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When's the Right Time to Sell a Family Business?

Current market forces may impact the value of a company.

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Estate planning too often focuses on minimizing the transfer taxes that might be incurred on a family business when a founder passes, endeavoring to use powers of appointment to increase basis or other strategies to reduce income taxes. But the critical step to enhance overall family wealth may be properly timing the sale of that business, if that's ultimately the client's succession plan.

Poor Timing; Life Goals

One obvious time not to sell is when the matriarch or patriarch of the business becomes incapacitated or passes away. Instead, business owners need to think about what their own life goals are and how they interconnect to the business. Then, the owner can look at the multitude of options available, and the planning can begin. This approach is no easy matter for many clients, as every advisor has had the experience of a client who won't "let go." Some clients are so emotionally attached to their business that they refuse to seriously address the inevitable circumstances of aging, disability or death.

Years ago, if someone sold their business, they retired. Today, sellers have many more options: They might sell their business completely and essentially cash out; or they might sell the majority of their business, yet still have a piece of equity to enjoy future earnings and remain connected. In some cases (particularly with a private equity acquirer), the owner may be able to stay on the board of directors of the business and continue to grow the business with the support of the private equity firm. This can offer several valuable advantages. The owner will have been largely bought out, and thus, there's less personal risk as he continues. Another option is to sell a minority portion of their business and maintain control yet take some of their personal risk off the table.

Age

In the past decade, the average age of business owners looking to sell has declined dramatically. A decade ago, sellers would typically be in their mid to late 60s before selling. Now many sellers are in their 50s. They're selling at a younger age to protect their own wealth by not having it tied up primarily in the business and because they want to pursue other activities or businesses.

Timing

The first step business owners need to take is to correctly identify what their objectives are to find a path that meets their goals. The client should never jump into a decision like this lightly and should seek guidance from a financial professional with the right experience. Advisors can play a critical role in that process. Independent and objective input is vital.

Younger generations of business owners are doing more research and viability analysis and more commonly sell a large portion of their financial position, but thereafter remain involved in the company. Some business owners are serial entrepreneurs who frequently sell outright and reinvest their earnings as capital in a new venture. And there are business owners who want to benefit from outside capital and expertise and sell perhaps 60%-70% of their business to a buyer who can add value and take the company to higher levels than they could have done on their own.

Disruptive Technology

Disruptive technology has completely changed almost every industry, severely impacting some businesses. You might call it the "Amazon Risk." Amazon has wreaked havoc in the retail market affecting all retailers directly and indirectly impacting real estate values, as well as suppliers and distributors. Since Uber and Lyft have risen in popularity, the value of a medallion for a New York City taxicab fell in value by more than 80% from over $1 million a few years ago to now around $200,000, if it can be sold at all. These are just a few examples of how "disruption" can decimate an entire industry.

Relatively young business owners (those in their 40s and 50s) who've built up profitable businesses and want to protect their families may be keenly aware of competition and technology that could make their business obsolete. Since much of their net worth is tied up in a single illiquid asset, their company, they want to stay ahead of the curve and consider long-term financial security options, like taking some or all the value of their business off the table.

At the same time that we've seen younger sellers enter the market, we're also seeing certain business owners who pushed off retirement because of limited investment opportunities. Some sellers in their 60s and 70s are concerned that if they sell, they may outlive their money. They may not necessarily want to continue to run their business, but they may feel they have no options. Typically, these are very conservative investors who've placed their liquid assets in Treasury bills and CDs, which until recently were only yielding very low returns. Some of these business owners fear stock market investments they don't understand and prefer the comfort of a business that they do understand. Fortunately, if these owners speak to a financial professional, they'll learn about the many options they have, which will provide growth for their company and a smart long-term strategy for themselves.

The market has been very hot the past few years, as owners of middle-market companies have enjoyed high valuations and multiple offers resulting from a continuation of low interest rates. This has enabled private equity groups to use inexpensive financing to facilitate higher multiples. Likewise, strategic buyers with vast cash reserves continue to be strong players as they look to grow revenue, profitability and capabilities through acquisition. In addition, many cross-border companies have chosen to expand their footprint into the United States.

Today the dynamic is shifting. While M&A volume and valuation trends are cyclical, there's no way of predicting how long an active M&A climate will last. Business owners should thus think carefully about the timing of their exit and how current market forces might impact the value of their company and future. Advisors should encourage and guide business owner clients through this process.

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