Plan On It!

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Develop your exit strategy sooner rather than later

Everyone will eventually leave his or her business. Most agency owners are aware that detailed planning will give them the best chance of decreased taxes, improved value, and higher probability of meeting personal goals. However, most don't take the time to plan.

Over the past year I interviewed 19 agency owners who sold to a third party. Every one of them said they wished they could have perpetuated the business internally. However, all of them said they were not able to make it happen. Only one of them had an exit plan in advance of the sale.

John Brown, exit planning specialist, speaker, and author of How to Run Your Business So You Can Leave It in Style, says he has hundreds of stories of businesses that have lost millions of dollars due to the lack of a plan. He believes that business owners who plan more than five years prior to their anticipated exit will have the best opportunity for reaching maximum financial gain and be able to meet most or all of their personal goals.

The top reasons I hear of why agency owners don't plan are:

• They don't have the time.

• They don't know what to do.

• They don't know who to go to for help.

• They don't know what they really want.

What follows are some of the key elements of an exit plan. Committing to these plan items will give financial reward and peace of mind to any agency owner.

1. BUSINESS CONTINUITY—PLANNED AND UNPLANNED

Business continuity is possibly the most important element of an exit plan. I have watched more organizations fail in exit planning because of the inability to manage the people side of perpetuation. I will be writing specifically on this topic in my next article. However, the two basic areas of business continuity include preparation and having systems in place for planned and unplanned events involving your employees and partners.

Planned events include retirement and growth (which creates the need for new leadership) as well as adding shareholders to an existing group.

Unplanned events include death, disability, employee terminations, and resignations. I also recommend planning for “change of mind” events with employees. A few agencies have experienced a key employee backing out on a stock purchase that dramatically changes the exit plan of an owner.

An effective business continuity strategy is to divide employees into four categories:

Key employees: If this employee left the business, it would have a financial impact on the value of the company.

Important employees: These are employees that make a big difference and would be difficult to replace.

Valued employees: Remaining staff should be considered valued. If they are not valued they shouldn’t be part of the agency.

Expendable employees: Many times we hang on to people who would be better off somewhere else. Helping them move on is best for them and for the agency.

Once these determinations are made, creating specific plans to maximize performance through governance, compensation, engagement, and performance management systems will bring great success.

Planned events are easier to put a lot of detail into and organize. The unplanned events take more thought and require more creative solutions.

2. **KNOW YOUR NUMBERS**

Three financial documents are critical to an effective exit plan.

The first is a personal retirement financial analysis, or knowing how much money you will need to live on after you retire. This is critical because you need to know this information to determine what is needed from the business in after-tax dollars.

The second is a business valuation. When you get closer to selling, a more detailed valuation will be required. However, a simple valuation from a certified valuation consultant is suggested.

Third, is an annual cash flow forecast through the end of the current ownership group, up until their departure from the business. If only one owner exists, determine the expected departure date and how the cash flow would work to buy the stock. If multiple owners are involved, run an annual forecast of each owner’s departure and how it will affect cash flow in the business.

3. **SET GOALS**

No goal is a bad goal, but not having goals is a bad thing. Knowing how much you want for the agency and the date of the sale are the most common goals. However, getting creative with goal setting will help create a stronger plan.

An entrepreneurial business is an opportunity for dreams to be fulfilled for individual owners. Some additional goals could be to address family members in the business, family members not in the business, key employees, community objectives, charity and philanthropy, success milestones, cultural objectives, and financial targets.

Any goals the owner(s) desires are important to establish early and revisit annually.

4. PROTECTION

Building a business to create value and a financially rewarding exit is a tough job. It can take years to develop and build. However, it can also be destroyed in a moment.

Death of a key owner, a data breach, the sudden disability of a key person, lack of funding for buy-back agreements, lack of key professional liability insurance coverage, and other areas of our professional expertise are grossly ignored in our own businesses. Many insurance agency owners fall short of protecting their net worth.

We know how to protect and insure our clients but we don't go through the effort of insuring ourselves properly.

Performing a thorough risk assessment on the agency to make sure it is protected against a large loss can help agency owners sleep a lot better at night. It can also create a great story to tell your clients when you show them how easy it is to not be insured properly.

5. INTERNAL OR EXTERNAL OBJECTIVE AND PLAN

Most agency owners want to stay independent. Building out the financial models of the options for exiting the business will help an exiting owner make the best decision. Most owners don't realize how many options are available.

On the surface, an external sale seems simple. However, my observation is that our industry is very narrow in its thinking about how to sell externally. The big national and regional buyers of insurance agencies are certainly a good option. But, other non-traditional buyers exist. Prospective sellers are wise to investigate the entire market before selling to anyone.

Go back and look at all the goals. Deals structured around charitable contributions, family trusts, and other creative strategies to reduce taxes can make the deal better for the seller.

Most internal sales are to family, key employees, an ESOP, or a combination of these options. All options are excellent if they meet the owner's needs and objectives. If working with a consultant, be sure they provide a complete evaluation of all options so they can craft the right plan that will put more money in your pocket and less in the government's pocket. Not all CPAs or attorneys are up to speed on all the options of internal business transfers, so choose carefully.

6. **TAX PLANNING**

Trusts, deal timing, payment timing, employee tax declaration, and other strategies will make a difference. Make sure your tax advisor is up to speed on all of these options and can help with a proactive plan.

7. **PERSONAL ESTATE PLANNING**

Work with a financial planner who can advise you on how to protect your estate through the end of your life including the financial transfer to family and charity.

Every element of a plan should improve the end result. If an owner wants to pay less in taxes, increase the sale value, protect the value, and reach personal goals, he should plan on it!