Florida Capital Advisors
BUSINESS ADVISORS

THE BUSINESS OWNER'S ULTIMATE GOAL:
Creating Investable Value Before Ownership Transition

written by:

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Over the next 5-10 years, many entrepreneurs will be transitioning ownership of their companies either internally to management/family or externally to a financial or strategic buyer. The first baby boomers began turning 65 in 2011, with 10,000 turning 65 every day. The baby boomer generation owns over 50% of the privately held businesses in the United States. A survey conducted by the Exit Planning Institute confirms that 75% of business owners plan to transition ownership in the next 10 years and 48% in the next five years.

Many entrepreneurs have a majority of their personal net worth tied to the value of their business, which will determine their level of financial independence in the future. A large percentage of privately held companies need to begin to focus on creating transferable enterprise value. Transferring ownership may be a challenge, unless your company has been operated as an investable asset.

Thousands of businesses will be entering the market over the next several years. To have a saleable company, it needs to be attractive to a potential buyer, whether it is an internal or external sale. Owners are leaving dollars on the table because they are focused on income generation and not creating enterprise value. A challenge a lot of entrepreneurs face is that the business is not sellable or does not make it to the next generation. While you may not be ready to transfer ownership in the next couple of years, a fact to keep in mind is over 50% of owner exits are not voluntary and happen because of death, disability, divorce or some other type of distress.

"OWNERS ARE LEAVING DOLLARS ON THE TABLE BECAUSE THEY ARE FOCUSED ON INCOME GENERATION AND NOT CREATING ENTERPRISE VALUE"

There are a number of items you need to address that will affect your decision on ownership transfer.

Ask yourself these questions:

When do I want to leave the business?

Do you have a valuation or transition price in mind for your business?

Are the net proceeds from the sale enough to be financially independent?

Is a family member or key management able to buy the business and capable of operating it successfully, especially if you retain partial ownership and hold or guarantee a note to finance the transaction?

Can you stage an ownership transition over multiple years?

Do you want to retain some ownership in the business?

What will I do after I leave the business?

Do you want to leave a legacy?

TRANSFERABLE VALUE

Creating transferable value in your business and successfully completing an ownership transfer is a process not an event. The purpose of value enhancement and transition planning is to maximize the value of your business at the time of exit, minimize taxes, and ensure you are able to accomplish all of your personal and financial goals in the process. Additionally, it includes a life after business plan. If you're like most entrepreneurs, a significant portion of your personal net worth is highly correlated to the value of your business. Unless you have financial resources outside of the business that will give you some level of financial independence, then your financial future is tied to the value you create in your business. You will need to monetize your business for a value significant enough after all costs and taxes to create an investment portfolio to provide income for life.

"IF YOU'RE LIKE MOST ENTREPRENEURS, A SIGNIFICANT PORTION OF YOUR PERSONAL NET WORTH IS HIGHLY CORRELATED TO THE VALUE OF YOUR BUSINESS."

THE TRANSITION PROCESS

Define your goals and objectives

Understand the current value of your company through a professional business valuation

Comprehensive financial planning with a qualified financial advisor

Creating and growing value in your company

Carefully evaluating your options

Calculating the proceeds from your business exit considering all costs and taxes

Action plans: business and personal

Your life after business plan

ENHANCING ENTERPRISE VALUE

The daily operation of a privately held business often consumes most of the entrepreneur's time, leaving little time left over to spend on strategic planning or value enhancement initiatives in advance of an ownership transition event. Taking time with family, existing management and your advisory team will help you define your goals and objectives, including business, financial and life after business goals. As you work through this process, it will become apparent that a significant time investment is necessary in order to properly address all of your goals. Goals should be specific, realistic, measurable and time-based.

Many owners feel they know the value of their business based on "prevailing multiples" within their industry or what a business in the same or similar industry sold for recently. It is critical to understand what the true value of your business is because it is the starting point of the planning process. A business valuation will give you an estimate of your company's value. Making sure the value of your business and your expectation of value are aligned is important as you plan ownership transition. There are various types of values and valuation methodologies, including earnings based, as well as market-based approaches. The purpose of a business valuation can also have an outcome on the value. If you are selling a minority interest to a family member or gifting shares of stock you typically have a different value than selling control of the company. Estimating a company's value is an art as well as a science. As a seller, it is important to establish your price expectations prior to marketing the company internally and especially externally.

