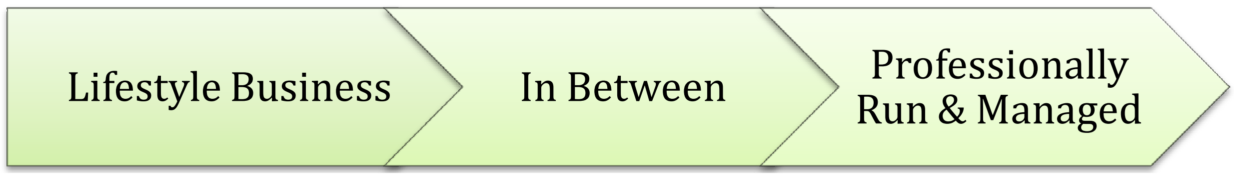
Are You Running a Lifestyle Business or Increasing Exit Options & Value?

In a previous article, we discussed the window of opportunity for exiting privately held businesses (see previous article here). We explained that current market conditions are favorable to business owners looking to sell and that market and industry timing can be critical to successfully exiting businesses and achieving a high value. However, how a business is run is just as important to exit options and value proposition.

Professionally run and managed businesses are in the best position to take advantage of market conditions and generate maximum value for the owners. However, few private companies are professionally run and managed. Many function as lifestyle businesses, providing current income for the owners but few exit options down the road, and *most* private businesses operate somewhere along a continuum between a lifestyle company and a professionally managed one.



A lifestyle business is typically one in which the owner is heavily involved. Often, the owner ***is*** the business. Extreme examples include residential contractors, one or two location retail stores, or small consulting firms. Lifestyle businesses have one or more of the following characteristics:

- Limited or no management other than the owner with most decision-making residing with the owner
- Commodity products or services
- Limited barriers to entry within the industry
- Limited customer barriers to exit
- Volatile revenue and earnings
- Concentration of customers (dependence on a few customers) and key relationships all maintained by the owner
- No functional advisory board
- Financial reporting is poor or is not used as a functional tool for understanding and proactively managing the business
- No formal budgeting or forecasting

Options for the owners to exit lifestyle business are usually limited to:

1) Winding down the company (i.e., going out of business),
2) Grooming a successor to gradually take over the business
3) Selling to another individual who might need significant training, financing support, and time to pay

In a professionally run and managed company, the owner(s), along with an outside group of trusted advisors, set the strategy, but a strong management team runs the day to day business. Examples include manufacturers of proprietary or branded product lines, niche distribution companies that also provide important services for their customers, or diversified multi-location services firms. Such companies usually exhibit most, if not all, of the following characteristics:

- Depth in management and strong management teams (beyond the owners)
- More proprietary products or services
- Significant barriers to entry within the industry
- Significant customer barriers to exit

- Recurring revenue streams
- Outside advisory board that meets routinely to discuss strategic direction
- Limited or no customer concentrations
- Excellent financials, forecasting, and performance metrics
- Growing, predictable, and sustainable revenue and earnings

Well-run companies have more exit options, including:

1) Sale to a strategic buyer
2) Leveraged recapitalization with a private equity group, or
3) Initial public offering (IPO) if sales are large enough and products/services have public appeal

Most privately held businesses possess characteristics of both operating styles. For example, a company might prepare basic financial statements and forecasts but then fail to compare their results to key industry performance metrics. The company might have a small management team to support the owner, but the owner is still heavily involved in day-to-day operations and all key decisions. The company might have a few unique products or services, but it is fairly easy for competitors to enter the market, or it is easy for customers to find alternatives. Examples include a commodity distribution business, a manufacturer of only custom made to order products, a mid-size consulting firm, or a staffing company. For these businesses, the sale to a strategic buyer or private equity group is possible at lower values, and sales to another individual are an option, but buyer capital constraints become more of an issue.

The implications for retirement planning can be extreme. With fewer exit options available, owners of lifestyle businesses cannot count on a large windfall from selling the company and must therefore rely more heavily on savings to fund their retirement. Additionally, providing seller financing or spending time grooming a successor can jeopardize or delay retirement plans. Owners of professionally run and managed businesses, by comparison, have more exit options and higher potential exit value, which can add significantly to retirement assets and provide more flexibility in retirement years.

The best way for business owners to take advantage of windows of opportunity is to plan ahead for an exit strategy and prepare the business for a possible sale years in advance. This might include growth by acquisition, which is usually only successfully accomplished by companies that have sufficient management depth and cash flow.

To establish a company that will be attractive to many buyers, owners should determine what type of business they are trying to build, create a strategic plan (see article Exit Strategy Planning for Private Business Owners), and then focus on value drivers to improve not only value but also probability of a successful exit. In our next article, we will discuss internal value drivers and why they are important.

Windward Advisors, LLC is a sell-side, buy-side, capital raise, and corporate growth advisory firm. Windward specializes in helping business owners better prepare their businesses, with the intention of increasing shareholder value by providing strategic planning and corporate growth advisory services, and by representing owners in the execution of sales, acquisitions, and financial structuring transactions. Windward is an advocate of ensuring that business owners are knowledgeable about their alternatives and we work closely with other trusted advisors to assist owners with properly preparing before pursuing transactions. If you are interested in learning more, please contact us for a no cost and no obligation consultation.

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