

Exiting a Consulting Firm



VS.



Selling a Home

By Kevin Kennedy

Most consultants and business owners believe that exiting their business is a process that they can handle themselves or deal with when the time comes. But many owners lose a lot of their hard-earned wealth or even fail to exit altogether because they do not understand the issues involved with a business exit.

An owner may believe that selling his or her business is akin to selling a residence. This article will explain the differences between selling a business versus selling a home—or, for that matter, how selling a business differs from the sale of virtually any other asset most of us will sell in our lifetimes. These comparisons become very significant because usually a privately held consulting business is an owner's largest, most valuable asset and his or her primary source of income.

ISSUE #1 – VALUATION

Home sale values are not a “range-of-value concept,” but rather they are based on the comparable sales value of neighboring homes that resemble the one being sold. More important, the value of a home is not dependent upon who the buyer is. In the world of residential real estate, all buyers are essentially equal, as they are either qualified for financing or they are not.

In the world of private capital business sales, the type of potential buyer is critical-

ly important. Different buyers bring different valuations to the business sale: some will pay more than others, and some will have to pay out over time. This is not the case in the sale of a home. But in the sale of a business, value and the stream of payments vary from buyer to buyer (for example, a competitor will pay more for a business than an employee who needs to pay through cash flow from the business). This leads us to issue #2.

ISSUE #2 – DEAL STRUCTURING

When homeowners sell their homes, they receive the negotiated selling price at the closing. In business exits, the amount of money received at closing often represents only a portion of the total proceeds, which are part of a larger negotiated selling price. (There is a general rule that smaller deals—less than \$2 million—are subject to more structuring of payments while larger deals get more cash at closing.) Included in the deal structuring are deferred payments, contingent payments, noncompete payments, consulting agreements, escrow payments, and continued lease and property rental payments. Complicating deal structuring even further is the fact that each of these payments is subject to its own tax rate. Also, as a general rule, buyers prefer to purchase assets of a company, whereas sellers prefer to sell stock. Again, this varies significantly from the sale of a home.

ISSUE #3 – TAXES

When people are selling a home, there is generally one tax rate. When people are exiting a business, there are endless potential tax outcomes for the transaction. The most easily recognized tax rate is the rate applicable to the sale of stock: the capital gains tax rate. This rate applies to the gain—the value exceeding the cost basis of the stock—that is realized in the sale of shares of the company.

Payments to an exiting business owner can be characterized as goodwill, personal goodwill, income, or, alternatively, can fall into an Internal Revenue Code section deferring the taxation until a future date, such as IRC sec.1042 for certain sales of shares of a C Corporation to an Employee Stock Ownership Plan (ESOP). The sale of a home does not afford the buyer and the seller options for reaching such characterizations or deferments of the taxes.

ISSUE #4 – TRANSACTION TYPES

The sale of a home includes all of the property and the structure(s) that are on that property. Therefore, residential sales are an all-or-nothing deal. Business exit strategies are limited only to one's awareness and imagination. One can sell a portion of or all of the company stock (or assets) as part of an exit. Many business owners do not know this. Once owners grasp this concept, their primary motives for the exit may be more easily achieved. In

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other words, different types of transactions are available to allow flexibility to the process of business-owner exit strategies.

ISSUE #5 – SERVICE PROVIDERS

The sale of a home generally includes the services of a real estate broker. A broker's responsibility is to know local markets (for value purposes) and to attract buyers to the listed property (often through an open house format). Alternatively, exiting a business includes the services of a professional (often an attorney) who can draft documents reflecting the agreement for the transfer of shares (or assets) of the privately held company, document any arrangements for future payments and security that are taken in lieu of payment at the closing (again, an attorney), assess the taxes that must be paid as a result of the

transaction (normally done in advance of a closing by an accountant), and understand the unique nature of the privately held business (transactional intermediary).


A transactional intermediary should have experience in the following:

- Presenting the business in a light most favorable to the exiting business owner;
- Locate potential buyers among a sea of investors;
- Collect, maintain, and enforce (if necessary) confidentiality agreements;
- Negotiate with potential buyers in a language that they understand (i.e., communicate the added value that the company affords buyers from a return-on-investment perspective); and

- Coordinate all of the service providers who are required to close on the deal.

In short, home sales are commonplace, whereas sales of privately held businesses require considerable experience and a delicate touch.

In the case of a building envelope consulting firm, the higher the owner's cash flow, the greater his or her choices. The most obvious exit channels in the industry are sale to a competitor, to management, or to employees. The keys are the owner's motivation and goals. Each option can then be matched appropriately to see if it meets the owner's financial goals after applicable taxes and fees. A professional exit planner can map out an owner's options and guide his or her choices.

As is evident, exiting a business is different from selling a home. Raising awareness of the difficulties involved can mitigate many of the complexities of business exits. The only way to keep an owner in control throughout the process is to choose a proactive approach for a successful exit strategy. 



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Kevin Kennedy

Kevin Kennedy is a national speaker, author, and thought leader on exit planning and succession for small business. He understands firsthand the challenges owners face from buying a company, transferring a business, and preparing the new owners for leadership. Mr. Kennedy sold his portion of the 63-year-old Evans Roofing Company to the leaders of its third succession team. The 200-employee company is ranked by *ENR* in the top 20 of its specialty contracting industry. He is now the president of Beacon Exit Planning, which advises owners in developing customized exit and succession strategies.



New OSHA Directive Gets Mixed Reviews

Two builders' groups have opposite opinions on new fall protection measures recently passed by the Occupational Safety and Health Administration (OSHA). The National Roofing Contractors Association (NRCA) is unhappy with the new rule, while the National Association of Home Builders (NAHB) has praised the new measure. The rule replaces a 15-year-old policy that was intended to be temporary when it was first enacted.

OSHA's action rescinds the Interim Fall Protection Compliance Guidelines for Residential Construction, Standard 03-00-001, which allowed builders engaged in certain residential construction activities to use specified alternative methods of fall protection rather than the conventional fall protection standards. The new directive requires all residential builders to comply with Code of Federal Regulations 1926.501(b)(13), which requires workers engaged in residential construction over 6 ft above ground level to be protected by conventional fall-protection standards. Conventional standards include guardrails, harnesses, and safety nets but not slide guards and other alternative measures.

The NRCA argues that slide guards provide a safe alternative to conventional standards and that OSHA did not use proper data in making its decision. OSHA officials cited fall-related deaths as the reason for the new directive.

"We're terribly disappointed OSHA took this action," said NRCA Executive Vice President Bill Good. "They have effectively eliminated a safe and effective method for preventing falls—one that has worked successfully for 15 years. They did this without any data to suggest that slide guards don't work, and they did it after assuring us they would take our concerns into account."

The NAHB, which recommended OSHA create the new directive, was pleased that the new guidelines set permanent standards. "Job site safety is the number one priority for builders," said NAHB Chairman Bob Jones. "This action will clarify which actions builders need to take to comply with OSHA regulations while helping to ensure safer work sites."

Construction and roofing companies will have until June 16, 2011, to comply with the new directive.

— PROSALES Information Service

CORRECTION

Two photos in the January 2011, issue of *Interface* were inadvertently switched. Photo 5 in the article by Nathaniel Martin on page 22 should have been switched with Photo 5 in the Chuck Marvin article on page 34. We sincerely regret the error.

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