



Ensuring Your Legacy: A Guide to Exit Planning
for Child Care Business Owners

If you own a child care center, you've likely poured your life into your business. While it may seem daunting to think about, developing an exit plan is essential to achieving the goals you've set for yourself and your business.

Why Do I Need an Exit Plan?

As a business owner:

- ❶ **You've invested money into your business, and exit planning can ensure that you receive a fair return from the sale of your business**
- ❷ **You've put your time, energy, and love into your business, and exit planning can preserve this legacy and enable you to leave on your own terms**
- ❸ **You've provided care to families in your community, and exit planning can ensure that this critical service continues after you leave**
- ❹ **You've created jobs, and exit planning can ensure that they exist after you leave**

This guide explains the process of creating an exit plan. It walks you through:

- ▶ **What exit planning is and why it's important**
- ▶ **Identifying your goals for exiting your business**
- ▶ **Special considerations for child care businesses**
- ▶ **An example of one child care business owner's exit planning process and outcome**

What is Exit Planning?

A successful exit plan:

- ▶ **Maximizes the value of your business at the time of ownership transfer**
- ▶ **Minimizes risk for the owner and the business**
- ▶ **Serves as a tool to maintain owner control throughout the transition process**

Exit planning is based on the premise that, at some point, every business owner will leave their business. Designing an exit plan is the best way to maintain control over this process. By creating and executing a plan, business owners can transfer ownership, while assuring that their goals can be achieved during the transaction.

An exit plan typically includes an owner's target departure date from the business and the owner's financial needs, as well as a succession plan, preliminary valuation, and financial projections for the business.

What is the Exit Planning Process?

The exit planning process involves 3 stages:



1 Stage One: Identify Your Goals for Exiting Your Business

The first stage of exit planning involves setting goals for yourself and your business, including:

▶ Your target date for exiting the business

What is your timeline for no longer being involved in the day-to-day operations? Do you have a different timeline for transferring ownership of the business?

▶ Your involvement with the business

What are your goals for future involvement in the business? Do you want to exit the business gradually over a staged reduction in ownership and responsibility, exit completely at the time of transfer, or remain actively involved?

▶ Your financial needs

What is your target selling price? What amount of annual income is needed post-exit? What amount of cash is required for immediate needs? What amount of money do you want to leave to your family? What amount of seller financing is acceptable to you?

▶ Your ideal successor

What role do you play in the business, and how will your role be covered when you exit? Do you want to sell to an outsider through a broker or an internet marketplace? Or do you have someone in mind who you want to transfer your business to, such as an employee or family member? What are the goals and needs of your potential successors?

▶ The legacy you want to leave

Would it be alright if the business ceases to exist as an independent entity? Do you want to preserve your center's legacy in your community? Are you looking to take care of or reward your employees?

Some of these goals require input from others. Conversations with family members and trusted peers can help with identifying your timeline and financial needs. It is often valuable to also consult a professional, such as a financial planner, CPA, or a lawyer.

The idea of retiring can bring up complicated feelings: excitement, sadness, hope, and fear. By planning your exit in advance, you will be more emotionally prepared for a future transition.

2 Stage 2: Develop Plan to Meet your Goals

After you've identified your personal and business goals, you can make a plan for achieving them. This is done by:

► Conducting a business valuation

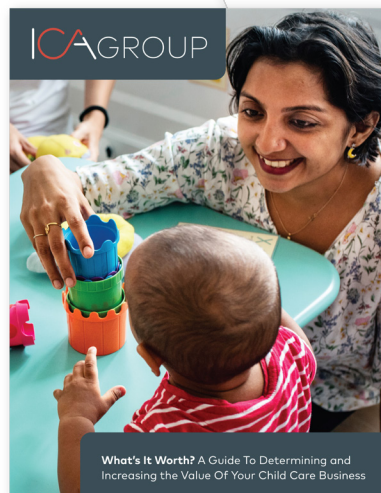
which will tell you what your business is worth and how the value is determined. You can use the valuation to assess the gap you need to fill between today's value and the value you need when you exit.

► Updating your business plan

which can serve as a roadmap for making business improvements and other strategic decisions that can maintain or increase the value of your business.

► Creating a management succession plan

which requires you to consider options for future ownership and management of the business. By outlining all the tasks that you perform as a business owner, you can develop a strategy to transition these tasks to other people within your target timeframe.



