CRESSET

How and when to plan for the sale of a business amid the pandemic

In response to the current pandemic and resulting economic crisis, many business owners are laser focused on doing everything they can to make sure their businesses are operating as efficiently and intelligently as possible. And rightfully so. For some, their very survival depends on it.

But as they try to ensure their businesses remain viable and emerge from the crisis in a position of strength, business owners should not lose sight of an eventual exit from their businesses.

Below, Chuck Gottschalk, CEO and founder of NextLevel – Building Enterprise Value (www.nlbev.com); and Vimala Snow, Managing Director and Head of Wealth Strategy for Cresset, explore how and when business owners should be thinking about transitioning their businesses amid the pandemic.

Chuck and Vimala, the current economic downturn has many businesses rethinking their transition plans, or considering the prospect of selling for the first time. What are the unique opportunities and challenges presented to business owners in this environment?

Chuck: Obviously, business owners are facing many challenges right now. Most companies have been negatively impacted by the crisis and valuations have taken a hit - for some much more than others.

Also, the appetite for acquisitions right now is not as strong as it was just a few months ago. There are buyers out there, but those that are active are more selective.

Right now it’s important to focus your attention on making your business as strong and resilient as possible. That includes both immediate and near-term actions to navigate these turbulent times, as well as pivoting where necessary or advantageous to emerge from this crisis with vigor and strength. By doing so, you can help to make your business more attractive, and more valuable, to prospective buyers.

Vimala: Although it may feel counterintuitive to spend time doing anything other than building value within the business right now, it is important to consider your longer-term personal and financial goals as part of any pre-transaction planning process.

While maximizing the sales price is essential, we also want to ensure business owners keep as much of the eventual sale proceeds as possible. Unsurprisingly, owners often come out ahead if they are thoughtful about how the business is owned and can navigate income and estate tax issues well in advance of a sale.

In fact, many of the tools we look at to mitigate tax consequences are most effective when the value of the business is lower than what it will ultimately be at the time of a sale.

So, while the current environment may actually be beneficial from a valuation perspective, one of the biggest challenges is finding the time to make decisions when the value will not be realized until the future.

So, is now a good time for business owners to be considering a sale?

Vimala: Yes. Because the benefit of many planning techniques increases as the value of an asset grows, it is better to plan before tackling all of the business processes and procedures that need addressing in order to make the business as attractive as possible to potential buyers.

But again, first figure out what's important to you and your family in terms of ownership of the business and what's to become of it. Only then should you dig into the specifics of preparing for a sale.

Chuck: Unless your business is already positioned to garner both strong interest and valuation in today's market, think about how you could strengthen it over the next one to two years before selling. By doing so, you can proactively "de-risk" the business by addressing key operational issues that could significantly enhance its value.

However, don't be so focused on an anticipated sale that it is to the detriment of the well-being of your business today. In other words, don't get distracted by the "shiny object" of a future liquidity event. Stay focused on your strategic and market positioning, the quality and support of your team, and strong operational and financial performance. Doing so can serve you well in any sale down the road.

What are the key components of pre-transaction planning? What can a business owner do to build value pre-exit?

Chuck: True value creation happens one to two years in advance of a sale. It's all about identifying and addressing those key value drivers in a business that can significantly enhance valuation. Risks and shortcomings in a business that can be identified and effectively addressed should be flipped into value drivers before taking the company to market. Examples include over-dependency on an owner in managing the business, customer concentration (when too much revenue is tied to one customer,) supply chain risk, scalability challenges, and lack of stable free cash flow.

That is just a sampling of the factors that can impact business value. There might be a couple dozen or more shortcomings that exist within any business. At NextLevel, we provide expertise and objectivity in helping a business owner zero in on the two, three or four issues that can have an outsized impact on the value of the business, and then leading or supporting the initiatives to effectively address them in order to help realize greater value. To really tackle those types of issues can take several months or a year or more, but the ROI on those efforts can be tremendous. That's why planning for a sale well in advance can pay off so significantly.

Having the right advisors by your side to work through these issues can be hugely important for a business owner. Often a business owner is simply too close to the business to see the issues, or doesn't yet have an appreciation for how much valuation might be left on the table that otherwise could be used to achieve his or her wealth planning and legacy goals.

What else should business owners focus on to make their businesses as attractive as possible to potential buyers when the time is right?

Chuck: Before going to market with your business, make sure to proactively prepare to be able to timely and effectively respond to all due diligence requests. Make sure all of your records are complete and well organized, all of your contracts are nailed down, your audit or review is complete and tax returns are filed. Those are the types of things that present your company well to a potential buyer. Missing the mark during due diligence could give a potential buyer hesitation or the impression that your company is poorly run.

