EXIT PLANNING SOLUTIONS

THE DEFINITIVE GUIDE TO ADDRESSING THE ASSET GAP

HELP YOUR CLIENTS BRIDGE THE GAP BETWEEN WHAT THEY HAVE AND WHAT THEY NEED

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BRIDGING THE ASSET GAP: AN ESSENTIAL STEP TOWARD EXIT PLANNING SUCCESS

Gathering accurate information about an owner's financial resources—including business value and the amount of financial resources necessary to achieve that owner's exit goals—is an essential preliminary step of every successful Exit Plan. This eBook describes what you, as an Exit Planning Advisor, must do to gather this information; which advisors can help you guide your business-owning clients through this step; and, most importantly, how you can help owners bridge the gap between what *they currently* have and what they *need* to live the post-exit life they envision.

One of the most important things business owners must know is the value of their businesses. This is especially true for owners looking to engage in Exit Planning, because the value of their businesses (i.e., what they *currently have*) plays a critical role in determining what they *need* to live a comfortable post-exit life. Unfortunately, even the most successful owners often base business valuations on assumptions, sentiment, and hope, only to find out that when they're ready to exit, they don't have enough money to assure financial security for themselves and their families. This eBook will show you how to help your clients avoid this tragically common fate.

This eBook presents common challenges that owners face in implementing Step Two of The BEI Seven Step Exit Planning Process™ (Quantifying Business and Personal Financial Resources), and provides strategies, ideas, and tools you can use to help them overcome those challenges. We've found that most owners experience two distinct stages as they embark on implementing Step Two.

First, they tend to make false assumptions about the value of their businesses. These assumptions are usually based on sentimentality, since many business owners view their businesses like a child: precious, priceless, nearly perfect. Because they tend to overestimate their businesses' value, these owners tend to procrastinate, pushing their plans to exit farther out based on incorrect assumptions.

Second, the lucky few who reach out to an Exit Planning Advisor—only 18% of owners have discussed their exits with an Exit Planning Advisor—discover that the assumptions they've made are wrong and, with the help of their Exit Planning Advisor and Advisor Team, aggressively act to bridge the gap between what they have and what they need (i.e., the *Asset Gap*). Those who fail to attain the services of an Exit Planning Advisor are typically shocked to find that when they are ready to exit, their businesses are not ready for their exits. This forces them to stay in their businesses long past their expected retirement dates to build enough value to assure financial security.

This eBook will allow you to address these issues, assure that your clients exit on their terms, and position you to reap referrals and profits for your essential services. Owners need your help preparing for their exits, and without you, most will fail to exit on their terms.

In this guide, you will learn how to help your clients identify and address the Asset Gap, which is the difference between what an owner *has* and what that owner *needs* to exit the business on his or her terms. You will learn about how to identify your clients' Asset Gaps, why business owners consistently fail to address their Asset Gaps, and how you can help your clients overcome their objections to accurately assessing their companies' value. In subsequent guides, you will learn about taking the steps you, your Advisor Team, and—most importantly—your clients need to take to implement an Exit Plan that allows your clients to leave their businesses when they want, for the money they need, and to the person they choose.

EXIT PLANNING CHALLENGES: THE ASSET GAP

"BEI Members often tell us that one of the most common and hardest hurdles to overcome is talking to owners about their Asset Gaps. Owners tend to overvalue their businesses while underestimating how much money they'll need to live comfortably after they exit. It's every Exit Planning Advisor's responsibility to guide owners toward bridging their Asset Gaps, and The BEI Seven Step Exit Planning Process makes that possible and easier to do"
–Elizabeth Mower, President of BEI

Business owners will face many formidable challenges in their quest to leave their businesses on their terms, some apparent, but many subtle and unseen. Several challenges that many business owners fail to anticipate include:

THEIR OWN MISPERCEPTIONS. Typically, owners (and their businesses) are far less prepared for a successful exit than they think. Their misperceptions lead to complacency and inaction. However, by probing the assumptions underlying these misperceptions and addressing the consequences of inaccurate assumptions, owners can focus on accelerating growth in business value and cash flow long before they are ready to exit, giving them a chance to exit on their terms. This eBook explores common misperceptions and describes what you can do to help owners avoid them.

