What's the Right Strategy for Exiting Your Business?

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When you hear the term "exit strategy," your first thought might be it's a way to end your involvement in a business. While that's an obvious conclusion, the term has other implications too. An exit strategy can also propel a business in a new direction of management or leadership, move a company toward its long-term goals, or pivot operations to maintain financial stability during challenging times such as the ones we've experienced during the past two years.

According to the U.S. Chamber of Commerce, a fully vetted exit strategy takes into account all stakeholders, finances, and operations, then details necessary steps to transition, sell, or close a business. While strategies can vary by business size and type, strong plans not only recognize the value of a business but also provide opportunities to optimize outcomes and build a foundation for its future.[1]

As we discussed in the previous two articles on this topic, "Are You Ready to Sell Your Company?" and "4 Exit Strategies for Transitioning Your Business", there are numerous ways to exit a business. In this third and final article of our series, we discuss the pros and cons of selling a business to a third party, recapitalization, and orderly liquidation.

Sale to a third party

Third-party sales of businesses are the most common exit strategy—in many cases, they present the highest dollar amount in the open market.

There are strategic buyers, which are usually larger companies. These types of sales are good for "bolt on" acquisition opportunities that already scale up or complement a company's existing business model.

Additionally, there are financial buyers—typically long-term investors who are mainly focused on cash flow.

The Changing Dynamics of America's Small Businesses

According to 2021 data from the U.S. Small Business Administration, there are 32.5 million small businesses employing a total of 61.2 million workers.[2] During the past two years, many business owners have had to make tough choices during trying times – difficult decisions that ultimately resulted in reshaping and executing their succession and exit-planning strategies.

According to a recent succession survey of companies of various sizes across all industries, two-thirds (65%) of the wealthy business owners surveyed have moved their businesses since March 2020. Their reasons included moving closer to family (31%), moving to lower-tax states (34%), and moving because working remotely offers flexibility in business location (27%). Furthermore, 75% of those surveyed are considering moving their businesses in the next three to five years.[3]

Pros:

- A sale to a third party typically brings the highest price.
- This is a rather quick exit strategy once the transaction is finalized (e.g., an outright sale or an earn-out).
- Usually, a sale to a third-party yields more cash up front (if not all up front).
- With regard to default risk, there is generally less risk for the seller with a third-party sale. (If you are like many owners selling your business, this is your retirement plan—having to rely on installment payments can be risky.)
- The terms of the deal can be less subjective and more immediate.
- A third-party sale could facilitate new growth strategies and goal-setting geared toward anticipated business outcomes. A third-party sale could help preserve the legacy of a company that has been struggling over time giving the seller confidence that the business will transition into good hands.
- This option alleviates any inter-company politics.

Cons:

- A business sale to a third party can be a tedious and long process.
- The sale process can detract from the focus and energy of running the business.
- With this option, it is hard to be discreet while brokering the deal without the industry finding out.
- Potential earn-outs after the actual sale can be a downside if the agreed upon performance metrics are not met.
- After the sale of the business, owners can become frustrated with various aspects of the process and terms.
- Overall, business owners may find it difficult and complex to close the deal on a third-party sale.

Recapitalization

Recapitalization is a strategic way to fund your company's balance sheet by bringing on a partner—typically a private equity firm—to finance the business with either debt or equity. This exit strategy gives the company an opportunity to seek quicker growth or fund research and development projects for a potential larger return as the end game.

Pros:

- Recapitalization allows for a full or partial exit depending on how much of the business was sold.
- This option reduces the owner(s) risk in the business by being able to diversify personal asset allocation.
- This exit strategy provides capital for faster growth and new projects with potentially higher return on investment.

Cons:

- Sometimes it can be a challenge merging two cultures and systems if the partnership is not a good fit.
- Owner(s) might not remain in charge if a majority interest is sold.

Orderly liquidation

One of the most difficult things to do as a business owner is to shut down the company you worked so hard to build. However, it may be your best option in order to repay your investors and still preserve, capital/investment.

Orderly liquidation is typically seen in companies that go out of business or shut their doors because of an unforeseen death, divorce, or distressed situation. Essentially, the sum of the total asset values exceeds the ability of the business to produce the income required to support the investment.

If you decide to liquidate your business, be sure to take these important things into consideration before you shut the doors for good:[1]

- File all business documents required by law to dissolve your company.
- Cancel unnecessary business expenses (e.g., registrations, licenses, business name, etc.).
- During the closing process, make sure employee payments are compliant with state and federal labor laws.
- File final tax returns for your business. Keep all tax records and business returns for the legally required time frame (typically three to seven years).

Pros:

- This exit strategy is good for a quick disposition of assets.
- Liquidation can be cheap in cost to facilitate.
- This can be a good option when asset values exceed the value as a going concern.
- Going this direction may be advantageous if the sum of the parts of the business is greater than the whole. This is especially true for asset intensive businesses.

Cons:

- The final proceeds of an asset sale could end up being very different than fair market value if you are needing cash quickly to pay debt or wind-down the business.
- No intangible capital (goodwill) is added to the total sum of the business as a whole.
- Selling tangible assets is different than selling an ongoing business. There are different tax implications and knowing your options can take time to understand.

We can help

Selling, recapitalization, or liquidation of a privately owned business can be complex. Commerce Trust Company is here to help you plan and navigate your various exit strategies. Contact us if you are ready to exit your business, have questions about how to proceed, or need further information and guidance from our professionals who have helped countless other business owners.

[1]Jacqueline Medina, U.S. Chamber of Commerce, "Ready to Move On? How to Create an Exit Plan for Your Business," https://www.uschamber.com/co/start/strategy/business-exit-plan, November 18, 2021

[2]U.S. Small Business Administration Office of Advocacy, 2021 Small Business Profile, https://cdn.advocacy.sba.gov/wp-content/uploads/2021/08/30144808/2021-Small-Business-Profiles-For-The-States.pdf, accessed April 15, 2022

[3]Executive Summary, "Succeeding Through Succession: Clarfeld | Citizens Private Wealth's Success and Succession Survey," https://clarfeld.com/Content/assets/pdfs/Succession_Survey_Executive_Summary.pdf, accessed March 16, 2022

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Anthony is a closely-held business advisor at Commerce Trust Company. He specializes in the valuation of closely-held businesses and business interests in a fiduciary or custodial capacity. The majority of the companies are valued on an annual basis in association with their review for determining the investments' suitability and inclusion in account portfolios; as well as managing valuation services provided for external engagements such as locating purchasers for, and completing the sale of closely-held business interests. Prior to joining Commerce Trust Company, Anthony was a financial advisor with Merrill Lynch Pierce Fenner & Smith, as well as PNC Investments. He holds a bachelor's of science dual degree in both finance and marketing from Saint Louis University. In addition to these degrees, Anthony holds his Series 7 and Series 66 licenses with the Securities & Exchange Commission (SEC) as well as the Life, Health, & Variable Annuity Insurance licenses with the State of Missouri. Anthony is a Certified Financial Planner (CFP) candidate and has completed two of the five levels. He is also a member of the National Trust Closely-Held Business Association (NTCHBA) and the Risk Management Association (RMA).