The Exit Strategies Newsletter

How to Exit Different Sized Businesses

'Exit Planning' is the process that a business owner follows in preparing for the largest financial and emotional transaction of their life – i.e. the transition of their privately-held business to a new owner. Now, despite the fact that ALL owners will one day leave their business, it is true that different sized businesses will have different exit options available to them and, therefore, owners need to know where they fit on the exit planning transfer spectrum as well as how to begin your exit planning today.

The Exit Planning Transfer Spectrum

The exit choices that are available to privately-held business owners are largely dependent upon the size of the business. In our case, we'll generalize by measuring the size of a business both in terms of revenue, the number of employees, and annual profits. The Exit Planning Transfer Spectrum below will assist you in seeing where you fit.

The Exit Planning Transfer Spectrum

	Solo	Micro	Lower Middle Mkt	Upper Middle Mkt
Revenues (millions)	$0-$1m	$1m - $5m	$ 5 m - $30m	$30m - $150m
# of Employees	1 to 5	5 to 15	15 to 50	50 to 200+
Annual $$	50k to $350k	$350k to $800k	$ 800k to $2mm	$2mm to $10mm

It is important to note that these size ranges by revenues, number of employees and annual profit are generalizations, not evenly applicable to every business and industry. This transfer spectrum is intended to help you calibrate where you fit in terms of the size of your company and how you can devise a plan for an exit. So let's look at each segment to see how different sized businesses can begin their exit planning today.

The solo-preneur

As a solo-preneur you have a job. Someone else needs to want to do your job, in your place, and you need to find that person to own your business after you. This applies to many private practitioners such as lawyers, doctors, dentists, accountants, etc . . . who work on their own. Conveniently, some 'trading markets' have developed for these businesses, as well as some standards for deriving a value for your solo-preneur business (the most typical being '1 times annual revenues', which means that if your business generated $350,000 in top-line revenue in the prior 12 months, then that may be the approximate value of the business). Another important issue relates to licenses required to conduct the activities of the practitioner. The requirement of a license (and appropriate training and experience) limits the potential buyer pool, making many smaller businesses more difficult to sell. Finally, most buyers of solo-preneur businesses DO NOT pay cash up front for the business. Rather, a nominal

amount is made as a down payment and the balance is paid over time. Remember that as a solo-preneur, you are selling a job, not a company (unless some valuable intellectual property exists, but these situations are rare). You can either mentor someone to learn your job (perhaps a family member) or you can sell your business to another individual either on your own (not recommended) or through a business broker.

The Micro-Business
The five (5) to fifteen (15) person company

The next type of business in the exit planning transfer spectrum is 'the five (5) to fifteen (15) person company', micro-business. This business often times still has a solo-preneur running the company and that owner has been able to hire other people to assist with 'processing' the work that comes in. In most of these situations, the workers in the company report directly to the owner and the owner is very involved in the day-to-day running of the business. In fact, without the owner, there really would not be a company. Most of these owners started as great craft-people who found enough demand for their products to add a basic support team to assist with the business generation and servicing roles in the company. Nonetheless, the employees are, in most cases, simply executing on the owner's directives. Although the employees communicate with each other on a regular basis, most, if not all, of the critical decisions are made by the owner. In fact, even if some 'management' is in place, a deeper look at these business usually shows that the 'manager' is actually more of a 'supervisor' without any real decision-making authority.

These businesses are saleable to only some strategic buyers who want to purchase the customer list and see their competitor go away or to another industry buyer if you have a proprietary process or intellectual property that generates profitable and steady cash flow. Owners of these businesses will generally not demand much attention from the marketplace if / when they decide to sell because they do not have enough scale and market-share to be worth the time and inconvenience of a large company making the acquisition. As a seller, the owner of this size business is best served in casing a 'wide net' to attract a buyer or working with a few key managers to purchase the business.

The Lower Middle-Market Business
The fifteen (15) to fifty (50) person company

It is hard for a business to get up to fifteen (15) to fifty (50) employees without some form of management structure in place. At this point in the businesses growth, these managers often times have incentive plans in place and have a good amount of decision-making authority delegated to them, which assists in the growth of the business. This is where companies begin to reach the multi-million dollars in sales volume and start to attract enough customers and have enough infrastructure and profitability to be attractive as an acquisition candidate. There are really two (2) versions of a management team that exist at this level.

First, is the 'vertical model' of management. This is where the entrepreneur is at the top of the business and is heavily reliant upon a second in command to run the business. The second in command actually runs the day-to-day of the business while the entrepreneur at the top remains the strategist and the visionary. The second in command handles the majority of the personnel and other issues within the company while the

entrepreneur brings in the business with the assistance of the supporting team.

Next is the 'horizontal model' for companies this size. This is where the entrepreneur finds more than one person to empower with decision-making authority in the company. These 'horizontal', fifteen (15) to fifty (50) person companies have 'divisional' or 'departmental' or 'functional' leaders who work with the team underneath them. Again, the entrepreneur chooses to empower a select number of folks and takes direct reports from the three (3) or so main functioning areas within the business.

What is the difference at the time of sale?

The 'vertical model' of doing business is a bit harder to transition because key decisions are still being made by a few folks and the entrepreneur is still very involved with the business. If the top few people (usually equity holders) do not stay with the business, then the transition of the company becomes very difficult.

The 'horizontal model' is a bit more effective for transition purposes because the owner has hired, trusted, trained and empowered more than one person in the critical areas of the company. This simply means that the business has fewer 'points of failure' which means that the risks are lower, making it more valuable and more transferrable to a future owner.

The Upper Middle-Market Business The fifty (50) to two hundred (200) or more people enterprise

When a company reaches the point of fifty (50) to two hundred (200) or more employees there are generally departments that function on their own with empowered managers to make decisions and take responsibility for the business generation and profitability of their division. The owner or owners at this stage are only taking in the information that is critical to them making decisions and are not getting involved in the minutia of the day-to-day functioning of the business. These enterprises start to become very attractive to the many professional investors as well as to strategic industry players and competitors. The reason for the attractiveness is that this company has enough demand from the marketplace to have a sizeable percentage of business but the company also is designed to be scaled to potentially a much larger enterprise. The exit planning techniques for a business this size will often times revolve around the communications and incentives that are put in place for the key managers as well as establishing a consistent trend of growth that is supported by solid projections and a story of independent and effective execution from the management team on a proven basis.

Concluding Thoughts

The size of your company will determine the things that you need to do to prepare for a successful exit. Planning is needed to have a successful exit designed and customized for your unique needs. However, this newsletter is written to get you started on the process and to begin to ask the right questions of your exit consultant as you head down the exit path.

Bobby G. Biggerstaff
Managing Partner
Strategic Advisors, Inc.
P O Box 41200
Greensboro, NC 27404
336-255-7072 (c)
336-854-9006 (o)
bbiggerstaff@strategicadvisorsnc.com
strategicadvisorsnc.com