Raising Capital and Developing Exit Strategies for the Closely Held Business Owner: A Tutorial for Financial Professionals

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Abstract: This article will detail a number of concerns of the 21st century small- to middle-market business owner and the ways in which financial professionals can help address those concerns, including raising capital to support the growth of a business and, ultimately, deriving liquidity from the significant amount of wealth tied up in a business.

Introduction

Business owners in the 21st century face a multitude of issues that require them to work on their businesses and not just in them. While competing in an increasingly challenging marketplace, they need to address their need for growth, raise capital to support that growth, develop an acquisition strategy for accelerated growth, and learn how to derive liquidity from the significant amount of their wealth locked up in their business interests. Not the least of their needs is that of preparing an exit strategy, including succession planning.

This article will detail a number of concerns of the small- to middle-market business owner and the ways in which financial professionals can help address those concerns.

Note the following statistics:

• The 2000 U.S. Census tallied just over 25 million U.S. businesses; 80% were closely held sole-proprietorships, partnerships, or LLCs generating more than $3 trillion in revenue in 2000.¹

• Over 90% of all business enterprises in North America are privately owned.²

• The proportion of family firms in the United States has been variously estimated as 90%, 95%, and 96%.³

• It is estimated that 63% of business owners lack a written strategic plan.⁴

• Nearly 40% of all family-owned business owners are exiting within the next five years.⁵ (Ultimately, every business owner will exit his or her business,
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voluntarily or involuntarily.)

• Such transfers will be included in what is often referred to as the largest transfer of intergenerational wealth in history. Economists estimate $10.4 trillion of net worth will be transferred by the year 2040 with $4.9 trillion being transferred in the next 20 years.

These compelling statistics and the aforementioned challenges suggest the need for sophisticated strategies and technical experts to devise and deploy exit strategies, estate/wealth preservation plans, and strategic plans for the sale of a business, as well as coordinated corporate finance and lending services. Often today’s pressing concerns about business growth and the capital needed to promote such growth dominate the minds of business owners. As a result, an adviser’s discussion is likely to end quickly when the subject is limited to wills, trusts, buy/sell agreements and estate taxes. While such issues are ultimately important—if not critically so—business owners are much more likely to be focused on surviving under the intense competitive pressures of today’s global economy. Owners are concerned about maximizing their value as shareholders and ultimately converting that equity into cash when they exit their businesses. An irrevocable trust or family limited partnership may not be nearly as urgent as access today to $20 million of much needed capital or the owner’s desire to profitably exit his or her business. Attorneys, accountants, financial planners and other financial professionals will need to be conversant with a broader list of solutions than has typically been within their realm of expertise and comfort levels.

The most important skill many financial advisers possess is their ability to create and maintain trusted advisory relationships. Trusted financial advisers come in contact with and count as their clients hundreds of business owners. They are, therefore, uniquely positioned as the adviser of choice to inform, lead, and coordinate their clients through what many consider to be the single most important event in the business owner’s business life—the exit strategy. Much emotion is tied into this event. It’s not all dollars and cents, which is what it is often reduced to by the transactional community. The owner’s business may be his or her identity, his or her “baby,” often the owner’s worth as a person. Solutions that are consistent with a business owner’s visions, values and goals are a critical element to successful deployment of financial strategies. Advisers need to know: What makes clients run? What keeps them awake at night? What brings them joy? How do they define happiness, success and fulfillment? It is with this vital data and intimate knowledge, along with keeping their clients’ best interests at heart, that financial advisers can bridge the gap from traditional advisory roles to forge relationships with investment bankers, mergers and acquisitions advisers, and other specialists who can help the clients examine all facets of a proper growth and exit plan.

