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What Could Go Wrong When Transferring Ownership to Employees?

We often hear owners *say* they want to transfer their businesses to third-party buyers when they first encounter the concept of Exit Planning. However, we've observed that in many completed Exit Plans, owners *actually choose* to transfer their businesses to employees. Some reasons for this decision include employees knowing the culture and values of the business, a desire to keep the business with people the owner knows and trusts, and employees' inherent desire and commitment to grow the business.

As owners start to consider options that include transferring to employees, they can forget to ask two important questions:

1. Do the employees I want to succeed me even want my ownership?
2. If so, how can I motivate each employee to stay and make the financial commitment?

Your love and enthusiasm for your company can cause you to skip these critical first questions. What may seem like a good fit to you can lead to chaos if the most important employees (often referred to as "key employees") cannot, will not, or just don't want to accept ownership. Fortunately, there are three things you can do to address this issue.

Talk to Your Key Employees

Knowing whether a key employee would consider and be capable of ownership is the most important step in transferring to a key employee, and it's often the step that's most overlooked. Many owners take pains to convince themselves that a certain key employee (or key employees) would be a perfect fit, but fail to ask the employee whether he or she is even interested in ownership. For some key employees, being a key employee is more than enough for them. Others simply don't have the skills to transfer into ownership. The best way to address these issues is to talk frankly with them about their aspirations and what they'd do if they were owners.

Incentivize Your Key Employees

Key employees who are interested in ownership can be scared away when they learn that ownership transfers aren't a gift. While this may be unreasonable, it's remarkably common. The idea of having to spend their own money to own the company can be overwhelming, especially when key employees don't have the funds to pay for a share of ownership upfront. Fortunately, you can quell this concern by creating and implementing an incentive plan that focuses their attention on growth and rewards them by turning performance into ownership opportunity.

"Handcuff" Your Key Employees

A key aspect of successful incentive plans is assuring that they handcuff employees to the business. Handcuffing key employees means providing lucrative payouts (based on performance) that take some time to fully mature. Key employees who leave the company too soon walk away from their benefits. This is an important element in an incentive plan that is intended to lead to an ownership transfer to key employees.

Talking, incentivizing, and handcuffing are the three basic aspects of most successful insider transfers, but they're also critical functions of successful business planning in general. We encourage you to learn more about each element before you begin the insider transfer process. If you'd like more information and assistance on how to best talk to, incentivize, and handcuff your key employees—whether you're looking to exit your business soon or not at all—contact us today.

fictitious names and do not represent any particular person or entity.

Please contact Dan O'Brien for a free one hour consultation on your exit planning needs
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