The Private Business Owners Guide to Leaving Your Business in Style

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Introduction

Leaving your business is hard work. You probably don't think it should be that way, but it is. Not only do you need to figure out what you're going to do with your business, you also need to figure out what you're going to do for the rest of your life.

The days of working till your 60 or 65 and then retiring for a short retirement is often over. Today, if you decide to leave your business there's a good chance you'll be around for another twenty years or more!

Join us as we take a trip with John Aardvark as he figures out how to leave his business when he wants, in the way he wants, leaving the business to whom he wants. Oh, and click here to let me know what you think about the journey.

Where you are today…….

You've worked hard to build a business. If you're like most people, you want to make sure that when it's time to leave your business, you want to do so with the maximum amount of value you can. There are seven specific steps that need to be taken to improve your chances or being able to leave your business in style.

Let's meet our friend John Aardvark –

John Aardvark is 48 years old. He's established a successful business, but had not managed to save anything for retirement. Every dollar he made, he reinvested in the business. Although, he didn't think he spent a great deal of money, every year, he was happy with the lifestyle he had put together for his family. John is seeing fifty in the very near future. This fact is causing him to think about someday leaving his business and having enough for him to enjoy the rest of his life.

John has a problem which he probably understands, but has not been specifically stated. He has no idea how he is going to leave his business and still maintain the lifestyle that he has put together for himself. The good news for John is that he is still young enough to make and implement plans that will get him to his goals.

Let's start our journey with John.

Step One, what do you need?

The very first step that John needs to take is to find out what he needs to become financially independent. This is what we call our lifestyle inventory. The way John will figure out his lifestyle needs is to sit down with this checkbook and figure out what his present lifestyle costs every year.

Here are the steps that John needs to take:

- Go through his checkbook and categorize all expenditures over the last year. This is much easier if you use Quicken or Mint.
- Look at all of the personal assets that he owns and wants to continue to own.
- List all personal assets that he would like to own in the future that he does not own right now.
- Put down a rate of improvement in his day to day lifestyle.
- Analyze what the annual dollar value is of the benefits that are provided by the company that does not show up in John's personal checkbook. These are things like cars, dinners out and vacations that he tacks on to business trips.
- Understand how much he'll have to pay in taxes in retirement to maintain the lifestyle he wants to have.

John doesn't know where to go to do this. Luckily for him, he's run across a financial planner who understands how to do plans for John's business.

The first thing John's planner has him do is read an EBook called The Four Boxes of Financial Independence. After reading this EBook John realizes that he's got a long way to go before he can even think about retiring. He also found that what he thought was true about his retirement wasn't.

This might also be true for you. Luckily, you can also read the Four Boxes EBook by clicking here.

The other thing that John learns, is his business is worth far less than he thought. He finds this out by taking step #2.

Step Two, What's it worth?

John went to his CPA and asked him about what he needs to do to leave his business. His CPA told him that one thing he needs to know is what his business is worth. Since his CPA was capable and understands that businesses have different values depending on who the buyer is, he is able to provide John with a valuation of what his business would be worth using a variety of valuation methods.

There are many drivers that will provide a value for your business. The truth is your business is worth what someone else is willing to pay for it. The trick is understanding what is fair value for both you and the potential new owner. No matter who is the successor owner of your business, they will need to be able to pay for it for the deal to be a good one.

As John looks at his business value he needs to understand the bite that taxes and fees will take out of the amount of money he ultimately receives. And depending on who the buyer is John also needs to be concerned what the tax cost is for the buyers. Lots of advisors know how help you understand what you must pay in taxes. If the buyer happens to be your managers or children, you better understand what they buyer must pay in taxes. Even if you don't sell to your children or managers, the more you can help your buyer limit their taxes, the more the buyer can afford to pay you for your business.

Let's look at an example of how devastating taxes are for buyers. Let's say you are selling your business for $1,000,000. If the buyer is buying the stock in a company and the tax rate is 40 the buyer would have to make $1,800,000 for them to give you the $1,000,000 for your business. This is because a stock sale is not deductible. Because it's not deductible the buyer will be using after-tax dollars for the purchase. When you use after tax dollars you first must earn enough money to pay the taxes and then use what's left over to buy the business. Our buyer in our above example would have to pay the government $800,000 in taxes before the get their $1,000,000. This is what makes the cost of the purchase$1,800,000.

