

# Successful Exit Processes of SMEs in Australia

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## **ABSTRACT**

Whilst it may be an idealistic notion that businesses will continue to grow and long outlast their founders, the reality is that most businesses have finite lives with the vast majority of Australian business start-ups ceasing to exist within fifteen years. The reasons for business expiration are essentially: failure, voluntary closure, and harvest. The nature of SMEs in Australia is that there are many start-ups and almost as many failures each year. Whilst there are significant studies on business cessation, there has been very little research focus on business exits (harvesting) that does not include business liquidation (voluntary or involuntary). The main aim of this research was to undertake an empirical study of Australian SME exits to identify the process that owners of SMEs undertake to execute a successful exit. A research framework for business exits was developed that consisted of a process with three overlapping stages: exit contemplation, exit planning, and exit execution. This study was based on an exploratory case methodology which focussed on the exit process undertaken by twelve Australian SMEs. From the results of the study the findings revealed that Australian SMEs undertake two types of exit process; one for reactive scenarios where owners responded to unsolicited offers from buyers, and proactive scenarios where owners prepare their businesses for an exit, identify potential buyers, and then execute an exit. Reactive exits are simpler and quicker to conduct than proactive exits. They are also less expensive to transact, less disruptive to their businesses, and because of their quick transaction time, pose a lower overall risk. The major management implication for exiting owners from this study is that exit preparation, not planning, is the key to achieving a successful exit. Preparation was identified to take two forms: deliberate or inadvertent. These activities contribute or build towards the business's saleability by removing potential exit barriers and enhancing the businesses brand, potential, and profitability. For buyers of small businesses this study concludes that in cases of craftsman style owners, an exit is often not about the price. For these owners, exits coincided with waning satisfaction because of management complexity, changed lifestyle requirements, or simply, longevity.

## **Keywords:**

Small to medium enterprise, small firms, business harvest, exits, planning, strategic decisions

# 1. INTRODUCTION

This paper reports on research into the process that Australian small and medium enterprise (SME) owners undertake when exiting their businesses. SMEs play a significant role in the Australian economy; they account for 99 percent of enterprises and 60 to 70 percent of jobs (OECD 2000). The nature of SME operation in Australia is that there are many start-ups and almost as many failures each year. Significant studies (Peacock 2000, Beddall Inquiry 1990, Lowe et al. 1990, Price 1984, Williams 1987) have been completed on areas associated with business cessation (liquidation, insolvency) because of the consequences associated with loss of jobs, social impacts, legal and regulatory issues, and possible flow on effects to other businesses and organisations. In comparison, very little research focus has been placed on business exits that do not include business cessation. Estimates of SME business harvests show that approximately 1.3 percent of owners get the opportunity to voluntarily exit their business (ABS 1997). Based on a June 30, 2004 population of 762,837 employing non-agricultural private enterprises, this represents financial activity of \$9.26 billion<sup>1</sup> or approximately 1.01 percent of GDP<sup>2</sup>.

A business harvest is a significant event for their owners as it represents a windfall capital gain for their equity and often, may represent the only chance that owners have to access the rewards of many years of hard work. Despite being of economic significance, less than two percent of SME owners actually get this opportunity so therefore it is important to understand how this event occurs and the dynamics of this process. The contributions this study makes

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<sup>1</sup> Bickerdyke et al. (2000) used data from A Portrait of Australian Business (IC and DIST, 1997) which attributes average value add of \$176K and \$5,784K for small and larger businesses respectively. This is then adjusted for annual CPI of 3% for the period 1997 to 2004. Assumed that 9,917 businesses are proportioned according to the actual population of small business (90%) versus medium / large businesses (10%).

<sup>2</sup> Based on 2004 GDP (US\$bn) 640.6 and exchange rate of 1 AUD = 0.70 USD (DFAT Fact Sheet May 2009).

are threefold: firstly it initiates a topography for practitioners and academics to describe what occurs; for owners and advisors it defines a framework to situate the extant 'how to' literature; and finally, it provides a foundation for subsequent research on the topic. In this study, a successful business exit is defined as one where the exit has been voluntary and the owner has received payment for the goodwill of the business.

Following this introduction is a discussion of the literature on the topic. This is followed by the research method, the study's findings, and finally a discussion of what the study found and its implications for management practice and further research.

## **2. LITERATURE REVIEW**

Exiting or harvesting a business can be viewed from a range of approaches. For some (Leonetti 2008, Timmons & Spinelli 2004, Fischbach 2005) it's a risk mitigation strategy where owners convert an 'investment which represents the majority of their wealth' (Leonetti 2008) into a less risky investment (cash, debt note). For authors like Hawkey (2005), Baker (2004), and Ahern (2003) it's the natural conclusion to the ownership cycle and the inevitability that one day most owners will retire. Timmons and Spinelli (2004) and Brown (2005) refer to it in the context of a journey and what owners can create, an owner's legacy to an industry or to his or her family (family business or wealth for the family), or simply about attainment or seeking a desired lifestyle (Baker 2004, Brenner & Schroff 2004, Hawkey 2005). Owning and operating a small business is often physically and mentally challenging even to the point of being a personal health risk (Schaper & Volery 2004) so exiting provides the owner with an option for reducing that risk. This does not always mean they have to

sever links with the business because exits such as mergers and ‘cash cowing’ permit the owner to improve their lifestyle without departing.