A LACK OF KNOWLEDGE. To whom or where can owners turn for help? Like most owners, many advisors have, at best, limited experience in planning, much less orchestrating successful business exits. Thus, neither owners nor their advisors know where to start, what to do, who can help, which design principles to apply, or which planning options exist to help business owners achieve their goals. You can fix this problem.

INADEQUATE TIME. Many owners wait until they are ready to exit to start planning for their exits. Most owners seriously underestimate how long it will take to prepare and implement a successful exit strategy. We calculate that about 200,000 out of 7 million businesses are capable of being transferred today while allowing their owners to achieve their goals and objectives. An average time span to plan and execute an exit strategy is 5–8 years, which, of course, doesn't start until you or a different advisor convince owners that they need to begin.

FALSE ASSUMPTIONS. Step Two is a breeding ground for false assumptions. Most owners find it difficult to accurately determine their businesses' value because of how personally invested they are in their businesses. They often find themselves under the allure of what BEI's founder, John H. Brown, termed the *Misperception Spell*, which is when the information owners use is vastly different from the facts. Without your help and expertise, owners cannot break the Misperception Spell.

MISCONCEPTIONS ABOUT COST. Owners often balk at obtaining a professional valuation due to the perceived costs. They assume that the valuation won't be worth the upfront cost, which often falls within a range of $5,000–10,000. However, that range is often miniscule compared to the cost of taking a business to market with an inaccurate valuation, and without an Exit Planning Advisor to explain that, many owners watch their Exit Plans fall by the wayside

EXIT PLANNING BENEFITS: THE ASSET GAP

"BEI's Exit Planning Advisors use their training to take a disciplined approach to determining business owners' Asset Gaps. Getting an objective sense of their Asset Gaps allows owners and the Advisor Team to implement the action items necessary to achieve the business owners' goals. After overcoming initial hesitation, owners who commit to quantifying their Asset Gaps are able to act quickly and aggressively to bridge them." –Elizabeth Mower, President of BEI

Like other challenges owners face in exiting their businesses on their terms, some of the benefits of Step Two are obvious, while others are hidden. The most obvious benefit is increasing business value and cash flow, allowing owners to exit on their terms and receive top dollar for their lives' work.

Some less obvious benefits of Step Two include:

CLEARS THE MISPERCEPTIONS. In dispelling misperceptions about the importance of determining personal and business financial resources, Step Two of the Exit Planning Process clears the path to an exit that achieves all of your clients' goals and aspirations. In our experience, one of the challenges of achieving these goals lies in convincing owners to properly determine their companies' value and the money they'll need post-exit to enjoy the lives they envision. Owners commonly use assumptions to make these determinations, which can destroy their hopes of exiting on their terms. Owners compound their mistakes by waiting until *they* are ready to exit, only to find that *their businesses* aren't ready for their exits. Step Two helps prevent owners from letting these misperceptions sabotage their Exit Plans.

KEEPS OWNERS IN CONTROL. The designs that we use in our Exit Planning Process keep owners in control of both their businesses and the courses of their exits until they achieve all of the goals they've established for themselves, their families, and their businesses.

PROTECTS YOUR CLIENTS. Step Two is like a vaccine for your clients: While there may be some initial pain as they have their businesses valued by an outside appraiser, the result is a robust business that can fight off the problems that often damage or kill an ownership transfer. This can transform the time owners spend in their businesses into time spent doing only things they want to do, rather than things they have to do.

REPLACES ASSUMPTIONS WITH FACTS. This eBook will give your clients the tools, strategies, and proof to help them overcome their assumptions and exit their businesses on their terms.

