SELLING YOUR BUSINESS: The Benefits of Selling to your Employees

Most business owners know that when it comes to selling their business the buyer(s) will be drawn from one or more of three broad categories: (a) an independent third party or parties (b) family members, and/or (c) management or employees. The relationship between the seller and the buyer is radically different in each of these cases and this impacts the manner of the sale and the likelihood of success. This article looks at the circumstances in which your best option could be a managed sale to your employees using an Employee Share Ownership Plan (ESOP).

Firstly, let's look at the seller's alternatives.

SALE TO ONE OR MORE THIRD PARTIES

For many sellers a sale to a third party previously unconnected to the business will be the preferred option. The transaction is relatively cut and dry. Although many sale agreements entail a vendor buy-back clause and vendor financing, to a large extent the risks in the business transfer to the buyer at the date of transfer. The seller's direct involvement ends on the date on which the seller's hand over period ends. This transfer of risk comes at a cost however: the buyer is likely to demand a lower price, or extended payment terms, in exchange for the assumption of risk.

SALE / TRANSFER TO FAMILY MEMBERS

Although some transfers to family members are treated in the same way as a sale to a third party, in most cases the transfer involves a phased payout over an extended period, usually through a gradual redemption of preferred shares. The seller's continuing stake in the company means that the seller continues to carry substantial risk, notwithstanding that the buyer usually has a fairly good knowledge of the business ahead of the sale. If the buyer fails to manage the business successfully the seller's retirement funding could be at risk; this carries not only a financial risk but a risk that family relationships could be disrupted as well.

SALE TO AN ESOP

A sale to management or employees has the obvious advantage of selling to one or more parties who already have a good knowledge of the business. It would be unusual for the employee(s) to have enough resources to buy the business outright, however, there are a number of financing strategies that can support the transition.

An ESOP is a managed process that can allow a flexible level of employee ownership ranging from 5%to 100%. Some owners implement an ESOP 5-10 years before they plan on exiting, providing them with some liquidity and time to build capacity within the team.

To implement an ESOP, outside specialists work with both management and employees on tailor-made solutions involving workplace culture, job responsibilities, financing, and legal and valuation issues. The process takes 3-6 months but is usually worth the effort and the expense. Research shows ESOP companies with a participative culture outperform traditional business models. Benefits range from an engaged culture to improved productivity and attraction and retention of employees.

Some notable Canadian employee-owned businesses include PCL and WestJet and a number of engineering firms.

Okanagan residents can find out more about ESOP's, their successes and processes, at the upcoming national conference of the ESOP Association of Canada, to be held in Kelowna from June 7 to 9. Go to www.esopconference.ca for more details.

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