If you can change the transaction to mostly ordinary income, you'll be saving your buyer a huge amount of taxes. Some of that would come back to you in the form of more money for your business. This is where you want to find an advisor who understands the art and science of using pre-tax dollars to buy a business.

Step Three, Increasing the value drivers of your business

John is in a cash business and has always run his business to limit the amount of taxes that he pays. He has done everything he can to have the business pay for personal business expenses if it's been legal.

John was very disappointed in the valuation his accountant gave him. At his accountant's suggestion, John engaged a consultant to help devise strategies that John could use to improve the value of his business for a potential buyer down the road.

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When you think about leaving your business, it's important to understand what drives value in your business. Too often I find businesses are taking actions that actually decrease the value of their business and they don't even know it. They might not be using cash effectively, servicing clients at a loss, selling to the wrong Customers or not taking advantage of the hidden value in their business.

In most business acquisitions, be it an outside or inside sale, the amount of money you will receive will be based on the ability of the business to produce cash for the new owners. When thinking about your business there's a good chance you'll need to spend a lot of time and effort to get your business ready for transfer. This means you will want to focus on the activities that create cash.

There are five things you need to focus on to create a sustainable business that a next generation owner will want to have. The keys to business sustainability are:

- Create a business with a recurring revenue source.
- Make sure you make yourself operationally irrelevant.
- Make sure your business creates enough excess cash for you, your business and growth.
- Make sure you systematize your business.
- Have clear values and a mission that is easily explained.

Click here to get our free one hour audio CD, Success to Sustainability.

Here's something else you need to know, most of the time, the next owner of your business will be a tax motivated buyer. By this we mean, they also will want to not concentrate on showing huge profits, but will want to have maximum cash in their pocket after taxes. It's up to you to structure your business so the new owner can use pre-tax dollars to purchase your business. Besides making your business easy to buy, you'll also want to make sure you have taken care of the easy things that add value to your business.

Some things you can do to improve the value of your business are:

- Install a deferred compensation program for yourself so the new owners can purchase your business interest using pre-tax dollars. This makes your business less expensive to buy.
- Quantify who your best Customers are and then put marketing programs in place to attract more of these types of Customers. You're now systematizing your business.
- Know what the key measurements are in your company and then make sure everyone in the company pays attentions to those key statistics. – Increases the value of your business.
- Learn about the Four Boxes of Financial Independence. – Click here to get your free EBook on the basics for knowing whether you can afford to leave your business.
- Have programs in place for paying your people for doing the right things that make your business more valuable. Meaning a bonus program that rewards what you and your company need. – Increases the value drivers of your business.

Step Four: Who's going to buy it?

John's children were in high school and he thought that one of them might want to go into business with him. However, he didn't want to wait fifteen years before he got out of business. John thinks that if his children didn't want the business, then he would like to see one or two of his key people take the company over.

Before deciding who's going to buy your business, make sure you've taken care of the first three steps. Some things you will want to think about is what's the future of your industry. If your answer is not good, then you can't sell to an insider. Why you might ask? Because when you sell to an insider, there's one thing for sure. They won't have any money and you're going to be the bank.

On the other hand, if you believe that the business is basically a good one and you would like to see it continue not only for your benefit, but for the benefit of your family or present employees, then an inside sale might be just the way to go.

There are only four ways to leave your business:

- A sale to an outsider.
- A sale to your managers.
- A sale to family members.
- Liquidation

Each of these options will have different strategies that are important in helping you achieve fair value from your business. Liquidation is one of the four and for most owners this is not a preferred method of leaving their business. If you are forced to liquidate, then you will have left all the good will in your business on the table. If you want to maximize the ongoing value of the business, only the first three options are reasonable options for you when it comes time to leave your business.

There are several values your business lives in at one time. Rob Slee calls this knowing what value world your business lives in. Value is always determined by the buyer. Your business is only worth what someone is willing to pay for it.