Financial Metrics That Impact Business Value

The "Iron Triangle" metrics were developed by child care finance and policy expert Louise Story as key child care business metrics that directly impact your ability to generate profits. Since EBITDA is commonly used in small business valuation, these metrics are a useful tool to increase the profitability of your child care center and its value.



Full Enrollment
Full Enrollment, which means ensuring full enrollment every day in every classroom. Center owners should strive for 95% enrollment, but expect 85% enrollment.

Full Fee Collection
Full Fee Collection, which means collecting all tuition and fees owed to your center on time. Center owners should strive to collect at least 90% of all money owed to the center.

Revenues Cover Per Child Costs
Revenues Cover Per Child Costs, which means that all tuition, fees, and other income cover your per child costs, or your program will lose money.

To illustrate how these metrics play out, consider two centers with the same enrollment and average weekly tuition rate of \$275:

The ICA Group | (617) 232-8765 | icagroup.org/childcare

3 Stage 3: Implement Your Exit Plan

Once you understand what needs to happen financially and operationally to achieve your goals, you should develop a timeline with key milestones for exiting your business. As you implement your exit plan, it's important to continually revisit the plan in case your goals change or your strategies for achieving your goals need to be adjusted.

Visit www.icagroup.org/childcare for information and resources on business valuation.



“According to the Exit Planning Institute, 79% of business owners want to retire in the next 10 years, but only 15% have talked to an advisor about their plans.”

Want Your Plan to Be Successful? Avoid common traps.

It's useful to be aware of some common owner beliefs and actions that can prevent your exit plan from being successful. These dynamics are addressed in the following tips:



► **Get Real**

Use a valuation to set your expectations for sale price. The belief that the business value is higher than the actual value (as determined by a valuation) and an inability to readjust expectations around sale price can be barriers to a successful sale.



► **Remember the Big Picture**

It's common to focus exclusively on top-line price for the business, but the transaction structure can have a large impact on the after tax net proceeds you receive for the business. As you weigh your options, consider the cash you'll receive for the business both upfront and as interest payments over time.



► **Let Go**

Failure to extract yourself from daily operations can jeopardize the business' ability to function without you, so focus on training and supporting staff to take over your role.



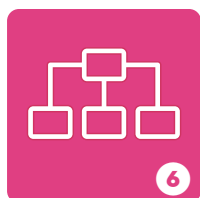
► **Be Prepared**

Don't enter into deals hastily or without preparation and due diligence. Your business is likely one of your most valuable assets. Treat the process with care.



► **Keep Your Eyes on the Ball**

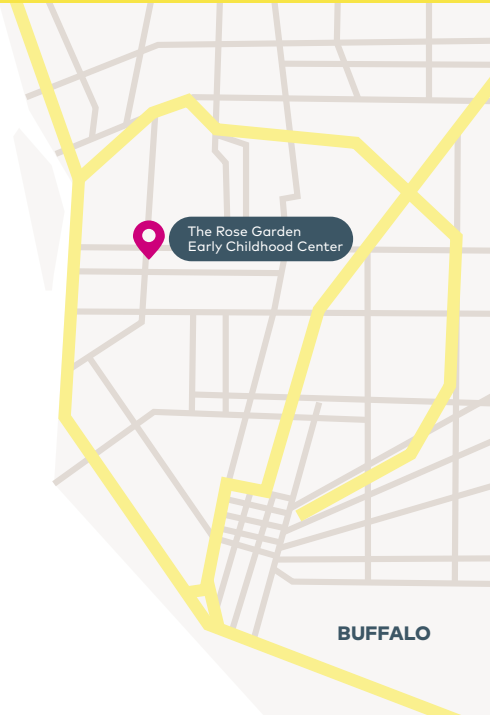
Pay attention to business performance, including enrollment, staff turnover, and spending, throughout every stage of the transfer process in order to maintain business value.



► **Be the Boss of Your Exit**

Implementing your exit plan can require additional support from professionals, such as a broker, financial planner, CPA, or lawyer. This support can be expensive. Before you begin working with any consultant, make sure they understand your values and goals for working together. It is important to manage your exit team and remain in regular communication to confirm progress.

Case Study: The Rose Garden in Buffalo, New York



The Rose Garden Early Childhood Center is a child care center in Buffalo, New York, founded by Judith Frizlen in 2008.

As the founder and executive director, Ms. Frizlen developed the Rose Garden into a premier childcare institution with a stellar reputation and a long waiting list.

As Ms. Frizlen considered her exit goals, she decided she wanted to turn over the business to her employees to reward them for their work and increase their income through profit sharing.

