Elizabeth Mower:

Owners don't have to exit. They don't have to want to exit. They do have to plan in order to have whatever it is that they're trying to do, be successful, but they don't have to leave.

Elizabeth Mower:

Hello. This is Elizabeth Mower, President of BEI.

John Brown:

And I'm John Brown, the founder of BEI.

Elizabeth Mower:

Each episode we take you into the world of exit planning, sharing the stories, struggles and opportunities of business owners and their advisors. We'll get into this episode's conversation, right after this.

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Elizabeth Mower:

Welcome back for another episode. We're back today to talk more about planning for business clients and the kinds of things that we are seeing. And John, you wanted to start us off today and kind of on a topic that you've been maybe thinking about a little bit more lately and maybe you've seen some examples of. Tell me what you wanted to talk about today.

John Brown:

So today I'd like to talk about the unintended consequences of exit planning for business owners. I thought that would be kind of a cool title.

Elizabeth Mower:

Right. It's not an oxymoron, but the planning is supposed to create intended consequences and well maybe we'll back up for a second and talk about what those are. The intended consequences of planning are having your business, go to the next owner that you choose on the timeline that you set for yourself if you're a business owner. Having your business have the value that you want or need from it.

Elizabeth Mower:

Those are intended consequences of planning for your business. And that's really what most people spend all of their time on is, "Okay, what consequences are you intending to get?" So that's what we would have called goals. And what do we have to do to get there, which is the part where we do the planning. Okay, so that would be the normal course of things. And what other kinds of things then can happen? How do we get unintended consequences?

John Brown:

Well, I think that unintended consequences is a result of doing all of that. So most owners as we know or that we know now need to do some planning and take action on that plan to grow their business. And we talk a lot at BEI about creating transferable value, which means you create cash flow, you create business value that exists apart from the owner. So that when the owner wants to leave, the value can be transferred intact to the new owner, whether it's a third-party, the kids, an ESOP, whatever. We call that transferrable value.

John Brown:

Well, what happens occasionally is that as the owner does that, does the planning and has to do things like develop a capable management team that can run the business without the owner. Put in state-of-the-art operating systems so that the operations and management of the company can continue without the owner being present. Diversifying maybe the customer base more widely. So instead of a few perhaps customers relying on a relationship with the owner. Now, there are far more customers not reliant on the owner.

John Brown:

So what's happening as we develop transferrable value is that the owner's role becomes less important. The business is no longer dependent on the owner's performance. Well, the unintended consequence of all of that is that the owner starts to like being in the business every day or when they want to be in the business a lot more than when they have to be there to work 60 hours a week to get all of the stuff done.

John Brown:

And so we're finding that owners are happier in the business and the business runs well without them. They're making more money. I think in general we can say that the last decade the owners have been making generally speaking more money. And so the urgency to leave the business isn't there. The evidence I would point out for that is, boy, probably starting 10 or 15 years ago we started reading, hearing about this big land rush, this tidal wave, this tsunami of owners wanting to exit their businesses. It hasn't-

Elizabeth Mower:

Many trillions of dollars of business wealth are going to change hands in the next few years. And it will be very dramatic and owners should be ready to do that successfully and advisors should be able to help them through it. That was the messaging 10 years ago.

John Brown:

Yeah. And so I think two things have happened. One, there's the larger group of business owners who haven't developed value sufficiently to allow them to access it, so they're not exiting. But we have this other group where we have the unintended consequence of, "Yes, I did develop value, which means I don't have to do nearly as much in my business and I can still make a lot of money and do the things I want to do outside the business."

Elizabeth Mower:

Right. And this kind of also then plays into. It's sort of the corollary on this unintended consequences is that we also see that if they like what they're doing and they're not burnt out and they're not sort of being crushed by the day-to-day minutia or what some of my clients called babysitting their responsibilities within the company and can do the parts that they really enjoy. That's good. They might stay longer.

