The top seven strategic business transition options

Many successful business owners we speak with choose their transition option based on something they have heard from an unreliable source. This could be from other business owner friends who might have already transitioned their business.

Generally, most business owners are not aware of all their transition options. This means they could be making one of the biggest decisions of their career with incomplete information. For successful business owners to be able to meet their business, personal, and financial goals, understanding all seven transition options that are available goes a long way. There is an eighth option, orderly liquidation, which is not a recommended avenue but generally is the cheapest of all the available options. Too often owners are forced into this transition option when the necessary education or planning has not taken place. The downside is they won't be able to maximize their value – as the owner won't get compensated for their intangible assets, they will typically have a higher taxable gain, and this ultimately disrupts company culture.

Just because a friend or family member was successful choosing a certain transition option doesn't mean it will work for you.

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Transition Options	Pros	Cons
1. Management buyout (MBO) In this transaction, a company's management team purchases the assets and operations of the business they manage. Management typically uses the assets of the business to finance the transaction. Generally, the owner holds a good portion of the purchase price through a seller note.	• No disruption • Can partner with other investors to obtain resources for growth capital • Retains human capital and provides manager continuity • Reasonable timeline can be created	• Unable to maximize value and deal structure • Tension could arise through negotiation and strain relationship • Managers don't necessarily make decent entrepreneurs • A lot of seller financing adds risk to seller • Buyers don't have sufficient capital • Business could suffer
2. Sell to a third party The business owner sells the business to an unrelated third party. There are lots of different types of buyers including (but not limited to) financial buyers, strategic buyers, individuals, and sometimes a combination. A sale could occur through an unsolicited offer, negotiated sale, or controlled auction.	• Generally, highest purchase price • More cash at closing • Shorter post-transition time frame • Favorable deal terms • Injects new talent • Creates clean break with family	• Process can be longer • Time consuming • Closing can be difficult • Highest cost of options (with highest benefit) • Lots of moving parts with significant investment recommended from external advisors • Requires post-transaction involvement • Confidentiality concerns

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3. Sale to existing partners This option is only available when there are multiple owners. Smooth owner buyouts are tied to the presence and quality of a buy/sell agreement. Most buy/sell agreements (if they exist) haven't been updated in decades.	• Educated buyer • Minimal interruption • Advanced planning completed • Known process if quality buy/sell in place and funded • Costs are reasonable	• Won't maximize value • Potential animosity • Loss of talent • Buy/sell could limit transition options • Proceeds generally are received over time
4. Family transfer The business transitions to children or other family member. About half of business owners want to transition their business to their family. Typically, less than one-third of owners transition their business to their family.	• Advanced planning completed • Preservation of family legacy • Controlled process • Minimal interruption • Costs are reasonable	• Navigating family dynamics • Path of least resistance, but not always a path to growth and success • Good strategy is often overlooked by family situation • Loss of key management • Won't maximize value • Unfunded buyers
5. Absentee owner Owners slowly (or quickly) transition all or the majority of the responsibilities to the management team. They don't sell the stock/shares and retain effective control of the company. They may check in periodically, but for the most part the business runs without them. This option gives owners who struggle with emotionally letting go an opportunity to see what it will be like being away from their business for an extended period while still retaining ownership.	• Very little cost (if any) • Owner continues to receive compensation from business • Minimal disruption to company • Transition can be slow and over time	• No new talent infused into business • Largest (typically) asset remains illiquid and susceptible to various risks (internal and external) • Loss of owner's knowledge • Don't 100% transition away from the business
6. Sell to your employees (ESOP) An ESOP (Employee Stock Ownership Plan) is a specific way to share ownership with employees that can provide tax benefits to the company, to sellers of stock to an ESOP, and to employees. A company sets up a trust fund to acquire and hold company stock. The company can contribute shares directly, contribute cash to buy shares, or have the trust borrow money to buy stock.	• Could cause employees to think and act like owners • Can retain employee talent as seen as additional benefit • Taxable gain could be deferred • Shares purchased with pre-tax dollars • Business stays in the "extended family"	• Typically, only good for transitions over time • Company required to buy back shares from employees who have left • Securities registration exemption required • Benefits are limited to certain entities • Complex and costly

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7. Recapitalization/Refinance The business owner could sell a majority or minority of the shares of the company. This generally involves bringing in an equity investor or lender to perform as a partner in the business. Participants can be creative in funding the business's balance sheet.	• Allows owner to take some chips off the table • Can be used with other transition options • Provides capital to fund expansion • Owner can take advantage of second sale at potentially higher value • Diversifies owner's asset allocation	• Results in accountability to investors • Give up some control • Social capital is affected • Takes a long time to complete • High cost in relation to benefit

For more information about the best option to transition your business,
contact your Key Family Wealth Advisor.

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