The idea of working with other advisers is not new. Financial service professionals have worked in cooperation with their clients’ CPAs, attorneys, property and casualty brokers, retirement plan third-party administrators and others for many years. This is done to ensure that the client’s needs are properly met from all aspects, i.e., tax, legal, product, etc. This relationship with other professionals is commonplace, necessary, and serves the client’s best interests. Indeed, it would be against the client’s best interest for the financial professional to make recommendations without coordinating with the client’s other advisers. And when the client does not have an existing legal, accounting or other needed professional relationship, the trusted financial adviser will conduct his or her own due diligence and introduce the client to one or several experts. While many clients do have an accountant and attorney with whom they already work, they do not generally have relationships in place that can execute specialized growth and exit strategies. The client either was not ready or did not yet perceive the need. But perhaps now he or she has reached that critical point where exiting becomes a top-of-mind issue. There are typically many choices. The client may ask: Who can educate me? Who can be objective? Who can guide me to an appropriate transaction, if that is what is called for? Which transaction? How will the business transaction impact my personal financial and estate planning picture?

The Value Path

The Value Path (Figure 1) summarizes the typical stages of business development and the needs at each stage. Entrepreneurs often spend the better part of their
adult lives nurturing and growing a business. They have taken on significant risk because they were passionate about their unique ability to compete in the marketplace and win based on their ideas, products, and services. Their company has survived and thrived and ideally has passed through the early stage, to the growth stage, to the late stage, and then to the point of exit.

The Value Path discussion is appropriate for initial interviews and in-depth data-gathering meetings with business owners. It provides a framework to facilitate a discussion of where the business owner currently stands on the path from early stage to his or her ultimate exit plan. It can also help probe to determine which topics are of concern to the business owner at his or her particular stage.

As seen in Figure 1, there are both traditional and nontraditional services and needs along the Value Path. Each stage has its own unique requirements for planning advice, capital, and exit strategies.

**Early Stage**

The early stage is typically characterized by 24/7 workweeks, a high degree of owner control and autonomy. The owner is often overextended and undercapitalized, trying to keep creditors at bay, minimize taxes, and reinvest profits to finance future growth, often at personal sacrifice. The majority of businesses will not survive the early stage.

**Growth Stage**

The growth stage is characterized by a new feeling of success. The business has made it. However, the owner cannot afford to rest on his or her laurels. The challenges of running a growth-stage business include: 1) attracting, training, and retaining employees; 2) obtaining additional capital; 3) building more infrastructure, inventory, equipment, and real estate; and 4) staying one step ahead of competitors.

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**FIGURE 1**

Value Path

<table>
<thead>
<tr>
<th>Start Up</th>
<th>Employee Benefits</th>
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<td>Growth Stage</td>
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Late Stage

During the late stage, the business owner has become a respected and influential member of the community. The business owner is now at a stage where he or she enjoys success and begins to think about how to convert the equity built up inside the business into resources for retirement, transfers to family members or employees, or the opportunity to satisfy charitable intentions.

Raising Capital

One of the greatest challenges business owners face daily is financing their business. Whether financing is used to fund a start-up, provide necessary working capital for current operations, fund growth, or fund an exit strategy, the appetite for capital is omnipresent. It is important to understand how business owners raise capital beyond the founder's own money, family, and friends.

The likely first source, of course, is banks. Banks have a process to approve loans based on their established loan policies, credit scoring, approval systems, and loan committees, and business owners need to know how a bank approves loans before submitting an application. There are various loan durations available, matching the need with the useful life of the underlying collateral. Other popular loans include lines of credit, which establish a maximum amount that can be borrowed, real estate loans, equipment loans, construction loans, and inventory loans.

Banks generally approve or disapprove loan applications based on “the 4 Cs of commercial lending”:

1. Is there sufficient character of the business owner and management team? Loan committees will consider the borrowers’ reputation, business background, and credit history.
2. Is there enough cash flow (typically three to five years of historical or projected cash flow, not necessarily to be confused with profits) to repay loans?
3. Is there sufficient capital encompassing all of the assets owned by a business? Owners must have sufficient “skin in the game” or else a bank will not lend. Generally, banks will look for 20%-30% owner equity into any business loans.
4. Is there enough collateral? Lack of sufficient collateral will cause a loan to be turned down. All collateral is not equal and will be discounted based on risk. For example, cash and cash equivalents may be considered as collateral on a dollar-for-dollar basis, while other assets such as accounts receivable, inventory, equipment, marketable securities, and real estate will be discounted by 20%-40%. Adequate collateral does not replace a lack of cash flow.