As you go through the decision process on whom the successor owners of your business will be, it’s important to know the new owners would want to own your business and what will get them excited about taking it over. In all instances, you must be able to communicate to the new owners, the value of your operation, both the obvious ones as well as the hidden values. This would come from recasting the numbers of your business realistically with what the new owners would receive in annual cash flow.

You will want to make sure that you remember to include a capital reinvestment number in your cash flow projections. Every time you leave out a major expense in showing the cash flow of your business, you run the risk of losing credibility with your potential buyer. If you are selling to a third party, you must plan that they will be sophisticated in evaluating your business. If making an inside sale, you don't want to oversell the potential cash flow because you will most likely have to play the role of bank for the new owners and you will want to make sure you get paid.

Recasting your numbers showing what the new owners will get can be a great tool in helping you maximize the value of your business. You must teach the new owners what they will be able to get out of the business on an after-tax basis. Done properly, this can dramatically improve the value of your business. If you skip this step, there's a good chance you'll receive far less for your business than you should.

Step Five, Your Key People

John had five key people in his company. He knew that if his children took the business over, he was going to need all five people to stay. He also knew that if he sold to one of the managers, the other four people would be needed. Finally, if he sold to an outsider, then all five of the managers would be important until the new owner decided how they would run the business.

One of the key value drivers of your business is the quality of your management team. All the successor owners should be very interested in your management team and how they will interact with each other after you're gone. Here's a sad fact, all of your buyers will be interested in your management team and not you, no matter what they tell you. In each of the scenarios with successor ownership your management team will either be a value driver or a value reducer for your business.

In all cases, you will want to make sure that your management team stays for a period of time during the transition from your ownership to your successor owners. One of the easiest ways to doing this is to institute a stay bonus program for your key managers. This is especially true for managers who will not be new owners of the company.

A stay bonus is a compensation program that allows all your key people to participate economically in the transfer of the business. Usually stay bonuses will have deferred payment schedules that are tied to triggering events such as the sale of the company. If the managers stay and perform at certain levels, then they would be eligible for cash payouts that would reward them for years of past service as well as getting the company through a transitional period.

Having a stay program in place will certainly be a value driver if you decide to sell to a third party. An outside buyer does not want you, but they certainly want your key people. Having an economic incentive for key people to stay will allow you to get more money for your business, both from an outside and inside buyer.

Step Six, Protecting your Asset

As John was thinking about leaving his business, he wondered what he could do to make sure that while he was running the business he was safe from law suits. He also wanted to make sure that after he sold the business he would get the money that was owed to him. He was especially worried about the situation where he might have to hold paper for any of the potential purchases that could buy his company.

In today's litigious society, it's probable that you will be sued if you own a business. Since your business is usually your largest asset, you will want to make sure that if sued, you can protect this asset from creditors or people who would like to win the legal lottery and ruin your quest for financial independence.

You need to consider setting up multiple entities that will shield your assets should you be sued. If you are in a business where liability can pierce your corporate veil and get to you personally, then you will want to speak with an asset protection specialist that understands what you can do to protect yourself from those who would take what you've worked your life for.

If you sell to anyone where he will be holding paper, you will want to make sure that you continues to have ultimate control over his business until you are paid for the business when it comes time for you to leave. The easiest way for this to be done is for you to have the company stock put in a voting trust that you control until the new owners have paid you what you're owed.

John wants to sell his business to his children or managers, so this will be relatively easy to accomplish as one of the conditions of sale. If John sells his business to a third party, then they will not allow a voting trust to be established. In that case, John must have security interests that will easily allow him to access cash that is owed him. This means that if John is acting like a bank (holding paper is being a bank) then he should act like a bank.

If John has structured his business for maximum tax efficiency at the time of sale, he can probably induce the buyer, be it an outside or inside buyer to give him the maximum amount of cash upfront they can come up with. Since we are going to structure our sale where the buyer gets a tax deduction for all cash they give us, there is an incentive for our buyers to pay us upfront so they get tax deduction in the year of the purchase.

Our primary goal in asset protection is to make sure we first get the cash for our business and then protect the cash we receive from those who would like to take it away. You don't want to be one of those sellers who provides seller financing and never gets paid the money that is owed through a sellers note.

