How Should a Business Owner Prepare for Retirement?

by Bryson J. Roof

Business owners have a multitude of potential retirement scenarios ranging from Private Equity deals to Employee Stock Ownership Plans (ESOPs), or even selling their business to an interested party such as a key employee, relative or competitor – just to name a few. Each option is an avenue to extract wealth from your business, but how do you effectively leverage a liquidity event to establish a strong foundation for a successful retirement?

What's the Rush?

You didn't build your business flying by the seat of your pants, careful planning and calculated risks forged your brand reputation to its current status. Why wouldn't you approach business succession planning in the same successful manner as running your business?

Whether it's employee turnover or raw material supply contracts not being honored, the daily hiccups of running a business take precedence over business succession planning, after all, retirement isn't on the radar for the next couple of years. Unfortunately, the multi-year implementation phase of a business succession plan is often under estimated, leaving many business owners in a pinch. Either you sell at a lower valuation or delay retirement to better prepare the company for the future transition of ownership. Neither option is ideal.

Start Early – Develop a Plan

Engaging a financial planning professional at the onset of business succession planning provides valuable insight into your financial picture. Most notably, the process quantifies the required portfolio needed to maintain your desired income in retirement.

All too often, business owners seek a financial professional's opinion after buyout terms are finalized, at which point a dramatic paradigm shift occurs. Instead of discussing the most advantageous approach to leveraging the owner's largest asset, the business owner is suddenly facing an irreversible final outcome without an action plan. Upon payment, owners assume the portfolio is of an adequate size to achieve the envisioned retirement lifestyle; however, without prior quantification, this is merely a guess. At this stage, attempting to replace your income with comparable employment is very rare. You owe it to yourself to take full advantage of the opportunity and have a forward looking plan.

Optimize Valuations

Quantifying minimum funding levels provides a baseline assumption and becomes extremely useful during the negotiation phase of a sale. A skill merger and acquisition advisor can devise a strategy to grow a company to meet the required business valuation. For example, the success of companies with $1 Million in revenue are often closely tied to the business owner, a merger and acquisition specialist can develop and setup a management team to avoid the business relying heavily on the owner and ultimately increasing the sale value.

Whether it is your CPA maximizing tax savings on the sale or your mergers and acquisition advisor developing a strategy to grow EBIDA – Earnings before Interest Depreciation and Amortization – your advisory team is vital to optimizing the valuation of your business. Specialize legal counsel are privy to wealth extraction strategies and may increase payouts through dividends or via debt financing. During your transition, charge your specialist advisors to coordinate with each other to maximize the net proceeds of your business sale and effectively recreate a paycheck in retirement.

Generating Income in Retirement

Just because the check clears doesn't mean the work is over. You are no longer on the payroll; as such, you need to create an income stream from your payout.

The challenge is determining the appropriate balance of growth to income, equities to fixed income and the selection of the appropriate underlying investments. An added benefit of your financial plan is the ability to create a suitable Investment Policy – a clearly defined investment strategy based on your income needs and your risk tolerance. An Investment Policy sets minimum and maximum stock and bond ranges to help reduce the emotions of investing and becoming too aggressive or too conservative based on over-reactions to market conditions.

Fixed income is commonly associated with safety and income production; however, with current interest rates at historic lows, retirees seeking income generation are faced with many challenges. To one extreme, cash and cash equivalent investments are not keeping pace with inflation, while the other extreme such as high-yield bonds and long-term fixed income are riddled with interest sensitivity risk –as interest rates increase interest sensitive investments decreases in value. After all your hard work, now is not the time to cut corners. Work closely with an investment advisor to establish the appropriate risk profile to preserve your wealth and allow your money to work for you.

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