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Selling construction business to employees a good succession plan

The next 10 to 20 years will see the largest transfer of business assets in U.S. history as the last of the baby boomers retire.



EXIT STRATEGIES

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A large number of construction businesses will be part of this trend, and owners of construction businesses need to consider their exit strategies.

Businesses are typically transferred by one of the following methods: sale to family, sale to third party, sale to employees, gift to family or liquidation. If a business owner wants the business to continue,

and wants to receive fair value because of financial needs during retirement, he or she typically will not consider gifting or liquidating the business.

For contractors, the transition of the business has historically involved some form of transfer to one or more of the owner's children. However, with demographic trends over the past several decades involving factors such as smaller families and substantial increases in post-secondary education, transferring the construction business to the next generation is a less viable solution than ever before. Quite simply, children of baby boomers have more career options than their parents' generation had.

The nature of the construction industry often makes the sale of a construction busi-

ness to a third party an ineffective succession planning option.

Because contractors have jobs, and jobs end and have to be replaced, construction businesses typically have a more volatile earnings stream compared to other industries. While construction businesses with strong track records and good earnings histories have sold to third parties, it is usually only when the business has substantial depth in management, which is not the norm for contractors.

Recent trends in the construction industry point to an increased number of business ownerships being transferred to key employees. Transitioning a construction company to key employees is realistically the only succession planning option available to business owners who wish to cash out, but who also want to see their successful business continue.

There are several realities that the owner needs to carefully consider before a successful transition to key employees can occur. First, the owner essentially buys himself out of the business with his own money.

Key employees usually lack cash for the buy out, and might lack the ability to raise funds from commercial lenders on their own. Ultimately, the proceeds from the transfer of the business will come from its

future earnings; the exiting owner will see pay out over time, typically five to 10 years after the business transfer.

Another factor that the construction owner needs to consider is that he or she most likely perceives the value of the business to be higher than what a fair market valuation would support, or what the key employee is willing to pay. The construction owner needs to understand that sweat equity does not necessarily correlate to business value.

In addition, the exiting owner might be surprised to learn that the new generation of owners might be willing to assume less risk than he or she did when starting the business. Typically, the way to bridge the gap in perceived business value involves extending the payout period, which means the exiting owner of the business assumes some risk during the transfer.

It often takes a minimum of five years to develop and execute an effective succession plan. During that time, the owner must identify the candidate or group that will succeed him or her, and then adopt and execute a win-win plan. Effective succession planning is a delicate and long process, and not simply a decision.

When properly planned, the sale of a construction business to key employees can be very successful and provide the best alternative for the business owner to achieve his or her desire of both a legacy and a financially rewarding retirement.

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