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# Exit Planning For Staffing Services:

## Planning Your Exit

*By Steve Sorrentino, Principal, MergeQuest*

If you've ever given any serious thought to exiting your business, there is no time like the present to start planning. Exiting is a multi-step process that can take from months to years depending on the size of the organization and the reasons for exiting.

When it comes to planning, how you exit your business is just as important as how you started and ran your business. The goal is to maximize the value of your company before converting it to cash, while simultaneously minimizing the tax consequences and managing the demands on your time to prepare for your exit.

Exiting planning involves documenting and executing a defined process of steps. The length of time required to complete the process is directly related to the complexity of the business and the circumstances underlying your decision to exit the business. Prior experience has shown that it can range from six months to several years – so time spent planning and preparing now is time wisely invested.

Exit planning typically includes the following steps in the process:

### **1) Determine Your Timeline and Objectives for Exiting**

Establishing your timeline is key to determining when you should start implementing your defined exit plan. Bear in mind that your timeline should include at least 6 to 9 months for the full cycle of the business sale preparation, marketing and transaction closure. You should also give some thought to such things as the firm's market valuation and types of transaction structures that are typically available in your firm's industry (i.e. the Staffing Industry). You should also give some thought to whom you might sell the business, whether family members, employees, or most commonly, an outside buyer.

Finally, with regards to your planned exit, you must think about whether you are going to exit the business to retire – or whether you are remaining with the business in some capacity after its sale. If you plan to exit the business to retire, you must give careful consideration to reducing your firm's operational dependence on your leadership while grooming a successor to take over any of your operational and/or administrative responsibilities.

### **2) Reach Agreement and Obtain Authorization from Shareholders or Partners to Sell the Business Entity**

Agreement and authorization to sell larger businesses and/or businesses with multiple shareholders or partners have typically been pre-established under some governing set of rules, such as the corporate bylaws or partnership agreement. It is best to determine quickly if there are any potential obstructions to your ability to sell the business. As such, settle disputes quickly and document any terms and conditions that might apply. If, however, you are the sole shareholder or proprietor of the business, a simple corporate resolution will do.

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### **3) Designate a Leader & Organize a Team**

Authority, roles and confidentiality should be established and clarified. The owner may be the only team member for a small business. For a large enterprise, however, the team may consist of a limited number of the executive management team and important functional managers whose expertise is needed, including: finance, human resources and the legal dept. This group should be as small as possible for efficiency and maintaining confidentiality – but large enough to include the expertise required to cover the basic planning issues.

### **4) Prepare a Detailed Master Plan and Assign Responsibilities**

Preparing a master schedule is the key control device to your exit plan. It provides the ability to establish specific steps and goals, measure progress, assign responsibility for specific tasks, estimate completion of critical steps and project the end of the process.

### **5) Have a Business Valuation Performed**

You should strongly consider having a business valuation performed by an industry-experienced professional (i.e. an M&A Advisor or Broker) to establish a baseline valuation. Note that most reputable professionals will update valuations in the future for a nominal fee – and that having a baseline value is an important benchmark. The valuation will also provide you with detailed insights into your firm's strengths and challenges – and will address the key financial and operational factors that drive business value in the Staffing Industry.

The valuation analysis will delve into the firm's overall business and financial performance (with insights to Balance Sheet performance, as well full P&L analysis regarding pricing, mark-up, gross margin, SG&A overhead expense and operating margin analysis vs. industry metrics), operational issues, employee efficiency, client concentration and profit contribution analysis. Finally, the analysis will also help you understand what corrective steps are needed to improve and maximize the firm's value prior to sale.

### **6) Engage and Assemble Your Outside Professional Advisory Team**

The timing of who to engage and at what point can vary depending on where you are in the planning stages of your exit plan. For most businesses, the advisory group consists of an Attorney, CPA, and as the lead advisor in this endeavor, an M&A Advisor (Business Broker) who is familiar with your industry. Professional expertise and advice in these areas will contribute to a smooth process and improve the outcome.