Almost without exception, banks will require personal guarantees from the business founders or largest stockholders. This puts the individual’s personal assets at risk. If traditional banks decline to lend, additional sources of borrowed capital include 1) local, state, and federal governments [such as loan programs sponsored by the Small Business Administration (SBA)], and 2) asset-based lenders who provide equipment loans, leases, and accounts-receivable factoring. These lenders take much greater risks than traditional banks, and lending rates are commensurately higher.

Finding someone who can help the business raise capital is a great boon to entrepreneurs, and some financial advisers now include loan brokering as a nontraditional but necessary service. A professional with intimate knowledge of the business, its owner(s), and the transaction has a real advantage in helping that business find money. However, the quest for financing is but one piece of the business owner's puzzle; the qualified adviser who considers the entire puzzle and helps determine what would best fit into the open space is truly valued.

Issues that complement the raising of capital include contract law, liability protection, estate planning, succession planning and general tax planning (Figure 2).

Other Sources of Early-Stage Capital

While raising capital will often be a primary issue for a business throughout the Value Path, early-stage capital is often the most difficult to raise. When lending sources are unavailable or insufficient, equity partners could be the solution.

*Angel investors* (as they are frequently called) are high-net-worth individuals seeking high returns who
typically invest $100,000-$350,000 in early-stage businesses. An angel usually has in-depth knowledge of a business or industry he or she is investing in through prior experience in management of a similar type of business. Angels often want to mentor or participate in management or serve as board members.

Venture capital (VC) firms are typically the largest cash investors in early-stage entities when banks and other lenders are unwilling to make sufficient capital available. VCs raise the capital they invest from institutions such as pension funds and insurance companies, who earmark dollars for such high-risk/high-return investments. VCs generally have specific industries they favor, such as technology, health care, or consumer goods. VC minimum investments are usually $100,000 to $4 million and their maximum investments range from $250,000 to $50 million. Most VC investment activity is in the range of $1 million to $20 million. To compensate for substantial risk taken, a typical VC deal anticipates annual return targets ranging from 30%-40% or more. Time horizons to liquidity are generally five to seven years. VCs often place certain demands on the business, such as gaining a substantial equity position in the business and seats on the board of directors.

Private equity groups are another source of capital for businesses. They are pools of capital usually funded by money management firms, pensions, other institutions and select high-net-worth investors. Private equity groups sometimes fund early-stage investments. Most often, they will fund growth- and late-stage businesses in need of “mezzanine” financing (subordinated debt layered between senior bank debt and equity), or buyouts in management-led transactions and leveraged “recaps” (the reverse of management buyouts where management ownership is reduced). Figure 3 shows the differences between debt and equity.

**Exit Planning**

At some point in the life of the business, typically the late stage, the owner must consider his or her exit plan. Thus, it is helpful to understand the key principles of exit planning as a process, not a one-time event.

The first step is to set goals and priorities. A few of the questions to be asked are: What does the owner want to do next with his or her business—continue to grow it and keep it until his or her demise? Is family succession an
option? Are children ready, willing and able to take the reins? Does sale to management or an ESOP make sense? Does the owner want to sell a portion or all of his or her business? What is the owner’s planned departure date and what will he or she do afterwards? Is the owner emotionally and financially ready?

The second step is to conduct an analysis of the current condition and determine the value of the business. Is the business ready to be transferred or sold, or are interim steps necessary to cure weaknesses and enhance value? How much income will the owner require post exit to achieve financial independence?

The last step is to identify exit options, choose the right one, and execute. Education is important in order to become aware of available strategies and their advantages and disadvantages. Once a course of action is chosen, an advisory team must be assembled to carry out that strategy properly.

Traditionally, financial service professionals who chose to specialize in working with owners of closely held businesses were often extremely qualified and comfortable with advising their clients in the areas of transferring business interests, business succession, and estate planning with such techniques as:

1. Transfer during lifetime via gifts to family members through the use of the annual $11,000 gift tax exclusion ($22,000 if made jointly) and, possibly, their lifetime $1 million gift tax exemption ($2 million if made jointly).
2. Transfer during lifetime via intrafamily sales—installment sales, private annuities, etc.
3. Transfer at death to family and others via testamentary bequests.
4. Transfer at death via a buy/sell agreement to family or nonfamily members.

