

# CASHING IN NOT SELLING OUT: WHAT ARE THE CHOICES FOR EXIT?

Galloway & Macleod became employee owned in 2010



**AS THE M&A market bursts into life after the recession, an increasing number of business owners are looking for options to exit their business.**

Alistair Gibb is a Succession Adviser with Scottish Enterprise. "Business owners can be guilty of delaying succession planning, and not investing enough time in considering all options. The starting point is what they want to achieve, and how that fits with the possibilities."

Alistair and his colleagues will take the business owner through all options to determine what matches their aspirations.

"The knee jerk reaction is to identify a trade buyer for the company. Of course, in many cases this is exactly the right course to take. It can be a clean sale. A trade buyer may pay a premium over the asking price to gain ownership of a lucrative client base, or valuable IP, for example. The money changes hands and the vendor can walk away without a backwards glance. Finding a buyer can be easy or challenging depending on the sector and business."

In a family firm, the first choice is almost always to sell to family. However, that's not always an option if the next generation has chosen a different career. Indeed, the Scottish Family Business Association found that only 33% of family firms reach second

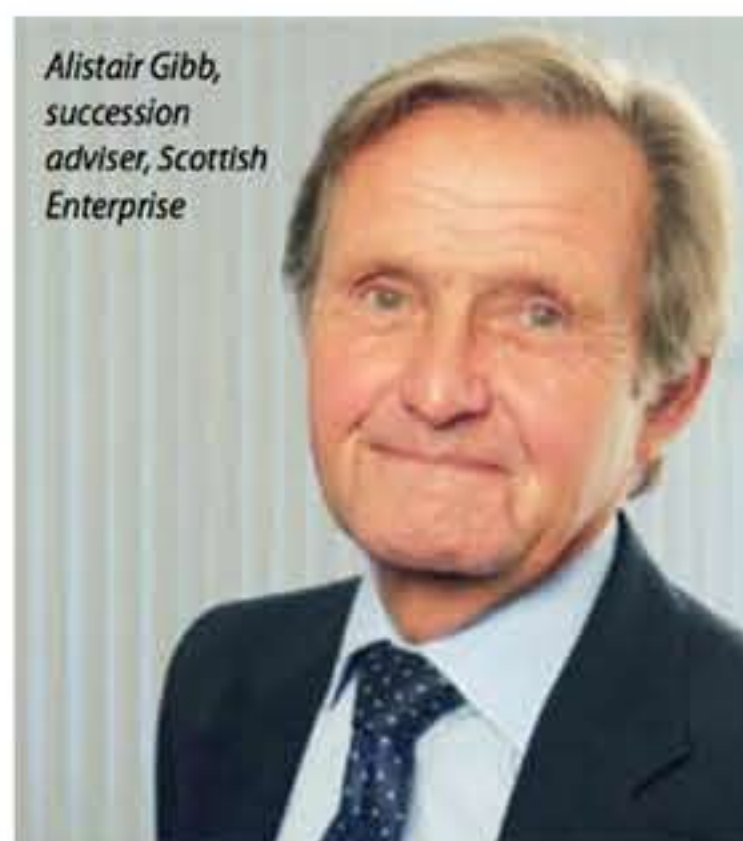
generation and only 9% make it to the third. The third generation of family owners of agricultural feed manufacturer, Galloway & MacLeod, sold their business to its employees in 2010. It was a good move for the firm, but it's a worrying statistic that more than half of family businesses have no succession plan in place.

Alistair has worked on a number of transactions

**Employee ownership as a succession route is fast gaining popularity... it allows owners a measure of influence over the future shape of the company**

where the business owners have decided on a sale to employees.

"An employee buy out can tick a lot of boxes. The vendors will achieve a fair market value for the business. They can have the satisfaction of knowing there will be minimal disruption to the operation



Alistair Gibb, succession adviser, Scottish Enterprise

and the employment of the workforce."

An added benefit for vendors is new legislation introduced in 2014. Sales to Employee Ownership Trusts are exempt from Capital Gains Tax as long as certain conditions are met. "Employee ownership as a succession route is fast gaining popularity", says Alistair. "I can see why. Employee ownership allows the vendors to dictate the pace of their exit and have a measure of influence over the future shape of their company."

