Reasons to Consider an Ownership Transition

Running a business is no easy task. It requires focus, financial resources, family support and to a certain extent, a little good fortune and luck. Nothing lasts forever, and at some point a business owner's life's work needs to become a source of support for another venture, be it a different business opportunity, retirement or family legacy. Transitioning from owner to something else can be quite difficult. It demands serious succession planning, a qualified team of experts, and impeccable timing for the outcome to deliver satisfying results. There are several reasons below for considering an ownership transition. Each of these represents food for thought as the business owner considers alternative succession strategies. These are important, since the business often represents a considerable portion of the owner's net worth.

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The first reason for seriously considering a transition is the owner's physical health.

Businesses are run by people, not by machines. Just like machines, people wear out. Most business owners do not have a contingency plan in case they're not able to continue to run their businesses. Nobody lives forever, and a major disability could seriously disrupt the financial stability and quality of life for many people after an owner's exit if there is no preparation for succession.

Owners have tremendous responsibility to their own families, families of employees, suppliers, customers and their communities. The ability to enjoy what comes from spending time doing something outside the business is an enormous responsibility that a business owner has to consider. Not all business owners can succeed with "deferred gratification" that John D. Rockefeller achieved. Where is the reward for all the owner's hard work and investment if it cannot be enjoyed?

Maintaining a lifestyle after the sale of a business has to be funded by succession planning that is skillfully conceived and executed, otherwise, the business risks becoming a luxury that fewer and fewer owners will be able to afford.

The market has changed

Market conditions are changing at an-ever increasing rate. Many industries are undergoing high-velocity change. Your business may have been a leader for the way things *used to be*. There's constant pressure to re-invest in technology and the skills needed just to maintain the existing business. Keeping tabs on the ROI of these investments is extremely difficult when customer preferences keep evolving. And even when they aren't, these investments have their own risks and require constant analysis to make sure the assumptions that made them attractive are still valid.

The economy has changed

Economic Variable	2014	2015	2016	2017	2018	2019
Real GDP growth	2.5%	▲3.1%	▼1.7%	▲2.3%	▲3.0%	▼2.2%
Job creation per month (000s)	250	▼227	▼195	▼176	▲193	▼178
Mfg. job creation per month (000s)	17	▼6	▼-1	▲15	▲22	▼5
Unemployment rate (December)	5.6%	▼5.0%	▼4.7%	▼4.1%	▼3.9%	▼3.5%
Labor force participation Age 25-54 (Dec)	80.9%	▲81.0%	▲81.4%	▲81.9%	▲82.3%	▲82.9%
Inflation rate (CPI-All, Avg.)	1.6%	▼0.1%	▲1.3%	▲2.1%	▲2.4%	▼1.8%
Poverty rate %	14.8%	▼13.5%	▼12.7%	▼12.3%	▼11.8%	Not avail.
Real median household income $	$56,969	▲$59,901	▲$61,779	▲$62,626	▲$63,179	Not avail.
Real wage growth %	0.4%	▲2.2%	▼1.3%	▼0.4%	▲0.6%	▲1.3%
Productivity growth %	0.9%	▲1.3%	▼0.3%	▲1.3%	▲1.3%	▲1.6%

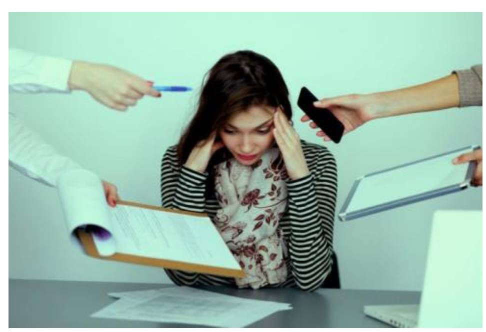
The economy changes in cycles. The business owner by himself cannot change the economic world around him. History suggests a recession every 5-7 years and some companies never recover. Can an owner weather another sustained economic downturn or a pandemic that slows the economy down? The mounting debt in government and the lack of consumer confidence leads to economic uncertainty. This uncertainty must be factored into any projections of the attractiveness of a business investment. If an owner missed out on a transaction because of poor timing before the economy tanked the last time, can he or she really afford to miss out on the next cycle?