But what if these approaches do not suit the client? Not every client is a candidate for succession planning. What if the client does not have children or partners in a business? What if the children did not inherit their parents’ passion for the family business? In the past, advisers would perhaps look to structure a plan to transfer to key employees without determining that it truly met the client’s objectives. Would he or she realize maximum sales price through sales to insiders? Can key employees afford a buyout or is the owner merely buying out himself or herself by substituting installment note payments for forgone salary, bonus, and profits? Will the owner’s ongoing need to continue to manage, be held responsible, and worry about actually receiving the buyout payments be the best choice?

**Potential Exit Strategies—Converting Business Value to Personal Wealth**

Financial advisers often need to be excellent problem identifiers, not necessarily problem solvers. The ability to recognize challenges and opportunities allows advisers to best serve business-owner clients by helping them clarify and focus on those issues and bring in experts to help execute the appropriate transaction(s). While by no means all inclusive, the following are a number of potential transactions for a client to consider.

**Mergers & Acquisitions (M&A)**

**Mergers**

A merger involves certain stock-related transactions to accomplish financial or liquidity goals of a business. While there are a variety of mergers taking place in the market, the most common are 1) forward mergers, where the acquired company is merged into the buyer’s company and disappears,
and 2) reverse mergers, where the buyer’s company is merged into the seller’s, with only the acquired company remaining.

Mergers have grabbed the headlines recently with huge deals such as Time-Warner and AOL. (Worth over $150 billion, it exceeds the annual GDP of 85% of the world’s nations!) Daimler-Benz, Coca Cola, and Louis Vuitton are just a few of the world-renowned brand names involved in recent M&A transactions. Most deals don’t garner this much media attention, and M&A activity is common in the small to middle markets as a successful technique for achieving owners’ personal exit goals.

**Acquisitions**

Companies can grow organically or through acquisitions. Acquiring other companies, if done correctly, may help achieve growth goals faster. Some of the benefits of an acquisition or takeover are:

- economies of scale and scope
- market expansion
- new capabilities and managerial skills
- competitive advantages
- development of new customer relationships
- greater technology and R&D capabilities
- industry rollups, i.e., consolidating fragmented industries
- prevention of competitor from acquiring target company
- globalization

Some of the most active acquirers of the last two decades include: 1) General Electric—617 acquisitions from 1981-1997; 2) Cisco Systems—30 acquisitions from 1993 to 1998; 3) Tyco International—24 acquisitions since 1986; 4) Microsoft—50 deals from 1994 to 1998; and 5) Intel—75-100 deals per year.

While such acquirers may seem too large for the interest of the reader’s typical client base, these large public companies occasionally acquire businesses in the small to middle markets because they may provide access to customers, patents, personnel, etc., that the acquirers do not have.

**Sale of a Business**

Beyond the obvious circumstances of illness and death, owners sell for the following reasons:

1. Capital gap—Their business has become too big to be small and too small to be big. It must grow or else it may wither and die. Growth can be risky and requires significant investment of energy and capital the owner may no longer have.
2. One-off purchases (i.e., yacht or summer home) that have been delayed or sacrificed due to the all-consuming nature of running a successful business. The owner plowed money back into the business and deferred personal gratification, and often, business owners may muse: “One of these days, when I sell the business, I’m going to do/have/go to...”. Of their clients, advisers may query: What’s their personal dream? What kind of lifestyle do they want to have? What is their definition of the perfect day/week/month/year?
3. Boredom or burnout.

When it comes time to sell, owners need professional advice because most business owners have little or no experience at selling. Corporate or institutional “acquirers” are experienced in the world of buying businesses at the lowest possible price and the best terms. Inexperienced sellers need representation and guidance to assure that they receive maximum value and fair terms.

