may also be viewed as a practical limitation. Furthermore, this paper attempts to understand cultural nuances that may impact the exit strategy process, as explored through the literature studies.

The analysis focuses on the meaning of exit strategies, both for the business owner and the investors. Through research analysis, it became clear that from end to end, exit strategies begin with the owner and culminate with the potential effect on the investors. By seeking to analyze this process, this paper seeks to understand the implications of choosing one specific strategy, as well as how to ensure that the strategy is carried out from start to finish. The secondary qualitative research is interpretive in nature, as this paper offers exploration into the topic building on theoretic principles that are in existence within the literature [12].

3.1 Discussion

The research reveals that there are positive reasons for an exit strategy, and that this strategy should form a core component of any business documentation. The exit strategy guides decision making, both for the next generation owner and the exiting business owner. This means that it acts as a blueprint for what actions should be taken in the event that an exit is imminent. With this blueprint, it becomes easier to determine the factors that can affect any exit strategy including the time needed, intention and business objectives for the business. Furthermore, there are numerous courses of action that a business owner can take following the

strategy that include being available for consultation within the business, or a full exit meaning the business and its operations are totally in new hands.

For the new owner, it touches on how they can ensure a return on the investment that they make with the business. By the business owner understanding the goal of the investor, the exit strategy can ensure that the business operations are competent and aligned to a certain exit strategy that is most likely. Money, or a return on investment is also essential for the business owner, and this may guide the number of months or years that the business owner works through making their exit.

Therefore, there are ongoing actions that the business owner needs to ensure take place, both for them and the investor. These including profit monitoring, staying legally compliant and setting up contracts with suppliers and stakeholders. From the literature, it becomes clear that ensuring these actions are in place will result in the right exit strategy being chosen.

4. Conclusion

A business owner who starts their venture may create five-year plans that seek to drive profits and sales. Also, business owners desire to achieve growth, taking their business from one level of success to the next. However, it is essential to create an exit strategy if things do not go according to the plan. Not only is this a plan that will guide business operations, but it is also a fail-safe to ensure that the business is never caught off guard in case of any operational challenges. The earlier in the life of the business, the easier the transition will be when it is necessary.

An exit strategy is vital to ensure that the company has the right revenue models and legal structure. Furthermore, it provides direction on investment, especially when looking at short and long-term growth goals and the types of investors that would be beneficial to the business. In the heat of the moment, putting together an exit strategy with tight time restraints may result in gaps that cost the business owner dearly. A logical and well-thought-out plan will ensure that there is minimal loss and that investments of all stakeholders are well protected.

To create the exit strategy, a finance professional like an accountant should be at the forefront of the draft plan. This finance professional should coordinate their work with a business attorney so that all due process is followed. Together, they will create the initial draft. Additional information can be added in from key managers and members of an exit strategy advisory committee. With all these contributions, it becomes possible to have a highly comprehensive document that can be updated when necessary.

Many people opt to write a will to ensure proper division of their assets should they pass away. This does not mean that they are planning to die. In fact, it is viewed as something highly responsible to do. It is similar to creating a business exit strategy. It does not speak to the commitment of the entrepreneur. It is merely a readiness tool to prepare for any eventuality [13].

There is something worth considering when creating an exit strategy, and that is how to react and respond to an unexpected offer by large companies who may be seeking an acquisition. This helps ensure that the business owner has some insight and can guide a negotiation well if a buyer is available. Sometimes exit is not voluntary, and even in this situation, significant benefits can be realized.

Future research should seek to analyze an actual exit strategy, seeking insights and opinions from all stakeholders. These should help to determine the planning phase effectiveness, those involved in the process, and the end result. Carrying out these end to end studies will help with understanding which processes are the most effective from start to finish. Furthermore, it will become easier to identify loopholes that may cause an interruption to executing an exit strategy.

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