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Coffeebreak

How to Invest During High Inflation in 2024 | Investment 101

Business Exit Planning Case Study: Common Mistakes to Avoid

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Providend

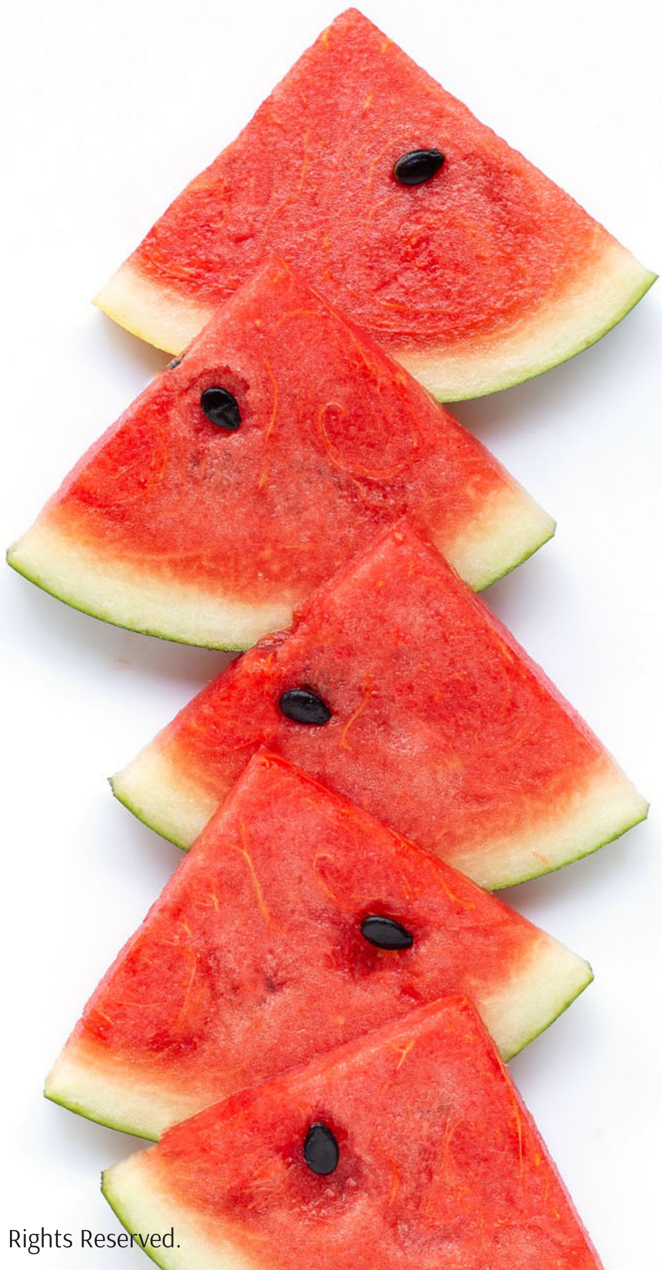
Dear Valued Client,

We often hear groans on how defining work objectives can be straightforward and struggles on pinning down elusive personal life goals. Exempli gratia, “Me”.

I belong to those who needed clarity and a defined path towards these goals, essentially providing me with the direction towards the attributing actions, pursuits and particularly, the intensity of discipline that I would need to achieve these goals. Inclusively, the wealth decisions to support these activities are often my primary concern.

Everyone has diverse goals at different stages of life and we usually prioritise those preeminent concerns at each stage accordingly. Nevertheless, we may find ourselves vacillating on our doubts or regretting when we reach that point in the future. This issue of Coffeebreak, brings you a story of a business owner whose primary goal was to leave behind a harmonious legacy for his business and family, but at the end, faced an eventful exit. This story furthered the approaches and strategies owners can employ when exiting their businesses and eventually achieve their holistic life goals successfully.

Providend has been helping our clients make life choices before enabling them with honest, independent and competent wealth strategies. Our Money Wisdom podcasts, featuring wealth journeys of our clients, showcase our pivotal role. If you come across anyone who might benefit from the podcasts, please share.



We would like to take this opportunity to honour the DADs in our lives while we celebrate Father’s Day in the month of June. For the sacrifices and the immeasurable positive influences they’ve made in our lives - Thank you, Dads!

Hope this edition of Coffeebreak would bless you greatly!