Why would owners consider their exit now? In addition to personal considerations, today’s tax and economic factors are quite attractive. Interest rates are still at the lowest levels in more than 30 years; therefore, the cost of capital is low. Long-term capital gains taxes, presently 15%, are lower than have existed for many years. The U.S. economic cycle is relatively strong, and inflation is low. The stock market is relatively strong, providing a currency for publicly traded companies to use their stock to make acquisitions. Finally, foreign buyers are keenly interested in entry into the U.S. markets, especially with the dollar relatively weak against major foreign currencies.

**Other Considerations in Selling a Business.** Financial advisers can assist business owners in defining options and implementing strategies that enable them to exit their companies on their own terms and at the most appropriate time. However, the following considerations...
must be made.

The goal in each transaction is to maximize the value of the business and create liquidity for the owner—whether a stock or asset sale, a merger, partial sale, or recapitalization. Ideally, a plan to reinvest those proceeds should be developed prior to the transaction. This is also an ideal time to update and revise, as necessary, the client’s overall estate plan.

Generally, a business owner should not try to sell the business on his or her own. A team, led by the client’s financial adviser, can retain the services of a competent investment banker who will identify and qualify potential buyers, create and defend a higher valuation, and create a controlled, confidential auction of the business. Services also include negotiation and structuring of the transaction and facilitation of the closing process with the transaction attorney. The investment banker will add value to the transaction in ways too numerous to list. If liquidity is paramount, then a sale of the business for cash is superior to all other alternatives. A cash sale permits the seller to diversify his or her holdings, as opposed to holding a large stock position in a larger public company or holding restricted stock after an initial public offering (IPO).

Small to middle-market businesses are often overlooked by the major investment banks. Many of the large firms have minimum fee requirements that can only be satisfied by businesses worth over $100 million. Below that level, the investment banking community is somewhat fragmented and consists of “boutique” operations. Many of these do an excellent job in the small to middle markets, but care must be taken to choose the right firm for a particular business and transaction to satisfy the owner’s objectives.

Business Valuation

Surprisingly, many business owners have no idea what their business is truly worth. They often rely on “rules of thumb” for their industry, which can be dangerous. In fact, these guesses can be off by as much as 50% in either direction. Thus, a business the owner believes is worth $10 million may really be worth $5 million or $20 million. Values will vary dramatically depending on the purpose of the valuation engagement. However, valuation is a critical component in the planning process. Valuations are typically needed to develop strategies to sell a business, for estate planning purposes, to buy out other stockholders, or for ESOP structuring and transactions purposes.

Depending on the purpose, there are a number of approaches to valuing a business. Generally, for purposes of selling a company, a market approach compares the company to similar public companies or recent industry transactions. Alternatively, an income approach includes capitalization of prior earnings (earnings before interest, taxes, depreciation, amortization—also known as EBITDA). Discounted cash flow analysis is a third valuation alternative. Various rules of thumb abound, and there is no substitute for a professional appraisal. What the business owner and his or her financial, legal or accounting advisers don’t know about valuation can hurt them financially. This is a key reason to retain an astute appraiser to make suggestions on valuing the business. Other advisers can potentially make suggestions that can enhance the value of a business.

Recognizing Opportunities

Merger, Acquisition or Sale

Far too many owners fail to plan for their eventual exit from their business in a timely manner. They buy into the myth that a “knight in shining armor” will come along and make them an all-cash offer for some outrageously high multiple of earnings at the precise time they are ready to exit. Others simply get so wrapped up in the day-to-day operations that they never take time to plan for the future. An owner should be prepared to sell at any time and should not wait too long to sell.

The financial adviser should be proactive and stand ready to play an important role in helping the business owner find the right advisers to guide him or her through each step of the exit process, from initial exploration to a completed transaction.

Questions to consider include:
Do shareholders desire liquidity?
Is the founder considering retirement on the near horizon?
Is family/management succession questionable?
Is the owner concerned by the need to reinvest capital to stay competitive?
Does the company have a division that does not fit its long-term strategies?
Has the client’s company been approached by a potential buyer?
Is the owner concerned about concentration of personal wealth tied up in business; does he desire diversification of his assets?
Will the company seek to accelerate growth through acquisition?
Multiple affirmative answers—or the presence of these situations—could be indicators that the business owner is a candidate for a merger, acquisition, or sale.

