EVERGREEN® EXITS

A DIVISION OF EVERGREEN WEALTH SOLUTIONS

ARE YOU BUILDING EQUITY OR INCOME IN YOUR BUSINESS?

Many business owners run their businesses based on their current lifestyle needs. However, when you begin to consider who will own your business after you, i.e. your exit from your business, you need to ask yourself whether you are focused on creating a stream of personal income from your business, or whether you are actually building equity, i.e. ‘value’ within the business. The difference between these two opposing perspectives will reveal itself when your turn comes to exit your business and may have a large impact on your ability to transition your company.

Is Your Business a Job or An Investment?

An owner who builds their business with a primary focus on personal income, for the most part, has a job. An owner who builds their business by making decisions that are likely to increase their equity value has an investment. One day someone other than you will be running your business. Will that successor be purchasing a job from you or an enterprise?

Your eventual buyer or successor will likely be interested in knowing about the equity that you have built, not about the income that you have achieved within your business. And, as an owner who is considering a future exit, you want to speak in terms of equity and not just in terms of income. You see, income can vary according to the personal needs of the owner-operator. However, equity can be expanded and value can be driven into your business once your focus moves to an 'equity driven' model.

The Building of Equity Value

Technically, 'equity' is a Balance Sheet term which is equal to your assets less liabilities; this equation reveals your owner's equity. However, we are not discussing the financial reporting within your business, we are discussing the manner in which you make operational decisions to increase the value of your business.

Let’s look at an example to make the point. Jim owns a distribution company and spends most of his time focusing on building strategic relationships to increase sales, as well as increasing the capacity of his business to distribute more products. He does most of this work alone, without an empowered or incentivized management team. Sounds simple enough. However, Jim's mindset is towards conducting these activities so that he can take a larger salary and bonus at the end of the year. Again, to most reading this newsletter, that sounds like a very reasonable objective. But there is a problem, a very predictable and obvious problem once Jim is aware of it.

The problem is that Jim is not spending any time considering who would be doing his 'job' at the company in his absence. While it is true that the company can run for a week or two as Jim takes his vacations. Or perhaps the business could even sustain for a few months if Jim were to want time off or had a physical problem that prevented him from working - these instances alone would not materially affect Jim's income. However, Jim is not protecting the equity in his business with his decision making process. Jim's equity, and hence his illiquid business wealth, is at risk because Jim has not focused on his business as an investment.

Who Will Own and Run My Business After Me?

What Jim needs to do in this case is begin to ask the important and crystallizing questions that will define how he exits his business. Jim needs to ask and answer the following question 'who will own and run my business after me?' But in order to get to that point, Jim needs to have some idea as to what his exit options are and which one is optimal for his situation.

For example, Jim may want his management team to take over the business. Well, Jim's succession plan will need to include specific action items and benchmarks for transferring responsibility and building leadership with his company. Jim should communicate with his management team his desire to transfer operational control and begin to put measures in place to start this shift. Moreover, Jim can establish incentive plans to retain and reward his key people as well as perhaps set the stage for funding his own buyout.

If Jim were considering a sale to an outside buyer, he would need to ask a few other important questions, such as “how long will I need to keep working with an owner to transition the company and how will that impact what I get paid?"

Building Transferrable Value

When Jim begins to make these changes to his behavior and the manner in which the business is run, he starts to build on the equity in his business because he is treating the business more like an investment and less as a job and he is creating more transferable value. Jim's role converts to that of an overseer of the activities within his organization, not the creator of those activities. As a result, over time Jim's presence will no longer be critical to the proper running of the business and a future owner will more clearly see that the company can run without Jim.

At this point in time, the focus on the business - as an entity separate and distinct from Jim's personal desire for more income - and the running of the business with a process in place- Jim is increasing the transferable value of his business. Jim's transferable value is increased because all business valuation is a prophecy of future cash flows. Now Jim can more confidently state that his future cash flows are more secure because his management team has decision-making authority and Jim has protected the ongoing streams of income and cash flow against his own short-comings and/or mortality. As a consequence, the transferable value of the business increases because a buyer or successor has a higher certainty as to the ability to achieve future cash flows in Jim's absence.

Concluding Thoughts

Owners who fail to make these important decisions leave the value of their business in a very uncertain state. Unfortunately, far too many business owners today are in this position. We hope that this newsletter has achieved its objective of getting you to think about whether you are creating income or equity in your business and whether or not you are on a path to increasing the transferable value within your company.

This information is for educational purposes only and does not represent individualized advice. Readers are encouraged to consult with their own professional advisers, including investment advisers and tax/legal advisors. Evergreen Wealth Solutions, LLC does not provide legal or tax advice.

EVERGREEN™ EXITS
A DIVISION OF EVERGREEN WEALTH SOLUTIONS

www.egexits.com Ed@EGWealth.com
1000 Commerce Park Drive, Suite 416
Williamsport, PA 17701
Phone: 570.601.6960 | Fax: 570.651.9032