Exiting can sometimes be associated with life cycle and growth of the business (Molod & Sattler 2005, Baker 2004, Moody 2004, Thurow 2001, Brenner & Schroff 2004, Coultahard et al. 1996). In these situations the original owner’s skills are not appropriate for the next stage of growth, and new owners with the appropriate skills, take over to grow the business to its next stage of development (management buy-ins and management buyouts). Sometimes the owner has neither the capacity nor the will to fund the next stage of the business’ growth, so exiting provides an avenue for the business to continue developing. In these situations owners recapitalise the business by taking on equity partners, merge with other firms, or seek a public listing. In some situations exiting is about industry or technology maturity when future prospects for the business are on the wane. Merging with other firms can provide access to newer technology or products, allow for synergistic operational savings so that business becomes more competitive, or to achieve operational scale to enhance future opportunities (Timmons & Spinelli 2004).

Furthermore, outside a purely business context, harvesting can be about achieving a status which allows owners to participate in philanthropic activities, in vibrancy and business renewal by being an ‘angel’ investor in new enterprises, or in the community by mentoring entrepreneurs and new business owners (Timmons & Spinelli 2004). In simpler terms, authors like Timmons and Spinelli (2004) refer to it as the ‘ultimate goal of entrepreneurship’, it is the business strategy; while for others (King 2002, Moody 2004), it’s just about financial gain. Because exiting also has other beneficial consequences; an exit

goal establishes a strategic focus, high standards, and “a serious commitment to excellence over the course of developing the business” (Timmons & Spinelli 2004, p. 608).

Leonetti (2008) states that an exit ‘process’ is determined by first establishing an exit goal. This, followed by the choice of an optimal exit option, and then to a strategy and plan to achieve that goal. This process takes the business owner through a course of critical thought processes which will help frame subsequent exit choices . Leonetti (2008) contends through his process that owner’s exit ‘choices’ are a factor of their financial situation and their mental readiness to exit. The dimensions of ‘financial readiness’ and ‘mental readiness’ are useful in understanding the influences on the exit decision, for example, what it might take to get an affirmative decision. However, this is somewhat limited in its application when applied to selecting exit options, mainly because it doesn’t always provide clarity of options. For example, many options can appear in almost all scenarios and assumes one of two states: “I’m ready” or “I’m not ready”.

Most literature on exit planning comes from trade based journals (Fischbach 2005, Molod & Sattler 2005, Basi & Renwick 2005, Brown 2005) rather than empirically supported publications. These journals acts as guides on “how to” and are generally not organisational specific. Several publications (Hawkey 2005, Knight & Whittaker 2002, Leonetti 2008, Coulthard et al. 1996, and McKaskill 2006) have also provide more detailed coverage of the topic, focussing on the prescriptive “how to” approach. Here some SME operators consider exit plans as an activity for some “indefinite time in the future” (Basi & Renwick 2005 p.38), but Schaper and Volery (2004, p. 355) stress the need to anticipate the options for exit because “the exit is more than simply leaving the business; it is the final piece in creating value”.

According to Mintzberg (1994), central to the issue of planning is the articulation of a strategy and a set of goals or objectives. Authors like Leonetti (2008), Basi and Renwick (2005), and Timmons and Spinelli (2004) refer to ‘a harvest goal’ as being central to the harvest process. Timmons and Spinelli (2004) argue that a harvest goal creates high standards and a commitment to excellence over the course of developing the business. In addition, it provides a motivating force and strategic focus to the business’ management. A harvest goal is “not a just a goal of selling and leaving the company” but also a process where real value is created, and through re-investment becomes a process for “economic regeneration, innovation and renewal” (Timmons & Spinelli 2004, p. 608). On this theme of value, Kupferman (2003) emphasises that plans require the owner to understand the drivers of value and how it should be measured. Barrow (2009) approaches planning from the perspective of the owner’s readiness to sell and the issues associated with the exit decision. He presents it as a ‘plan for the rest of your life’ which includes issues of coping with retirement, other stakeholders in the decision, and questions of uncertainty and guilt associated with pricing, staff, and customers.

A major theme covered by some of the literature is the necessity for business owners to both plan their exits and plan them early. Common in many publications is the advice of planning for the future or contingency planning. Fischbach (2005) emphasises a plan timeline of up to ten years whereas Hawkey (2005) stresses the need for owners to even consider exit planning right at the start by structuring their ownership correctly for exit, including structuring correctly for tax purposes. Others like Timmons and Spinelli (2004) and Leonetti (2008) stress time frames as broad as three to ten years to ‘time’ an exit when market conditions are best suited. In addition, Hawkey (2005) says that the plan should include a

nominated exit date. Basi and Renwick (2005, pp. 38 - 39) emphasise planning for 'best case' and 'worst case' scenarios, as without them "the plan is probably incomplete". "The exit plan is a device to get the owner to think about the future" and should be dovetailed into the ongoing business plan, which in turn, is tailored to fit in with a nominated (most likely) exit option. Kupferman (2003) relates time to the benefit; the longer the time, the greater the potential benefit.

