Business Owner Newsletter

EXITS ARE INEVITABLE, FAILURE IS NOT: PLANNING A SUCCESSFUL EXIT

We understand that business owners are so busy addressing today's economic challenges that they can overlook the critical task of Exit Planning. We also understand that, at some point, all owners exit their businesses. When that day arrives, owners want to exit on their terms, the most important of which are financial confidence and choosing the person or entity that will receive or buy the business.

Designing a comprehensive Exit Plan—which is both based on your Exit Objectives and flexible enough to adapt to changing economic, business, and personal circumstances—can be the difference between liquidating your company and selling/transferring it for millions of dollars.

Let's look at the characteristics of a good Exit Plan in light of a sad but common story of two hypothetical business owners who failed to plan:

Several years ago, Doug, an Exit Planning Advisor, met with Jim and Tim McCoy, the owners of a thriving construction company. What Doug assumed would be a business-planning meeting turned into a "we are getting out of business so how do we do it?" meeting. As successful as they were, the McCoys were tired of navigating the labyrinth of government regulation and paying ever-increasing taxes. Ultimately, the day-to-day grind of running a multimillion-dollar company had taken its toll.

For the McCoys, a sale to a third party was not feasible, not only because neither brother was willing to remain with the company after the sale but also because they had failed to develop a strong management team. Few savvy buyers will purchase a company without a great management team committed to remaining after the sale.

Transferring ownership to one or more key employees also was out of the question. None had been groomed to assume ownership responsibilities nor had the McCoys taken action to fund this type of buyout.

Transferring the company to their children was impossible, because both owners' children were too young to be active in the company.

The McCoys' only exit option was to liquidate, because their highly profitable company had little worth beyond the value of its tangible assets. After the liquidation sale, dozens of employees lost their jobs, and Jim and Tim left millions of dollars on the table.

How Can You Avoid the McCoys' Fate?

- **Plan Ahead:** The issues Jim and Tim ignored (including not grooming a management team and failing to plan) proved to be their downfall. However, these and most other issues—if addressed in advance of an owner's exit—can be resolved in a manner that (1) is cost-efficient, (2) enables the business to be transferred, and (3) adds to the value of the business. In our experience, most owners with Exit Plans need 5–10 years to implement all of the strategies necessary to exit successfully. Owners without Exit Plans spend far longer than that waiting and hoping for a buyer.
- **Set Measurable Goals:** An Exit Plan must set goals, provide accountability, and measure results. This is especially important when goals include protecting and growing value, and minimizing taxes.

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- **Incorporate Flexibility:** Plans should have the flexibility necessary to react quickly and effectively when the unexpected happens.
- **Use a Time-Tested Process:** Ultimately, we suggest that owners engage in The Seven Step Exit Planning Process™, a systematic process that has helped thousands of owners exit their businesses. One way to look at our Exit Planning Process is to associate each Step with a question. As you progress through the Process, you will be able to answer "Yes" to each one.

1. **Setting Exit Objectives:** Do you know your retirement goals and what it will take—in cash—to reach them?
2. **Determining Business Value:** Do you know what your business is worth today, in cash?
3. **Increasing Business Value:** Have you identified the best ways to increase your company's value and cash flow?
4. **The Third-Party Sale:** Do you know how to sell your business to a third party without having to pay exorbitant taxes?
5. **Transfer Your Business to Insiders:** Do you know how to transfer your business to insiders (family members, co-owners, or employees) for cash rather than give it away?
6. **Protect Your Business:** Do you have a continuity plan for your business should you die or become disabled?
7. **Protect Your Family:** Do you have a plan to help protect your family should you die or become disabled?

The thought and actions that go into answering these questions constitute your unique Exit Plan. For more information about how to begin answering each of the aforementioned questions affirmatively, contact us today.

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BUSINESS OWNERS AVOID THE PITFALLS OF NO MAN'S LAND

Many businesses can get stuck in "No Man's Land" while they are growing which often confuses them.

Let's look at the construct of this phase:

Businesses do not grow in straight lines (unlike many sales forecasts) – they grow in stages. It requires an investment in something to get to the next level of growth – "You have to spend money to make money". And so, the chart looks like the one below.

And so when a business is growing in a Bull market, you hear stories like: "The business ran out of money" or "We used to make a lot more money when we were smaller and had less people, offices etc" – these are the blue phases below. But in the Bull phase some businesses can still move through and into the next uplift phase – the red phase.