Elizabeth Mower:

And then we can also see that business owners are comparing the amount of money that they can earn from owning a business to the amount of money that they can earn in investments from that same values of my business is worth $10 million. "Then what income stream am I deriving off of it today? And I'm happy so I'm not trying to run away anymore." And then comparing that to, "Okay, if I took those chips off the table, pay taxes on that and then invested the remaining amount. What would the return that I could get be?" Doesn't look that good."

Elizabeth Mower:

And we've talked about this. It's one of the things that sort of flows through some of the content that BEI produces is that business owners have to make that assessment all the time. And so it's not quite the unintended consequences that now they have more options really is what you're saying. The more they can stay-

John Brown:

Or that they can sell.

Elizabeth Mower:

Or they can sell so they have more and better options available to them and more business owners than maybe we expected, maybe more baby boomers than we thought are sticking around. And they're also evaluating, "What are my other choices for things I could be doing or ways I could be making money or continuing to benefit my family?" And they're saying, "This business is actually not a bad-"

John Brown:

And they like doing it. Their friends or their customers or other friends, the employees or people that look up to them and vice versa. So I think there's a lot of non-financial benefits of continuing to own your business. Which then may raise a question in the minds of the people listening are, here are two people who have an exit planning business, helping business owners exit their businesses. And now we're suggesting that maybe that's not what you want to do, but that's okay. For us what we're trying to do is create businesses that are successful that can run well without the owner's presence. And then it's up to the owner to decide what she wants to do.

Elizabeth Mower:

Right. An exit is whatever an owner makes of it. And that's just goes back to fundamental planning in the way that what I usually call BEI style planning, which is that, owners don't have to exit. They don't have to want to exit. They do have to plan in order to have whatever it is that they're trying to do, be successful, but they don't have to leave. And I would say there are a lot of professional advisors who maybe get a little wound up about the idea of helping business owners exit their businesses and maybe have blinders on don't always see the options that are available to their clients to stay in or do less, or maybe shift the way that the business operates or participate in.

Elizabeth Mower:

I've seen lots of businesses where they essentially break up the business activities into these different kinds of things. And a business owner may stay with a smaller portion.

John Brown:

Right. Well, I can still be active in maybe a subdivision or a particular segment of the business. I think that's very typical. The one thing I would add to all of this though is that if you're an owner listening in and you're thinking, "Well, that sounds pretty appealing to me." By all means move farther along the road. But one thing we should pay particular attention to in that scenario is business succession planning, business continuity planning. What happens business owner to the business and to your family if something happens to you if you become disabled or you die during this length and ownership period?

John Brown:

We really need to deal with that scenario so that the goals you've set for your business and your family will be achieved, whether you survive or whether you don't.

Elizabeth Mower:

Right. I tell people all the time one of my grandfathers lived to be I think 102 and had he been an owner of a very successful business, he wasn't, he was a regular guy. But had he had a very successful business when he was 65 or 70-years-old, instead of decided not to leave, "Things are going really well. I think I'm going to keep this business." Keeping it until age 102 would have required some pretty extensive planning in order to have it go well and have it end well. So even business owners who do some planning, changed their mind, decide to stay, delay their departure or something like that, that brings up additional planning. I agree with you that needs to happen so that this longer connection to the business can be satisfied.

Elizabeth Mower:

This actually brings up sort of one of the unintended consequences that I was thinking about when you mentioned this topic and that is that in family business we now see that if parents, founders, moms and dads are sticking around with the business longer, they've raised their children in the business, one or more children are active and are working in the business, those children have to deal with the fact that mom and dad or whichever one of them involved is maybe not leaving.

Elizabeth Mower:

We've got lots of business owners who've got children who are in their 40s and even their 50s, sometimes their 60s, the children have not fully been able to take over ownership of the business because the parents are staying longer. It does create a little bit of an unanticipated or an unintended consequence in family dynamics where in previous generations, so 50 years ago that just wasn't quite so much of a thing. The children grew up in the business, took over the business. They took over during their sort of what would have been their prime working years maybe age 25 to 55 or something in there.