According to Schaper and Volery (2004) there are three main elements to planning an exit. Planning an exit is a balance of these three elements: the first is strategic elements linked to the business environment where for potential buyers to be interested in the firm, the business must have an established track record and still have potential for growth. In practical terms this means the firm has a good stream of successful and upcoming products and be well established in the market. Secondly, entrepreneurs personal aspirations; because the business dominates its owner's life the personal goals and objectives are integral in any plans to exit. And finally, the business financial situation where the financial performance of the business can determine the exit options available to the owner. An example of this is a high debt-to-equity ratio may be attractive to corporate investor who could restructure the balance sheet, but be less so to a smaller buyer. The presentation of these elements are illustrative in highlighting key aspects of what a plan needs to address rather than a systematic process describing actions, outcomes and resource commitments (Legge & Hindle, 2004).

Authors like Hawkey (2005) are more prescriptive and detailed about the actions required and stress it as "a long term process" and not an isolated event. Hawkey (ibid.) argues that an exit plan should be an integral part of the overall business and strategic plan and the business should be steered and developed with the nominated exit option in mind. The Hawkey

(ibid.) process provides the most detailed and cohesive guide to steps involved in the exit planning process. Upon choosing an exit option, Hawkey's model states that two parallel and simultaneous planning processes are established; one for the business and one for the owner. Hawkey's process is supported by Leonetti (2008) who stresses that the overall exit plan is driven by the goals, motives and financial requirements of the owner. Leonetti defines exiting according to two owner related dimensions: 'mental readiness' to exit and 'financial readiness'. Whilst this researcher would overall agree with the general framework and thrust of Hawkey's model, it displays some practical limitations.

### **3. RESEARCH METHOD**

In this research a case study strategy has been adopted. Collis and Hussey (2003) describe case studies as being "extensive examination of a single instance of a phenomenon of interest" with the intention of gaining a rich understanding of the context of the research and the processes being enacted (Morris & Wood 1991, Gilmore & Carson 2007). Its strength comes from being able "to *explain* [sic] the causal links in real-life interventions that are too complex for the survey or experimental strategies" (Yin 2003a, p. 15). A case methodology is valuable when issues are difficult to extract from their context. Yin (2003a) considers case studies as empirical investigations that explore contemporary phenomena within real life contexts, especially when the boundaries between the phenomenon and context are not clearly evident.

In this study, primary data has been collected through interviews asking questions in uncontrolled situations which are used as the basis for twelve case studies. These interviews were divided into two categories: primary, with principal shareholder/owners and secondary, with other shareholders and/or advisors. Secondary data such as business or exit plans and



contracts were also sourced. In this study cases were selected on the following basis; where a successful exit occurred , and where the researcher was able to gain a level of rapport with the potential interviewee through personal contact or by introduction from a mutual contact.

In determining the number of interviews necessary to complete the twelve cases in this study, two interviews for each case were attempted; the principal shareholder/owner was selected for the main interview (primary interview) with a separate supplementary interview (secondary interview) with either another shareholder or advisor to the exit process. However, due to single shareholdings and unavailability of advisors in some cases, a total of sixteen interviews were completed. In this study the main interviews with owner/principal shareholder are referred to as primary interviews and any subsequent interviews as secondary interviews.

Although the main source of data in this study is via a primary interview (Yin 2003a), where possible this was corroborated with other sources of information. The researcher undertook several strategies for corroborating data. Firstly, where secondary data in the form of printed Business Plans was available to the researcher, it was compared to the outputs from the interview data Yin (2003a) refers to this as non-converging evidence. Secondly, data triangulation (Yin 2003a) of a second source of interview data was established by interviewing a business partner or exit advisor for a specific case. This was then compared with the data from the initial interview.

The interview method used for this research was a semi-structured interview. A broad set of standardised questions was used to guide the interview. A case study protocol was used by the researcher to provide an overview of the study project, to develop field procedures, to

assist in the development of the case study questions, and as a guide for the study report. Interviews were conducted with former business owners<sup>4</sup> who had successfully exited their businesses. All data was considered relevant irrespective of initial classification, and all thoughts and perceptions immediately recorded after the interview(s) as reflective notes. To supplement the transcript data from each interview in this study, the researcher employed three additional notations relative to the interview to identify critical subjectivity and reflexivity (Lincoln 1995). These notations involved making field notes during the interview, writing reflections (post-interview) on the case specifics and the interviewee in the context of the research questions, and writing a set of self debriefing notes on the interview.

