Planning for a Liquidity Event

Choosing the Correct Exit Strategy

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Choosing the best exit strategy for a company is a daunting task. The goal for business owners is to maximize the value of the enterprise for themselves, their employees and their stockholders. Some popular exit strategies include a sale to the highest bidder or a strategic partner, a public offering in the United States or abroad, or a sale of an interest in the business to a private equity investor. To determine the best alternative, it is necessary to weigh several factors.

- Is the business best positioned for a sale (based on the industry or the scope and size of the enterprise) or do the public markets or a private equity investor present an opportunity to brand and grow the business?
- Do the business owners desire to remain with the company or is the preference for a clean break?
- Is it a buyers or sellers market?
- Are the capital markets open to new issuances?

These are some of the questions that should be assessed when making a determination how to proceed. The best advice is to plan ahead. Even if you have no immediate plans to pursue an exit, you should understand the markets and think strategically to best position your business for a liquidity event down the road.

Planning for an exit event is critical for you and your business. What steps should you be taking in the planning process? As counsel to a variety of business at different stages, we are often asked to weigh in on strategic alternatives. Having worked with business owners over the years in planning for and effectuating liquidity events, several common themes have emerged.

1. Focus on Execution

Above all else, keep focused on the execution of your business plan. Planning for and executing a liquidity event can be an extremely time consuming and distracting process. Don't let it be! If you remain steadfast in the achievement of your business objectives, execute on your plan, dedicate yourself to attracting real customers and revenues, your exit event will take care of itself. The primary focus of the business owner should always be on the success of the enterprise, not the consummation of the exit.

2. Be Bought, Not Sold

One common mistake business owners make in the pursuit of an exit strategy is to lose sight of the short-term needs of the business. For example, a business may have some short-term capital needs to address to attract, retain and grow its customer base. The business owner, believing an exit event is at hand, may elect to forego the short-term expense in light of an impending transaction. A failure to address short-term cash needs, however, could have long-term repercussions. Several factors dictate that it is better to spend the money now.

Transactions can often disappear as easily as they arise or a transaction can take significantly longer than expected. Equally important, the long-term success of the business may be tied to the transaction. Often times earn-outs, bonuses under employment contracts or other consideration depend on the financial performance of the seller's business post-liquidity event. For these reasons, sellers should continue to run their businesses in the ordinary course and meet short-term capital needs to achieve long-term objectives. Saving a few dollars now could certainly cost the seller many dollars in the long run.

3. Surround Yourself with Excellent Advisors

Unless you have some transactional experience, a liquidity event poses many challenges to a business owner. The nature of the transaction (M&A or IPO), the specific terms of the transaction and continuing obligations after the sale, employment issues and tax and accounting considerations present a litany of issues to consider. It is neither necessary nor advisable to go through the process alone. Seasoned professionals are available to guide the seller through the process.

Very early on, you should engage an experienced attorney, accountant and other advisors (such as an investment banker) to assist you. Lean on your advisors. It is not uncommon to hear the CEO of a company explain that he or she has achieved great success because he or she has surrounded himself or herself with smart people. If you choose carefully, the advisors will have a great deal of experience to draw from and will be able to provide excellent guidance recommending exit alternatives, structuring the transaction, avoiding pitfalls, preparing the company for a liquidity event and completing the transaction.

Many business owners raise concerns regarding the costs involved in engaging service professionals, however, most business owners that have experienced a liquidity event will attest that the right professionals add to, rather than detract from the value of a particular transaction. In addition, the better the advisors, the more time a business owner can devote to the matter at hand – the day-to-day operations of the business.

4. Choose Correct Exit Strategy

There are several options when considering exit alternatives. For many, a sale of the business is the logical choice. Others may opt to raise money through the public markets or to sell a piece of the company to private equity investors. Recently, the public markets, in particular, have not been an attractive option. While many are familiar with the perceived downsides to going public (compliance costs, personal liability exposure of officers and directors and short-term financial performance pressures), there can be legitimate reasons to test the public markets (creating a national brand, providing liquidity to employees and investors or using the publicly-traded stock as currency in a roll-up strategy). Still others have used the public offering route to attract buyers.

In addition, private equity can provide a much needed capital infusion to a company. A business that accepts private equity investment should note that with the investment comes a fairly short-term liquidity horizon – 5 to 7 years to position the company for sale or to go public. Once again, professional advisors can be extremely helpful in vetting the available options and guiding a business through the process.

Choosing and pursuing an exit strategy is both exciting and intimidating. A business owner contemplating a liquidity event is faced with a myriad of issues. Selecting the correct route to follow is not always easy. Moreover, above all else, in pursuing a liquidity path, make sure your number one priority is the continued health and prosperity of the ongoing business.

For more information on planning for a liquidity event, please contact the author **Joseph C. Marrow**.