Warmest Regards,
Chief Operating Officer

Moon Shary

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Business Exit Planning Case Study: Common Mistakes to Avoid

Jerome Song, Associate Director for Business Exit

The owner of a precision engineering company, Mr Tan (fictional name), is 58 years old and plans to retire in five years. His company has grown over the years and is one of the Enterprise 50 award winners. Mr Tan's company is generating approximately S$2 million in cash flow each year. Post-COVID-19, the economy began to soften, and the company's revenues and earnings dropped significantly.

At this time, a competitor in the same industry reached out to Mr Tan to buy over the business, but Mr Tan was not keen to explore this further as he was trying to rebuild the business performance. Without any concrete research, Mr Tan was convinced that if he sold his company, it would be worth little more than its asset value. As a result, he continued to work in the business well past the point where he found it fulfilling or energising.

Mr Tan is married and has two children, David and Evelyn. David is interested in leaving his corporate job to play a more active role in the family business, although he does not have much experience in the engineering industry. His sister Evelyn currently works as a fashion designer and has expressed little interest in the family business.

Mr Tan's wife Mrs Tan, a retiree, holds some shares in the company but is not active in the company's management. Mrs Tan has been trying to encourage Mr Tan to scale back his involvement in the business so that the two of them can enjoy their retirement years together to travel the world.

Mr Tan's Attempt at a Business Exit Plan

Mr Tan consulted a few professional advisers when the competitor expressed interest in buying his business. However, he was unable to gain clarity to move forward with any decision as there were conflicting viewpoints due to each adviser's specialised expertise and professional biases. This inadequate coordination among advisers exacerbated the conflicting advice. Without a cohesive strategy, these advisers provided recommendations that were incompatible and counterproductive, leaving Mr Tan unsure of which path to follow.

Mr Tan then met with his lawyer to create a will as he feels that that will take care of his estate after he passes on. To train the next generation to take over the company, David, his son was parachuted into the family business and made CEO while Mr Tan took on the role of Chairman. At this point, the family believed the business succession plan was "complete".

Challenges Unfold: A Year Later

Mr Tan was prepared to reduce his involvement in the business a year later but found himself unable to do so. Under David's leadership, the business began to struggle, partly due to David's lack of experience and focus. Consequently, Mr Tan increasingly relied on two key employees, neither of whom were family members nor shareholders, to manage business operations. David became aware of this, leading to a growing resentment between him and the two key employees.

Meanwhile, Evelyn, Mr Tan's daughter and David's sister, felt undervalued. She observed David enjoying a substantial salary and company car, while also witnessing the company's performance decline under his leadership. Feeling her inheritance was at risk, Evelyn harboured resentment towards family members who supported her brother.

Mr Tan started to experience pressure at work and home, resulting in health complications to his heart and blood sugar levels. His doctor advised him to reduce his time in the office and as a result, Mr Tan's absence created a void that David struggled to fill, as he was not adequately prepared for the role of CEO. Consequently, the company's two key employees left the company, taking valuable customers with them. Sales plummeted, and top salespeople left for rival companies.

Evelyn noticed the company's market value decreasing and demanded David's replacement, in fear of the company's fate and years of her father's effort being poured into the business. Mr and Mrs Tan are equally concerned about the company's poor performance affecting their retirement plans, further exacerbating Mr Tan's health issues.

Challenges and Consequences: Two Years Later

Mr Tan's health declined further, and he even suffered a mild heart attack. As the company continued to suffer, the rift between the children deepened, leading to a complete breakdown in communication. Family get-togethers were cancelled, adding to the sense of disarray. Mrs Tan was deeply saddened and felt helpless throughout the past two years.

Sensing that Mr Tan would not replace David, Evelyn intensified her efforts, advocating for her father to sell the company to a third party for cash. Her persistence added more pressure to the already tense situation, while Mr Tan was recovering from his heart attack.

Ultimately, the company was sold to a third party, and the value received was only a fraction of what Mr Tan had in mind when he made his retirement plans. The lower-than-expected sale proceeds left Mr Tan and his family with a profound sense of disappointment and regret.

A Legacy Fractured

Unfortunately, David, despite his best efforts, was ill-prepared to secure a similar job elsewhere and found himself struggling professionally for many years. His attempts to transition into a new career path were met with numerous challenges, leaving him in a state of uncertainty and financial instability.

Meanwhile, as Mr and Mrs Tan's retirement plans were forced to undergo extensive revisions due to the lower-than-expected sale process, the financial strain weighed heavily on the family. The updated financial plan revealed that a significant portion of the sales proceeds would need to be allocated towards their retirement needs, leaving little room for the inheritance David and Evelyn had hoped for.

