The Buyer of Your Business You May Not Have Thought About...

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When contemplating a sale of their business, many business owners automatically assume it will be to family members or to an outside third party buyer.

Business owners have a lot of pride in the businesses they have built, and they often feel that one of the greatest gifts they can bestow on their children is to transfer the business to them. This is what has been called the "someday this will all be yours" syndrome. But the reality is that most children do not want to take over the family business. They may have separate careers of their own that they are loathe to give up, or they may not have the previous generation's skills and abilities to keep the business profitable and successful.

Confronting the reality that the children don't want to take over can be a surprise for many business owners. Consequently, a business owner might look to an outside buyer as the next logical choice. This action may be more likely if they hear an acquaintance bragging about the high selling price they realized when they sold their own business last year, without any mention of debts, outstanding fines, and fees they may have had to pay out of the proceeds. Owners may believe that they have multiple suitors ready and willing to buy the business, but they can find the deals evaporating when "minor" details like financing are discussed. Or they may think that selling to an outside buyer is the least stressful form of business transfer, when in actuality they may be unprepared for the amount of legal and financial due diligence, and general business polishing, required to get their business ready to sell.

Business owners can suffer from what is termed "seller's remorse," and be unprepared for changes to the business (loss of jobs, closing of the business, changing the name, etc.). This is especially so when new owners make radical changes to the business the seller has spent a lifetime building, a business that provides jobs for family, friends and neighbors, and finances valued benefits for the community. A lifetime of goodwill and reputation can evaporate very quickly. Lastly, some business owners may be looking to cash out some equity, but may not be ready to retire from the business. Selling to an outside buyer may not give them that option.

The positive news is that there are additional options for the business owner in selling to the employees. These fall into two categories: sales to some employees (management/key person buyouts) and sales to most or all employees through Employee Stock Ownership Plans (ESOPS) and worker owned cooperatives. These strategies share some common benefits:

1) Selling to the employees doesn't necessarily mean selling for less. In fact, the net proceeds from selling to the employees may be higher than selling to an outsider.

2) Selling internally usually reassures creditors, banks, customers, and others that there will be some continuity of leadership and skilled management. This can increase the likelihood of getting a deal done, obtaining a fair price, and the ongoing success of the business, which is especially important if the selling owner is getting paid out over a period of time.

3) Business owners are generally independent by nature, and usually like the fact that the business is independent as well. Selling to the employees allows the company to remain independent, at least in the near term.

4) Selling to the employees rewards some or all employees for their efforts in making the business a success.

5) By selling to the employees, owners can remain involved in the business for as long as they want and as much as they want.

6) And they can continue to enjoy much of the same regard and respect that they earned from individuals and the community over the years, because employee buyers are likely to care about the business's reputation and contributions to the community.

In addition to the above general benefits, a sale to employees through an ESOP or co-op can result in some significant tax breaks for both the seller and the business. Chief among these are deferral of capital gains for the selling owner, with the potential of a capital gains-free transfer of wealth to the next generation (ESOP and co-op), ability to deduct both interest and principal on the loan transaction (ESOP), and the potential for the business to become a 100% income tax-free corporation as it moves forward (ESOP).

Obviously, there are a lot of details to be worked through. Some of those can be found on the OEOC website, www.oeockent.org. While not applicable for every company and situation, selling to employees can be a powerful tool for the business owner.

A slightly different version of the is article appeared in the BizBox Blog on Slate.com. Thanks to my colleague Roy Messing for suggesting the topic of this article. **OAW**