# Think About Transferring Your Company To Insiders

**Michael Wildeveld, CEPA, M&AMI, CM&AP, CM&AA, CBI, CBB**
michaelw@veldma.com

**Veld Mergers & Acquisitions**
www.veldma.com
1 Park Plaza, 600
Irvine, CA 92614
310-652-8066

Business owners decide to sell their businesses to insiders (co-owners, a key employee, or group of key employees (KEG—Key Employee Group)) for many different reasons. Rightly or wrongly, some believe that their companies aren't attractive to outside third parties. Others make this choice because they want to "reward" longtime employees with business ownership or want to give Key Employees the same shot at financial security they had. Still others have already made vague promises of ownership or believe the only way to continue their legacy is to transfer to key employees. Another group believes that a gradual sale to Key Employees will motivate those employees to increase the value of the company. Whatever the reason, we suggest that before you choose this exit path, you consider the subjects raised in this issue.

## Learn About The Transfer To Insiders

It is not particularly easy to transfer business ownership to key employees, children or other quasi-paupers without taking a great deal of risk. These transfers can succeed, however, with: 1) proper planning, 2) a well-managed company, and 3) given time. Proper planning begins with knowing what to do. You can read *The Completely Revised How To Run Your Business So You Can Leave It In Style,* (especially Chapters Four and Seven), attend workshops and seminars on the topic, and meet with your advisors.

## Test Your Assumptions

Do the key employees that you assume will want ownership really want to be owners? Many motivated, loyal employees want to remain employees. They don't want to take on the stress, sleepless nights, and specter of financial disaster that you carry. To succeed you, key employees must possess the same spark that motivated you each day to make something of your business—no matter the risk or personal cost.

In addition to desire, do your key employees have the ability to run the business without you? Good, even great, management and key employees do not equate to good, even passable, successor ownership.

Don't be surprised if one or more of your Key Employees declines to buy stock—even under the most favorable terms. It is difficult, if not impossible to know what fires burn within your key employee group until you present it with a concrete proposal.

## No More Promises

If you have made any promises (even vague promises) of ownership to one or more of your employees, you will have to handle those promises as you design your transfer of ownership.

## Consider Age Of KEG Members

Keep in mind that if a member of your KEG is older than 50 or so, he or she may not want to spend years acquiring stock only to turn around and sell it—probably via a long-term installment note and at a value not substantially greater than the purchase price. Instead, that employee may prefer to receive ownership-type benefits via a Phantom Stock or SAR plan. Do you know when each of your would-be successor owners plans to retire?

## Examine Your Risk Tolerance

Do you want to reduce your exposure to risk as you depart? Many owners decide that the KEG's privilege of purchasing—at a bargain price—the company's stock, should be balanced by increasing the risk that the KEG bears. You might transfer risk to your buyers by insisting that the KEG uses its money for down payment for initial stock purchase, or that it use personal collateral (such as their residences) as security for any installment note. You might transfer even more risk by insisting that your buyers obtain a bank loan for the entire initial purchase (possibly with the company's guarantee).

## Examine Your Successor's Risk Tolerance

How much risk do you want your successor to assume? Are you willing to look exclusively to the future cash flow of the purchased stock for payment, rather than to your successors' other assets? Most owners want their successors (usually a KEG) to feel and bear some of the risk of a downturn in cash flow. They believe that KEG members only become true owners when they bear an element of risk.

## Understand the Need for Low Value

Do you understand the need for a low enterprise value in this type of transfer? If selling your company for the lowest enterprise value permitted by a qualified appraiser goes against your grain, you are not alone. It goes against the grain of nearly every business owner. Yet that is precisely the tool owners need to use in order to maximize the money they receive while simultaneously minimizing the risk of non-payment. If you are contemplating a transfer to an insider, the valuation number is not nearly as important as developing a projection or model of future cash flow after your departure and as the buyout begins. To be paid, you need to tap into future business cash flow. Placing the lowest defensible value on your company ultimately helps you to avoid excess taxation.

## Consider Your Timeframe

If one of your objectives is to leave your company immediately, a transfer to employees is fraught with risk. If, however, you can wait four to eight years to be completely cashed out, a well-designed exit plan can make that happen. Using this longer timeframe not only reduces your risk of not being paid, it allows you time to continually evaluate each member of the KEG to determine which employees are suitable for ownership before you lose control.

Talk about these issues with your business advisors to determine whether a sale to Key Employees is the best exit path for you. If you have questions about any of the issues raised, the advisor who sent you this newsletter can provide more information.

*The information contained in this article is general in nature and is not legal, tax or financial advice. For information regarding your particular situation, contact an attorney or a tax or financial professional. The information in this newsletter is provided with the understanding that it does not render legal, accounting, tax or financial advice. In specific cases, clients should consult their legal, accounting, tax or financial professional. This article is not intended to give advice or to represent our firm as being qualified to give advice in all areas of professional services. Exit Planning is a discipline that typically requires the collaboration of multiple professional advisors. To the extent that our firm does not have the expertise required on a particular matter, we will always work closely with you to help you gain access to the resources and professional advice that you need.*

*This is an opt-in newsletter published by Business Enterprise Institute, Inc., and presented to you by our firm.  We appreciate your interest.*

*Any examples provided are hypothetical and for illustrative purposes only. Examples include fictitious names and do not represent any particular person or entity.*