As a result, both siblings were resentful. They found themselves grappling with a mix of disappointment and frustration, silently attributing the reduction in their inheritance to their father's decisions. This unforeseen outcome led to a strained atmosphere within the family, as they navigated the complexities of their altered financial situation. While David and Evelyn understood the necessity of adapting to their parents' revised retirement plans, they couldn't help but feel a pang of disappointment. This turn of events was not what Mr Tan had envisioned when he embarked on his business exit journey two years ago.

What Could Have Been Done Differently?

Mr Tan committed some of the common mistakes that business owners make. Firstly, he had postponed planning his exit, relying solely on his intuition about the value of his business.

A comprehensive business valuation is one of the cornerstones of the business exit planning process. Knowledge is power, and knowing your business's value allows you to ensure that your plans and goals are on the right track. A business valuation can give you a significant advantage, especially when negotiating with potential buyers.

Firstly, because Mr Tan had not obtained a proper business valuation, he failed to realise that his business could have been sold for significantly more than just its asset value.

Secondly, while Mr Tan had engaged in some estate planning, he neglected other critical issues that could affect the success or failure of his exit from the business. Working with a Business Exit Adviser could have offered various options, including a Management Buyout (MBO) led by the General Manager, which would have been an ideal outcome. This approach, funded by private equity and debt, would have facilitated a smooth transition of ownership and management, minimised disruptions and maintained business stability during the transition. It would also have addressed Mr Tan's concern about leaving a positive legacy among his children.

Unfortunately, this is how the vast majority of business owners approach the process of exiting their business. Despite overwhelming evidence that business exit planning is a vital part of business ownership, most business owners fail to create a robust exit plan, often due to a combination of psychological barriers, lack of awareness, and practical challenges.

Questions to Ask Yourself as a Business Owner

- Do I have a cohesive, high-functioning management team in place, and are they aware of the long-term strategy for the company?
- Am I confident that my successor candidate has what it takes to take over when I retire? If not, how can I prepare them for the leadership challenge they will eventually assume?
- What is the end game, and do we have the right team to get us there?
- How can I ensure that my key employees will stay with the company for the long haul?
- Have we experienced a major growth event or challenge that requires new talent or the development of existing talent?

Empowering Business Owners Through Strategic Business Exit Planning

As Business Exit Planning practitioners at Providend, we help business owners strategise the exit of their privately held companies. Business exit planning covers the business owner's goals and objectives in terms of company value, employees, and market position, as well as personal aspects such as family and community.

A business exit plan serves as a comprehensive roadmap for successfully navigating the transition out of a privately held business. It addresses all pertinent business, personal, financial, legal, and tax considerations involved in selling a private company. Its ultimate aim is to maximise the business's value upon exit, minimise tax liabilities, and ensure that the business owner achieves their personal and financial goals.

We work with SME business owners who are contemplating exiting their business in 12 to 36 months. This is either because it has reached their value expectations, or the owner is ready to retire or pursue a new challenge. Our clients will typically be targeting an exit value of S$5 million or greater.

One thing is certain, at some point, all business owners will exit their company, whether because of age, health, retirement or their unfortunate demise. To ensure a departure on their terms and at the right time, business owners should begin crafting their exit plan now. Delaying this process risks relinquishing control to the buyer when it is time to sell.

An effective business exit plan starts with defining what you are looking to achieve, what is driving you to exit your business, and what needs to be achieved to make it feasible.

Being a trusted adviser to our affluent clients for over two decades, we will help align your personal financial needs and objectives with your current or required business valuation, translating this into achievable goals where there is a mismatch. We will also help you define your post-exit commitments and important considerations such as legacy and employee retention.

By starting the process now, you take control of your future and pave the way for a successful outcome when the time comes to exit your company.

Reach out to us today to start crafting your tailored business exit plan, integrating it into your personal wealth plan, and leave behind a harmonious legacy for your business and family.

Learn more about our business exit and succession planning philosophy here.

03 Our Podcast Has a Special Miniseries!

Being a trusted adviser to our clients for over two decades, we have received numerous questions about who Providend serves and the clients we have. We have decided to curate a collection of these stories into a mini-series titled “The Story of Our Clients’ Wealth Journey,” from seeking guidance to overcoming challenges and experiencing the benefits of working with Providend.

Each episode offers valuable insights that will resonate with your own financial journey. Tune in and share with friends who would find this useful!

LISTEN NOW

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