- Attorney - The attorney should have experience in business transactions. An attorney will also be called upon for legal document review and preparation, in addition to pre-transaction due diligence, etc. Consequently, it is best to work with a law firm that has expertise in M&A transactions.
- CPA / Accountant - The CPA not only generates your financial statements and prepares your tax returns, but also ensures that your accounting is done under Generally Accepted Accounting Principles (GAAP). Your CPA will also assist you with

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assessing the tax implications of the business sale – and will advise you accordingly. Finally, a CPA will help explain how a “review” audit of your financial statements will help ensure the credibility of your firm’s financial information.

- **M&A Advisor** - The M & A Advisor is your link with the buyer community. He should be able to perform a market valuation of your company and determine how it aligns with buyer criteria, as well suggest ways to increase the value of your company. When your company is ready, the M&A Advisor can advise how to properly document the company to attract the best possible buyers. The best buyers may be public or private corporations looking for strategic or synergistic acquisitions, or financial buyers such as private equity groups looking to re-capitalize the company for growth. The M&A Advisor will package and market your company to the buyer community. During this deal-making process the Advisor will screen buyers for confidentiality, financial and business viability, evaluate offers, negotiate letters of Intent, and help facilitate due diligence and the closing process.

It’s important for you to understand the skills, strengths and limitations of your advisors and how, when and where to use them – and that it’s important to keep these professionals focused on their areas of expertise: attorney’s for legal matters, CPA’s for financial and tax matters and your M&A advisor for such things as business valuation, deal structure, negotiation strategies and buyer introductions - as well as other sale-related transaction matters.

## **7) Prepare a List of Assets and Perform a Physical Inventory**

The inventory is used to help establish part of the value of the business, make decisions, and manage disposition of assets if necessary. Fixed asset values also become the basis for tax calculations (capital gains or losses) on final tax returns. It is also required information that any potential buyer will want to know prior to purchasing the business.

## **8) Review All Contractual / Lease Obligations**

This process typically involves the approval from outside parties, such as vendors and possibly clients (for those that have client contracts in place) and in some cases, may involve negotiation of contract or lease assignment or termination terms. For staffing firms, it is very important to review any and all client contracts to determine if there are any “assignment” restrictions or “change of ownership” clauses within the contracts. If so, these contracts should be carefully discussed with both your M&A Advisor and your Attorney – as you may not be able to assign these client contracts without the consent of your client – a situation that will need to be delicately discussed with any potential buyer.

The other key area of contractual concern for staffing firms is the existing real estate lease(s) for office space. This area may be a bit more challenging to navigate, as there may be several real estate leases in force for firms with multiple branch offices – which means there are multiple landlords to deal with in any lease negotiations. To the extent possible, it is advisable to keep real estate leases to under three years in length, and if at all possible, you are well advised not to renew real estate leases for extended terms during the year that you plan to sell the business – as this keeps you off the lease obligation avoiding the challenges

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of lease assignment – while allowing the buyer to decide if they wish to continue with a particular office location and/or current lease space and terms (a buyer may wish to close the office, move the office, reduce the office space, or consolidate the office into one of their existing office spaces). Other leases obligations to review include automobile leases, office equipment and telecommunication leases.

For those staffing firms that utilize Accounts Receivable Factoring / Financing, it's important to review the terms of the factoring contract, as there may be early termination fees involved depending on the length of the current contract. This, too, should be carefully discussed with your M&A Advisor.

Also, bear in mind that you will need to settle any outstanding bank loans or lines of credit balances prior to selling your business – so at some point you will need to contact your bank to determine the bank's acceptable procedures and timing for the loan payoff(s). Bank loan payoffs can typically be coordinated to take place simultaneous with the closing – where the buyer simply wires part of the closing proceeds to the bank – thereby obtaining both debt and UCC-1 lien releases (for the benefit of the buyer).

