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Have You Saved Enough to Sell Your Business?

By Jane Johnson (http://www.axial.net/author/janejohnson/), Business Transition Academy | December 13, 2016

More often than not, the largest asset business owners have is their business. Some may have as much as 90% of their net worth tied up in this illiquid asset. The majority haven't saved adequately outside of their business, which means that when it comes time to sell the business, they are financially dependent on it to fund the rest of their lives. But as with any investment, it's extremely risky to put all your eggs in one basket.

After having spent so much of their time and energy on growing the business, probably the last thing an owner is thinking about is saving and investing in outside interests. They get used to using their business as a personal piggy bank, drawing sizeable salaries and bonuses in addition to paying for vacations, travel, and many other perks out of the business. The business becomes more of a lifestyle than an investment. But treating the business as more of a lifestyle than an investment can prove problematic when it comes time to sell. The owner may need to extract significant money from the sale of the business to achieve their retirement goals and support the life to which he or she has become accustomed.

For owners who find themselves in a similar situation, there are a few ways to reduce your dependence on the business and ensure your long-term financial security.

1. The first step is to take stock of your financial situation including the assets you have saved *outside* the business and your annual budget.
2. Next, calculate your **wealth gap**, which is the difference between what you currently have saved outside the business and how much you need to have outside the business to

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generate your desired long-term income. Using some assumptions, you can calculate how much money you will need to net, after taxes and fees, from the business sale.

3. The next step is to look at ways to diversify your investments and supplement your income sources with non-business assets.

This may seem like a lot of work. It is, but it's a necessary part of your overall transition strategy and will yield fruitful results with sufficient time and planning. Let's look at each of these steps in more detail.

Taking Stock of Your Financial Situation

This is often an eye-opening exercise. You may be surprised to find out just how little you have saved outside of the business and how much cash you are taking from your business in the form of salary, perks, and benefits.

This can be dangerous, especially if you plan to sell the business or transition the ownership to others in the next several years. The pressure to produce cash may drain the business of necessary capital for growth and sustainability. Ratcheting up discretionary spending to improve personal lifestyles or to minimize tax liabilities can also inadvertently decrease your company's profits and reduce the company's value.

Calculating and Closing Your Wealth Gap

Determining your wealth gap – i.e., calculating how much you need to net from your business transition – is also a necessary exercise. Those owners who are almost solely dependent on their businesses will need to draw much more out of the sale of their businesses than those who have diversified their holdings.

This means that you will have to sell your business for a specific (usually higher) price in order to fill your wealth gap and fund the next stage of your life. Unfortunately, when it's time to finally sell, many owners find out that their businesses are worth less than they had hoped and find it nearly impossible to find a buyer who is willing to pay what they're asking. The reality is that without continued income from the business or from an income stream derived from selling the business, many owners will see their standards of living dramatically decline.

There are multiple ways to close the gap, including:

- Saving more money outside the business
- Increasing the value of your company
- Decreasing your spending and income needs
- Developing additional sources of post-transition income

Diversifying Your Assets

While asset diversification is the key to minimizing risk and generating the best returns in investing, for some reason, business owners are often remiss to diversify assets outside of their businesses — perhaps because of a perceived loss of control. But the truth is, privately held companies are risky propositions. According to the Bureau of Labor Statistics, only 26% of businesses survive 15 years or more. Factors far outside the control of the owner including economic recessions and many other external forces like competition, technological advancements, health-care costs, and tax law changes can have dramatic impacts on a business.

Diversifying your investments and supplementing your income sources with non-business assets, such as real-estate rental income, interest, and dividends can help protect you from these risks. If your assets are well-diversified, you will be in better shape than an owner who is solely dependent on their business for income.

Saving money outside your business will also give you more choices when it comes time to transition out. For example, owners who have saved a lot outside may be able to afford to sell the company to family members or key employees who will not be able to pay top dollar for the company.

Conclusion

If you prepare well in advance (we recommend 3-5 years) of any kind of business transition, you can be proactive about saving more money outside of the business, therefore lessening your dependence on the business and the upcoming ownership transition. You can assess where the business is in its lifecycle and determine what needs to be done to keep it healthy and growing. This analysis and proactive action can have a dramatic and positive impact on your business and your long-term financial well-being.

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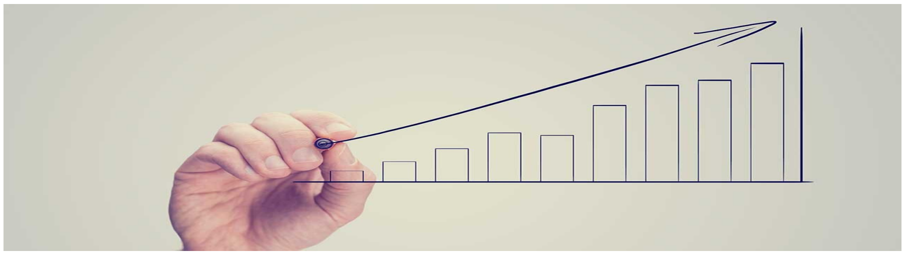
***By Karen Sibayan** | **January 13, 2016** ()*



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During negotiations in an M&A deal, buyers and sellers look closely at several factors in order to agree on a price that properly captures a company's value. One of the closely examined metrics in this process is EBITDA, which stands for earnings before interest, taxes, depreciation, and amortization. EBITDA is used as a way...

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