RELATES COSTS TO THE BIG PICTURE. While owners might hesitate to pay for a professional valuation, this eBook will put the upfront cost of a professional valuation in the context of the future costs of using assumptions over facts. This will help you communicate the importance of a proper valuation to your clients.

YOU ARE NOT ALONE

BEI always encourages owners to engage advisors skilled in Exit Planning to organize and streamline their Exit Planning processes. In fact, we've included input from several Members of The BEI Network of Exit Planning Professionals™ in this series. These professionals are from a variety of disciplines (e.g., investment banking, financial planning, insurance advising, law, accounting, business brokerage, and ESOP creation and maintenance). They have incorporated Exit Planning for business owners into their core services and have found that working with owners is the most satisfying part of their careers.

For years, owners had no one to turn to for advice about how to exit or prepare their companies for their exits because advisors simply did not know how to help. One of BEI's founding and continuing goals is to equip advisors to prepare both owners and businesses for an owner's exit.

After reading this eBook, we encourage you to contact us, either at 303-321-2242 or info@exitplanning.com with the subject "eBook 2: Asset Gap Help," so that we can help you help your clients determine their Asset Gaps.

THE ROAD AHEAD

Planning a business exit is a journey, and the destination determines the quality of the rest of your clients' lives. With your help, owners choose which path to take to reach their destinations. To best describe how you can help owners map the most successful exits possible, this series focuses on you and the key concepts you will use to plan the exit best suited to each client.

Additionally, by incorporating knowledge of the Exit Planning Process into their practices, advisors report the following benefits to their practices:

- They find more satisfaction in their practices because (a) they are no longer "order takers" or "first responders" performing tasks only upon client request, and (b) they take more pride and joy in addressing their clients' "big pictures."
- As they align their skill sets to address an owner's most important financial event, their client relationships deepen and become long-lasting.
- They forge better working and referral relationships with advisors in complementary professions.
- They can differentiate themselves and their firms from competitors who lack both Exit Planning training and access to a successful process.
- Exit Planning serves as an engine for growing their practices.

WHERE'S THAT CONFOUNDED BRIDGE?

Beginning to build the bridge across your clients' Asset Gaps can be confounding at the outset. Your clients may feel threatened to learn that their businesses aren't worth as much as they had assumed. They may balk at paying advisors to provide them with accurate business valuations, cash flow analyses, and tax projections. They will likely contend that they need less money after they exit than they really do, based on nothing more than hope and conjecture. Fortunately, BEI provides numerous tools, including The BEI Seven Step Exit Planning Process, to help Exit Planning Advisors guide their clients toward successful exits. In conjunction with the other guides in this series, this guide describes the most important actions you and your clients can take to fulfill the necessary objectives of Step Two.

THE ASSET GAP

In the last guide, you learned how to help business-owning clients establish their exit goals. Achieving those goals requires accurate information regarding your clients' personal and business resources, and their personal financial needs. However, finding and using accurate information is much harder than it seems, as you'll learn in this chapter.

Business owners assess their ability to achieve their exit goals—principally, financial security—by addressing five questions:

- Is your financial security goal accurate, or unrealistically low?
- Have you accurately quantified the resources (both business and personal) currently available to attain your financial security goal?
- Do you have an Asset Gap, a shortfall between the resources you have and those you'll need to achieve your financial security goal?
- How big is your Asset Gap?
- What must you do to bridge your Asset Gap?

Asking and answering these questions is a part of every owner's Gap Analysis.

WHAT IS AN ASSET GAP?

Too many owners realize the true extent of their Asset Gap only when they are ready to exit. At that point, they are doomed to spend years in what can feel like indentured servitude, creating value in a business they no longer want.

The purpose of this guide is to help you determine whether a gap exists between the value of your clients' *current resources* and *the resources they will need* to achieve their exit goals. For example, let's assume that an owner, Mary, needs $5 million in investment capital to meet her financial security goal. If she estimates that she has $3 million right now (non-business assets plus the net proceeds she'd receive if she sold her business today), her gap is $2 million. Based on this estimate, she can move to the next phase of the planning process: creating and implementing a series of actions to close that gap by her exit date.

