

# Financial Security After Selling Your Business

*The following is adapted from our new book, [Your Next Adventure: Planning for Life After the Sale of Your Business](#). The book shows you how to craft a robust transition strategy that considers your business, personal, familial, and community needs. From pre-sale to post-sale, you'll learn how to plan ahead, assemble the right professional advisors, and incorporate your values, legacy, and loved ones into every choice you make.*

When you sell your business, the first questions you should be asking are “Whose transition is this?” and “What does financial security mean now?”

Financial security means different things in your pretransition world than in your post-transaction world. Pretransition, financial security refers to your confidence that the business will continue generating the cash necessary to support the lifestyle your family has come to appreciate. Your family's financial security is embedded in the business.

Post-transition, or post-transaction, the entire structure that has been standing for the past ten to thirty years, or between one or more generations, is significantly changing form. In the post-transaction period, you will develop a new family definition of what financial security is and learn how to achieve it. There is a shift from private equity wealth creation to long-term wealth preservation and income production.

The expected return on equity in a privately held business should be, by definition, higher than the return on investment in publicly held securities. That's one of the reasons entrepreneurs choose to start a business. They decide to be owners of private equity because they enjoy the higher return they may receive, as well as the satisfaction of being their own boss.

This point illustrates the financial change of mindset an owner experiences about the whole transition process: *Will I be able to generate sufficient returns in the public market to maintain my lifestyle while preserving wealth over my lifetime and, hopefully, for future generations?* This adjustment in thinking is not just for the owner; it's for the family. You need to know you will be able to generate the kinds of returns necessary to continue the quality of life that everyone in the family has come to enjoy and expect. One helpful way to look at the shift is to think about going from running an operating company to managing a financial company.

## Primary Components

The move to overseeing a financial company involves four major components:

1. **Managing the assets.** This is your pool of capital resulting from the transaction and the savings your family has accumulated. How it is owned and invested determines the

remaining components.

2. **Managing cash flow.** It's critical to a business and critical to a family. How cash flow is created depends on how your asset base is structured and invested.
3. **Managing risk.** Risk of loss in a financial company is mitigated through investment diversification, combining disparate investments uncorrelated in their price movements. Much like having a mix of customers diversified in geography and industry, spreading your investment assets lessens the impact of any one loss and provides opportunities for gains from multiple sources.
4. **Succession planning.** In your business, succession planning has led to the transition in ownership you are currently planning. In the financial company to come, estate planning is your succession plan.

In working through the transition from an operating company to a financial company, all of these components are intertwined, affecting and being affected by the decisions made when you sell the business.

## Managing the Assets

During the time their businesses are operational, many business owners draw whatever cash flow they feel is necessary for their lifestyle and that their business can afford. They are accustomed to withdrawing money from the business each year and supporting the family with it. The business generally continues to become more and more valuable while they continue to take what they need as the business grows. There is always a healthy tension between what is taken out of the business for personal use and what is reinvested in the business to support future growth and value enhancement.

When you convert the value of your business to cash and invest it in the public markets, depending on the amount of wealth involved, you may be faced with consuming both income and principal in order to support your lifestyle. In a very wealthy family, that's not a concern, but with smaller pools of capital, some consumption of principal is possible. This is not something you likely did while building the business value. You are accustomed to having the business value increase while you continued to enjoy the fruits of that investment. That may or may not be the case when you move to the public markets. This underscores the difference in managing a financial company when the business-supported wealth creation has ceased: it can be an unnerving adjustment for the family.

Business owners will ask, "Can we live the life we want to live?" "Will we still be able to leave an inheritance to our heirs?" "Can we pursue our philanthropic goals?" These are questions to plan for early, in the T minus 3 or T minus 4 time frame (the three to four years leading up to the sale), and the family financial advisor can help you translate your lifestyle needs into wealth

accumulation goals. When you start to build the value of the company, you need to identify what the minimum number is that you need to reach your desired goals. It's a number you'll need as you enter into transaction negotiations. Or you'll need to adjust your lifestyle expectations based on your asset's ability to generate cash flow.

## Managing Cash Flow

Structuring the investments properly depends first on understanding the family's cash-flow needs. Investments are structured in time and place according to the sequence and source of future cash-flow requirements. It is useful to think of both recurring and one-time expenses separately.

To align investments so cash flow will be available when needed, a family's future goals and the cash flow necessary to fund them should be clear. It's good to plan ahead in increments of years, then forecasting annually for next year's needs at each year end. This validates the longer-term investment strategy in place and allows your advisors to adjust as necessary to generate the cash flow you require. How much you plan to spend drives the types of investments made to generate the necessary cash flow at the right time.

As an example, cash liquidity needed in the near term will be conservatively invested, generally in interest-bearing securities with low expected volatility in price. This ensures a steady flow of dependable income without much change in the underlying value of the investment. In exchange for this relatively safe investment, the returns are low and may be inadequate in the long term to meet all the family's needs. That is why a larger portion of your wealth will be invested for long-term growth, to meet cash-flow needs well into the future. The investment decisions on how to keep your wealth invested change as your cash-flow needs change. Managing your assets for cash flow becomes an iterative process requiring close coordination with your advisors.

## Managing Risk

Business owners create a fairly high-risk environment simply by owning a private company, which represents a concentration of your wealth in private equity. Not only your wealth, but also your cash flow is being driven by one business. Post-transaction, you will not want the same level of risk concentration because you will no longer have any operating control. And to protect the financial company's value that you created, you will need to manage the amount of risk you're willing to absorb.

Most businesses seek to develop and maintain a long customer list with a diversified customer base versus having their business dependent on a few dominant customers. A financial company is no different: diversification within your investments spreads risk across multiple sources so you're not overreliant on any one area.

## Succession Planning

Much like you needed to define an ownership transition plan for your business, the estate plan acts as your formal wealth transition plan, directing how your wealth will be distributed, owned, and managed upon your passing. Estate planning is primarily a combination of tax, ownership, and control planning within the family. Its primary purpose is to determine the asset owner's wishes for the control and disposition of their property during life, upon their incapacity, or their ultimate death, and then to design the appropriate structures to achieve those results.

This will be different after a business sale because the management, control, and disposition of financial assets is more flexible than when an operating business is involved. Now that the resolution of business ownership and management is behind you, longer-term decisions about the family assets may be easier to make. However, to take full advantage of potential income and estate tax savings, while also achieving family goals of passing wealth to heirs and philanthropy, it's important to start the estate-planning process pre-transaction. Begin planning, but resist making significant decisions too early. Major decisions are best saved until you've grown accustomed to running your new financial company and understand what ownership transition of important family assets will best serve their needs. This area demands careful thought and consultation with trusted advisors.

If you build a good estate plan, the likelihood that your family succession plan will be successful is greatly improved, and your family can enjoy financial security for years to come.

*For more advice on business transitions, you can find [Your Next Adventure](#) on Amazon.*

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*Together, at Harvest Capital, they help clients attain life goals, as well as financial objectives.*