Elizabeth Mower:

They really take over leadership of the business. But when the parents end up staying involved longer, the children don't get to take over as quickly. And somebody who's looking at the overall, I don't know, the biosphere that has all of these moving parts in it is going to need to think about that because what are these other generations of the family need if the first one is holding on tight or holding on a long time? That's maybe okay. And it's certainly as we've said it's their right to do, but subsequent generations have to change their planning as well, right?

John Brown:

Right. It could and so again we can talk about these unintended consequences forever because there can be a lot of them. So in Elizabeth's scenario, what I've found is that a lot of owners want to hang in the business especially in a family-run business, they don't necessarily need to control everything. Sometimes they just want a place to go to. They want to maintain some of the customer relationships. They want an office in the office building that they're in. And so they just want to still be part of the business, although they're not averse to transferring ownership and maybe control to the kids. I think that can happen a lot.

John Brown:

And then maybe the final thing I'd say in all of this is that if you're thinking of staying a long time in the business, you need to explain that to your key people. You need to have-

Elizabeth Mower:

So they don't wander.

John Brown:

Yeah, they'll wander and they're going to say, "Look, he's 74-years-old and he's still hanging in. What's going to happen to this business without him and what's our future in the business?" You need to have a plan. You need to have a way to motivate and keep these key employees long-term where they see the benefit of staying long-term with the company. And they see that ultimately there is a succession plan in place so the business doesn't fall apart.

John Brown:

So staying in the business indefinitely, you don't need an exit plan necessarily to exit on a certain date. But you do need to do all of the planning to build transferrable value, to keep the key employees motivated, to keep the successor owners, maybe the children happy, or at least satisfied with what ultimately is going to happen with the transfer of ownership.

Elizabeth Mower:

Mm-hmm (affirmative) and there's all different kinds of these kind of I would say for the most part nice, unintended consequences or benefits of doing proper planning. Very small examples I can think of before we close would be things like I think I'm going to put my business on the market and sell it. So I start getting the business ready. I start cleaning up and making sure that my financials look good, that my operations are up-to-date, that my engagement in my marketplace is as effective as possible. And when I've done all of those things, it affects my profitability in a way that I didn't fully anticipate that it would. It affects my business's ability to be successful because I'm no longer making decisions on, "Geez, I'd like to be able to take the last year of the month off. So let me change all of our projects around for that." Now I'm actually running my business in order to build what you call transferrable value. And it gives me some other options and it gives me maybe some opportunities to sell the business in a way that I didn't have before.

Elizabeth Mower:

And it might give me the planning that I do for business continuity as you mentioned, "So what if I die or become disabled? What will happen to the business? Who will do what?" Okay, well, if I do that planning today and communicate those plans with other people, I have now created a more stable business where people have more information and there's lower risk. So if I reduce the amount of risk in my business, then my unintended consequence might be that I'm able to spend more time away from the business.

Elizabeth Mower:

That's not really what I was trying to do. I was really trying to protect the company in case I have a stroke, but now I haven't had a stroke, but I can actually go off and do some other things. So unintended consequences comes throughout the planning process where we're really trying to achieve one thing and we may end up with all these other kinds of potential benefits, right?

John Brown:

Right.

Elizabeth Mower:

All right. Well, I think that all it really does, all we've done today John is say, "Planning is good and lots of good things come from it." But that is what we think, so I think it was accurate.

John Brown:

Well, that's also why we plan.

Elizabeth Mower:

That is why we plan. So join us again for another episode. We will be back to talk more about why we plan and how planning will impact businesses, their owners, their families, their communities, their industries, and all other matters. So thanks for being here today. Thanks, John.

John Brown:

Thank you, Elizabeth.

Elizabeth Mower:

We'll see you next time.

Elizabeth Mower:

Thanks for listening. Join us for our next episode. For more content like this, please visit exitplanning.com.