Finally, you should also keep in mind the timing of termination dates for all insurance contracts and employee benefit plans – both of which will commence with the transfer of the business and employees to a buyer's organization.

### **9) Decide if you Need to Close any Branch Offices**

The timing of this step is important.....as there may be under or non-performing branch operations that are not contributing to overall bottom line profits. If so, and depending on the reasons and history of the branch underperformance, you are well advised to consider closing the branch and eliminating the additional overhead – thereby improving your firm's overall Net Profits. This of course will contribute to a better business valuation in the long run.

### **10) Get Your Recordkeeping House in Order.**

While this list is not meant to be all inclusive, it identifies many of the key documents you'll need to have assembled and up-to-date for any buyer review, including:

- Quarterly tax filings, such as Federal 941's and State Unemployment Insurance
- Federal Tax Returns (last 3 years)
- Insurance Policies (e.g. Business / Liability / Worker's Compensation / Health)
- Worker's Compensation Current Open Claims Report
- Worker's Compensation Loss Runs (last 3 years)
- Employee Manuals
- Employee Benefit Plans
- Contracts and Lease Obligations

### **11) Prepare and Keep Financial Statements Current**

Perhaps the most critical piece of the underlying business valuation puzzle is the firm's financial statements – both historical (last 3 years) and the current financial statements. It's

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important that you have your Accountant prepare your firm's financial statements at least once a month - and that Income Statement summaries are compiled on a quarterly and annual basis. It's also advisable to have your Accountant prepare what's known as a rolling 12 month set of Income Statements – showing the firm's financial performance on a trailing 12 month basis, which is a key consideration in preparing the firm's valuation. Bear in mind that the firm's underlying valuation is dynamic and not static in nature, and that any significant changes in its financial performance on a current basis (i.e. its net profitability) will affect its underlying market value.

Also, one final note on financial reporting: audit “reviews” by a reputable CPA firm are a worthwhile investment. Reliable financial information during the years leading up to a business sale will verify your company's financial track record and eliminate uncertainty for the buyer.

## **12) Special Governmental Filings**

Most buyers will want assurances that your business has been and currently is in compliance with required governmental filings, most importantly, the filing of tax returns and remittance of federal and state taxes. These include taxes on payroll, unemployment insurance and business income taxes. You will also need to identify and have released any liens on your firm's assets (as evidenced by UCC-1 filings with the state). In order to substantiate your compliance, you will need to obtain the following:

State – Certificate of Good Standing (Secretary of State's Office)

State – Certificate of Compliance – Taxes (Department of Revenue)

State – UCC-1 Release (Secretary of State's Office)

## **13) Stay Focused on Running Your Business During the Planning Stages**

Bear in mind that it's also important to stay focused on running your business during the marketing of your business – while simultaneously working to improve its financial and operating performance. This means that you should continue to:

- Drive profitable sales revenue growth;
- Focus on improving your firm's Gross Margin level;
- Reduce operating costs where possible;
- Hire competent employees to fill any internal job vacancies;
- Weed out and terminate any under or non-performing employees;
- Keep collection efforts focused on collecting past-due receivables;
- Maintain your advertising and promotion programs

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In conclusion, an exit plan is a comprehensive road map that helps business owners successfully and profitably exit a privately held business. A well thought out exit plan asks and answers all of the critical questions that a business owner and his or her advisors must consider. The planning and preparation process, timing of events and tasks must be tailored to the type and complexity of the business.

A well-developed exit plan also enlightens a business owner how to maximize the value of the business, minimize taxes and ensures that he/she is able to accomplish all personal and financial objectives in the exit process.

A comprehensive and integrated exit plan ultimately empowers business owners with crucial information needed to make informed decisions, while providing the essential tools to maximize after-tax sale proceeds – while ensuring fulfillment of both personal and business goals.



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