The study's data was analysed using two core approaches. Based on the principles prescribed by Glasser and Strauss (1967) for grounded theory, the first approach is a content based analysis which guides the analysis to the theoretical understandings. In this approach the data is reduced, organised, and displayed (within-case and cross-case displays [Miles & Huberman 1994]) to determine the level of support between the research framework and the empirical data. When this process was completed the data is then re-ordered in a range of conceptual 'frames' in an attempt to explain what does not match or to better explain the key elements of the overall process.

## **4. FINDINGS**

This study analysed the exit activities of twelve SME owners who had successfully completed exits of their businesses. The initial analysis of the data focussed on classifying characteristics of the sale and buyer. Where the owner approached the buyer this was termed

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<sup>4</sup> A successful business exit is one where the exit has been voluntary and the owner has received payment for the goodwill of the business.

‘proactive’ and the reverse was ‘reactive’. It soon became evident that buyers had a great influence on the sale process so buyers were classified according to whether they were internal or external to the business and what their relationship was (See Table 1).

In the design of this study exit contemplation was conceived as the stage in the exit process where owners postulated on a future exit; where the owner considered, deliberated, and romanticised on issues (when, how, who, and how much) in relation to harvesting their business. It was suggested that this was either a continual process at the forefront of the owner’s regular decision making processes or an ad-hoc irregular thought on optimal scenario outcomes. It was anticipated that all owners would reveal some level of exit contemplation. However, it is found that only eight owners contemplated exiting and only three owners ever ‘romanticised’ about optimal harvest outcomes (see Table 1). Of the owners that did contemplate exiting, it generally coincided with owners who planned and strategised their exits; the exceptions being Case RQ150 who exited differently to his plans and Case NM160 who made a strategic decision to exit.

The next step in gaining a better understanding of the topic was to direct the focus of this examination onto the individual owners and determine if there were traits or group characteristics which helped describe their reported behaviour. Smith's (1967) seminal work

Case Identification	Years of Ownership	Sale Type	Buyer Type	Buyer Identification	Exit Preparation	Exit Contemplation	Romanticising	Type of Entrepreneur
ZY110	7	Reactive	Internal	Partner	Not Evident	Evident	Not Evident	Craftsman
XW120	11	Proactive	External	Customer	Evident	Evident	Evident	Opportunist
NM160	12	Proactive	External	Known Other	Not Evident	Not Evident	Not Evident	Craftsman
VU130	14	Reactive	External	Competitor	Not Evident	Not Evident	Not Evident	Craftsman
TS140	4	Proactive	External	Unknown	Evident	Evident	Evident	Opportunist
RQ150	16	Reactive	External	Known Other	Evident	Evident	Not Evident	Craftsman
PO170	11	Proactive	External	Competitor	Evident	Evident	Evident	Opportunist
JI180	12	Reactive	External	Competitor	Not Evident	Not Evident	Not Evident	Neutral
LK190	9	Reactive	External	Customer	Evident	Evident	Not Evident	Craftsman
HG200	6	Reactive	External	Supplier	Evident	Not Evident	Not Evident	Craftsman
FE210	5	Proactive	Internal	Staff	Evident	Evident	Not Evident	Craftsman
DC220	3	Neither	External	Known Other	Not Evident	Evident	Not Evident	Opportunist

**Table 1:** Summary of data identifying buyer and sale characteristics, preparation, contemplation, and entrepreneurial types.

on entrepreneurs refers to entrepreneurs as 'craftsman' at one extreme and 'opportunistic' at the other. 'Craftsman' are categorised as paternalistic and autocratic with goals of independence, autonomy, and producing a quality offering. Financial gain and growth are not their key motivations of 'craftsman' and operating their own business is symbolic of their success. The 'opportunistic' entrepreneur on the other hand is well educated, engages in long-term planning, and is able to delegate to managers. He or she will have a well rounded formal education and management experience, and is risk-orientated with growth being the major goal for their organisation. Kuratko et al. (1997) identified that some entrepreneurs are not just motivated by extrinsic goals (personal wealth, income opportunities) but also by

intrinsic goals such as recognition, excitement and a sense of accomplishment. Porter and Lawler's (1968) motivational model suggests that entrepreneurs are also motivated by the act of entrepreneurship through starting and building organisations and taking advantage of opportunities. Combining these features together, it can be concluded that some business owners might be reluctant sellers because the business plays a more significant role than just financial gain. Without over generalising entrepreneurial characteristics in the context of this study, it is deduced that 'craftsman' style owners are less likely to want to sell than 'opportunistic' ones.

