



How to Grow Value in an Often-Ignored Asset Class

Planners must understand their business-owner clients' underlying personal needs to help them address their business needs

By Patrick B. Gilbert



Patrick B. Gilbert, T7 Partners, advises business owners to help maximize the value of their business prior to a transition or transaction. He assists in value enhancement and realization at all levels and has been involved in transactions ranging in value from \$5 million to \$3 billion. Find him at www.t7partners.com.

YOU WILL SERVE A WIDE RANGE of clients throughout your career. However, for the business-owner client, there exists a unique opportunity to help grow value in what is an often-ignored asset class—the privately held business.

So, how should you think differently about the unique needs of business owners? And how can you help them grow the value of their most prized asset?

Think of a Business Not Unlike Other Investments

First, let's acknowledge that it may seem strange to speak of a privately held business as a separate asset class, but most business owners likely don't share the same hesitancy. That's because a privately held business, like fixed income, equity, or even alternatives, such as real estate, has two elements of investment return: income and capital appreciation.

The income component is the free annual operating cash flow of the business. The capital appreciation component can be thought of as the value the business may be sold for in the future. Think of these two elements as forming the investment life cycle. As such, your goal as the wealth adviser is the same for each—to help your client grow the value of both. The good news is that the process you should follow, while interrelated, is essentially the same.

Begin with the Right Approach

Wealth advisers typically approach business owners and their businesses from two extremes. On the one hand, there are those who miss the untapped value creation potential in a privately held business. This is likely because the privately held business is a unique investment asset and is usually outside the scope of most wealth advisers' expertise. Yet, while not as liquid as most other investments, the privately held business has the potential for the greatest investment return compared to any other asset class. So, if you want to bolster relevance to business owners, do not overlook the growth potential of their business.

On the other hand, more self-assured advisers are quick to advise their clients on their privately

held business. Doing so, they may assume to know exactly what the business owner needs most to grow the value of their business. Their advice may take various forms, but unfortunately, it is sometimes given without a robust understanding of how actual business value is created. This is especially evident when business owners are contemplating a transition or transaction, which is the point in time when value, or the capital appreciation element of investment return, is ultimately determined and realized.

Neither approach pinpoints what the client needs most, and this could eventually place the client relationship at risk. Yet more often, there is a missed opportunity to optimize the value of the business, which results in suboptimal client outcomes and fewer assets managed over time.

Discern the Underlying Need

Astute wealth advisers take a different approach. First, they acknowledge that advising a business owner is not altogether different from working with other high-net-worth clients. Like other clients, you must understand their needs and then develop an investment approach with consideration given to short-term and long-term objectives. However, since a great deal of the business owner's wealth is tied to their business, this brings with it special consideration.

The primary challenge in advising business owners is learning how to discern their underlying need, especially as it relates to how to maximize and realize the value of the business. This skill set is vastly understated—even among so called “business advisers.” Therefore, it is no surprise to find standardized approaches, no matter how heavily marketed, do not grow actual business value. Different thinking is needed.

For context, business-owner clients typically use

a wide array of advisers to assist with the operations of their business. As such, when the market perceives a business as an attractive acquisition target, there will be a flurry of inbound solicitation. This includes deal professionals, such as private equity buyers, strategic buyers, and sell-side investment bankers, but it will also include other competing wealth advisers. This does not concern astute wealth advisers, because their focus on discerning the underlying need of the business owner ensures they add value in a way others cannot.

Here's the fundamental problem. When soliciting professionals engage with business owners, they do so only through the lens of what services they provide. Consequently, they are rarely able to diagnose the underlying need of the business owner, especially as it relates to how best to maximize the value of the business, including both its cash flow and value of the business at the time of a transition or transaction. Their incentive is to sell specific services, not to discern complex needs interwoven around business, family, and personal matters. But when needs cannot be clearly discerned, the value of the business cannot be optimized.