But the reverse can happen in a Bear market – when the downturn kicks in some businesses pull back on expenditure and the belt tightens. This can take a business into Unwinding the operation. And so, a business can unexpectedly move from a Growth Phase back into an Investment Phase.

The Growth Phases, where revenues kick up because of the previous Investment Phase

The Investment Phases: where you put more money into the business to create the next layer of growth

Now there are many forms this investment can take but today we are going to focus on staffing levels. We work with a lot of professional service organizations and so we are going to use numbers that are appropriate for them, but the theory applies to all types of businesses, the numbers just change.

Professional Services are most profitable at 1, 4, 12, 24, 48 employees and so on. It is not to say that they are unprofitable at other numbers, but the margins suffer, and they are considered to be in no man's land. In the 1-48 employees 9, 17 and 33 are challenging places to be. Why? We are working with one firm that has 18 FTE's and 2 partners who are the rainmakers. They are struggling to bring in enough business to support not only the associates but the admin team they felt was necessary to grow the business but is now proving a drag. They are profitable but the 2 partners are feeling burnt out. They had a choice to make, drop back to around to around 12 employees or push on with more investment till they get to around 24 employees. They have decided to move forward. They are looking at the type of associate they recruit (more willing to grow a book of business), investing in technology, investing in marketing, for the first time SEO, and raising prices. Yes, I said raising prices. We have to lean into this while inflation remains high and demand for most professional services remains strong.

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Nigel Hartley is a hybrid business advisor/coach with Shirlaws. He helps business owners who are stuck on a problem or who need to scale or pivot from a particular strategy. He has owned and operated multiple businesses and leverages that experience along with world class Shirlaws IP to facilitate measurable improvement in four areas; infrastructure, assets, generating revenue, and creating culture. He can be reached at (707) 536-6338 or nigel.hartley@shirlawsgroup.com

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EXECUTIVE BENEFITS: VALUABLE SOLUTIONS FOR RECRUITING AND RETAINING TOP TALENT

Business owner clients recognize the worth of their top employees. They implement key person insurance plans to protect against the loss of that employee due to death or disability. Yet they often overlook the most likely way a key employee will leave their company — for a better offer from a competitor.

An executive benefits plan can help retain those key employees by providing valuable benefits beyond the company's standard benefit offer, for a select few employees, and each executive can receive a custom benefit. It can help mitigate the "reverse discrimination" effect caused by IRS qualified plan contribution limitations, as non-qualified benefit plans are not subject to these caps.

Types of executive benefit plans

Executive benefit plans come in many different shapes and sizes, and which plan is right for your client will vary based on your client's goals and objectives. But, with so many plans to choose from, one of them will meet your client's needs:

- **Executive Bonus Plan:** The employer pays the premiums on a life insurance policy that is owned by the key employee, who can use it to provide death benefit protection for his/her family or as a source of supplemental retirement income through withdrawals and loans.[1] Retention Bonus Plan: The employer agrees to pay their key employee a bonus if he/she stays for an agreed-upon period of time (if not, the employee will forfeit the bonus).
- **Split Dollar Arrangement:** Provides for the joint ownership of a life insurance policy where the employer helps provide an employee death benefit protection and potential supplemental retirement income.
- **Salary Deferral Plan:** A type of non-qualified deferred compensation (NQDC) plan that allows selected participants to defer a portion of their income for the upcoming year.
- **Supplemental Executive Retirement Plan (SERP):** A type of NQDC plan that can be designed to provide post-retirement income, pre-retirement death benefits, or both.

Advantages for the employer

- Employers can select participants and offer different benefits to different employees.
- These plan types are not subject to the same contribution limitations as qualified plans.

- In general, these plan types require significantly less administration than qualified plans, and the reporting requirements are minimal.

Advantages for the employee

- There are no plan contribution limits, so the executive can be granted a higher benefit.
- The employee can defer taxation, and in the case of a salary deferral plan, can defer more of their salary than a qualified plan like a 401k would allow.
- In general, the employee does not have to pay taxes on the benefits until they are actually received.

Disadvantages

With non-qualified plans, the employer does not receive a tax deduction until the benefit provided is actually paid out. And, for NQDC plans, plan assets are held by the company and subject to the claims of company creditors.

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