Using the demographic data collected on business owners (education level, number of staff, previous business experience, and what they did after the exit) with a thematic analyses of responses to identify management philosophies (single manager versus management structure), an attempt was made to 'classify' owners according to Smith's (1967) entrepreneurial topography on a seven-point continuum scale. Of the twelve cases analysed, seven were owned by 'craftsman' style entrepreneurs, four 'opportunists', and one was considered neutral. In the eight cases where there was no contemplation of an exit or only slight consideration, six were owned by 'craftsman' styled owners, one was neutral, and one an 'opportunist'. This suggests that the process of exit contemplation is undertaken mainly by 'opportunists' type entrepreneurs. This finding brings to the fore the issue of 'owner's entrepreneurial characteristics' and whether this plays a role in what exit process is undertaken. It is concluded that the owner's characteristics are a significant factor, and the research model (to date) is only indicative of the process likely to be undertaken by 'opportunists' owners. As these characteristics (craftsman - opportunists) indicate whether owners are likely to undergo the complete exit process or an abbreviated version. 'Craftsmen' style owners appear to be reluctant sellers who are intrinsically micro-focussed

and do not spend much time or effort contemplating selling their business. When ‘craftsman’ exit, it is likely to be sudden (a reactive sale) occurring because the timing suits the owner. There is minimal preparation, and implementation usually begins shortly after the initial exit decision<sup>5</sup>. Finally, the concept of exit contemplation transitioning from a state of romanticising to realism was supported by only three cases (XW120, TS140, VU170). In the context of the preceding discussion on exit contemplation, this study concludes that ‘opportunists’ entrepreneurs tended to romanticise, case DC220 again being the exception. This supports the description of opportunists who strive for growth and focus on long-term planning.

The issue of exit preparation is expressed in the context of formal planning activities (Hawkey 2005, Knight & Whittaker 2002, McKaskill 2006), contingency options (Schaper & Volery 2004) with long range timelines (Fischbach 2005, Hawkey 2005, Timmons & Spinelli 2004). The study revealed little or no support for formal planning activities by exiting SMEs, and when there was activity, determining the details of planning (either formal or informal) from execution activities was intricate. When there was preparation activity it was not always done solely because of the exit – this was referred to as ‘inadvertent preparation’. As a result, an adaption to the research model was made during the pilot phase which grouped all activities (formal planning, informal planning, execution activities etc.) prior to the provisional exit decision and referred to the set of activities as ‘exit preparation’. Activities following the provisional exit decision are referred to as ‘exit implementation’. Based on the thematic analyses it was concluded that exit process should be examined in several contexts; deliberate preparation, inadvertent preparation, and buyer preparation. The original concept used in the research model involved only ‘deliberate preparation’ which refers to any

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<sup>5</sup> Defined as a ‘provisional exit decision’.

activities (planning or execution) directly related to exiting. Inadvertent preparation refers to activities that aid the exit process or enhance the prospects of being sold but are not done for the purposes of exiting. Examples of these are signing on a new supplier agency, or adopting internationally recognised systems or standards (AS 8000, IAS38, etc.). Finally, the main preparations for some exits are done by the buyer; this is usually the case for reactive sales. Buyer preparation involves developing the business case for acquisition (a form of business plan), forward sales or budget forecasts, and background checks (on the owners, organisation).

Legge and Hindle (2004) define a 'plan' as a schematic description and a course of action. Using this definition none of the twelve business exits studied here had formal exit plans<sup>6</sup> but seven cases showed evidence of deliberate preparation prior to exiting. Preparation was more evident when owners proactively sought buyers, rather than the reverse. This usually took the form of documentary information for buyers (Information Memorandums, financial reports, taxation records, budgets and forecasts, etc.). Cases which were reactive sales (RQ150, LK190) also undertook some activities which prepared their businesses for exits but generally their preparation was less extensive and more directed to the needs of the buyer.

In the literature a strong emphasis was placed on early planning, typically three to five years, but some recommended even ten years in advance (Fischbach 2005, Hawkey 2005, Timmons & Spinelli 2004). While there was little evidence in this study of formal planning, those cases that did plan were generally prepared well in advance of buyers appearing. In the case of XW120 who formed their business always with a future intention of exiting, preparation

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<sup>6</sup> A formal exit plan refers to a written plan written for readers other than the writer and an informal exit plan refers to a plan to an unwritten plan or a document prepared primarily for use by its author.

took the form of regular management meetings where product development (consulting services) and business strategy was tailored to identified potential buyers of the business. For RQ150, exit preparation occurred many years in advance of the specific exit date or prospective buyer. With a pending retirement (five to ten years) the owner began his exit preparation by ‘operationalising’ the management of the business through the Standards Australia quality accreditation process (ISO 9000). This was done so that acquired experiences and practices necessary to operate the business were documented for succeeding managers. In two cases (PO170, RQ150), earlier attempts at an exit also prepared their businesses for their actual exits. Case PO170 aborted an exit via an initial public offering (IPO) in early 2003, and the changes made for the IPO (a restructured management team with a Chief Financial Officer added and the identification of partners to participate in the IPO which were subsequently used in the ‘roll-up’) shortened the timeline for the eventual exit and enhanced the sales prospects. In the year preceding the actual exit, the owner of RQ150 made several unsuccessful attempts to merge with competitors to refresh the business and reduce his personal workload. During that time he upgraded his management information systems to implement an e-commerce front-end, and to provide better management reporting. Both these changes aided the saleability of the business to the eventual buyer.