Competition

Your competitors are not sitting idly while you enjoy business success and market share. If you provide something of value you will have competition.

An owner needs to possess some degree of paranoia relative to his competition to keep the business healthy. But watching an owner's life's work shrink in value while the company's products are commoditized is not pleasant, especially if the erosion of value involves the owner's largest investment asset.

Stress



Competition, lack of certainty, market changes increase the stress of running a business. The constant pressure associated with dealing with operating issues, financial institutions, and the frequent need to pledge personal assets to cover banking obligations can be overwhelming. Anyone who has ever borrowed from a commercial lender knows what it's like when times get tough, and servicing a loan is in jeopardy. An owner who has signed a personal guaranty when times are good, now starts to realize what that guaranty means when times are not so good. Asking for a waiver on a bank covenant creates many a sleepless night and stress-filled days. Even if you're lucky enough to have a clean balance sheet, trying to keep it that way can require skillful navigation through an alligator-infested swamp. Managing the balance sheet can be more than a full-time job in itself.

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Taxes and Government regulations and Inflation

There are "stress generators" you cannot control. Taxes, state, local and federal regulations are examples of these. Huge unbalanced budgets lead to higher taxes. Unfunded pension liabilities at the state and local levels lead to higher local taxes. Every new government program has its own regulations. Regulations generally lead to higher costs, lower profitability and a hit to business valuations. Frequently, rising costs cannot be passed on to customers forever.

Government monetary policies have kept inflation down. Unless more product and service value can be generated and monetized, the margins of a business will get squeezed. Customers have more choices now than ever before. Bigger companies have an advantage because they can consolidate, spread overhead over more production and still add value. Price and service reign supreme but increased production costs will have to be absorbed by suppliers. The smaller firms could become a financial bone-yard.

Fatigue

All of this stress leads to fatigue. Starting and running a successful business is much more than a full-time job. It takes years, and the energy required to handle day-to-day challenges is enormous. As much as things seem to be well managed, there isn't an endless supply of energy to deal with business issues. When fatigue begins to settle in, decisions take longer to make, mistakes are more prevalent and, like the human body, the business becomes less nimble. As owners reach retirement age, it's normal for them to think about "what's it all for?" and to begin to look at other, more rewarding activities, and where they'll get the financial resources needed to pursue them. Succession planning has never been more important.

Waiting will not make things better

Too many changes in customer issues and relationships are making things more complex; not simpler. Business paradigms and how we interact with customers are under constant pressure. Staying competitive and creating value for your customers takes action with all its inherent risks. The time it takes to achieve maximum value for a

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business is measured in years, not months. An ownership transition within three years means owners have to start **now** to understand, develop, and implement a plan to get there. Anything can happen in the meantime.

It is a well-recognized view that any company that is not generating a return greater than its cost of capital (generally considered to be between 25-30% for privately held, lower, middle market companies) is actually destroying value for its owners. For these businesses, waiting too long to sell will eventually lead to zero or even negative value. Despite the emotional challenges and their best intentions, owners of such businesses are better off financially, liquidating their single largest asset and investing in something that is actually creating value.

When owners say, "I'll consider selling my business in five years," what they're really saying is "getting ready isn't a priority for me now," and often they never get to it.

Failing to Plan is Planning to Fail

We understand all of these reasons above (and variations thereof) for not having a solid exit strategy yet. But business owners need to understand why it's absolutely critical to have one. Chances are you already know and just don't want to think about the fact that people who don't make a plan generally lose their business to one of the five Ds: *death, divorce, disability, distress or disagreement*. This means you (or your heirs) will likely get a fraction of what your business could be worth. This is a tragic, but all too common scenario that can be avoided, so start planning your exit strategy today.

While good things may come to those who wait, this doesn't apply to a rapidly changing business environment. Business owners owe it to themselves and those they care about to protect their life's work. They can't do it alone, and nobody is going to do it for them. They need the professional help of a team of skilled specialists. If you start now, you might be ready in 1-2 years to execute a process that will take another year to complete. All the while, the clock is ticking.

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