Step Seven, Investing the Proceeds

John is now 62 years old and he is about to pass the business on to his children. The total sales price is $3,000,000 of which he is going to receive $1,200,000 up front. John will also be getting $150,000 per year for the next twelve years so he won't need to use any of the upfront money to live on.

This is the first time in his life that he has had to invest this amount of money and frankly, he's scared as to what could happen to money he's receiving for his business. He knows this money must last the rest of his life. The sale of a business is often the first time an entrepreneur has real money to invest. John was great at running his business, but he was not an experienced investor. Luckily, John had good advice for his investments and learned early that the goal of investing money from the sale of his business was not maximizing his returns, but making sure there was enough to live on.

The first step that John did when thinking about selling his business was figuring out what he needed. This exercise helped John to find out that he lived below his means. If he managed his money prudently, he would have plenty of money to live out his life. John's investment advisor continued to work with him to understand that prudent meant enough and not getting a maximum return.

John got a financial plan done with an expert who understood financial planning for private business owners. This advisor helped John realize what a realistic expectation of cash was from his business. The advisor helped John understand the difference between a pre-tax lifestyle that came from owning a business versus an after-tax lifestyle that he would get once he sold his business. The advisor also helped John get a realistic view on how much money he spent a year. John had learned through some bad luck that many financial advisors didn't know how to plan effectively for people like him. His present advisor and John felt confident that selling was a good financial move now.

John realized that it was important for him to get a fair return on his investment, but it was more important that his capital base did not disappear in a severe market correction. For this reason, he insisted that his investment managers had strong and solid programs to limit his losses during a market down turn.

I believe that as you start to accumulate significant amounts of investable assets that you must concentrate on capital preservation more than capital growth. John learned that segregating his investments into three different buckets would help him keep the decisions he made while thinking about selling his business. Using the bucket approach would help John stay invested when the market turned against him. John's wealth manager insisted that John think about worse case scenarios, not just the rosy ones that John liked and probably you like to think about.

When you sell your business, you have converted an engine that produces cash every year that you control to an investment that in many respects will be out of your control. This is the main reason you need to have an investment strategy that will help you stay the course in both good and bad times.

Step Eight – What's next in your life

John had done all the things that he thought would make a smooth transition. He knew what he needed in retirement, who was going to buy the business, how to value the business, how to improve the value, keep his key people in place and how to protect his assets. The one thing he hadn't thought about what was what's next in his life.

When John's advisor asked him, what was next in his life, John didn't have a good answer. Because of this answer, his advisor recommended that until John had a good answer, he should put his sale on the back burner.

The number one reason we see business owners be unhappy with their business sale is because they don't have a compelling future after they sell the business. Too often I hear owners tell me they'll play a lot of golf. That's a good answer for about two or three months.

The truth is once you sell your business, your phone will stop ringing and much of your social circle will disappear. You will wonder what happened to all those great friendships that you developed while running your business. Once you're out of your business you also become out of mind for those who you used to socialize with.

It's not that those people are bad people....they're not. It's just what happens. If you don't have a compelling future for things that will keep your mind occupied after you sell there's a good chance you'll end up with what's called sellers remorse.

This is step 8 in the process. Many times it should be step one. Start working on a what's next answer two to five years before you sell. If you do this step correctly, selling will become an obvious choice. You'll have put together activities and groups that will keep you engaged in a way that might even have you in a position where you won't care what happens to your business after you're gone. You'll be too involved in what you're doing now.

Conclusion

Because John went through his exit planning in an orderly manner, he could put together strategies that helped him get what he wanted both while he was running his business as well as when he decided it was time to leave. He understood the importance of using the eight steps as the basis for his planning.

Most importantly, John put together an advisory team that specialized in helping him realize the maximum value from his business while limiting taxes not only for himself, but for the successor owners of the business. He learned early on, that controlling taxes on both sides of the transition was probably the most important key in improving the value he could receive from his business when it was time to leave.

I hope that you, like John put together a team that will help you make the proper plans so that when it comes time to leave your business, you can do so in style.

Now it's your turn....Give us a Call

Every business sale is different. Have a free 30 minute phone call with Josh Patrick. You're guaranteed to get at least one good idea.

Click on the button below to choose a time and date that work for you.

Click Here To Set A Time To Talk With Josh