PRACTICE MANAGEMENT

The Central Role of the Planner in Business Liquidity Events

by Timothy K. Bronza, CPA/ABV, ASA; Paul H. Auslander, CFP®, GFS; and Alan H. Marrullier

In the increasingly competitive environment of financial planning services, it is critical for financial planners to strengthen their practice and position themselves as a primary professional adviser to the client.

The business owner market segment should be of particular importance to financial planners, as many private business owners will be monetizing their business (an outright sale of the business or partial liquidity event) at some point in the future. In fact, in 2012, SME Research conservatively predicted that between 1.36 and 2 million baby boomer-owned businesses would be for sale in the next five to 10 years.[1]

This article will introduce the concepts designed to enhance the planner's ability to effectively advise the private business owner on his or her most important asset, their business.

Succession Positioning

Perhaps the most important need a planner can fulfill for his or her business owner client involves succession positioning, which is the process of enhancing the value of the business and planning for its succession or transition. Succession positioning requires significant advance planning and coordination of a multidisciplinary team. The financial planner has an opportunity to quarterback the process; it should not be the planner's goal to execute each and every role. As the quarterback, the planner assembles the professionals needed to position the business, identifies the requisite skills and attributes of team members, and develops relationships with these professionals. It is important to note that the succession positioning process usually becomes more complicated in situations involving multiple owners.

Succession positioning of the business incorporates three key disciplines that the financial planner can influence: succession planning, valuation, and corporate finance. These three disciplines are components of a larger set of disciplines that involve growth management, mergers and acquisitions, and risk management.

Succession planning is the process by which the business owner considers liquidity options and exit strategies. Valuation involves the task of determining what the value of the business is in the relevant market for the business, as well as identifying the key value drivers of the business and risk considerations that impact the business. Strategic corporate finance is the process that needs to be executed in order to monetize the business according to a chosen course of action.

Succession Planning

Effective succession planning is often initiated by framing the conversation with the business owner in terms of growing the business. Early conversations should focus on strengthening and protecting the business, such as reducing the level of risk associated with the business. The comprehensive personal financial plan of the business owner is a critical component of succession planning, as the business must be considered as an asset in the mix of the total portfolio.

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The financial planner can be instrumental in changing the focus from a sale number to a comprehensive financial plan that incorporates asset preservation, lifestyle continuation, philanthropic desires, and non-financial goals.

Selling the business is often an emotionally charged topic for the business owner. Strict confidentiality is a key consideration. If the business involves multiple partners, the conversation can become contentious.

The fundamental task for the financial planner in terms of succession planning is to use a proven framework to address succession and transition in a non-threatening way to gain a deeper understanding of the goals and concerns of the business-owner client.

A useful tool for the financial planner to assist in the succession planning discussion is to recommend the business owner complete a thorough diagnostic assessment of the business enterprise, performed by qualified professionals, that involves the following elements:

- Review of the business owner's personal objectives and business objectives
- Review of recent financial results and financial position
- Financial ratio analysis
- Valuation and review of relevant merger and acquisition transactions
- Industry review
- Identification and analysis of key performance indicators[2] (KPIs) of the business
- Qualitative assessment (value enhancement and risk considerations)
- Comparison of the business to its peer group
- Objective, independent valuation of the business
- Conclusions and recommendations

A thorough diagnostic assessment can minimize the inertia involved in the succession planning process and provide insight as to how an objective third-party might view the business. An assessment can also establish an arm's length valuation of the business for personal financial planning purposes such as life insurance coverage amounts.

Valuation

Effective asset allocation begins with a thorough understanding of risk, growth prospects, and value of the business owner's largest asset—the business itself. Financial planners (and business owners) frequently underestimate the concentration of the value of the business within the context of overall asset allocation. Although the issue

of concentration of business value for asset allocation purposes is beyond the scope of this article, the importance of a having a thorough understanding of the value of the business cannot be overstated.

Market information relative to private businesses is imperfect; a frequent lack of transparency and reliability regarding private business transactions make it difficult to form valid conclusions regarding value. Contractual terms related to transactions may not be readily available, or worse, may be distorted. As a consequence, opinions related to value for private businesses are frequently formed on superficial and incomplete information.

