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Preparing to Sell Your Company:

How business owners can optimize the sale of their business while managing a potentially difficult transition

Kelly L. Baumbach, CFP®, CEPA®
Managing Director

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We've worked with entrepreneurs over the years who have poured their hearts and souls into their businesses. And when the time is right, many consider selling their company. Planning ahead can allow an entrepreneur to take steps to increase the value of their business. It can also help them to sell at the right time - when the price they can get for their business is optimal or before health issues or other problems might force them to sell.

While many business owners understand that a transition plan is important, 43% have no plan in place and 80% do not have a written plan.[1] Few ever take steps to consider their financial situation and personal needs prior to a sale. Fewer still prepare for the financial aftermath and the fact that, once the deal is complete, they will have a potentially large lump sum of money. From our experience, this lack of preparation can create problems.

Exit planning is simply good business planning. Identifying and planning for a transition helps increase the likelihood of a positive outcome. By determining your own financial and emotional needs, you can make choices that maximize your financial and personal wellbeing.

Why Planning Ahead is Rare, But Important

It makes sense why so few business owners plan ahead. Most are too deeply enmeshed in the day-to-day of business to give much thought to selling their business or the post-close financial windfall.

Many business owners think they can sell their business at any time, but they may be surprised to learn that nearly 80% of the businesses put on the market don't sell.[2]

Planning ahead can help improve the outcome. Business owners may be able to increase the value of their business for later sale by making changes that could make it more attractive to a future buyer. For example, if the business finds its sales are concentrated among a small group of customers, it can take steps to diversify and expand its customer base.

Business owners should also carefully consider their own personal finances, like how much they will need from the sale in order to support their retirement goals and lifestyle. Many may have pulled a comfortable income out of the business. When selling the business, will the proceeds be enough to support them when they are no longer drawing an income? Business owners should estimate their needs prior to a business sale negotiation.

Lastly, business owners need to prepare for life after the sale. This will be one of the most important and extreme transitions a company owner will ever make. The owner will go from having a concentrated holding and the bulk of their net worth tied up in their business, to selling it all for a lump sum of cash. Most business owners have so much of their identity tied up in their business that few have other hobbies. They invested most of their energy in the company and are rarely an expert at anything else. We often find that few know much, if anything, about managing their investments, income planning, or the tax implications of their portfolios.

When to Begin Planning and Who to Talk To

Exit planning is a collaborative process. It involves putting together a team of experts who can help you maximize your decisions and get the most from your ultimate business sale. This is best done at least 3 to 5 years before putting your company on the market.

Many begin by talking with M&A experts who can identify potential buyers and guide them on deal terms. Just as important are valuation or accounting experts who can evaluate your business and current financial statements to make recommendations on steps to take that could eventually improve the sale value of your business. Are certain costs out of line? Are you overly concentrated in some vulnerable industries? Can you add adjacent services that could increase sales and diversify your customer base? It can take time to make these changes, reinforcing the need to begin this process well before you are ready to sell.

A financial advisor with experience in exit planning is also an important partner to engage early on. Most business owners have 80 to 90% of their wealth tied up in the business.[3] But few have a post-sale financial plan. A customized financial plan should address annual spending needs, retirement goals (travel, gifts to children or grandchildren, large purchases like an additional home) and any charitable aspirations.

Avoid Classic Behavioral Finance Mistakes

Selling a business is emotional. As students of behavioral finance, we know that people's emotions often inappropriately drive financial decision making. This is a mistake. Business owners aren't immune to behavioral mistakes. Recency bias, the tendency to put more emphasis on the newest information we receive, can prevent us from carefully weighing all the evidence. Confirmation bias leads us to look for information that reinforces our existing beliefs. Regret avoidance keeps us from making tough decisions because we don't want to admit we made a bad call. All these mistakes can impede careful and thoughtful decision making, especially when emotions run high.

This is all the more reason to have a plan and consult with your trusted advisors to make rational decisions.

Common Behavioral Finance Pitfalls

PHENOMENON	DEFINITION	EXAMPLE
Confirmation Bias	Tendency to seek out information that reinforces existing beliefs	Relying on opinions of valuation of your business that most closely match your opinion while discounting opinions you don't agree with
Recency Bias	Emphasis on more recent information over information received further in the past	Discounting the long-term contributions of an excellent employee because their work has suffered lately due to personal challenges
Regret Avoidance	Avoidance of decision-making that could potentially lead to regret over a wrong decision	Delaying sale of a car with mounting issues even as the cost of repairs adds up

Take Specific Steps to Prepare for the Unexpected

Business owners should take time to think about the financial ramifications, talk about their goals, and take a few steps to ease this difficult transition. A few factors to consider:

- Think about how important it is to preserve your wealth. Psychologically, we find many business owners struggle with the fact that they've transitioned all of their net worth into an asset that is now valued daily. An investment portfolio can fluctuate quite a bit more than the value of the business ever did. For many, this is a key source of anxiety. While business owners often felt in control while running their businesses, many feel a lack of control on a 500 point down day in the market.
- While it is hard to control, the timing of your sale can have a significant impact. If you sold your business in late 2019 just before the COVID-19 crisis, you had a much different experience than someone who sold and invested their proceeds in March after the market collapsed. For most, the priority is to preserve the wealth they've created, so we generally encourage business owners to keep this in mind and average their purchases of stocks or risk assets slowly over as long as a year. We also encourage business owners to err on the side of being more conservative, at least initially.
- In our experience, the majority of business owners immediately buy an asset to celebrate the sale - a luxury vacation condo, a new expansive home, a sports car - even before they've given rigorous thought to their financial future. This may be perfectly justified. But it is a good idea to plan for what you can afford in order to maintain a desired lifestyle. Without thinking this through, some may later regret such a large purchase.
- Don't forget the "little" stuff. While it may seem like a small thing, more often than not, a business owner is scrambling to determine where to wire the money once the deal closes. Those who work with an advisor in advance will have given some thought to where the proceeds will go. There will also likely be a big tax payment due. It should be obvious, but that payment should be segregated right away. Health insurance is essential, and most business owners will not continue on the company plan.

- Some owners take the opportunity to address estate planning at this point and spread the wealth across multiple generations. For many with significant wealth, today's historically high estate tax exemption may provide further encouragement. An estimate of the lifetime income needs of the business owner will help determine how much is available for the family.

Having a preliminary exit plan, even if it isn't finalized, can help ease the transition when selling a company. Money can be emotional. The anxiety this process produces can be overwhelming for many business owners, and the emotions involved are often even more complicated than other financial transitions. For all these reasons, taking the time to plan ahead and think through what you will do post-sale can go a long way in helping to ease the transition.

Kelly Baumbach, CFP® is a Certified Exit Planning Advisor with Wealthspire Advisors

Endnotes

1 https://exit-planning-institute.org/state-of-owner-readiness/

2 Walking to Destiny, Snider, 2016

3 https://exit-planning-institute.org/state-of-owner-readiness/