Legacy Wealth Management
Group of Las Vegas

Learn…

The Guide to Effective Business Exit Planning

Between now and 2045, an estimated $84 trillion of wealth will be transferred.

One study suggests that 80%–90% of a business owner's net worth is tied up in the business itself.

If you own a business, chances are high that it is the largest asset on your personal net worth statement. Have you started thinking about how you are going to monetize this asset — extract value from it when you are no longer involved? Indeed, can you even imagine yourself no longer involved in your business? No longer owning it?

At some point in a business owner's life, he or she will need to make two critical decisions about the future of that business: how and when to exit. Yet many business owners avoid discussing their own transition from the business, commonly known as exit planning.

What steps should a business owner take to begin the exit planning process?

1. Recognize the Need to Begin Planning for an Exit

Just the acknowledgment that this kind of planning is necessary for an ideal outcome is a huge first step for many owners.

Questions to ask include:
· Who am I outside the business?
· What are my goals in life?
· Do I have the team in place to run the business or other plans for when I am gone?
· Am I personally ready to exit the business? If not, what do I need to be true to be ready when the time comes?

2. Assemble Your Exit Planning Team

As noted earlier, the financial advisor is often the "quarterback" of the team, guiding the process while bringing in other specialists as needed. Other core members of the team include the owner's CPA, estate attorney, insurance professional and business attorney. Other professionals who may be brought in are the valuation specialist, business broker, growth consultant, investment banker and business banker, among others.

It is important to be aware that the owner's current advisory team may not be experienced or equipped to advise on the complexities of a business exit. In that case, additional professionals with exit planning expertise may be needed to complement the existing advisors.

3. Obtain a Business Valuation

Whether an owner is planning to transition the business internally (to key employees or to the next generation in the family) or is open to an external sale, a crucial step is to have the business appraised by a business valuation specialist who will analyze financial statements, make adjustments, compare to peers in the industry and arrive at a value that is generally expressed as a multiple of EBITDA (earnings before interest, taxes, depreciation and amortization).

4. Calculate the Owner's Wealth Gap

Once the initial valuation is established, the owner's financial advisor in collaboration with the owner's CPA can calculate the expected net proceeds from the sale and answer the question: Is this going to be enough to live on for the rest of my life? If the answer is no, that means there is a wealth gap: the difference between how much an owner needs to have as an income-producing nest egg and how much an owner will have from the sale of the business.

The wealth gap can be closed if the owner has income-producing or growth assets other than the business such as an existing portfolio. It can also be closed by finding ways to increase the value of the business. A business growth consultant can serve as a key member of the exit planning team in this instance, working with the owner to implement changes to the business — some minor, others more fundamental — that will increase the multiple and therefore increase the value of the business.

The wealth gap can also be narrowed by taking advantage of strategies to reduce the taxes owed from the sale, which increases what the owner gets to keep. For instance, certain advanced charitable plans can reduce the tax liability for owners who are philanthropically inclined. If the business is a C-corporation, an owner may be able to take advantage of the Qualified Small Business Stock (QSBS) exclusion, which can be a powerful tool to avoid capital gains.

By taking these steps, an owner can begin laying the groundwork for the post-business phase of life!

Sources

1 "Cerulli Anticipates $84 Trillion in Wealth Transfers Through 2045." Cerulli Associates, January 20, 2022.

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3 2023 National State of Owner Readiness Report. Exit Planning Institute, 2023.

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