However, this method of determining the Asset Gap is fatally flawed. In Mary's case, her analysis was based on assumptions rather than accurate information (e.g., how did Mary come to the $3 million estimate?). As advisors, we often think it's simple to use accurate, objective information to evaluate the Asset Gap, but for owners, it can be challenging. Many owners rely on inaccurate assumptions about both their businesses' value and what they will need to live a comfortable post-exit life.

Creating an Exit Plan based on inaccurate information is like taking the helm of a cruise ship and telling the passengers, "Let's go someplace warm," only to ask, 10 hours later, "Has anyone checked the supply of diesel, food, and toiletries?"

BEI does not advocate for journeys that (a) lack a destination, map, and supplies, and (b) have a low probability of success. Starting a journey toward an uncertain destination even slightly off course can mean missing the desired port by hundreds of miles. Catching and correcting that miscalculation is the difference between reaching port and drifting aimlessly.

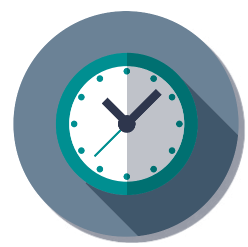
Owners who wait too long to address their Asset Gaps—and worse, owners who use inaccurate information to address their Asset Gaps—often face challenges that prevent them from exiting their businesses on their terms. Without accurate information about their starting and ending points, how can they possibly know what it takes to reach their desired destinations? That's where you, as an Exit Planning Advisor, need to take the reins and explain to clients what the functions of a proper Gap Analysis are:

- Accurately establishing the owner's starting and ending points, which enables the owner and your Advisor Team to chart a path between the two.
- Providing the owner with the motivation to bridge the Asset Gap as quickly as possible.

BENEFITS OF THE GAP ANALYSIS

In addition to the two functions a Gap Analysis serves, it also has several important benefits:

- Determining the size of your clients' Asset Gaps allows everyone involved to efficiently develop and execute strategies to close the Gap.
- Learning the size of their Asset Gaps should motivate your clients to increase business value and cash flow sooner and more forcefully than does remaining blissfully unaware of the work they need to do. Conversely, owners with small or absent Asset Gaps can turn their attention to important Exit Planning endeavors, such as deciding what to do with the money they make from the sale of their businesses.
- The Gap Analysis gives owners a new and more realistic understanding of how much time, capital, and effort it will take to get from where they are to where they want and need to be.



A BEI OBSERVATION

Unless owners perform a Gap Analysis based on accurate information, they operate under the Misperception Spell.

THE MISPERCEPTION SPELL

Exit Planners help create and implement successful Exit Plans based on accurate information about their clients' personal and business resources, and personal financial needs. We emphasize accurate because the financial resources and needs owners think they have typically vary dramatically from their actual financial resources and needs. The challenge of breaking the Misperception Spell towers above all others in this guide.

Unless you help your clients break the Spell, planning is worthless. Goals and aspirations remain mere fantasy. Even worse, your clients' misperceptions will create complacency and inaction when they should be moving as quickly as they can toward their exits.

There are six common misperceptions owners have regarding the Asset Gap:

- The amount of income they will need after they exit.
- How long they and their spouses will live.
- The rate of return they expect on invested assets.
- The value they assign to their companies.
- The growth rate they predict for business value and cash flow.
- The net proceeds they expect from the sale of their companies.

Why are these misperceptions so prevalent? First, most owners fail to consider the headwinds that depress financial returns and elevate the amount of capital they need to exit on their terms.

A second cause is inherent optimism: Entrepreneurs generally believe that they can find a way to grow their businesses despite all evidence to the contrary. After all, if owners placed reason above passion, they probably wouldn't have ever started their businesses![1]

[1] In 1983, Howard Stevenson, a Harvard Business School professor, defined entrepreneurship as "the pursuit of opportunity without regard to resources currently controlled." That definition is as true today as it was in 1983.

