Virginia
Regulatory Hot Tip 2016 – 6

Professional Insurance Agents Association of Virginia and DC, Inc.

EXITING THE WORKING WORLD?

So, what is your plan? How do you plan to actually get to retire? Is retirement even for you? Lots of folks tell me that their retirement plan is to retire in place and certainly that is a strategy. Just leave any clean up to your loved ones. But, perhaps you ought to check with your spouse and children. Maybe they don't want to be the sweeper who enters the stage--from the left, and ultimately ends up sweeping everything into the garbage can. Having worked with spouses who are left to sell a business they did not want to be involved in, need the money from, and really don't want to take a year to get it all straight after their loved one's sudden death----I can say this, it is not easy.

Others tell me that their business is not worth anything, but it has sustained them and their families for years, so it has to have some value. So, just in the off chance that this is a subject that is occupying your thoughts, let's explore some things for you to consider.

Keep in mind that there is no "one size fits all" strategy in formulating your exit. I have clients who began second and third careers after the age of fifty. But, you need to understand yourself, your goals and weigh them against your health or that of your spouse. What you don't want to do is wait until the trigger, whatever that is, occurs and be forced to sell your agency at a fire sale just to get on with your life and take care of the emergency that is facing you.

Get your head straight about what you should be doing to prepare to exit.

In preparation of this article, I asked some professionals who oftentimes assist their clients in thinking about and executing exit strategies for their most important advice to y ou, the individual contemplating establishing an exit strategy. **Rene' Haines,** of **FocalPath Coaching,** offers the question for business owners to ponder, specifically, "can your insurance agency run without you? If the answer is no, then the planning must begin. The creation of an Operations Manual which documents agency processes, procedures, emergency contacts, contingency plans, etc. should be an integral part of the exit strategy process."

I also consulted a business colleague, **Bernie Henderson, President of Woody Funeral Home**, though obviously not in the insurance agency business, Bernie spent years as the individual tasked with purchases of competitors' businesses. His title then was Corporate Development Representative for an international corporation in the funeral home and cemetery business. He offers this sage advice: "When every day seems like yesterday – and you are not able to grow your business any further, it is time to get out." Curiously, he opines that items that you may believe important, such as the beauty of your facilities or the real estate that you own are truly not important to most buyers in establishing a price. The real price is established based on your incoming revenues and prospects for adding revenues. Spending money on your business to enhance anything other than that is for your own personal enjoyment, but don't assume it will add a penny to the bottom line sales price. Lastly, he offered an astounding comment: most of the businesses he purchased would have been more valuable had the owners sold them five years prior to when they did.

Exit Strategies to Consider:

One strategy that some businesses have worked toward is working with another agency to create a third marketing entity for the two agencies to market together through. Or, housing the two agencies in the same location so that there are some synergies in rent payments, staffing and the like. This strategy might also contemplate a sale of one agency's assets to the survivor after the death or total disability of one of the principals.

A second strategy is to identify someone, not currently a competitor, and arrange a buy-sell agreement triggered by death or disability. The formulae for valuing the agency should be included in the document or a process for that determination to be made. Most importantly a funding mechanism has to be put into place so that either party can have access to funds to make such an arrangement work.

Or, suppose you have identified a rising star that already works in the agency and who has exhibited interest in perhaps purchasing business. But, how to assist this rising star to be able to afford the business when the time is right? Consider some sort of joint fund between you and the rising star where each contributes from current income such that the fund matures to be ready at the time it is needed. Alternatively, consider purchasing a life insurance policy on the rising star with a cash value component that could be used to at least partially fund the purchase. Of course this would presume that the rising star is insurable, that there is enough time for the cash value to grow, etc.

Lastly, some owners have resorted to going to known entities that make a career of purchasing businesses and perhaps reselling them or running them.

Purchase Price Holds:

Charles S. Pearson, Jr., CPA, known to friends as **Chuck Pearson of Pearson of Pearson & Company, PC**, offers the thought that many purchases are contingent upon future renewals, usually a percentage of "trailing commissions." To the extent that you can, "I would advise not permitting any portion of the purchase price for your business to be tied to future income." Generally the purchaser wants to hold back some of the payment to see if the business "sticks" so to speak. Obviously, unless you intend to remain as a consultant, agent, or in some other role, you will have little control over what happens to the agency business, customer service, or anything else. In fact, the new owner may simply "flush" all of those ideas that you put into place to retain business, and thus, impair your chances to receive the full purchase price for the business. Chuck Pearson suggests that even though current and potential revenues dictate pricing, keep in mind your most valuable assets are your relationships with your policyholders, which ultimately provide for your current and future commissions.

Assemble your team:

You need to have professionals that you trust and can work with to address questions as they arise during the exit strategy process; they serve as an extension of you, your relationships, and your culture.

Chuck Pearson also reminds you to understand what may work best for you from a tax stand point may not work at all for your purchaser. For example, the "value" of your relationships is considered "goodwill" and is treated as preferable long-term capital gains assets for you, the seller. …but the purchaser would prefer more, if not most, of the purchase price be allocated to hard, fixed assets because the amortization and depreciation rates are reduced from 15 years to as low as 5 years (and are available for upfront expensing under Internal Revenue Code Section 179). Keep in mind that there are going to have to be compromises as you move forward.

Plus, as you negotiate and come to terms on the exit strategy, you need to make sure that every step in the process is well documented and agreements are in place to effect the strategy that you select.

I made a mistake – this exit strategy isn't going to work:

Be prepared to back up and rethink and restart your plan. It may be costly, but if you discover that you and the purchaser can't work well together in the negotiations phase, you may have to rethink: (i) whether you want to remain within that agency at all after the sale, (ii) whether you believe that your employees will remain, (iii) whether you believe this person can actually pay you out----if the payment plan is to make installment payments. Discuss how opinion differences will be resolved before you sign. Be sure you believe you can communicate with your purchaser and there is mutual respect for how you developed a business asset worthy of purchase and your years of maintaining and developing relationships is really what's being purchased and what differentiates you from other available agencies.

In Summary

Chuck Clement of **James River Wealth Advisors**, who has worked in the insurance industry wearing many different hats, offers the following observations,

"When business owners come to our firm for financial planning for retirement, they typically have a 'misguided' opinion of the business value leading to overstating their retirement liquidity. The faces of despair when the valuation reality hits home is not pretty. Mentally, the business owner is out, but financially they are trapped?

Further, Mr. Clement offers, “preparing to exit is understanding the valuation techniques and corresponding values for your business. Will your business value meet your retirement liquidity expectations? Valuation models are also used to demonstrate the business transformation levers to focus energy and resources to maximize your investment. When the time comes to transition your business, there should be no surprises for you.”

Where ever you find yourself in your business career, it is not too early to consider your retirement strategy. There are professionals and tools that help guide you in this process, no matter where you find yourself on the retirement path. But, don’t put your head into the sand, the earlier you start making plans, the more likely it will be that you can retire within your retirement time frame and with enough funds to retire. But, planning is essential to make the process work.

As we learned to approach a problem in CPCU classes, you can use that same approach to meet your retirement goals. **Identify** what/when you plan to retire. **Determine** how you are going to get there ---your exit strategy. **Evaluate** what you need to do to get to your retirement goal. **Monitor** the process as you move forward in your agency. Re-evaluate as you go along and “tweak” the process to make it work for you.

Good luck to you as your move forward with your business,