Private Placements—Debt and Equity
A private placement of equity is the sale of stock to individual investors that is sold privately and not in a public offering. It is generally an inexpensive and quick way to raise capital; however, compliance with SEC and other documentation requirements must be met.

A private placement of debt or equity can be done for private or public companies. In a debt-financed private placement, the company must have predictable cash flow to service the borrowings. In an equity private placement, the company must have a thorough business plan and a strong, experienced team of managers.

Questions to consider include:
• Is the company enjoying strong growth?
• Does the company wish to raise capital to support such growth?
• Does the company need to finance an acquisition?
• Is recapitalization a possibility? Does the owner seek liquidity, but not a total sale of business?
• Does the size of the offering make the public markets unsuitable?
Furthermore, if a business owner has had difficulty raising capital through traditional banking channels, alternative financing methods such as private placements should be considered. An early-stage capital raise may prove essential to grow a company to the point where a potential buyer becomes interested in the company.

Management Buyout (MBO)
MBOs are acquisitions of an operating company or corporate unit in which the senior management of the business participates as a significant equity partner in the acquisition. MBOs were formally referred to as leveraged buyouts (LBOs) but that term has fallen out of favor. LBOs often were financed largely by debt.

Questions to consider include:
• Does an internal or external management team want to buy a company or a division of a company?
• Does an internal management team want to acquire or substantially increase an equity position?
• Does a minority shareholder(s) desire to buy out a majority (older, retiring) shareholder?
Much planning is necessary to structure the transfer properly in order to minimize taxation for the buyer and seller and secure monies due.

IPO
Most readers will recall the IPO frenzy in the technology sector during the mid to late 1990s. An IPO involves the sale of stock to the public, as opposed to remaining a privately held business. Only the strongest middle- to large-market companies may even consider this. An IPO is really a financing tool to grow a company, rather then a direct exit plan. In the short term, the owner may be able to take some “chips off the table,” but the real payoff may not occur until several years later due to selling restrictions on publicly traded stock. IPOs require a tremendous amount of effort and commitment, both before and after going public. However, there are many advantages to an IPO, including:
• There is the potential for increased valuation of stock after the IPO.
• Public stock gives the business “acquisition currency” to acquire other companies.
• Public stock options can be used to attract and reward top talent.
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- New stockholders provide a major infusion of capital to grow the business further. Questions to consider include:
  - Is the company enjoying rapid growth and does it anticipate strong, continued growth?
  - Do the owners require immediate liquidity?
  - Does the company have compelling products or services with proven markets?
  - Does the company have a strong management team that recognizes responsibility to stockholders?
  - Does the company have recognized backers (e.g., well-known venture capital investors)?
  - Would being public enhance the company's position with customers and employees?

**Employee Stock Ownership Plan (ESOP)**

An ESOP is a qualified retirement plan with vesting schedules, contribution limits and other ERISA requirements. What makes it unique is that the purpose of an ESOP is to buy company stock. ESOPs are authorized to borrow money to do so and are not concerned about investment diversification.

Questions to consider include:
- Does the owner desire to create a market for his or her stock without losing control?
- Is the owner seeking a method to compensate and reward long-term employees with equity?
- Does the owner want to finance corporate growth using untaxed dollars?
- Does the company have a fairly large and sophisticated pool of employees?
- Is the owner interested in deferring capital gains taxes (perhaps indefinitely under certain circumstances)?

There are numerous transactions that go beyond the scope of this article that include joint ventures, strategic alliances, restructuring activities (i.e., divestitures, carve-outs, spin-offs, etc.). Changes in ownership may also take place through leveraged recapitalization, dual-class recapitalization, and share repurchasing.

**Exit Strategy Process**

The exit strategy process is all about building and realizing value. It is also about understanding the value of the business and exposing it to a wide range of prospective buyers. For reasons not always immediately apparent, valuations from one buyer to another can vary greatly depending upon their individual requirements. For this reason, it is often true that the best buyers may not be those one would naturally assume. A seller of a garden supply business may think his or her best buyer is a competitor who wants greater market share and product line extension. A better opportunity might be an offshore company looking for distribution in the United States for its patio furniture product line or a foreign financial buyer looking for attractive properties in order to diversify its holdings. Sorting all this out and achieving maximum value from the transaction usually requires the engagement of an M&A advisory firm or investment banker.

