Preparing for a Successful Descent

Four Questions to Answer Before Transitioning Your Business

Most business owners approach planning for the transition of their business as a highly secretive topic and assume if they take a low-key approach they won't raise suspicion from their employees, suppliers, customers, competitors, or even worse – their banker. While it might come as a surprise to most business owners, everyone, including your banker, knows that you're getting older and at some point will eventually ride or sail off into the sunset to retire if you don't die working at your desk.

In some circles, George Mallory and his climbing partner Sandy Irvine are thought to be the first people to summit Mt. Everest. While that's an amazing legacy, most people probably would prefer Sir Edmond Hillary's legacy. He and Tenzing Norgay are credited with being the first people to summit and successfully complete a descent off Mt. Everest. While we'll never know why George Mallory failed to make it off the mountain, we do know that Sir Edmond Hillary did a great job planning for his descent because he lived to share his experience with the world. The effort to reach the top of Mt. Everest is not easy, nor is creating or running a profitable business for 15 to 30 years. Congratulations are in order because you've ascended or are near to summitting your Mount Everest. It's been a hard journey, so take a deep breath and enjoy the view.

According to a study put out by the Pepperdine Private Capital Markets Report, the number one reason business owners contacted a broker or investment banker to sell their business in 2018 was due to retirement.[1]

Now, are you ready to begin your descent, or do you think you still have time and are okay working off a rolling five-year plan? How much time and money have you invested towards managing the illiquid portion of your wealth by working with a team of advisors to prepare yourself and business in anticipation of a transfer? If you're like most owners of privately owned businesses, you have a semblance of a plan in your head and nothing is documented in writing. Odds are worse that you haven't vetted out the strategies or options being contemplated. It's probably because you can't find unbiased advice or are tired of being sold a solution. You are used to making quick decisions and figuring out the details along the way. While that approach might have worked in the past, is that really the one you want to take for something this important? While it's possible you could successfully transition your business with limited or piecemeal planning, odds are your personal and business legacy will be more similar to George Mallory's legacy than to Sir Edmund Hillary's. Regardless of when you decide to implement a transition plan, it makes sense to design, document, and analyze different options before you find yourself in a position where you are forced to implement some sort of transition. It also means getting your business transaction ready today.

After all of your hard work, will you be satisfied with just reaching your proverbial summit or do you want to successfully complete the descent? If so, when is the "right" time to think about preparing yourself and your business to be transferred so you can successfully enter the next phase of your life?

Businesses That Are Transaction Ready	
1. Are more valuable and transferable than ones that are not	4. Are more fun to operate
2. Are better prepared if an unsolicited offer appears	5. Retain a higher percentage of employees
3. Run more smoothly	

Where to begin?

Whether you're wondering where to begin the process of developing a written business transition plan or already have one in place, consider these four questions:

1. What amount of liquid capital do you need to achieve your personal financial goals?
2. What's an estimate of your business' "range of values"?
3. How does your mental and financial readiness impact your transition options?
4. Is the value and transferability of your business negatively impacted because it's too dependent upon you?

1. What amount of liquid capital do you need to achieve your personal financial goals?

It would be preferable to know today rather than at your retirement party if you have a "gap" between how much liquid wealth you need vs. what you currently have available vs. the value of your current net worth. While you may feel comfortable with crunching the numbers in your head, it may help your spouse to see a thoughtful and professionally prepared analysis on paper that takes into consideration inflation, life expectancy, charitable wishes, estate planning, and a host of other items. There's an incredible level of certainty and stress relief to "know" you're going to have enough vs. just "guestimating" what you'll need or have available after transitioning the business to a successor.

2. What's an estimate of your business' "range of values"?

Most business owners realize the value of their business isn't a static number but is dynamic and impacted by the following: 1. reason or motivation behind the appraisal, 2. buyer's expected rate of return, and 3. buyer's access to capital markets. If a large majority of your wealth is tied up in your business, it becomes even more important to gauge what amount you objectively could expect to extract from your business. This will dictate what actions you need to pursue during the period prior to reaching your retirement date.

The value of any business is assessed both by its past financial and operational performance and its future potential. A buyer looks backwards for a guesstimate of what the business might accomplish in the future when she/he owns it. As a seller, it's important to understand there are five ways a buyer (aka an investor) might view your business' range of values based on its financial performance. As a seller, can you articulate a good story that explains your business' profitability: 1. based on a point in time, 2. over several years, 3. based on how it compares to its peer groups, 4. based on how it performed to budget or plan, and 5. based on any strategic or synergist opportunities.

Buyers also gauge the quality of a business's operational performance to assess the potential or possible cash flow and rate of return a business can support. The problem is this is much harder to analyze than financial performance. Most business owners and appraisers assume that most companies average near the median, and that's why initial offers tend to decrease as one progresses through due diligence. Every business looks attractive from a distance, but less so up close. The more clearly one can articulate a business's market and operational value drivers, the more likely the range of values will be higher than the averages for your industry.

3. How does your mental and financial readiness impact your transition options?

The viability and success of both internal or external options is highly dependent upon how well various options "fit" with your goals, objectives, and state of mind. The viable options will present themselves by assessing your mental and financial readiness. For example, if you're completely burnt out and dying a slow death daily as you get up to go to work, then selling the business for any price might just be the only option available. If on the other hand you're not ready to transition out of your business because you're not mentally or financially ready, then you have a few more options available to consider.

4. Is the value and transferability of your business negatively impacted because it's too dependent upon you?

While it might seem counter-intuitive, the less your business depends on you the higher it will appraise and the more transferable it is because any potential successor isn't worried that the most important asset isn't walking out the door the day after the closing. Whether you have a "C" tattooed to your forehead or are a closet control freak, it's better to take action now rather than later to make your business more transferable.

The process of transitioning out of your business, just like descending down a mountain, requires different muscles, skill, and patience than was required to build a business or ascend a mountain. If your financial future independence, personal happiness, and legacy depend on a successful outcome, you should consider beginning the process sooner rather than later. If you're not ready to begin, then consider making an effort to answer the four questions posed above.

If you need help and want advice that's agnostic of solution and timing,
contact a Key Family Wealth Business Consultant.

[1] Everett, Craig R., "2019 Private Capital Markets Report." Pepperdine University Libraries. Publishing date: 18 March, 2019. Access date: 3 June, 2019. https://digitalcommons.pepperdine.edu/gsbm_pcm_pcmr/12/