

## Gearing Family Businesses Towards Retirement

*by Bryson J. Roof*

Family operated businesses face the usual business challenges ranging from increasing revenue and new sales to rising expenses and taxation; however, many small business owners also struggle with diversification. For many business owners, the vast majority of their wealth is concentrated in a single asset: their business. This asset is neither diversified nor liquid, potentially placing their retirement at high risk.

### **Reducing Risk**

Business owners often utilize insurance policies to create capital for contingencies such as death, disability or liability lawsuits, and to avoid business liquidation in an untimely fashion. The inherent risk of concentrating their wealth into a single asset is often overlooked.

One way to diversify outside of the business is to invest a significant portion of income into other assets such as stocks or bonds via a 401(k) or other qualified retirement plans. Not only do contributions reduce your taxable income, the funds have the potential to participate in market returns. Spreading wealth over various assets should help to lower the risk associated with having a large portion of the owner's wealth invested in their business.

Business owners and operators should consider using a professional financial adviser to develop an overall Investment Policy, incorporating the

business as an asset in the portfolio. Other key factors to defining the Investment Policy are the business owner's age and time horizon to retirement, their risk level and income requirements.

### **Planning an Exit Strategy**

Business owners can receive significant value by clearly defining retirement income needs prior to negotiating the sale of a business. All too often, business owners engage a financial professional for detailed planning after finalizing buyout terms. Earlier involvement in creating a financial plan provides a framework for negotiations. After all, how can you negotiate a beneficial deal if you don't know the portfolio value required to fund your retirement?

For example, specifying the income desired in retirement, determining the actual financial need and projecting the longevity of the portfolio are the basis for quantifying goals and evaluating alternatives. Using a structured process will help in weighing alternatives and consequences of the goals that matter most.

### **Extracting Value**

Capital can be extracted with or without a sale. The options vary based on the goals and desires of the business owner. If the intent is to keep the business running, a sale to a family member, an employee or merger with an existing firm may be appropriate. An advisory team can explore various options and make a recommendation based on the business owner's specific situation. Planning will help owners decide which solution is most appropriate for their circumstances.

Many business owners focus on sales or buyouts as the only way to withdraw value from a business. Without a sale, it may be possible for capital to be transferred by dividend distribution. The appropriate advisory team will be able to provide insight as to whether this is a viable option given the specific scenario. It will be important to include dividend distributions into the financial plan for accurate financial projections.

In addition, the financial and non-financial goals can be achieved through refinancing and extracting equity from the business, similar to pulling equity from a residence. Knowledge of capital requirements will be useful in deciding alternatives in negotiating the transaction. Most likely, this alternative will provide less capital than a sale or buyout and will require continued personal management; however, it provides the opportunity to retain control of the operation and opportunity for succession planning.

### **Wealth Preservation**

It is not uncommon for business owners to splurge upon the sale of a business, buying a vacation home or a new yacht. Selling the business for a lump sum is certainly a celebratory event; however, now is not the time to dismiss the financial plan. Invest the dollars earmarked for retirement – chances are you don't want to start another business because you have exhausted all your assets.

The combined processes of personal financial planning and developing a comprehensive exit strategy provide direction for investment decisions. This process is especially

beneficial for business owners whose wealth is concentrated in their business and are contemplating securing their financial needs for retirement. Developing an investment strategy for asset allocation and disciplined management will significantly reduce risks and improve the chances of retirement goals.

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