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The Exit Strategies Newsletter

Should You Raise Your Company's Debt Ceiling to Plan for Your Exit?

With the United States Congress considering whether or not to increase the debt ceiling to avoid defaulting on our country's obligations, owners may want to consider whether or not they should increase their personal debt ceiling as part of their exit plans. This newsletter highlights the fact that all debt is not created equally and that 'transaction' and 'exit' debts may empower you to have more options and to assist you in creating an exit plan that meets your goals.

Would you Buy the United States Today?

As an exiting owner, you need to identify what type of owner would continue to benefit from your business into the future. Most exit transactions include the elimination of debt at the closing of the transaction as the exiting owner pays off the company's liabilities and/or the new owner assumes those or new liabilities to fund the business. To help with an analogy, would you purchase America today, knowing that our debt ceiling needed to be raised in order to fund our current obligations?
Despite your answer to this question, it is important to remember that there are two (2) types of debt, good debt and bad debt as debt is, itself, not an inherently bad thing.

Debt of Two Different Kinds – Personal versus Business Debt

A privately-held business owner's view of debt is quite different than that of a government or a publicly-traded company. Owners recognize this unique nature of their corporate debt when they sign the *personal guarantee* that states that failure to pay will result in a bank (or other lender) seeking personal recourse for the loan. The debt in this case does not end with the business, but continues on to the owner and the owner's family. This usually means that the owner's home and other assets are included in this repayment expectation so that a privately-held business owner literally takes this debt home with them to the bed in which they sleep. Public companies and Congress do not think about such consequences as they consider raising their debt ceilings.

Good Debt versus Bad Debt

We also know that there are good debts and bad debts. On the personal finance side of debt, it is very easy to identify 'bad debt'. Clearly, high interest-rate credit cards and other forms of 'predatory' lending are bad debts to possess.

Good debt, on the other hand, may be in the form of a home mortgage (at least one that is in-line with one's income and upon which payments can be made). Home mortgages allow for the purchase of an asset without requiring 20 or more years of savings in order to acquire it.

Debt Drives Exit Transactions

So, despite the different forms of debt, it is important to recognize that debt is necessary to facilitate transactions such as business exits. Unlike debt that is incurred in growing a business, a different analysis is undertaken when funding an exit transaction. And one of the primary reasons that merger and acquisition activity – i.e. the sales of privately-held businesses – has been depressed for the last few years is due to the inability of buyers to access debt capital to purchase companies (another reason is that profits are low and owners do not want to transact at low valuations). Debt is a reality of business transactions and must be viewed in a different manner than debt incurred for business financing purposes.

Your Debt Ceiling and Your Exit

In order to have someone pay you for the value of your business you are either going to have to accept that your buyer will fund the purchase with debt borrowed from someone else (unless it is a corporate buyer with lots of cash on their balance sheet), or you will have to be the provider of that debt. When you provide debt to a transaction, and in effect raise your debt ceiling, you are serving the role of the bank and allowing your buyer to purchase the business over time, presumably with the ongoing cash flow of the business.

For example, if your management team wants to buy your business from you and you feel comfortable that they can continue to run it without you, it is important for you to view the debt that you are extending to them differently than debt that you have borrowed to run the business. This debt is 'transaction debt' and is likely very necessary to make the transaction happen.

In order to get an exit today, with credit still very tight, you may need to raise your debt ceiling and consider alternative structures for your exit that meet your personal goals.

How Much Should You Be Willing to Raise Your Debt Ceiling?

The answer to how much debt you should be willing to incur for your own exit is a personal decision and will be different for every exiting owner. However, the fastest way to determine how much is right for you is to look at the difference between your personal savings and your current lifestyle and figure out how much of a gap needs to be covered. If the 'value gap' is very large, your debt ceiling may need to be high and there may be a lot of personal risk to your exit. If the 'value gap' is low, you may not need to raise the debt ceiling too much.

What to Do Next?

Your next step should be to consult with an exit planner about your personal debt ceiling being raised and the size of your value gap. Consider that 'transaction debt' is unique and how you are willing to approach the extension of this debt could expand or limit your exit options. Remember that a proactive approach to planning your exit is always the best approach. This is particularly true when it concerns your debt ceiling.

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