This is where the train can come off the tracks. While a business owner may be able to express a *presenting business* need, they are rarely able to express their *underlying personal* need, which often lies at the intersection of business and personal wealth planning. To be fair, the business owner, especially at retirement age, is usually going through not only a business transition but a personal transition as well. They are likely experiencing restlessness, self-doubt, and lack of direction. In most cases, they are going down a path they have never traveled before—both personally and with the business. To complicate matters further, there are few people they can trust to advise them.



Provide a ‘Continuum of Advisory’

This is where astute wealth advisers can be a trusted voice. Other professionals are calling business owners to sell their technical services. However, they are not in a position to discern the business owner’s needs since this process takes time and requires strong fiduciary intent and care. This is true no matter how needed their services might be down the road.

What the business owner most needs from you is a “continuum of advisory.” They need a process that over time moves them from confusion to clarity. This can be thought of as a process of learning, which occurs in sequence and includes elements of how to enhance the value of their business. This learning process is critical in that it allows the underlying need of the business and owner to be discerned over time—both by you, as the adviser, and by the business owner.

Furthermore, this should occur before engaging specific service providers, specifically deal professionals in situations where a transaction is contemplated. If not, you introduce competing agendas at a time when your client “does not know what they do not know.” Approached in this way, you are stewarding your client through a continuum of learning before any decisions are made related to the value of the business or, if relevant, its sale. This places your client’s needs first and creates strong fiduciary alignment by setting them up to maximize the value of their business along the entirety of their investment lifecycle or ownership of the business.

Four Steps to Business Value Enhancement

When providing a continuum of advisory, four critical value-enhancement steps should be considered. The point is not that you are expected to deliver on these services, but to facilitate a process by which these outcomes are achieved before any decisions about the future of the business are made.

1. *Align Business Strategy*

Any business can enhance its value, but there are constraints to growth, such as the owner’s timeline, certain capital considerations, and general market dynamics. Yet most businesses do not reach their full value potential because they are not properly aligned to achieve it. This is symptomatic of lacking a clear strategic focus, which is often disguised in choosing what is good over what is best.

Start by defining the business’s unique value-add with consideration given to how best to leverage it in the market. This is likely instinctive to your client, but they may never have been forced to articulate it. Furthermore, you may find that your client lacks a holistic view of their own market, where their actual value-add is different than what they believe it to be, especially when there are rapidly changing market dynamics. Regardless, define clear value differentiators and an initial business strategy, and ensure the two align.

2. *Model ‘True’ Economics*

Second, build a dynamic, economic model. Model the current state of the business, existing cost structure, and profit dynamics at a unit level rather than rely on aggregate reporting, which is designed for financial reporting or tax purposes. Analyze the two largest unknown dynamics affecting profitability—changes to volume and mix. Build the model for scenario planning. This will help evaluate certain strategic decisions across the entirety of the business as well as its various segments.

3. *Design a Value Creation Plan*

The third step to value enhancement is the design of a value creation plan. Examine multiple facets of the business, with an eye toward how to improve margins, enhance current operations, build out a

more sustainable business model, and enhance the overall transferability of the business. Ask what process, system, and organizational steps could be taken to leverage the company's value-add to unlock greater overall value. Draw on the business's current resources but also consider what additional capital investment may be necessary. The owner may not need to make the investment themselves but only quantify it so that the link between capital investment and incremental business value is clear.

4. Execute Upon the Plan

The final stage of value enhancement is to execute the parts of the value creation plan that are possible within the constraints of existing resources, capital, and the owner's timeline to exit. It usually takes an operating cycle and a half for most operational changes to show measurable financial impact. Those elements of the value creation plan that cannot be implemented should still be outlined, since they will help communicate the growth potential of the business internally and to outside parties, if needed. Owners may think of what they can execute themselves as the "Operating Plan" and the inclusion of the other elements as the "Strategic Growth Plan."

Conclusion

In the end, there is a tremendous opportunity to help your business-owner client maximize the value of their most valuable asset. But it requires strong fiduciary care focused on discerning your client's underlying need and an understanding of how business value is created. Doing this, you will not only differentiate yourself in a crowded market, but you will be providing your clients what they most need, a trusted wealth adviser, who is instrumental in helping them grow the value of their most overlooked asset. ■