

Before the Sale: Getting Your House in Order (appearing in Executive Decisions, April 2008)

Michael Tucci, President of Lexington Wealth Management, and Bob Russell, partner at Pabian & Russell, LLC investigate the team approach to helping business owners develop and execute an exit strategy.

Grizzled veterans will pontificate about how successful enterprises are built from strength, character, and luck. These elements, they say, together serve as the underpinning of business. But when company owners look forward to the exit in the distance – the sale towards which they have driven for decades – they should put those intangibles behind them. Planning is the only real mechanism for ensuring the most value and smoothest transition when a company changes hands.

Because luck and life can bury the business as quickly as they can build it. There are countless cases of death or disability forcing a sale at pennies on the dollar, or of families being torn apart by a sloppy succession. Should tragedy strike, emotional trauma does not have to be accompanied by financial disaster; business owners must brace for the unpredictable by beginning the process early.

To achieve intended results, an organization must develop a highly focused strategy well before any transitional event approaches. Indeed, a well-crafted plan should be formulated as far as three to five years before a sale. The process begins with getting the corporate house in order to guard against life's sometimes unexpected interference.

A United Front

Historically, company leaders may look only to an investment banking firm when the time comes to sell. But putting a team of trusted experts in place to navigate the process and protect the owner's interests is paramount to a successful exit: there are a number of moving parts that should be addressed by professionals in the CPA, wealth management, legal and consulting fields.

Financial Health

The books may look solid, with healthy margins and consistent growth. But how many liberties have been taken by ownership? Are family expenses, however minimal, being run through the company? Has anything slipped through the cracks?

A first step in crafting a plan is to have a qualified CPA examine the company's financial status and make recommendations on how to make it as clean as possible. The CPA can also apply their perspective to issues like entity structure, tax and cash flow planning, and setting the company in a position of strength to survive a transition or sale.

“Choosing the entity structure can have a lot more to do with the exit strategy than it does with operations,” says Mike Tetrault, an owner at CPA and business consulting firm Wolf & Company P.C. in Boston. “Most companies’ operations can be managed to have similar tax results regardless of the structure. It’s when it comes time to sell that the flexibility of the right type of entity becomes most important.”

Management Team

Company founders know how much of their time, money and personality have been devoted to managing it. No surprise, then, that reducing their role is often the furthest thing from their minds – but one of the most important steps they can take.

Mary Adams, Principal and co-Founder at management consultant Trek Consulting, says she often advises owners on restructuring at the top to enhance the sale. “Value has to be built on a structure that will endure after the owner walks away,” Mary says. “That rarely means bringing in a clone of the founder – on the contrary, it’s usually a number of people in the second tier of the company that can ease into leadership roles and ensure that the management ideals and performance remain strong and intact.”

Transitioning leadership should always be in the back of an owner’s mind, Mary adds, although a 3 to 4 year lead time should be sufficient to put a full leadership team in place.

Valuation

Heading into the sale process with no qualified target price in mind can be disastrous; business owners should consult a valuation expert to address this before they communicate with potential buyers. Specialized valuation firms can provide this service, as can properly accredited CPAs and M&A firms as they begin their pre-sale, evaluative process.

For straight liquidity events, this helps to avoid unrealistic expectations or selling at too low a price. Valuation is equally critical when transitioning a family business to a new generation. Difficult circumstances can arise in several areas; for example, consider the death of a business owner who passes operational control of the company on to her children without assessing fair market value. Sorting out the intricacies of the estate can take years, and as the surviving husband retains financial control, the children might grow the business significantly. Determining the boosted value of the shares to be divided will be no easy task without an official starting point.

Preparing an Estate Plan

Just as owners take steps to protect the value of a company, they will also want to ensure that maximum value is passed on to heirs. The estate world is a landscape of Swiss cheese, with regulations and tax implications at every step.

“There is great opportunity for business owners to pass wealth to the next generation, but it doesn’t come together on the eve of a sale,” said Bradley Van Buren, an attorney who specializes in estate and gift planning as a member of the Private Wealth Services group of Holland & Knight, LLP. “We try to emphasize with both corporate and individual clients the wisdom of being ahead of the game. We can implement a transfer strategy to move the value of the company and preserve the assets for the next generation, but there are significant challenges that must be negotiated.”

Preparing a Personal Wealth Plan

There are two ways to look at a sale: found money or earned money. Most owners scoff at the former and embrace the latter, yet they do rarely take advance steps to protect their wealth. The right wealth manager can act as a partner, understanding how the sale can be leveraged over the long term, its merit as the culmination of a life goal, and how to work with business owners in assembling the right team before the personal wealth is in hand. In addition to handling the proceeds themselves, wealth managers can assist with the transition out of ownership and the lifestyle decisions that accompany such a liquidity event.

Tapping into this expertise allows the sold company to continue to earn even after a transition. After any gifted shares are set aside, owners can assign portions of the remaining funds to address different life stages: short term lifestyle expenses, mid-term goals, and reserve funds for unforeseen disasters and late life security. Allocated correctly within appropriate investment vehicles, these three buckets afford allow an owner to enjoy sale proceeds and peace of mind for the future.

The Path Ahead

Success means different things to different owners and different buyers. Especially within family businesses, the right to maintain control over operations may outweigh financial considerations. Taking the long view with respect to personal goals can mitigate negative effects of what will be an emotionally exhausting and life changing event.

Bringing a team together, getting the house in order, and establishing a well-rounded plan will give owners the real foundation they need to get the most out of their business. They can save strength, character and luck for Las Vegas.