The management buyout has similarities

with the employee buyout; the buyers know the business, there is continuity for employees and customers, and with "skin in the game", the management team is highly incentivised to ensure success. Raising the necessary finance can put strain on a small number of individuals. And, of course, these individuals will themselves be seeking an exit at some stage in the near future, thus raising the prospect of yet another distracting succession discussion.

An existing shareholder or a group of shareholders may offer to buy the shares directly from an exiting shareholder. That's a really simple solution but it doesn't happen very often.

Another option is for the company to buy the shares back from the shareholder. This buyback means that there are fewer shares in circulation, increasing the value of remaining shares. It's common for family businesses to operate a share



Robert Burns, Burness Paull

buyback scheme to retain family ownership of the firm. One downside is that it can mean control is concentrated in the hands of one or a few people.

Floating shares on the stock market has the advantage of bringing new cash into the company. The costs associated with making that Initial Public Offer (IPO) are high and the outcome can depend on the state of the market at the time of the float. And not everyone wants to run a business in the full glare of the financial press.

Valuing a business is not an exact science, says Alistair. "Everyone has their own opinion about pricing a business. Like any market where there is a single seller and limited buyers it comes down to negotiation." In an internal transaction, which is usually more collaborative than an aggressive buyer/seller negotiation, there has to be an agreed method to arrive at a fair valuation.

"It depends very much on the business. As a starting point, it's usual to begin with a multiplier of profit. I would consider what assets the company has. Does the company own property? Will that remain with the business or will the owner retain ownership and lease back? Hopefully, we would agree a price acceptable for both the vendors and buyers."

How is that price funded? Leading Corporate Finance lawyer, Robert Burns of Burness Paull is

seeing more willingness from lenders to support transactions, although vendor financing remains a strong element.

"Yes, banks are open for business but I don't see mainstream lenders being the sole funder for transactions. It's more usual to see a "parcel" of funding which includes some individual investment, a slice of external borrowing, and deferred consideration from the vendor. Indeed, a feature of a trade sale would often be some kind of "Earn-out" where the vendors' value will increase on the achievement of agreed performance triggers. There are specialist lenders appearing who will lend to companies in specific circumstances, for example, for companies making the transition to employee ownership."

As with all things legal, the devil is in the detail. Robert counsels that due care is taken to be fully appraised of the terms and conditions of any



Richard Wadsworth, Carbon Financial Partners

investment or debt. "There are risks with vendor financing, and the vendors should be comfortable these risks are mitigated against in the deal."

External funding also requires that care be taken. "There are costs with an external lender and there may also be certain conditions imposed such as the right to a place on the board. The remaining board members might want to consider the consequences of such external influence on the company."

It can be difficult for a vendor to assess how much cash they need to make it worthwhile to sell. Richard Wadsworth, Financial Planner with Edinburgh's Carbon Financial Planning, advises every individual is different.

"It's important to understand what your lifestyle might look like to allow you to apply a 'price tag'. Sailing the world and living in the Alps will demand a higher income than looking after the grandchildren and playing golf at the local club. If you continue to work, you'll need less capital to provide you with an income. If you want to start a new business, that might require some capital, and it may not immediately, if ever, provide you with an income."

Ultimately, you'll get to a number you would like to secure from the business. If this is less than the valuation of the business, that's great news – you should be able to lead the life you want. If it's more, you may need to re-evaluate your aspirations."

Entrepreneurs invest a lot more than their money in a business; it is only fair they get the appropriate value out of it when they move on. It can take a lot of thinking, and a fair bit of discussion, to arrive at a plan they are happy with. Taking time to consider all the options and make informed choices, makes for a happier retirement.

## FREE EVENTS PROGRAMME

Scottish Enterprise is running a series of free events on succession planning and employee ownership. See table below for more details. To book your place, register online at [www.scottish-enterprise.com/events](http://www.scottish-enterprise.com/events) or call 0300 013 3385.

Date	Event	Location
18 May 2016	Selling your business: options, value and financial planning	The Lighthouse, Glasgow
15 June 2016	Managing Leadership Succession	Apex Waterloo, Edinburgh
7 September 2016	Governance and decision making in employee owned firms	The Lighthouse, Glasgow
5 October 2016	Enhancing Engagement: the employee stake	Apex Waterloo, Edinburgh

[www.scottish-enterprise.com](http://www.scottish-enterprise.com)