In 2015, Ms. Frizlen stepped out of the Director role to focus on the transition and systematizing operations. The Rose Garden's Assistant Director moved into the Director position. In 2016, Ms. Frizlen also began training staff in marketing, policy, human resources, and payroll responsibilities.

“My daughter worked at the center, but she likes working collaboratively and didn't want to own the business by herself. And I thought the culture of the center would be lost if I sold the business to a chain.”

Business Snapshot



Year established



Year transferred to employees

While the business value was significant to Ms. Frizlen, she also wanted the new owners to profit from ownership within the first few years of taking over the business, and so she approached the selling price with some flexibility. Ms. Frizlen wanted to fully exit the Rose Garden by 2019, with no remaining financial stake in the business. She determined that some seller financing of the transaction was acceptable during this period. She also determined that she'd enjoy having a continuing role with the center focused on coaching the center's staff.

Ms. Frizlen worked with two cooperative development organizations, the ICA Group and Cooperation Buffalo, to successfully transfer the business to her employees. In 2017, five employees purchased the business to

operate as a worker cooperative. Cooperation Buffalo helped secure financing for the deal through the Working World and the Financial Cooperative, with 70% of the financing coming from these cooperative lending institutions and 30% coming from Ms. Frizlen as seller financing. In the year leading up to the transition, employees also participated in training with Cooperation Buffalo to equip them with the skills and tools they'd need to run the business. Ms. Frizlen stepped out of daily operations in May 2017, but continued to come in weekly to check on the business performance through December 2017.

The transfer to employee ownership created a continuity of care for parents and children. The center did not have to hire new staff to replace Ms. Frizlen, and daily activities continued as usual. Two years after the transition, employee-owners continue to work as teachers, but also engage in new tasks such as conducting tours, writing blog posts, reviewing time sheets, and meeting with the director.

Special Considerations for Child Care Businesses

While many aspects of exit planning are universal across industries, there are also some issues that are unique to the child care industry to consider in your planning process.

1 Ownership of Real Estate

For center owners who also own the building that the child care center occupies, your exit plan should consider the real estate as well as the business. In some cases, center owners maintain ownership of the real estate, sell the business with a long-term lease for the building, and receive rent payments from the business over the terms of the lease. In other cases, the real estate value might be significantly higher than the business value, and it could be in an owner's best interest to prioritize selling the building to a buyer who won't necessarily use it for a child care business. Connecting with a real estate appraiser in your area can help you understand what transaction options exist for selling real estate.

2 Managing a Lease Transfer

For center owners who lease the building that the child care center occupies, consider how this lease will be transferred to new ownership. Will your landlord be amenable to renewing the lease for a new owner? Many owners have personal guarantees on a lease, which can create challenges when they exit the business. In some cases, it's helpful for an owner to stay on as a personal guarantor, even after they've exited the business. Planning in advance can help ensure that the center will be able to occupy the building after you exit the business.

“Being able to guarantee that a buyer will be able to continue to operate the center at its current location, whether through building ownership, a long-term lease, or a landlord who will continue to rent the building to a new owner, can minimize risk for a buyer and increase the business value.”

3 Recruitment and Retention

For center owners who are dealing with common business challenges such as staff recruitment and retention, participatory employee engagement or a transfer to your employees could help address this challenge. Research has shown that job satisfaction and growth are higher in employee-owned companies. A business that is owned by its employees has a unique advantage in recruiting, retaining, and motivating exceptional staff.

Employee ownership refers to a business that is owned and controlled by employees of the business. In a conversion to an employee cooperative (aka a worker cooperative), the shares of a business are transferred from the existing owner to the workers. Generally, all workers who meet basic eligibility requirements become owners. The company typically takes out a loan to purchase the shares from the selling owner, and then pays off the loan using its profits.

4 Transfer of Licenses

As highly regulated businesses, child care centers require a number of licenses. You will need to work closely with your licensing representative to navigate the license transfer process as you exit the business. Your goal should be to minimize disruptive center downtime during the transition and ensure that a new owner will be able to legally operate the business at the time of transfer. Ideally, you would talk to your representative early in your planning process. However, the best time to engage your representative depends on your relationship and the trust you've developed.