The act of operating a successful business could be inferred as ‘unplanned exit preparation’. ‘Preparation’<sup>7</sup> can be defined “as any proceeding, experience, or the like considered as a mode of preparing for the future”. The thematic analyses identified that there were many circumstances and practices that contributed to a successful exit. These ‘occurrences’ were not often conducted with an exit in mind, but nonetheless it was highlighted by owners as

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<sup>7</sup> Meaning of ‘preparation’ at *Dictionary.Com*, viewed 26 January, 2009. <<http://dictionary.reference.com/browse/preparation>>.



being critical to the success of the exit. At the end of the thematic analyses these occurrences were categorised 'inadvertent exit preparation' and they were assembled into two main groups: "business systems' and "practices, circumstances, and incidents".

There are some internal management systems which make some businesses better prepared to sell than others. Knight and Whittaker (2002) highlight the need to have readily available management reports (sales budgets, profit and loss reports, cash flow forecasts, trade debtor reports, trade creditors, inventory reports) and systems for managing contracts (employees, suppliers, customers) and intellectual property. Owners are able to implement these systems and prepare information for buyers upon request. However, delays in responding to requests or not being able to readily demonstrate in-house systems that show the business is professionally managed is likely to undermine the buyers confidence, reduce the buyers price, or both (McKaskill 2006, Hawkey 2005). From these findings, the first facet of inadvertent preparation is therefore defined as any implementation, development or use of a business system that will enhance the confidence of potential buyers. Case PO170 provides an example of this type of preparation, implementing a much larger and more expansive 'backoffice' system (Great Plains SQL) than was required to operate the business, because it was an industry standard and had a well recognised accounting system. The preparation was well received by the acquirer who was five times larger and was about to upgrade to that system.

Implementations of business specific systems are not the only examples of inadvertent preparation. An unexpected outcome from the cross-case display and the thematic analysis was that in ten out of twelve cases the acquirer was known in some form to the business owner. Of these the significant relationships were: two were purchased by customers

(XW120, JI180), one by a staff member (FE210), one by a partner (ZY110), and four (HG200, VU130, RQ150, PO170) trade related (i.e. supplier, competitor, colleague). When significant incidents or event are categorised in the thematic analysis, it can be concluded that in some instances key practices or interactions that occur during the normal course of business are significant, because they can impact or influence the ultimate buyer of the business. The unexpected outcomes described above are characterised as the second facet of inadvertent preparation. They are defined as any business or personal practice, circumstance, or incident that contributes to a favourable seller's outcome is a form of unintentional exit preparation.

It might be argued that favourable incidents that occur are not preparation but in fact a set of circumstances that serendipitously aids the exit. Viewed in reverse, if a buyer had entered into negotiations with high degree of scepticism of the owner's integrity – what would this have done to a potential sale? Clearly, establishing a favourable business and personal reputation is sound preparation for an exit. Therefore, it is concluded that circumstances, practices, or incidents between the business/owner and a known entity (competitor, supplier, customer etc.), however they occur, can aid an exit, and so by definition this is referred to as the second facet of inadvertent preparation.

In summary, the exit process consists of three forms of preparation: deliberate, inadvertent, and buyer (see Table 3). Deliberate preparation refers to any activities (planning or execution) which directly relate to exiting. Inadvertent preparation refers to activities that aid the exit process or enhance the prospects of being sold but are not done for the purposes of exiting. And finally, the main preparation for some exits is done by the buyer and not the

seller, buyer preparation involves developing the business case for acquisition, forward sales or budget forecasts, and background checks.

Although, defining or categorising the specific activities related to each exit was beyond the scope and intention of this study, activities related to the exit are incontrovertible and generally well supported in the literature (Timmons & Spinelli 2004, Schaper & Volvery 2004, Hawkey 2005, Fischbach 2005, Molod & Sattler 2005, Basi & Renwick 2005, Brown 2005, Knight & Whittaker 2002, McKaskill 2006). A cursory analysis of the data shows that both planning and execution activities were present in all exits, despite the frequent difficulty

Type of Preparation	Details	
Deliberate	Planning (formal & informal) and Execution	
	Prior Exit Attempts	
Inadvertent	Business Systems	Financial Systems
		Management Systems
		Information Management Systems
		Intellectual Property
		Legal
		Human Resources
	Practices, Circumstances, Incidents	Internal
		External
		Personal
	Successful Business Operation	
Buyer	Background checks, reference checks, forecasts, raising finance, preparing a management team	
	Planning (formal & informal) and Execution	

**Table 3:** Summary of activities associated different types of exit preparation.

Of distinguish between them. Exit planning in this stage was done by both the owner (deliberate exit planning) and buyer (buyer exit planning), but how much and to what extent, often depended on whether it were a reactive or proactive sale. Overall, implementation

activities varied according to their owners' and buyers' specific requirements. Short implementation periods usually referred to fewer requirements, but the reasons for longer settlements ranged from significant buyer requirements such as due diligence and supply of detailed information (Cases XW120, RQ150, PO170), exit barriers<sup>8</sup> (Hawkey 2005, McKaskill 2006), to simply long settlement requirements by the buyer or seller (Cases TS140, ZY110).

