Entrepreneurs and Exit Planning

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THURSDAY 6 FEBRUARY

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PCD CLUB MEMBERS ENJOYED AN INTERESTING BREAKFAST PANEL DISCUSSION ON THE TOPIC OF ENTREPRENEURS AND EXIT PLANNING, WHICH IS AN EVER POPULAR TOPIC AMONG OUR MEMBERS. THE STORIES OF THOSE WHO BUILD BUSINESSES ARE USUALLY FILLED WITH EXAMPLES OF ENDEAVOUR, RISK TAKING AND DECISION MAKING, INTERESTING TO THE PROFESSIONAL ADVISORS THAT SEEK TO KEEP THEM ON THE RIGHT TRACK.

Ken Chapman, Head of Wealth Planning at EFG in London, opened out the event with a story of a client he advised many years ago. The client in question had built a highly successful business that was listed on AIM. In the weeks prior to the company moving to list on the main market, Ken advised him to consider some estate planning opportunities that would not exist when that transition took place. The client was naturally absorbed in the complexity & liquidity event arising from the listing, so decided not to pursue the options available. Six months later, Ken saw his client and

discussed the limited options available to mitigate the now substantial inheritance tax liability on his estate. The message is clear; to undertake any necessary planning in advance to avoid missing opportunities in the run up to a transaction.

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Our panel shared their substantial experience on advising entrepreneurs on their journey to sell the businesses they had established.

Derek Zissman, the founder of Crossroad Partners, draws on his M&A experience of 37 years at KPMG. In terms of preparation for sale, Derek noted early preparation as vital, before answering two key questions: Why are they selling? What are they going to do next? He saw too many founders without a clear answer on these questions, suffering ill health or boredom which brings them back into new ventures, which often end in near disaster.

The timing of sale can be driven by a number of factors: health; tax considerations; unexpected life events that were not foreseen. Derek advised never to sell to an entrepreneur as they will squeeze every drop of value from the transaction, a big company is more likely to give concessions on key points in the interest of getting the deal done. Getting a good legal team in place is vital to represent the seller versus a buyer equipped with leading M&A firms.

If businesses are well prepared, transactions can be swift, but sellers should be prepared for a long, arduous and complicated process, often requiring them to spend weekends and evenings on the transaction while running the business during the day.

Hannah Wailoo, Partner in the Private Wealth team at Trowers & Hamlins, discussed some of the key tax issues that clients might face, which are principally CGT on sale of shares and IHT considerations pre and post the liquidity event. An important consideration is the availability of Entrepreneurs Relief (ER) to reduce the tax rate on the capital gain arising from the sale. Does the business qualify and can spouses or family members be involved to maximise the relief available? Trusts can be used for estate planning where the shares in the business qualify for business property relief.

Adrian Jones, Partner in the Corporate team at Trowers & Hamlins, gave some insight on how the Due Diligence in conducted to help the transaction move smoothly. The sellers want to present the business in the most favourable light to prevent the buyer from reducing the value of their offer during the due diligence process. This might include checking the Company Registers, Companies House records & filing, IP rights and ownership (particularly Software). Data protection and any potential breaches of GDPR can carry substantial penalties. The buyers need to understand the way the company uses data. Any disputes with HMRC, employees, or other parties can be settled in order to maintain focus on the big picture.

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In terms of preparing Business Plans, Derek noted that working with a strong CFO is essential for the transaction to move forward as the buyer is interrogating the financial information of the company. Buyers are looking for the quality of the earnings and certainty of revenue (are they dependent on certain key customers?) Past projections are useful to compare with actual results to show how accurate they are at forecasting, but he suggested placing no reliance on numbers any more than 2 years ahead. The next 12 months projections are the most accurate and reliable. Honesty in financial disclosure is critical.

The role of the founder of the company going forward is another important aspect. Will they stay on afterward? Derek advises his clients to walk away after the transaction, unless there is a compelling reason to stay on and only then, provided a well negotiated contract is in place. Often, when founders believe they can repeat their success, they start another similar business, most of which end in failure, because they no longer have the hunger and drive and worse, they fail to recognise the industry has moved on from their original insight and innovation.

Ken asked the panel on the importance of tax breaks in entrepreneurship.

Hannah commented that entrepreneurs start businesses out of passion rather than due to beneficial tax breaks.

The tax incentive schemes can be complex and are rarely understood by founders business running companies. Entrepreneurs Relief and Business Property Relief are valuable and likely to be reviewed by the government; changes could be made to both reliefs in the March budget.

Why do deals fall over? Derek noted that it can come down to a difficult founder, who may change their mind about selling the company. The buyer may pursue other targets in these circumstances. The founder's valuation of the company can be unrealistic, but a good advisor will be clear on the price and advise their client accordingly. Confidentiality is a key consideration; how to keep the deal secret is a challenge as once open news in the market, valuations will fall.

Ken asked the panel what do sellers do once the transaction is complete?

Hannah said they often take a break and go on holiday. When returning they are increasingly interested in pursuing passions like restoring cars or sailing a boat, but increasingly there is demand for philanthropy. This can be facilitated by legal structures during life or on death with give the founders involvement and satisfaction post sale. Trust in their relationship with advisors is key.

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