

# 10 mistakes business owners make when thinking about whether to exit

## Prepared by:

Mitch Gorochow, Center for Business Transition, RSM US LLP  
mitch.gorochow@rsmus.com, +1571 341 4061

April 2019

Exiting your business, whether through sale or succession, can be fraught with stress. However, some of that anxiety can be alleviated by addressing 10 missteps business owners often make.

## 1. Being too emotionally attached to the business

It is understandable that business owners have an emotional attachment to their businesses. After all, they have typically birthed the ventures, nurtured them along, sacrificed to make them work, and poured their heart and soul into trying to make them successful. Often, owners view the business as a reflection of their own personal worth, not just financially but also as the culmination of their life's work. It is a source of pride and accomplishment and not just a means for financial security. I have heard one business owner speak about the business like it is a member of the family. When thought of in those terms, it is no wonder that many business owners do not have an objective view of their business, especially its value to a potential buyer.

However, it goes beyond that. A business owner contemplating an exit asks questions. Who will take care of this business like I do? Who will understand how to run this business like I do? What will happen to my legacy that I dedicated myself to building? With this mindset, how could the owner's judgment not be clouded?

Business owners need to prepare for separation, just like a parent might get ready to send a child off into the world to be independent. This distancing may provide a fresh perspective with increased objectivity about what are the right circumstances for an exit. One action that can help is finding other passions. I had a successful business owner find his fulfillment by investing his energy into the refugee crisis. He no longer laments about what will happen to his business, and was more than ready to exit when the right offer came

along. Another way to start to break emotional ties is to be purposeful about empowering others in the company to take on greater responsibility. A business owner said to me "I wish I would have done this sooner. The guy I put in charge is doing things I never would have thought of."

By gaining some distance, business owners can not only gain objectivity about their business, but also better prepare themselves for the emotional separation when the right time comes along to exit from the business.

## 2. Not understanding how buyers will evaluate their business

I have heard an owner allude to how valuable his company is based upon new impressive headquarters that were recently completed along with a new warehouse space to accommodate more inventory. While these actions may cause pride and eventually lead to enhanced increase in value, they are not by themselves likely to elevate what buyers are willing to pay to acquire the enterprise.

Notwithstanding some possible strategic purpose in purchasing a business, buyers are focused on predictability of the future cash flow the business will generate. If a buyer feels comfortable that cash flow in the future has few risks of being interrupted, and that cash flow will continue to grow, then just like any investment, one can expect to pay a higher price. The greater the return and the lower the risk then the higher the price. Additionally, efficient enterprises drive higher pricing. The less one must invest to generate cash, the more desirable that business is in the eyes of a buyer. Stay away from shiny objects that tie up capital and cannot be supported by a specific, attractive return on investment.

### **3. Underestimating the importance of a committed management and leadership team**

Many business owners underestimate the important role that key talent plays in their organization. Not only is that the X-factor that separates the high performing companies from average performers, but in today's competitive economy, companies cannot have too much talent. Potential buyers generally evaluate how well a target's management team is functioning. Are they collaborative, empowered, results oriented? It is highly likely that an acquirer would be concerned about how the enterprise functions after the owners are gone. Can they rely on the team below the owners to not miss a beat? I had a client who, anticipating the sale of his business, started to terminate his team. His thinking was that by not having his people still employed any buyers would have the flexibility to bring in their team and thus make his company more attractive to an acquirer. He learned that was a big mistake.

### **4. Not preparing for life post-sale**

We reviewed earlier that most successful entrepreneurs have invested heavily of their time at the exclusion of other fulfillment and interests in order to create a successful company. But when it comes time to move on to the next phase of their life, often they are not prepared to fill that void. I can't tell you the number of times I have heard former business owners say "I thought I would love the freedom to do whatever I wanted. I thought I wanted to play golf five times a week, enjoy the family and go on vacations whenever I wanted, but I am bored and not challenged." Just having financial independence and flexibility does not lead to fulfillment. Most people eventually recognize that they need a reason to get out of bed in the morning, beyond hitting the links.

Successful executives are accustomed to planning for their business's future. That same approach needs to be taken for their personal future after the business exit. There are so many ways that can lead to gaining purpose. One just has to spend the time to find a passion. From involvement in charities to teaching, consulting, mentoring or even starting a new career or business. People are still vibrant in their 70s and 80s, but to many the paradigm about retirement has not yet caught up with today's reality. Developing interests that one is passionate about and finding purpose in one's existence is critical before an owner leaves the business so he or she can not only gain perspective about the enterprise, but also to get a head start on a successful next phase of life.

### **5. Not properly and thoroughly evaluating all exit options**

When I was first starting out in my consulting with business owners who are thinking about transitioning from their business, I made the mistake of not realizing how little some owners know about the various exit options. In one case, the owner decided to sell 100 percent of the business to a third party. After exploring his motivations further, we realized that his goal was to diversify his wealth, as practically all of it

was tied up in the business. He still had a passion for his work and his preference was to continue in the business. He knew nothing about recapitalization or even whether the right private equity group might be willing to buy a minority stake in the company. He was proceeding without doing the requisite research and preparation. This exploration totally changed his direction. Doing research and having resources that can shed light on all possibilities are an important early step toward an eventual successful exit. There is also much to understand about who potential buyers/investors/successors might be and how to go about finding the right representation to bring you to market, or whether internal options such as an employee stock ownership plan (ESOP) or a management buyout are viable alternatives. Understand and evaluate all options before setting a course.