## 5. DISCUSSION & CONCLUSIONS

Firstly, in the SME context and from the results of this study, there was no evidence of formal planning (written exit plans or business plans with an exit strategy) and at best, planning was informal as recommended actions and activities (by external advisors), or actions conceived by the owner's own means. Secondly, the planning literature (Coulter et al. 1996, Mintzberg 1994) refers to planning as specific, interlinked, and sequential steps of action. Activities associated with inadvertent preparation from this study were often isolated (i.e. one-offs), spasmodic, opportune, and were often dual or multi-purpose (i.e. done for more than one reason). Overall, evidence of preparation from this study was associated with activities and events that contributed towards a possible exit by reducing potential barriers (Hawkey 2005, McKaskill 2006) and/or enhancing exit opportunities (e.g. preparing potential buyers). Respondents referred to specific events or activities, rather than steps, plans or processes as significant to their exits. Therefore, the term preparation was considered to be more descriptive of what was actually occurring.

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<sup>8</sup> A typical *exit barrier* was the inability of the buyer to raise funds for settlement e.g. Cases HG200, FE210, DC220.

The findings of this study concluded that not all business owners contemplate exiting. Exit contemplation was undertaken mainly by ‘opportunists’ type entrepreneurs while ‘craftsmen’ style owners (Smith 1967) were reluctant sellers so had not spent much time or effort contemplating selling. Therefore, the provisional model of the exit process represented refers to the all-embracing process undertaken typically by ‘opportunistic’ and ‘craftsman’, undergo an abbreviated version with minimal contemplation and preparation. It has also been deduced that ‘romanticising’ and ‘realism’ phases of exit contemplation are undertaken primarily by ‘opportunistic’ owners/entrepreneurs.

Delineating preparation from planning also defines a point in the commitment of resources for exiting. Results from this study showed that in the preparation stage, significant contributions were made towards exit preparation, but these usually did not require major resource commitments. In general they were done as a matter of course in operating the business. Planning on the other hand usually occurred when owners had made the commitment to exiting after an exit timeline was established.

### **Implications for Management Practice**

This study found SME exits fall into two major categories: they are reactive, where the owner responds to an unsolicited offer from a potential buyer; or they are proactive, where the owner seeks suitable buyers for the business. In this study no attempt has been made to identify which scenario produces the better outcome, but the literature on strategic buyers (McKaskill 2006, Schaper & Volery 2004, Molod & Satler 2005, Brown 2005) emphasises the significant financial benefits to sellers in identifying and transacting sales with a strategic buyer as opposed to financial ones (see Section 3.9.2). The process of identifying a potential buyer infers ‘proactiveness’ by the seller, but this does not account for buyer-seller

disequilibrium which financially benefits a reactive sale situation, particularly in the case of reluctant sellers. On the other hand, proactive exits encourage scenarios which result in competitive bidding and potentially superior outcomes. This contrasts with reactive sales which generally involve a single buyer.

Reactive exits are simpler (have little contemplation, less preparation, and fewer decisions) and are quicker to implement than proactive exits. The implications for management are that reactive exits are less expensive to transact, less disruptive to their businesses, and because of their quick transaction time, pose a lower overall risk (exposure of sale to competitors, customers, suppliers, and financial risk). Does this mean that SME owners should simply wait for potential buyers to approach them? Not necessarily, but this reinforces the commonly expressed belief that risk and potential reward are positively related with each other.

In proactive exits where owners strategise their exits and consider their exit options, literature emphasises the need for planning (Hawkey 2005, Knight & Whittaker 2002, Leonetti 2008, Coulthard et al. 1996, and McKaskill 2006). The findings of this study however, found that planning played a minor role in SME exits. Certain activities, events, and planned actions all contributed to preparing the business for exit. This study found that sometimes these were planned, especially in complex exits, but more often they were inadvertent, spasmodic, and even opportune. The major management implication for exiting owners from this study is that exit preparation, not planning, is the key to achieving a successful exit. Preparation may encompass an exit plan, but owners with an exit objective can also undertake activities that contribute or build towards the business's saleability by removing potential exit barriers and enhancing the business brand, potential, and profitability. For SME owners, it is about

adding an exit dimension to their management decision processes. This requires their consideration of “does this enhance or hinder a future exit?” and take this into account when considering courses of future actions or other options. A practical example of this is tax planning. For example, declaring minimal profits to reduce tax payments could also reduce the amount received for the business in an exit.

The benefit of an exit objective, characterised by a pilot exit decision, is that it forces owners to continually look into the future and forecast how current activities and decisions might on impact a future exit. The case data highlighted many instances where owners have specifically recalled seemingly unrelated activities (to an exit) that were significant to them achieving their exit objective. Examples of this were: hiring key management personnel; developing key product lines; and implementing scalable backoffice systems.

In this study most owners (eleven out of twelve cases) previously knew the buyers of their businesses, indicating that managing and nurturing the owner’s reputation and relationship with key stakeholders (suppliers, competitors, partners, staff, and customers) is a significant form of inadvertent exit preparation. While running a sound business and enhancing personal reputation could be classified as ‘sound business practices’ that owner’s should do as a matter of course, this study concluded that good practice will both increase the owner’s chances of exiting and achieve their financial objectives.