Financial advisers are not, nor should they be, investment bankers or M&A advisers. However, it is advantageous to develop relationships with these firms and have a deep understanding of this market and its dynamics. These specialists can assist the business owner in analyzing the crucial factors leading up to a decision to grow, sell, merge, or take advantage of other opportunities with his or her business.

Once a choice is made, there are well-defined procedures that need to be in place in order for the process to be efficient and orderly. Some of the obvious steps that need to be taken by the exit strategy advisory team include:
- identifying the client's goals
- valuation of the business
- recasting of financial statements
- development of proforma financial statements
- narrative description and overview of the business and the market
- identification of potential buyers
- discussions with prospective buyers
- negotiation with buyer(s)
- letter of intent
- due diligence
- purchase agreement
- closing the transaction and follow-up

Understanding the taxation of a particular exit strat-
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egy is also crucial. Some of the considerations are
- asset versus stock sale
- avoiding double taxation
- tax-free reorganizations
- use of deferred compensation
- reverse mergers
- spin-offs
- preserving net operating losses
- use of charitable tools such as remainder and lead trusts, foundations, and bequests

The more formally organized and detailed the exit strategy, the less likely the company will be sold below its optimum market value. While it is time consuming and can be emotionally challenging, the end result of a successful exit strategy should be a happy seller and a contented buyer, ideally each achieving most of their objectives.

Conclusion

The role of the financial adviser is to assist business owners in defining options and finding experts to implement strategies that enable the business owners to transfer their companies on their own terms at the most appropriate time. Financial advisers should consider the following steps to broaden their practices and assist their clients in raising capital and developing exit strategies:

1. Become knowledgeable, but resist becoming an expert—if only because compliance departments will have their own liability considerations.
2. Apply exceptional relationship skills to assemble an advisory team and refer clients to experts who can provide capital and objectively analyze, educate, and transact the ideal exit strategy.
3. Create a comprehensive financial and estate plan to meet the clients’ objectives of financial security and preservation of wealth for their family and/or charity.
4. Widen horizons and expand vocabulary in order to speak on topics that are of paramount importance to the business owner but not previously part of the adviser’s repertoire.

It is essential to have these discussions with business-owner clients. Since the greatest amount of wealth in America is within privately held businesses and their transfer is often the biggest event in the business owners’ life, owners need a trusted financial adviser to turn to for advice and guidance. Unfortunately many financial advisers are on the sideline; exit plans are executed every day and most advisers are not involved. The result of a well-executed exit plan is the creation of liquid dollars to enable the seller to achieve his or her personal vision of financial security. This will also create opportunities for investment management and wealth preservation. Exit planning also provides a unique introduction to business owners and differentiates the financial adviser with clients and among other professionals. This level of advisory service may lead to higher planning fees and greater client retention. Finally, financial advisers may be able to participate in referral and/or finder’s fees on certain transactions when disclosed and conducted in a manner approved by their compliance departments. Of course, the primary objective is to serve clients’ needs first, last and always.

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(5) Ibid.
(7) Ibid.
(8) Ibid.
(11) An excellent source for information on merger and acquisition firms that serve the small to middle markets is the Alliance of Mergers and Acquisition Advisors (AMAA), www.advisor_alliance.com. The AMAA offers the Certified in Mergers and Acquisitions (CM&A) designation.

APPENDIX

Internet Resources

- www.sec.gov—Securities and Exchange Commission, for companies with similar businesses to compare valuations
- www.mergerstat.com—comprehensive source of M&A data
- www.aicpa.org—American Institute of Certified Public Accountants
- www.appraisers.org—American Society of Appraisers
- www.instbusapp.org—Institute of Business Appraisers
- www.equitystrategiesgroup.com—information for advisers to owners of closely held business
- www.SPARDATA.com—information on business valuation
- www.exitplanning.com—Business Enterprise Institute