### **6. Not facing family issues head-on**

When family is involved in any aspect of a business, it adds a layer of complexity and potentially emotionally charged dynamics. Going about exiting from one's business in itself can be emotionally taxing. Adding to that how such an event may affect family members can make the journey overwhelming. I have seen family-run businesses where the CEO and de facto head of the family is so concerned about upsetting the family construct that it caused them to do absolutely no planning on management succession for fear of alienating certain family members. One owner said to me that he feels like he is imprisoned by his family business and he has no way to break out. Another owner who wanted to wind down was lamenting that having family in the business used to be a blessing, but now it feels like a curse. "My wife is in my ear to make certain all of the kids are happy, but making all the kids happy and what is in the best interest of the business are two different things. I need to make certain the business will thrive when I am gone, so my retirement is funded."

My observation is that businesses and families who have dealt with these issues successfully have done a few things well. The first step is making certain the next generation, or any other family members, do not have a sense of entitlement. It needs to be made clear as early as possible to all parties that the advancement of family members will be based strictly on their performance. Then, don't deviate from that edict. Successful family businesses have sometimes formed family councils. This venue provides family members the opportunity to address personal issues that sometimes spill over into the business setting, as well as provides a forum to make family-related decisions and, for some in the family, to learn their responsibilities of being engaged in a family-owned business.

### **7. Not understanding and planning for the new economy**

Recently, I read an article about 50 iconic brands that were likely to go out of business soon. Five years ago, most of us would have thought that these companies would be thriving today, not on life support. Many of them could just no longer compete given the changing ways commerce is

being conducted. Think about all of the disruptive companies that have quickly become forces to be reckoned with. An acquaintance of mine owned the largest fleet of cabs in the region. His business was extremely successful for years. In a relatively short period of time, however, his significant asset dwindled to be worth almost nothing. He finally sold it for a fraction of its previous value, and the business soon shuttered. He did not recognize quickly enough how technology could affect his investment through ride-hailing technology.

Business owners need to anticipate and prepare for myriad challenges caused by our quickly changing world. Changes in demographics affect a company's ability to attract and retain a workforce. Cultural norms and changes in tastes surely affect buying patterns. I am working with a client who received a surprise visit from the Environmental Protection Agency (EPA). The EPA just shut down the operation until they were satisfied the environmental issues were completely resolved to their satisfaction. He told me "this was something that never would have happened 10 years ago. All of us would have worked together to address any concerns." The point is that business owners must stay abreast of the world around them and not be caught flat-footed. Otherwise, their company and its value could dissipate quickly.

## **8. Not cleaning up bothersome contingencies**

Buyers of businesses are averse to two things—surprises and unknowns. We were at the tail end of assisting a business owner in selling her business. The potential buyer, a public company, had just secured its board's approval. One of the last areas of due diligence was around the employment status of the seller's workforce. A significant number of that workforce were not employees, but rather independent contractors. There were some grey areas regarding whether they should be classified as employees or contractors with regard to taxes, but the seller was comfortable with how the arrangement had been structured. However, being a public company, the potential buyer was sufficiently concerned about liability if the workforce in question filed a class action suit for years of unpaid payroll taxes. The deal fell apart before it was resuscitated with a significant financial hit to the seller. There were ways the seller could have removed the issue if she had sufficient runway to address this prior to a possible sale.

Owners should prepare for an event by cleaning up loose ends such as lawsuits, threatened or filed, where they are defendants; employment claims; IRS issues; Department of Labor and EPA matters, etc. Unresolved issues equate to risk for buyers and that is always a caution sign for them. What about contingencies that you, as a possible seller, might not even be aware of? While you may not be able to eliminate surprises with a 100 percent certainty, consider conducting sell-side due diligence to find areas of concern before the potential buyer finds them.

## **9. Working "in" the business and not "on" the business**

Just like when a homeowner is selling a house, resources must be dedicated to make certain that changes are made to enhance curb appeal such as landscaping, painting or replacing appliances in order to fetch a better price in a shorter time frame. This takes time and money, but provides an eventual payoff for the seller. Business owners need to do the same thing to get their businesses ready. However, many business owners don't focus on the big picture as they are very engaged in the day-to-day operations of their enterprises. That's their passion; that's what they are comfortable with.

In the three to five years prior to exiting from one's business, it is critical that a business owner spend appropriate time and resources preparing for an event. There is much that typically needs to be addressed to get ready. Some of those areas we have previously addressed in the article, including clearing contingencies, securing a high performing management team and understanding the exit landscape. However, that is just the tip of the iceberg. Tax planning, operational improvement, documenting policies and processes are just a few other areas that need attention if one is going to maximize success when the time comes to put the leadership of the organization in someone else's hands. The key is that these initiatives take time and resources and the leader of the enterprise needs to make such an initiative a priority.

## **10. Being overwhelmed by all of the moving pieces involved in an exit**

Yes, there is a great deal that needs to be done. Certainly, it can feel like an insurmountable task. Unfortunately, that feeling of being overwhelmed causes too many business owners to effectively freeze and do nothing. In my opinion, this is the biggest mistake that owners make in anticipation of exiting their businesses. They just let things happen to them, have less control over the entire process and settle for a less than satisfying exit.

Here are some simple ways to combat this problem: First, start early. As we already mentioned, plan your exit three to five years in advance. A significant runway will allow for the interferences of daily business life. Next, build a plan. You had a plan when you started the company. You planned as you were growing the company. You need to plan for how you will exit the company. Spend time understanding all of the moving parts, and create a road map to address them from beginning to end. Finally, get support. You need a trusted team around you, and consider engaging professionals who can guide you in building your plan and help you to quarterback the entire process.

**+1 800 274 3978**  
**rsmus.com**

This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. Internal Revenue Service rules require us to inform you that this communication may be deemed a solicitation to provide tax services. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed.

RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent audit, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit [rsmus.com/aboutus](http://rsmus.com/aboutus) for more information regarding RSM US LLP and RSM International.

RSM, the RSM logo and *the power of being understood* are registered trademarks of RSM International Association.

