Florida Capital Advisors
BUSINESS ADVISORS

Advice and thought leadership for entrepreneurs

How to Accomplish an Internal Sale of Your Business to Management or Family

If you decide the best scenario for you is to transfer ownership of your business to management or family, more often than not you will need some combination of bank financing and seller financing. The buyer's goals most likely will be to minimize their personal out of pocket equity contribution and to maximize the amount borrowed. This approach not only covers their buy in, but also can provide additional working capital to accomplish new growth strategies and cover closing costs associated with the acquisition.

The key to executing this approach is to minimize the lender's perceived risk in financing the transaction. Admittedly banks are in the risk business; however, there are strategies that seller and buyer can collaboratively employ to minimize the risk of a particular transaction. One way to mitigate risk for the bank is for buyer/borrower to utilize the SBA 7a Government Guaranteed lending program.

The SBA 7a lending program can be used to facilitate the purchase of businesses. While there are restrictions on the size and type of companies that qualify, as well as limits on the net worth of guarantors, the program does allow for up to a 75% government guarantee to participating banks on loans up to $5 million. SBA 7a loans have more flexible repayment terms and can be used to finance an acquisition of an entire business, infuse the company with additional capital for growth, purchase new equipment and/or real estate, and to cover closing costs associated with the loan.

If you are looking to sell your company to key employees or family, a possible strategy for overcoming the down payment/equity injection requirement is to create an ownership-based management incentive program.

Under this program you can transfer a percentage of the stock to key employees based on achieving certain performance metrics. A stock based incentive plan will provide a strong incentive to key management.

Another strategy is to allow key employees or family to buy a portion (20%-30%) of the company in advance of selling the entire company. The purchase price of the stock could be offered at a significant discount to allow the acquiring shareholders to buy-in at a favorable price using personal resources. If the buyers do not have sufficient resources for the buy-in, the company or selling shareholder could provide some or all of the financing that is needed.

A dividend policy could be implemented so that distributions are sufficient, after taxes, to repay the loan in full over a reasonable period of time. Prior to SBA7a financing being allowed to fund your complete exit from the business, any loans to finance the partial buy-ins would need to be repaid. Since key management or family would then own at least 20%-30% of the business, this scenario would typically meet the lender's down payment requirement and the Buyer(s) could then borrow the rest of the money via an SBA 7a loan to cash you out entirely.

Chuck Owston, CMAA, CEPA
Managing Director
407.540.5802
cowston@flcb.com

Peter Allport, CEPA
Director
407.540.5806
pallport@flcb.com

Accomplish an Internal Sale of Your Business

To execute on this plan, several criteria will need to be met. Probably most important, a capable and competent management team will need to be in place. Additionally, there cannot be excessive leverage on the business and cash flow needs to be sufficient to repay the loan, as well as provide for ongoing operations and growth of the company. If you ask bankers what makes a good loan, most will respond that a good management team is needed as one of their top answers.

In order to finance a purchase transaction by a management team or family, the bank will assess their capabilities. If a good management team is not in place, it will not only hurt the value of your business, it will get in the way of financing an ownership transfer transaction. The key to any successful transition is to plan appropriately and implement strategies well in advance of the transition event. Having a strong advisory team, along with a good banking relationship will help ensure a successful transition.