PERSONAL PLANNING

Engaging in the personal financial planning process well in advance of a transition event will determine the amount of assets and income post transaction needed for your desired lifestyle. A qualified investment advisor can serve as the leader of your planning team as it relates to your personal financial well-being. Your investment advisor should integrate your business transition plan with your personal financial goals. Proper planning includes income planning, investment management, risk management, asset protection and estate planning.

If most of your net worth is in the value of the company, your ultimate exit from the business is dependent upon the amount of proceeds received from an ownership transfer. If the net proceeds received will not adequately fund an investment portfolio to create the income you need, then you will have to focus on creating more value in the company prior to an ownership transition. During this value enhancement timeline, which may take one to three years, your investment advisor can begin to work with you on building an investment portfolio if the company can make distributions to you in excess of your current compensation.

ENTERPRISE VALUE DRIVERS

Enterprise value drivers in a business include personal factors, business operations, industry/market conditions, financial performance, legal and regulatory issues. How relevant you are to the success of the business can have a meaningful impact on value. An outside buyer may not pay top dollar if the owner is highly critical to the ongoing success of the business or a large portion of the purchase price will be in the form of an earn-out. Customer relationships, skilled management and sales teams and diversification of the customer base are critical components to maximizing the value of a business. Documented processes and procedures will demonstrate to a buyer a well-run business.

Make sure any lawsuits or potential litigation are addressed and resolved. A buyer is likely to be concerned because of the unknown impact of litigation, potential liabilities or environmental issues. Not resolving these issues may result in discounting the price a buyer is willing to pay. Use time in advance of a sale to get company records and financials in good order. This may take several quarters to accomplish. Create dashboard reports to track company financial progress towards goals. These value drivers are in control of the business owner to address ahead of an ownership transfer. Economic cycles, availability of private capital and lender's willingness to provide leverage to transactions all have an impact on the company value.

OWNERSHIP TRANSITIONING

If you've determined there is sufficient value in the company to accomplish your goals, it may be time for you to begin the ownership transition process. As a business owner selling some or all of your business will be one of the most important events you undertake. Transitioning ownership of a business can occur either internally or externally. You may want to stage an ownership transfer over a period of years, selling a percentage of your ownership initially, with a full exit down the road. This will give you the opportunity to stay engaged and potentially enjoy another liquidity event in the future. Selling a portion of your company now, with a complete ownership transition later will also help diversify your net worth. As with all decisions there are pros and cons to every option. An external sale to a third-party generally yields the highest price. It may be important to you to preserve a legacy by transferring ownership to family, employees or existing management. Family or management may have the desire to purchase the business, however they may lack the capital or management expertise to operate the company successfully without the prior owner's involvement.

While obtaining the best possible price upon ownership transition is important, it is the net investable proceeds available to build an income stream for your financial future that is most critical to a successful outcome. Taxes, fees and expenses, as well as interest-bearing debt will be subtracted from sale proceeds. Also, post-closing adjustments, which include balance sheet targets, working capital true-up, escrows and holdbacks will also be deducted from sales proceeds.

TAKING ACTION

Creating value in your business and ultimately transferring ownership is a process. A business owner and their advisors should develop and implement personal as well as business action plans. Think in terms of 90 day cycles. An example of a personal action plan is to begin the process of financial planning. Another is to develop a contingency plan in the event something unexpected happens. Business action plans could include such things as formalizing your value enhancement and transition advisory team, determining management succession plans, key employee retention strategies, as well as looking for opportunities to de-risk the business. One final consideration that is very important to a successful ownership transfer and long term happiness is your "life after business" plan. Many business owners find they regret their decision to exit the business because they have not adequately planned the next phase of their life.

The best ownership transition strategy is the one that best fits your business, personal and financial goals. Decide first on what you want to accomplish. If it's just the highest sales price, work on creating value in your business and selling to a financial or strategic buyer may be the best choice. If your legacy and seeing the business continue are important to you, then an ownership transition strategy such as family succession or selling to management/employees might be best for you.

Whichever path you chose, the time to start the process is now. Planning a strategy in advance will allow you the time to build the value of your business and maximize the proceeds from your transition. It is critical to assemble the right advisory team. Transferring ownership of your business is one of the most important decisions you will make. Surrounding yourself with a qualified advisory team will assist you with the critical thought process to achieve your goals.

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