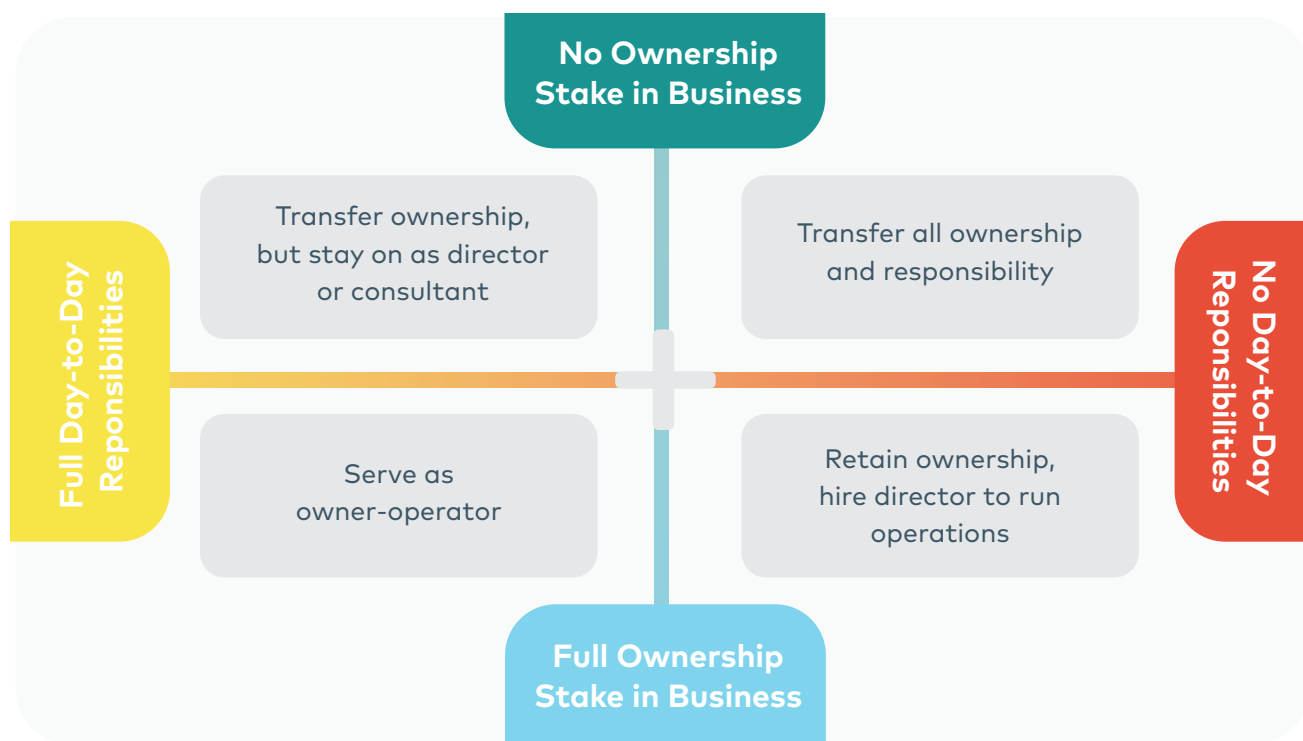
5 Market Influences

Your business success is connected to what's happening in the broader economy. Growth in per capita disposable income influences demand for child care, and state budgets impact the government's ability to invest in programs that benefit the industry. The difference in selling in a good market versus a bad market can significantly impact the value of your child care business. Planning ahead enables you to time your exit to maximize value based on what is happening in the economy.



6 Transition of Ownership and Responsibility

For center owners who want to decrease their responsibility but aren't ready to exit completely, there are many options for how you can think about transitioning ownership, responsibility, or both ownership and responsibility. For example, you can exit the business in stages over time, gradually giving up day-to-day responsibility. Similarly, you could agree to help with the transition of the business to new ownership and develop an employment contract for that work as part of the sale of the business. If you are an owner who also serves as the center director, it might be possible for you to maintain ownership but hire someone new to take over as director. Or, you might want to bring in new owners as partners or employee-owners and maintain your responsibility over day-to-day operations.



How ICA Can Help

ICA recognizes that as the owner of a child care center, you've put your heart and soul into your business and the quality care it provides. Although it can be hard, planning your eventual exit from the business is one of the best things you can do to preserve the value of your business, ensure your legacy, and achieve the retirement goals you desire. Our exit planning staff can help you set exit goals and determine your financial needs for retirement. After working with us, you will receive a summary report including:

- ▶ **Business Health Check and Cost of Care Analysis**
- ▶ **Enterprise Valuation**
- ▶ **Analysis of Business Value Drivers and Tips to Maximize Value**
- ▶ **A Summary of Paths to Exit the Business**

Visit icagroup.org/childcare to learn more about succession planning services.

