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Passing the Baton

It's not just your clients that need help with exit strategies for their businesses

By Marie Swift | 8/1/2008

Most small-business owners don't have an exit strategy — and that's just as true for financial advisory firms as it is for their business-owner clients. Yet it is essential to have a practice continuation plan in place in case of sudden death or severe disability, particularly for sole practitioners and small firms where one professional is the sole service provider.



Don Patrick, CFP, managing director of Integrated Financial Group in Atlanta, remembers when one of the advisors in his branch told him she had only six weeks to live. While she had done some succession planning, it was not nearly enough. Patrick had emphasized the importance of developing a continuity plan, but his colleague hadn't really committed to the process until her cancer diagnosis. As soon as she shared it with Patrick, they drafted letters and met with clients to inform them that the practice would be changing hands. Using the firm FP Transitions, they listed the practice for sale and within days received great offers from four businesses that were good cultural fits. A few weeks later, the business was sold.

"We got it done, but it was not ideal," says Patrick. "We might have gotten a higher price had the sale not occurred under duress." Patrick is counseling all of the advisors within his consortium to start planning for the eventual transition or sale of their practice — and to get the plan in place without delay.

"Continuity plans aren't focused on the joys of retirement and reaping the rewards of a work-life well spent, but rather on death or disability, events that every advisor hopes won't happen," says Chris Kirby, a practice management consultant with Securities America, one of the nation's largest independent broker/dealers. Without a proper plan in place, an untimely death or disability can leave clients and customers in the lurch.

Devery "Rusty" Cagle, CRPC, CAP, CFP, president of Greenville, S.C.-based ASE Wealth Advisors, regularly discusses business exit planning strategies with his clients. "I am always astounded that we are the ones who have to ask clients about business exit planning rather than the other way around," says Cagle. "And when we do bring it up, the response is often the same: nothing has been done to plan for an eventual exit. They may have a vague idea of what they think will work, but haven't done their homework to put a plan in motion."

Scott Thomas, president of The Financial Farmer, a Maitland, Fla.-based wealth advisory firm and author of *Financial Secrets for the Man of Means*, recommends that advisors find out what is most important to their business owner clients and use it as a scare tactic to get them thinking seriously about continuity planning. "Continuity planning is akin to estate planning; most people don't want to talk about it because your own death isn't a popular topic of conversation," says Thomas.

Patrick adds this zinger, "If you have a business worth \$1 million and don't plan for succession, it's like dropping \$1 million out of an airplane and watching it float away."

Know the Value

Business exit planning is about preserving your legacy. Many advisors have sad stories about a client who passed away without a concrete and executable plan. There are several important steps in the process, including business valuation. “Knowing the value of your business is vitally important in protecting, growing and ultimately realizing its worth,” says Kirby. “In continuity planning, the valuation becomes a reference point for owners, key employees and family members in understanding the underlying equity. Knowing what it is and how it’s calculated is helpful in taking appropriate steps to protect and transfer that equity, especially for a professional services business.”

For estimating the value of most businesses, Patrick’s rule of thumb is two times the recurring and predictable revenue stream. Thomas adds that there are many variables to consider beyond industry standards and formulas. “It’s important to focus on the amount of money you can feasibly leave to your heirs — not some trophy amount. And if family members are, in effect, the continuity plan, the advisor is wise to urge caution. Family members should be evaluated as closely as any other buyer,” Thomas warns.

Continuity plans can be more critical than succession plans, says Brett S. Ellen, CFP, president and CEO of Calabasas, Calif.-based American Financial Network (AFN), but it’s important to start thinking about the day that you’ll leave the business to pursue other interests. AFN’s customized approach to financial planning, wealth management and corporate benefit planning services has helped Ellen earn Circle of Stars status each year since joining Securities America in 2004. In 2007, he earned dual honors as the top representative in production and as the top advisor in assets under management.

“With a succession plan, an advisor has the opportunity to implement strategies that increase the value of the practice during the years prior to retirement,” Ellen says. “A continuity plan, however, must be executed at a time of crisis, when the value of the practice immediately begins to erode with each client who hears the news and has no idea how his account will be handled.”

Ellen uses a four-step funnel process to help privately held business-owner clients make better decisions. First, he looks at the business entity. According to Ellen, a C- corp. is generally less desirable than an S- corp. or an LLC, unless you plan to take the company public. Second, he determines whether the owner would be better off with a stock sale or an asset sale. “Generally, stock is best, and that relates directly to the decision about the most appropriate entity,” says Ellen. Third, taxes might be reduced through creative planning strategies such as gifting or sale of stock to children. “That can be a smart way to transfer wealth while also creating stock discounts up to 45 percent. The kids get the growth inside their estate and employees can buy in at the same price.” Fourth in the funnel: compensation and costs. “The goal is to reduce costs, increase profitability and improve the overall value of the business,” says Ellen. “One way to do that is to create incentives that push staff members to think and act like an owner. Pay-for-performance, profit-sharing and other qualified plans can be useful here.”

Another key question he asks: “Where are your greatest strengths? Push toward your profit margins to get a better multiple, to get a better price,” he says. But the most important aspect of all, according to Ellen, is coordination of the professionals. “The biggest mistake is having professionals who are not aligned.”

How far ahead should business owners start planning? “As soon as they have the first thought about exiting the business. Until a letter of intent is signed, there are plenty of steps that can be taken. One of Ellen’s favorite tax strategies is charitable lead trusts, but that’s another topic. ---