Third, owners are reluctant to pay professional fees, assuming that the cost of professional services isn't worth the trouble. However, professional fees typically cost less than they assume, especially compared to the cost of basing an Exit Plan on inaccurate information.

Finally, owners commonly believe that they don't have Asset Gaps. Similarly, owners who realize that they do have Asset Gaps typically argue that their Gaps aren't as large as others', and that they can quickly and easily fix theirs. They say, "There's no urgency for me to act now. I can postpone acting until I'm ready to exit." These are the fantasies of an owner under the Misperception Spell.

Consider the experience of BEI Member Pat Carroll:

> Typically, the most common "false assumption" I hear from my owner clients relates to their expected net proceeds from the sale of their companies. They've made an estimate of value, usually based on an industry rule of thumb, and they underestimate the portion that the IRS takes from the sale price. For that reason, I always recommend a "tentative" valuation, and we run through the numbers together. A tentative or "thumbnail" valuation is accurate enough to use as a foundation for an Exit Plan but not as expensive as a formal valuation. A napkin estimate of taxes generally drives home the point that under the U.S. Tax Code, a $10 million sale price is far from a $10 million payday.
>
> The owner that comes to mind when I think of owners who are left speechless by a tax bill is a longtime personal financial-planning client who had been approached by a competitor. (I also cite this story as a great example of why it is so important to meet with an Exit Planning Advisor early in the Exit Planning Process.) The competitor made a generous offer to buy her company and have her work inside its company. The prospect of taking her chips off the table appealed to my client, but when we put pen to paper, we ran smack into the significant amount of retained earnings that my client had built up in her C corporation. My client's likely tax bill approached 50% of the purchase price and sent her right back to the competitor to negotiate. When the competitor refused to increase its offer, my client walked away from the deal.
>
> Like most of the people I see, owners are looking for some guidance. With respect to the amount of income they'll need after they leave their companies, owners are like everyone else. I've never seen one person live on less than 100% of his or her current income.
>
> In thinking about life expectancy, owners again mirror the general population: They just don't think that much about it. I use "100 years old" as the life expectancy in my forecasts, and not one person has ever objected.
>
> Interestingly, owners are, by and large, conservative in the amount of risk they'll assume to generate a desired rate of return. I always include two rates of return in my projections to illustrate "what a difference a percentage makes."

Once owners realize that (a) their assumptions about the size of their Asset Gaps may be false and (b) they might not have accurate information, you can help them break the Misperception Spell.

Let's re-introduce Francis, a fictional business owner, to demonstrate the process BEI uses to accurately determine the financial barriers that stand between owners and their successful exits.

A BEI OBSERVATION

Business owners often think that they have more time and resources than they really do in their approaches to their business exits. Additionally, they fail to realize that even when their businesses are successful, they will need more from their businesses in terms of value to achieve their financial independence goal.

FRANCIS AND HIS ASSET GAP

Francis opened his meeting with his Exit Planning Advisor, Malcolm, with his assessment of how much he would need to support the post-business life he desired.

"I think my business is worth about $1.5 million today, and I plan on growing cash flow much more quickly now that the recession is over. My investments float around $1.2 million. I think my wife, Rita, and I can live on $120,000 per year, and I want to be sure I've got enough money invested to live that way for 25 years. I think I could probably sell today and have enough. Don't you agree?"

Malcolm replied, "You've just told me a few things:

- *What you think your business is worth and that it's going to be growing much more rapidly.*
- *What you think you and your wife can live on after you exit.*
- *How long you think you will live.*
- *That you believe that you can sell your business today for enough cash to live comfortably.*

I don't know whether any of that is accurate, but I do know that if your estimates are as reliable as most owners', you are living in a world of hope, not reality."

Francis, like most successful business owners, was not flattered when Malcolm implied that he was dead wrong about his projections, and that he misperceived what he had and what he needed.