Common Ownership Transfer Options for Child Care Businesses

It's important for business owners to understand all available options when selling their business to a new owner. In the child care industry, options for ownership transfer include:

Sale to large child care company or chain	Sale to an owner-operator	Sale to a director, lead teacher, or group of employees (management buyout)	Internal transfer to family members	Sale to staff as an employee-owned business (cooperative)
National companies, large regional chains, and private equity firms are typically the only buyers who can purchase centers with a 100% cash offer. This limits risk to selling owners by allowing them to completely cash out of the business at the time of sale.	Few owner-operators will be able to fully finance the purchase of a center, resulting in the need for a combination of seller financing and bank financing. Owner-operators typically rely on small business lenders for bank financing, and these lenders factor in the buyer's creditworthiness. Sellers considering financing a sale to an owner-operator must use special caution when selling to an operator who does not have previous experience owning a child care center.	Low wages in the child care field make it challenging for most managers to access the funds to purchase a center outright. Most management buyouts will require a combination of seller financing and bank financing. A manager's desire to purchase the business does not necessarily mean they are financially able to do so. Small business lenders will factor in the buyer's creditworthiness as they consider financing the business transfer.	Family transfers may require seller financing, especially if your family member is not an experienced business owner. You might also feel like you should take on more risk with the financing because you are transferring within the family. Bank financing is typically available if your family member has a strong credit history or a proven track record of business success.	This is an unfamiliar option to traditional banks and requires financing from mission-aligned Community Development Financial Institutions (CDFIs) that lend to employee-owned businesses. These CDFIs underwrite loans using some of the same standards as traditional banks, but they do not look at the creditworthiness of individual employees.

What is seller financing?

85% of all business sales include seller financing, which means the buyer pays the seller in installments over time from the profits of the business, as opposed to the full price in cash at the time of sale. Seller financing increases risk for the selling owner, since the business must generate profits in order to pay back the loan. However, by receiving interest payments in addition to the sale price of the business, seller financing can be a way to maximize total profits from the sale of your business.



	Sale to large child care company or chain	Sale to an owner-operator	Sale to a director, lead teacher, or group of employees (management buyout)	Internal transfer to family members	Sale to staff as an employee-owned business (cooperative)
② Likelihood of finding a buyer	<p>Each chain has a strategy for the size, location, client base, and type of center they like to acquire.</p> <p>Generally, larger centers with modern, well-maintained facilities and a demonstrated track record of profitability are good candidates for large chain acquisition. It can be helpful to work with a broker who specializes in these acquisitions.</p>	<p>Owner-operators make up the majority of buyers in the industry and are often found using your existing social networks. Although it can be sensitive, connecting with local competitors looking for a second location is often a productive way to find a buyer. It can also be helpful to work with a local broker to identify potential buyers.</p>	<p>This option requires a lot of trust to talk to your staff about exiting your business and their financial capacity to take over. If your key managers are also approaching retirement age, this may impact their ability and capacity to purchase your business. Planning ahead for this exit option by training a motivated and entrepreneurial staff member to become your successor can be very valuable.</p>	<p>While family transfers are decreasing in frequency, this option is another common way to exit your business. However, it is important not to assume family members will buy your business. Plan ahead by having open and honest conversations with your family members to see if your goals align.</p>	<p>Because the risk of business ownership is spread out among a group of people, it can feel easier for employees to say yes to taking over the business. Because of the way financing works, this option is less dependent on the financial ability of employees and more dependent on their desire to take over the business. Because this is an unfamiliar option, it requires support and training to help employees decide whether this is an option they want to pursue.</p>
③ Value	<p>In general, selling to someone you don't know can generate the highest selling price, since setting the price remains an objective process and strategic buyers might be willing to pay more for the business because of the advantages they see in owning it.</p> <p>If you use a broker to sell your business, they typically charge a commission of about 10% of the sale price.</p>	<p>In general, selling to someone you don't know can generate the highest selling price. If you end up identifying a buyer who you have an existing relationship with, you might feel pressure to negotiate on price. If you provide any seller financing on the deal, you'll receive interest payments on top of principal payments, which increases the total amount of money you receive for the business.</p>	<p>Because you're selling to a buyer who you have a relationship with, you might feel pressure to negotiate on price. Additionally, these buyers might have insider information to negotiate on price. If you provide any seller financing on the deal, you'll receive interest payments on top of principal payments.</p>	<p>Because you're selling to a family member, you might feel pressure to heavily discount or even gift away the business. You might also feel pressure to reduce the interest rate on any seller financing, thus reducing the total amount of money you receive for the business.</p>	<p>Owners can get a fair price for the business because the sale price will be determined by a financial valuation of the business. Because you're selling to a group of buyers who you have a relationship with, you might feel pressure to be flexible on price.</p>