What are the pitfalls business owners should avoid in preparing their businesses for sale? What are the lessons you've seen learned the hard way?

Vimala: Beyond the financial aspects of a sale, too many business owners forget to communicate with key stakeholders when the time is right about a pending sale. That includes both family members and employees. Do they know what you are planning? Do they know their roles with the future company? Do they have one? Do they even want to be involved? The answers to these questions could change the course of a transaction and are important to hear sooner rather than later.

A potential buyer will want reassurance that a competent leadership team will be in place to continue to run the business. Make sure those people understand their future roles, and actually want what you have in mind. Prepare and implement a transition plan for the people who will be involved with the business after the sale.

Finally, make sure that any planning you do to drive tax efficiency is not overcomplicated and impractical. I've seen business owners who have worked to unwind structures put in place for tax efficiency because they found the constraints on access to liquidity and loss of control to be too disruptive to their lifestyles. The goal is to strike the appropriate balance so you can enjoy post-sale life.

Chuck: Arguably, the biggest pitfall is not being as prepared as possible to present your company from a position of strength. That speaks to the strategic, operational, and financial underpinnings of the business, as well as the impressions made in presentations and during the due diligence process. With respect to the former, not taking the opportunity before jumping into the sales process to understand a buyer's perspective of your business can be a big mistake. Doing so can allow you to strengthen your positioning by proactively addressing, before going to market, the most significant risks and shortcomings in your business a buyer could use to discount your valuation.

Another significant pitfall that catches many business owners off guard is not incenting key employees to remain a part of the company through and beyond a sale. A buyer typically views key employees as critically important to the future of the business, and if there is a risk that some might leave, that can negatively impact price and even the viability of the deal.

Also, don't overlook the need for approval of your sale transaction by shareholders, as well as holders of options, warrants, or other types of rights. Addressing that well in advance can avoid unnecessary last-minute turmoil. Surround yourself with good advisors who are experienced in guiding business owners through these sorts of potential pitfalls.

Many business owners tend to focus only on the financial aspects of a sale. What else should they be thinking about and planning for?

Chuck: Business owners are often very concerned about their people and what will happen to them post-sale. They tend to care deeply about the cultural fit with a new buyer. Will their key people have opportunities available to them with a new owner that will be motivating? Will they feel valued and respected within the new culture?

It can blow up a deal if key people on your team quit because the new company doesn't align with their values or they view it as a poor career move. Addressing that with a prospective buyer early enough in the sales process can help you understand fit, as well as opportunities for a win-win that can help in locking in key employees to strengthen the deal.

Vimala: This is a really important question for every business owner to ask themselves in preparing for a sale: **What's next?**

Often, a business owner's identity is wrapped up in the business. That can land them in an existential crisis after the sale. Their sense of purpose can be gone, and that can be traumatic.

Take time well before the sale to map out what you want your life to look like and where you will derive fulfillment going forward. That could be a new business venture, that could be philanthropy, that could be travel. The point is to take the time to develop a plan for what's next … and get excited about it.

We recommend bringing your family together to talk about your vision as part of this process. Most wealthy families are adamant that their kids do not become unmotivated "trust fund babies." One of the easiest ways to prevent that is to make sure your kids have a strong sense of purpose, values, and a clear understanding of what it means to be a steward of a family legacy. Recognize that while at some point the conversation may lead to conversations around the level of a family's wealth, the dollars involved should not be the starting point.

Yes, enjoy the money and celebrate your success, but align the family on how you will use the money to not only make the family stronger, but make the world a better place in the process.

What can business owners who are considering a sale do now to get ready? What are the first steps?

Chuck: View the current environment not just as a challenge to navigate through but an opportunity to pivot where appropriate or invest in those aspects of your business that can allow you to emerge in a position of strength. Without losing sight of the importance of continuing strong operational execution, begin to focus on what may make you attractive to a buyer. "De-risking" your business can put you in a position of strength when the time comes to sell and can give you greater leverage in structuring a deal that achieves your goals.

Vimala: Recognize that time spent working on the business - not just in the business - is time well spent. By that I mean dedicate time to think through those bigger questions about family values and ongoing purpose. Too many business owners get so wrapped up in operating a business that they don't think through the impact of a sale on them and their families. That is just as important to think through as the fate of the business itself. Take the time now to explore the broader impact of a sale on you and your family. Doing so can result in a much happier outcome for everyone involved.