

Grooming a Business To Fund a Retirement By Martin C. Daks - 9/3/2007

When business owners think about retirement, one of the first things that comes to mind is how much money they can get by selling their company. But experts note there may be a significant gap between what an owner thinks a business is worth, and what it's likely to fetch on the open market. Taking some steps now may help an owner to avoid an unpleasant shock later, they say.

"The good news is that so far we're seeing an active market for good businesses," says Louis Miele, a partner with the Fairfield CPA firm Leaf, Saltzman, Manganello, Pfeil & Tendler LLP. "But it isn't necessarily bulletproof, just as we've seen recently in the stock market and in real estate. So it's a good idea to have some backup plans."

One obvious approach is to establish a 401(k) or other tax-deferred retirement account early on, and to contribute as much as possible to it. Often though, business owners and others never quite get around to doing that.

"To some degree, the decision to rely on a business to fund retirement involves a specific point of view," says Miele. "Some entrepreneurs believe they're building retirement assets through their sweat-equity efforts, instead of reducing their current income to fund their retirement."

If they're willing to accept the risk, then owners need to be sure they've built value into their business, he adds.

"Identify the strong points of your business and be sure a prospective buyer can easily understand what they are," says Miele. "Goodwill [or reputation], a customer list, or property, plant and equipment are all components of a business' value that will be vital when you start executing your exit strategy."

Miele recently advised a family-owned construction contracting company in northern New Jersey that was seeking a buyer.

"There were no next-generation issues, so we were looking for an outside buyer," he says. "The company has a great reputation, an experienced staff, and its balance sheet was enhanced by a valuable roster of equipment."

The clincher, he says, was the owners' agreement to continue working for the new buyers for a specified period of time, and their willingness to sign a covenant not to compete with the new owners.

Randall Paulikens, a partner with the accounting firm WithumSmith+Brown in Red Bank, says a small business' value often centers on the owner's expertise and personal customer contacts.

"In one recent transaction, an older doctor in central New Jersey who wanted to retire spent about six months working closely with the younger doctor who was buying his practice," says Paulikens. "Basically, they wanted patients to see that the older doctor, who was their trusted medical professional, was giving his blessing to the doctor who was buying the practice."

The retiring doctor told his patients why he was leaving, and expressed his confidence in the younger physician.

“It sounds like an old-fashioned thing to do,” says Paulikens, “but it helped the younger doctor to establish himself as a protégé of the older physician, and made it more likely that he’d retain existing patients. And, of course, it helped the older doctor to maximize the selling price of his practice.”

He has some other tips for owners who are thinking of putting their company on the market.

“Clean up your books,” says Paulikens. Although a company typically tries to minimize its income for tax purposes, a low level of profit isn’t likely to attract a good buyout offer. “If you’ve been running personal expenses through a business [a practice that CPAs frown upon, because it may be illegal] then stop doing it, so your financial records reflect the business’ accurate results. Also, if you’ve been running a one-person operation, consider trying to groom management that can keep the business growing if you’re not there. This will make the company more attractive when you market it, and your management may even emerge as a buyer.”

Neil Becourtney, a tax partner with the CPA firm J.H. Cohn LLP in Roseland, says an entrepreneur should “clean up any skeletons” before marketing a company.

“Be sure you’re up to date on your tax filings and your financial records,” he says. “Also be sure your business is properly registered with sales tax and other authorities. Environmental cleanups and other litigation matters should also be investigated and documented or settled, if possible. A buyer is likely to find out about these kinds of issues during a due-diligence process, and they could scuttle the deal.”

Even if a buyer doesn’t find any outstanding problems, Becourtney says sellers may be asked to sign an indemnification agreement, committing them to cover the costs of any undisclosed issues.

“A seller may be able to avoid this by structuring the transaction as an asset sale, where the buyer is just buying the business’ equipment and other assets, instead of the business itself,” says Becourtney. Some buyers prefer this approach, since they may be able to avoid existing business-related liabilities.

“Generally, though, a seller wants to sell the stock of the business, since it may result in a lower tax liability.”

Because the sale of a business represents a unique transaction, there’s no single “best” approach. But owners who start their planning early and pay attention to the process are likely to be more satisfied than those that take a shortcut.

As Miele says, “You’ve spent a lifetime creating value for your business. When it’s time to get out, you want to be sure you can walk away with a payout that reflects all that value.”

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