STRATEGIC ADVISORS

The Exit Strategies Newsletter

WHY AN EXIT PLAN WILL HELP YOUR BUSINESS GROWTH: AVOIDING THE BUSINESS CAPITAL MOUSETRAP SYNDROME

The illiquid nature of private businesses often forces owners to wonder where their investment dollars truly are. Since a company is valued by the cash flows that it produces, the people and products that you have sell, deliver and generate those revenues. To make a simple point, growth requires an investment in people and products before they generate revenue. And, sometimes the additional revenue and profits do not come back. Moreover, even if the revenue and profits do arrive, owners generally take out the cash from the ongoing cash flows. However, if an exit plan was in place, owners would have more confidence in investing in their businesses. And, as the retirement income needs grow amongst baby boomer owners, there are competing needs on owner's cash and, hence a reduced desire to reinvest in your business.

Let's begin with a few general concepts about businesses and about what an exit plan does to assist with growth plans.

Businesses are Either Growing or Shrinking

Similar to other living organisms, a business is in a constant state of growth and decay. If not tended to, the business will decay. If properly watched over, the business will survive. Tending to a business requires capital and management. And, as mentioned, this is where the baby boomer owner will get stuck. There will be a lack of desire to fund the business because there is a competing need to fund one's retirement.

The Problem with Illiquidity – the Business Capital Mousetrap Syndrome™

So, the owner who does not want to fund their privately-held business will be reluctant to do so because there is no vision of how the money that is invested will turn into cash in the future. This problem is one of illiquidity. In other words, a capital infusion into a business will generally go in a number of directions within that business and may or may not contribute to the overall, increased value of the business. Moreover, most owners have no sense of whether or not value in their business is being improved other than whether or not cash flow is increased. Well, cash flow is an important indicator of value but not the only one.

The Benefits of Having an Exit Plan

If you have a well constructed exit plan, you will not only know the areas where you can invest to increase the value and/or sustainability of your business, but you will also have a view as to who will potentially own your business in the future and how that value will be realized. This type of exit planning empowers you to have more direction and confidence with the infusion of capital into your business because you have a more clear idea of how that 'investment' is going to return to you.

Your business can get caught in the Business Capital Mousetrap Syndrome™ whenever you are in a position of needing to make an investment of capital into your private business with no idea as to how you are going to get that money out. A mousetrap lures the mouse and then closes the door behind it, trapping the animal until someone comes along to open the door (and/or kills the mouse).

When you put money into your business are you wondering whether it is trapped in this illiquid form forever?
Will your business capital die like a mouse with all of your money trapped in the 'box'?

Without an exit plan, it is possible that this is the case for your business and your only current plan to extract that equity is through the ongoing cash flows of your business. Avoid the Business Capital Mousetrap Syndrome™ by structuring an exit plan so that you are confident in investing in your most valuable financial asset.

A Professional Investor's View

There are a world of professional investors who buy and sell privately-held businesses every day. The view that they hold is that they will first ask the question, 'how will we get our money out?' before they make an investment in a company. The reason for this type of thinking is that these professionals are aware that money invested in a privately-held business is very difficult to get back out. So, before they put their money in, they develop an exit plan.

Why an Exit Plan is Necessary for Your Growth

If you are a baby boomer owner who is not sure about funding the growth of your business, how much would an exit plan help with that decision? Let's look at an example.

Bill Brown, age 58, would like to grow his business and then sell it to the managers or to an outsider in five (5) years when he retires. He forecasts a need of an additional $500,000 in order to add a few million dollars in value over that time period. His bank is willing to lend the money to him assuming that he personally guarantees that debt.

Bill is also thinking that he could continue to take a larger salary and bonus from the business for each of the next five (5) years without burdening the cash flows with the growth plan. This would put Bill in a better personal financial situation for his retirement. And, after all, Bill is not assured that the growth will happen but can count on cash being paid out to him today.

If Bill knew the value of his business today and had an exit plan as to who would pay him for that value as well as when the transaction could likely occur, his decision to invest in his growth would be better informed. Bill would have confidence in his 'downside' and would be targeting and driving the company's growth to accommodate certain buyer's needs and desires, giving better direction to the overall growth plan.

Bill's exit plan assists him in the decision to grow as well as in how to further build the company.

Concluding Thoughts

Businesses need capital and people to make them work. Owners who are reluctant to continue building their businesses face a daunting situation of simply milking the businesses cash flows and watching a slowly dying business fade with their retirement goals. An exit plan is a way to provide confidence in your growth decision as well as a way to increase the value of your company.

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