Finally, for buyers of SMEs, this study concludes that in cases of craftsman style owners, exiting is often not a financial decision. Timing of an offer in resolving insurmountable or difficult issues could be as important as achieving particular financial objectives. This requires potential buyers to understand the type of entrepreneur he or she may be dealing

with, and to be both persistent and aware of circumstances that may influence an owner's decision to exit. Craftsman style owners are more interested in the achievement and satisfaction of the service or product they provide, rather than financial returns. When this satisfaction wanes because of complexity, lifestyle, or longevity, this study found that buyers can find opportune times for successful exit offers.

### **Limitations and Implications for Further Research**

This study has provided insights into the SME exit process by identifying the major stages and key activities associated with SME owners exiting their businesses. Despite being one of the earliest studies on the topic with scope for articulating original knowledge, this study, like all empirical investigations, has its limitations.

Firstly, a recall of details from owners whose exits have occurred up to ten years earlier can have a tendency to recall positive details only (interviewee response bias and retrospective bias), and few setbacks or details of activities that failed or did not proceed according to expectations (referred to as a 'halo' effect). Consequently, the concluded process may be portrayed as trouble-free and linear, not accurately describing what actually occurred. To overcome this limitation, a further study is recommended testing the concluded model with owners of more recent (within two years) exits. Design of the study should be directed towards investigating a cross-section of exit related activities and decisions at regular time intervals (as opposed to just the successful ones), to provide enhanced levels of detail.

Another limitation of this study was that it only surveyed selling owners. In the case of craftsman style entrepreneurs involved in reactive exits, it was found that many of them did no exit preparation. An explanation for this was that although some preparation was



undertaken by buyers, such investigation activity fell beyond the scope of this study. Therefore, to gain a more insightful understanding of the exit process it would be beneficial to take a dyadic approach and conduct further research which identifies and integrates the buyer's activities into the overall exit process. It is anticipated here that buyer activities in reactive exits would be similar to seller activities in proactive scenarios. Examples of this could include negotiation and transition arrangements with suppliers, and preparation of contracts of sale. This study could include buyers in both reactive and proactive sales, but in this case it is anticipated that the reactive buyers would be more active and show higher levels of planning. Their exit preparation is envisaged to be in the form of establishing a relationship with the owner (a buyer version of exit contemplation) to improve the owner's receptiveness of potential future offers. It is hypothesised that net activities will be similar in both types of exits; in reactive exits some of the key activities will be undertaken by the buyer, and in proactive exits they will be primarily done by the seller/owner. This study could be further enhanced by an analysis of comparative costs and resources associated with the respective exit activities.

A further limitation of this study involves the characteristics of the sample. The twelve cases used in this study were purposively selected, which creates an inherent problem of generalisability of the study's findings (Eisenhardt 1989, Yin 2003a). In this study analytical generalisation as opposed to statistical generalisation has been applied, with the rigor of the findings coming from the replication of cases (Eisenhardt 1989, Yin 2003a). Further, the aim of this research was to generate theory rather than test theory, with wider generalisation never being its intended purpose. However, although it is possible and likely that this sample is representative of successful SME exits, generalisability of the findings could be restricted. As this research has introduced a new area of study, future investigation using a positivist

approach to investigate the five primary factors identified in this conceptual model (see Figure 9.1), is desirable to test the study's findings, and further enhance its generalisability.

Five further topics are recommended for future research. The first is investigation of the concept categorised 'exit pre-conditions'. Here it is hypothesised that this concept consists of factors which act as pre-determinants to possible exit options and the exit process. Support for this concept comes from the literature by Barrow (2009) which refers to factors of the owner's 'exit readiness' and 'financial readiness'. One example of this includes a benchmark turnover or level of profitability; where a low turnover might limit potential buyers who are interested in the business. The second topic derives from comments made by two interviewee respondents about their irreversible commitment to the exit once the process got underway. This suggests the possibility of a 'point-of-no-return' in the exit process associated with financial (wasted resources), personal (emotionally decoupled from the business), and business factors (distracted management). An investigation identifying this point and its associated factors and consequences would be valuable because they form a major milestone in the process. It is hypothesised that passing this point without exiting may result in business failure or a forced exit.

It is hypothesised that 'time in business' forms an inherent exit trigger for SME business owners, and as such causes owners to be receptive to exiting. The demanding work regime of SME ownership and exhaustion of new ideas eventually results in some owners questioning their ability to contribute to their business's future. A study into factors that result in this condition, variances within business characteristics (number of owners, size of business, business type) and the ownership longevity/cycle would provide a valuable contribution to knowledge of the exit decision.

Finally, it is hypothesised that exit contemplation, the exit trigger, and barriers to exit (specifically stakeholder aspirations) are interlinked and fluid. The underlying assumption is that the exit requirements of owners are not static but dynamic and linked to the environment, operating factors, length of ownership, and business success.

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