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When you want out

Janis Cowhey

By: Bernadette Starzee February 3, 2016

When people work hard for decades to build and grow a business, often their dearest ambition is for one or more of their children to take it over when they retire. Things don't always work out that way.

"Many of our closely held family businesses plan far in advance for the succession and continuation of their family business from one generation to the next," said Steven Wolpow, managing partner of Nussbaum Yates Berg Klein & Wolpow in Melville. "But we also have clients that for a variety of reasons decide that their long-term exit plan does not include someone from the family taking over."

Sometimes, the kids don't want to run the company, which isn't necessarily a bad thing, according to Janis Cowhey, a partner in the trusts and estates practice group at Marcum, which has offices in Melville.

"Unless someone from the next generation is as passionate about your business as you are, it's not always a good idea" to pass the reins to that family member, Cowhey said, noting that many businesses fail in subsequent generations because it wasn't a good fit for the successor.

In many cases, the closely held business represents the single most valuable asset of the owner and comprises a significant component of his or her personal net worth, Wolpow said.

For this reason, "being able to monetize that asset is super-critical to these clients," Wolpow said.

External options

Accountants like Wolpow help clients without a suitable successor come up with creative solutions, including selling to a strategic buyer, such as a competitor.

“A competitor may be in the position to pay the highest value for the business, because the competitor will have the ability to reduce duplicate facilities and overhead and combine the businesses together into one very profitable organization,” Wolpow said.

Competitors may learn better practices from buying the business, further allowing them to streamline their operations, Cowhey said.

“What better way to get rid of your competition than to buy it out?” she added, noting it’s especially common for larger companies to gobble up smaller competitors who are looking for an exit strategy.

Strategic buyers aren’t always competitors – sometimes the business’ products or services are complementary to the buyer’s existing business.

“The buyer is looking for synergistic opportunities,” said Fentress Seagroves, a partner in the mergers and acquisitions practice at PricewaterhouseCoopers, which has offices in Melville.

Selling the company to a private equity firm or investment group is another potential option.

“Private equity firms and other investment groups invest in many ‘portfolio’ operating companies,” Wolpow said. “We have found that this type of investor will also offer top dollar for a company that fits into their strategic sweet spot.”

It’s a good time to sell a business, according to Seagroves, who noted “there’s a lot of money out there, and private equity firms are looking for investment opportunities. Good companies in today’s marketplace will always find a buyer, whether private equity or strategic.”

When marketing the company to outside buyers, the business owner should work with an adviser – such as an accountant, lawyer or investment banker – to prepare the company for sale.

“The adviser can coach the management team and prepare them for due diligence,” Seagroves said. “A lot of times private companies have never been through a transaction before, and you will be at a negotiation advantage when you are prepared for how buyers will determine value and what questions they will ask.”

Internal options

Sometimes the owner can find a buyer or group of buyers around the company water cooler.

A long-term employee, whom the owner didn’t originally think of as a successor, may rise because he or she knows the business, said Mark Meinberg, the Syosset-based partner in charge of EisnerAmper’s Long Island operations.

“Over the years some of our clients have successfully sold their business to the existing management team that is in place,” Wolpow said. While grooming the individual or individuals to take over requires a long-term commitment by all parties, “it can be a seamless way of transitioning the ownership of a business, because the customers and vendors are already used to doing business with the management team,” he said.

Unlike when selling to cash-flush equity firms, funding an internal purchase can be tricky.

“Funding the buyout usually involves a longer-term buyout, bank financing and, to some degree, seller financing,” Wolpow said.

A popular option is what accountants refer to as a “boot strap” deal: an assisted buyout in which the employee takes ownership and completes the buyout over a period of time with funds from the company’s cash flow.

“The buyer will say, ‘I’m going to buy you out, and I don’t have to go into significant debt,’” Meinberg said. “At the end of the day, the owner wants to do everything he can to ensure he’ll get paid. He can stay involved as a consultant, perhaps with a modified work week. The buyer builds equity in the business over, say, three to five years. As he pays off the seller, the buyer owns that much more in the business, with no debt. It’s like when you buy a house – you pay principle every month and gain equity in the house.”

Another option is to sell to a group of employees through an employee stock ownership plan.

“An ESOP is a tax-advantaged type of arrangement that has worked well for some of our clients,” Wolpow said. “It is also more complicated and has to be done carefully to get all of the benefits from it.”

The owner is paid for the business upfront when the ESOP takes over, but the deal involves bank financing, and the bank typically will want the owner to remain involved in the company for a period of time, Meinberg said. Because an ESOP is expensive to set up, it’s typically not a great option for companies with only a few million dollars in revenue, he said.

Plan early

The most important succession planning advice accountants give their clients is to plan early.

“The more you are prepared for it, the more likely you are to have a robust management team to handle the transition,” Seagroves said. “What you don’t want to happen is have the CEO wake up sick one day, and the transition is out of his control. If you have a great management team in place, you can weather that scenario.”