

## **A novel plan to pass on your business**

### **It's great having a profitable business but what do you do when you want to retire?**

by Morris Kaplan  
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IN 1980 Glenn and Harry went into business together and are the owners of a thriving concrete-formwork construction business.

Both aged 56, they're thinking about retiring.

"We'd like to ease out of the business within five years," says Harry. But potential buyers are scarce.

A point highlighted by Byron Bay builder Richard who simply downed his tools earlier this year and bought a newsagency.

"The game's too tough today. I've had enough. Sometimes it's easier to just close the doors and move on," he said.

Glenn and Harry have a different view: they want a big payout - an uncertain proposition in a market that has enjoyed some good years but which is getting tougher by the day.

Many business owners are likely will find themselves in the same spot.

The problem is many entrepreneurs have as much as 90 per cent of their net worth tied up in their companies.

The trick is turning that equity into cash on which to retire. Enter ESOP, or the Employee Stock Ownership Plan.

Interest in ESOPs has been growing over the past few years, and it's easy to see why.

The plans allow owners to sell their businesses directly to their employees in transactions financed by the business itself.

Interest is so significant that the federal government has established a special task force charged with the job of making such schemes more accessible to business owners and their employees by offering 'template' solutions.

It's an appealing exit strategy but ESOPs can be expensive to set up, requiring independent valuations and agreements, trust deeds and documents that need to be legally drafted.

Moreover, in order for an ESOP to work cost effectively, a business needs to be profitable, with at least \$1 million or so in total valuation.

Say a business owner decides to sell his shares in his business valued at \$1 million, to his employees.

To transfer ownership, the company creates an ESOP – a kind of trust account – and takes out a loan from its bank for \$1 million, 100 per cent of the business value.

The business then loans the \$1 million to the ESOP, which uses the funds to purchase the owner's shares.

Then, the business repays the loan by making annual payments through the ESOP, treating the payments as they would any other employee-benefit expense.

After each payment, a proportionate number of shares are transferred into individual employee ESOP accounts.

Finally, after five years, when the \$1 million loan is repaid, the employees will own 100 per cent of the company through the ESOP.

This can be achieved through a series of deals spread out over a few years, during which time the owner gradually transfers ownership and day-to-day management of the business.

ESOPs work best when there is a good relationship and good communication with employees.

It's important to communicate what they are getting – shares in the business worth a certain sum – and what they're not getting.

The latter typically includes a voice in management or seats on the board and voting rights; instead, the ESOP's shares generally are voted by the independent trustee who administers the plan.

Under the plan, when employees retire or die, the ESOP is obliged to buy back their stock at the current value.

Business owners who embark on this process need to realise that it will culminate in their retirement.

Glenn and Harry are preparing for this and have handpicked the new leadership team.

"We knew that employee ownership was an option as we already have a profit sharing plan in place and we wanted employment continuity for our staff," says Glenn, whose business has a turnover "in the millions" and a staff of 30.

The two partners opted to sell 100 per cent of their holdings to employees, and together, will walk away with roughly \$1 million each for their shares.

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