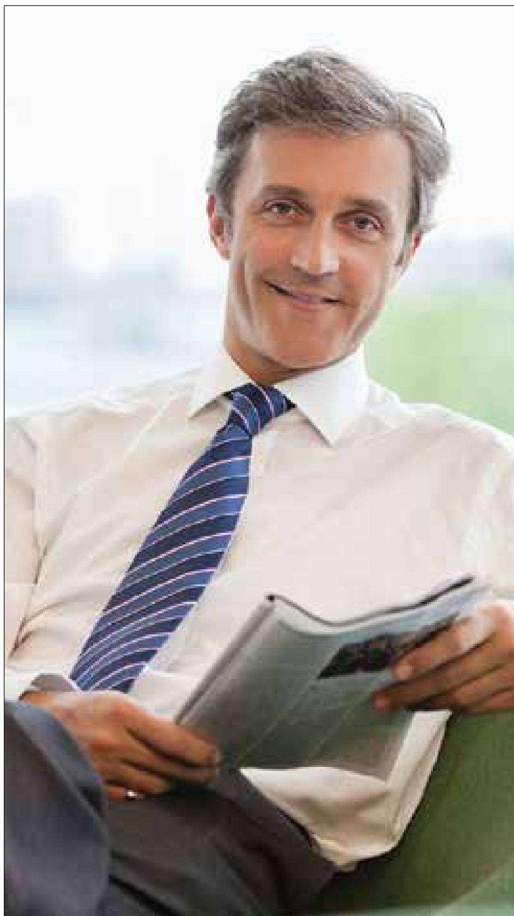
Valuation issues are compounded by the fact that the business owner is often in an inferior position when it comes to negotiating value with possible buyers, such as private equity funds and strategic buyers. These buyers are savvy financiers, armed with skills designed to achieve the most advantageous deals. The business owner, on the other hand, typically executes a liquidity event only once in a lifetime. This problem can be exacerbated, as many business owners operate from a reactive position—they start thinking about the value of their business once they receive an unsolicited offer or are confronted with a personal crisis necessitating the sale of the business.

For these reasons, a business owner should consider having a diagnostic assessment and valuation performed by a competent business appraiser that understands how to analyze a business from a strategic standpoint. It is imperative for the financial planner to forge relationships with competent business appraisers so that the planner has access to the valuation expertise necessary to strategically position the business and best advise the private business owner. For every business there is a range of values based upon the perspective applied (growth, exit, recapitalization, partner/management buyout, liquidation).

It's also important for the business owner to have a realistic understanding of valuation for strategic planning purposes. Similar to an annual review of a portfolio of the business owner's liquid assets, an annual valuation will shed light on whether business value is going up, down, or is static.

Corporate Finance

Corporate finance for the closely held business involves several key professional disciplines, such as accounting, investment banking, law, valuation, and taxation. The illiquid nature of



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the private business and the related challenges to monetize the business necessitates a team of advisers to achieve optimal outcomes. As previsouly noted, the financial planner can make him or herself indispensable by assembling and leading that team.

Liquidity options are not restricted to a sale of 100 percent of the interest. Partial sales can be an option. Liquidity options are not mutually exclusive (for example, self-recapitalization, line of credit, merger and acquisition transition, or management buyout). If your business-owner clients have limited knowledge of these options, this again reinforces the need for competent advisers.

A qualified investment banker can be a key resource for the financial planner in terms of deal-making advice. Planners who align themselves with experienced transaction intermediaries have access to a wealth of resources that constitute essential tools to assist business-owner clients in realizing their objectives.

When one considers that the execution of a recapitalization or liquidity event can take six months to a year, the investment banker relied upon to execute the deal should possess a number of professional and personal attributes. The team you assemble will be living with the business owner and his or her team for an extended period of time. As with the other trusted advisers, the intermediary selected to either raise capital, recapitalize, or exit the business must be a strategic team player who is in tune with both the personal needs and objectives of the business owner as well as the realities of the business enterprise.

Above all, the intermediary needs to demonstrate the ability to successfully meet the client's objectives. Almost closing a deal or almost raising capital does not count. Past transaction experiences and client references are some of the most critical components of the selection process. Gauging personal chemistry and bedside manner for interpersonal fit along with negotiating style, objectivity, decisiveness, methodologies, wide-ranging experience, and financial acumen should be thoroughly considered in the evaluation and selection process.

Conclusion

Successful value creation for the business is a process, not an event. Just as a review of a portfolio of publicly traded securities is a key element of financial planning, the succession positioning of the business is critical to achieve the financial goals of the business owner. Financial planners are postured both from a relationship and a skills standpoint to assemble the right team of advisers for their business-owner clients to effectively plan for the succession of the business.

The planners who forge these professional relationships and build effective teams of experts are able to solidify their relationship as the primary trusted business adviser, and enhance their own revenue prospects. Should the business owner complete a partial or full liquidity event, the financial planner will be in the position to harvest and manage the sale proceeds related to the transaction. An emphasis on longer-term sources of revenue, such as the business owner market segment, provide growth and diversification to the dynamic financial planning practice. ■

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Planner Takes the Lead

The financial planner may be best positioned to take the lead in coordinating the team of professional services providers to the business owner. The planner possesses a number of attributes needed to lead the business owner's team of professionals, including:

- A thorough understanding of financial planning issues germane to the business owner
- Frequent opportunities to interact with the business owner that result in strong relationships, often over multiple generations
- Intimate knowledge of the client's financial and non-financial issues and goals
- Increasingly, a fiduciary responsibility to act in the client's best interest
- The ability to distinguish appropriate and inappropriate planning approaches for a particular client
- The capability to draw on a network of allied professionals to assemble a team that results in the ability to deliver value-added services in excess of the value of services as if delivered on an individual basis

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Endnotes

1. See "Baby Boomer Business Owners: Will There Be a Mass Sell-Off?" by SME Research's Carey McMann, published in September 2012.
2. See *Key Performance Indicators: The 75 Measures Every Manager Needs to Know* by Bernard Marr, and *Key Performance Indicators: Developing, Implementing and Using Winning KPIs* by David Parmenter.