The TIP of the ICEBERG

It's the part you *don't* see that sinks the ship

Opportunity Knocking...Part II: Buying or Selling a Business in Stormy Times

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In Issue 1.1 of *The Tip of the Iceberg*, I wrote about a veritable Tsunami of Opportunity that is rapidly approaching landfall, driven on by the Boomer Retirement Bubble. Let's talk now about how to take advantage of that opportunity…regardless of whether you are a Boomer with something to sell, or a NextGen looking to buy/invest/grow.

Consider the lay of the land here. First and above all, remember the importance of a person's individual Net Worth (assets minus liabilities). Net Worth is the key to retirement for a huge and growing number of Americans, as the old-style defined benefit pension plans increasingly disappear. So…whether you are a buyer or a seller of a business, *keep you eye on the bouncing ball that is your own Net Worth!!*

Most business owners today have their personal net worth (read "retirement") tied up in three places (in decreasing order):

1. Their **Business**
2. Their **House**
3. Their **Investments** (including cash, stocks, bonds, insurance, etc.)

For most business owners, "retirement" has usually meant a Liquidity Event of some sort (cashing out of the business) that shifts a large chunk of the persons' personal Net Worth from #1 to #3. Often this transfer takes the form of cash. But is it really that simple?

The trick with such a transfer is always ***when*** to do it, and ***how*** to do it properly. It is important for buyer and seller of a business alike to understand that getting the "when" and the "how" right will have a dramatic impact on how big the liquidity event will be…and for most business owners that means it will have a big impact on how comfortable their retirement years will be.

During the first six months of 2008, market turmoil (in stocks, bonds, real estate, and especially **credit**) has continued to fester and deepen, and by most accounts as I write this (mid-summer, 2008) this situation will continue at least into the middle of 2009, perhaps

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even longer if other forms of securitized debt (student loans and credit cards, to name just two) also start showing increased default levels. The jury is still out on that.

How does all this effect the business owner's retirement, and that knocking at the door?

Boomers still need to retire…that is inevitable. The issue is not "if," but "when." Most of them have taken a considerable hit to their net worth in this downturn (especially in category #3, with the stock markets down over 20%...and in the case of some widely held stocks, down over 50%; drops in category #2, housing, vary by location, but that is what triggered this whole mess). So, as business owners do the math now, they may conclude that they don't have enough net worth left right now to be able to *afford* to retire…this at a time when most of them don't even know what their largest asset, their business itself, is really worth (they may know what price they want to ask for it—not at all the same thing as what it is really worth). Business owners may fear (with good reason!) that the price they can get for it will also be a lot less than just a year or two ago.

Consider the other two links in the business buy/sell chain: the business buyer, and the lending source who will finance a sale. Potential buyers have taken the same kind of hit to their net worth as the business owner has…but without having the large asset category of a business to help (perhaps) prop up the other two. This means the amount of cash or liquid assets (securities, home equity) that they traditionally would tap for their down payment have shrunk, in some cases dramatically, and in ways that a simple market correction will not fix for a long time (remember, a 20% drop in asset value requires a 25% increase in value to get back to where it started!). It also means the value of personal assets that they can pledge as collateral for a note, or to back a personal guarantee, have also dropped.

As for lenders, they have been scrambling to raise capital reserves, and in most cases have gotten extremely conservative in their underwriting criteria (something that was long overdue in principle, but perhaps they have over-reacted to compensate). Lenders are simply much more skittish about lending for small business acquisitions, even with guarantees from the Small Business Administration.

Now…what effect do you suppose this will have on the fair market valuation of small businesses going forward, if owners still have to sell at some point, but buyers have less cash and lenders are more stringent in lending?

Can anyone say "perfect storm"? More reason than ever before for business owners to start planning ***now***…before they ***have*** to sell, to find ways and deal structures that will let them cash out on their own terms. More reason than ever for prospective business buyers with cash to start looking actively for opportunistic targets ***now***…they ***are*** out there!

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