	Sale to large child care company or chain	Sale to an owner-operator	Sale to a director, lead teacher, or group of employees (management buyout)	Internal transfer to family members employees	Sale to staff as an employee-owned business (cooperative)
4 Timeline for transferring ownership	<p>Because these buyers are selective about the types of centers they acquire, it can take longer to find a buyer. But once you've identified a buyer, you can exit on a faster timeline.</p>	<p>Once you've identified a buyer, you can often exit on a faster timeline.</p>	<p>Because this option requires management to take over your responsibilities, the timeline depends on how much succession planning you've done. This option can also happen gradually, at a pace that suits your needs.</p>	<p>Because this option requires family members to take over your responsibilities, the timeline depends on whether your family is already involved or familiar with the business. This option can also happen gradually, at a pace that suits your needs.</p>	<p>Because this option requires employees take over your responsibilities, the timeline depends on how much leadership development and training you've done.</p>
5 Owner involvement post-transaction	<p>Because this option does not require seller financing, it typically results in you having no control or connection to the business post-sale.</p>	<p>Your involvement post-sale depends on whether you've provided any seller-financing and your financial dependency on the future success of the business. Your willingness to stay involved with the business can increase the likelihood of finding a buyer and securing financing.</p>	<p>Your involvement post-sale depends on whether you've provided any seller financing and your financial dependency on the future success of the business. Because you have a relationship with the buyer, they might turn to you for advice and support, regardless of your formal relationship to the business post-sale.</p>	<p>Keeping the business in the family means that the business will likely continue to be a part of your life. Having family ties to the new owner(s) can make it challenging to establish boundaries regarding your continued involvement.</p>	<p>Your involvement post-sale depends on whether you've provided any seller-financing and your financial dependency on the future success of the business. Ideally, you'd stay connected to the business as a consultant or board member to support employees in successfully taking over the company.</p>

Sale to large child care company or chain

Sale to an owner-operator

Sale to a director, lead teacher, or group of employees (management buyout)

Internal transfer to family members employees

Sale to staff as an employee-owned business (cooperative)

This option creates uncertainty for the future culture and "feel" of your center. These buyers typically centralize curriculum, administration, and other business functions, which can result in culture changes or even employee layoffs.

This option creates uncertainty for the future culture and "feel" of your center. New owner-operators can continue the business as is, or bring different skills and energy that results in culture changes.

These buyers can preserve the center's legacy and values by maintaining what is working well with the center's operations and culture. Because they know how the business works and have relationships with families and staff, this option can create stability during the transition. While this option rewards the employee who takes over the business for their years of service, it can create unfavorable dynamics with other employees.

By keeping the business in your family, you can preserve your legacy and the "family-owned" feel of your business. If the new owner has been closely involved with the business, they'll know how the business works and have relationships with families and staff, which creates stability during the transition. This option can create unfavorable dynamics in the company if family members are not already leaders in the business.

This option can preserve the center's legacy and values by maintaining what is working well with the center's operations and culture. Employees already have relationships with each other and with families, which creates stability during the transition. This option also rewards employees for years of service. As employees approach their work with the insight of both a worker and an owner, they often come up with innovative ideas and solutions.

These buyers are selective about the centers they consider, often looking for programs that offer top rated care, up-to-date facilities, and a demonstrated track record of profitability, which limits the number of centers for which this option is a possibility.

This option comes with a lot of uncertainty. The owner-operator's experience leading a child care center, the changes they implement, and how they're received by families and staff will all likely impact the transition.

Because many center managers do not have the savings or creditworthiness to purchase the business, this option can be challenging, regardless of a manager's desire to take over the center. Pursuing this option requires having open conversations with key managers about their financial capacity to purchase the business.

Mixing business and family can be complicated, and family members might not have the same understanding of what the transfer entails. Pursuing this option requires having honest conversations with family members about your vision and goals.

Cooperatives are not well known, and so employees might need additional training and support to pursue this option and learn how to successfully run a child care center.