Once owners become aware that they are enchanted by the Misperception Spell, they are not happy. But before Francis took offense, Malcolm suggested that they put his assumptions to the test by collecting empirical data. They could then base his Exit Planning process on those data rather than assumptions.

"For the calculation of business value, let's get the business appraised. I can provide a few recommendations," Malcolm told Francis. "Your CFO can generate accurate cash flow forecasts, and we can ask your financial planner to supply a realistic assessment of your future income needs and likely investment returns."

Francis quickly turned his focus to the practical: "And how much will all that cost?"

"What will it cost to base the biggest transaction of your life on assumptions?" Malcolm asked. "What will it cost to run out of money and return to the workforce, earning entry-level money, at 70 years old?"

After a brief silence, Francis said, "I hadn't thought about that. But still . . ." he trailed off.

Sensing Francis's reluctance to spend money on tasks not directly related to producing income for the company, Malcolm suggested, "Let's at least weigh the cost of professional assessments against the cost of proceeding with guesses about cash flow, investment returns, tax consequences, and the rate at which you can expect the value of your company to grow."

Francis agreed to charge his CFO with providing cash flow forecasts, and Malcolm arranged meetings for Francis with a business appraiser and a financial planner. Francis agreed to hire them after learning what they would do and that their services would cost about half of what he'd assumed.

THE RESULTS

Within a few weeks, Francis and Malcolm met again to talk about the findings from his professional advisors. They assessed his ability to achieve his exit goals by addressing the five questions we posed at the beginning of this guide. We suggest that you have your clients ask themselves those questions as well.

Let's examine the results and compare them to Francis's original assumptions.

IS THE FINANCIAL SECURITY GOAL YOU SET ACCURATE, OR UNREALISTICALLY LOW?

In 2014, several researchers noted, "[T]he fact that consumption does not decline early in retirement ignores the fact that many people do not have the resources to consume at that pace over their entire retirement. In summary, given the clearly documented decline in assets to income over time, our best assessment is that U.S. households are more likely than not to be falling short when it comes to saving for retirement."[2] This assessment applied to Francis's situation before he committed to his Gap Analysis.

The financial planner found that Francis's assumption that he and Rita would be happy with a retirement income of $120,000 per year (pre-tax) was completely unrealistic, given Francis's current annual spending of $175,000–225,000. The financial planner suggested that Francis aim for a post-exit, pre-tax income of at least $200,000 per year as an alternative to slashing his spending almost in half.

Further, based on current life expectancy tables, 33 years was a better estimate of life expectancy for Francis and Rita (post-exit) than his estimate of 25 years. Thus, Francis would need more capital to fund a longer post-exit life.

A BEI OBSERVATION

Like most owners, Francis had no intention of scrimping during his post-exit life. He correctly assumed that his wife had had her fill of cutting coupons during the growth phase of his business, when they'd invested every available dollar back into the company. He quickly agreed to adjust his post-exit, pre-tax income target to $200,000 per year. At BEI, we've noticed that owners generally spend *more* after they exit than they did when they owned their businesses. Spending does slow as they age, but usually only after they've accumulated all the toys, homes, and travel experiences they desire.

[2] Alicia H. Munnell, Matthew S. Rutledge, and Anthony Webb, "Are Retirees Falling Short? Reconciling the Conflicting Evidence" (working paper, Center for Retirement Research at Boston College, 2014), 15.

SPENDING, BROADLY DEFINED. We've already discussed the importance of basing calculations of financial needs and wants on the amount your clients are spending today. However, many owners forget to factor in how perks affect their spending. Owners often "pay" themselves for health insurance, provide themselves cars, and take allowances for food and travel. When your clients calculate their current spending, make sure they include all the perks they take.

THE QUESTION TO ASK YOUR CLIENTS: Is your financial security exit goal appropriate when compared to what you currently spend?

THE QUESTION TO ASK YOURSELF: Do you have a team of expert advisors—including a business appraiser, financial planner, and CPA—to call upon as needed for this step of the Exit Planning Process?

HAVE YOU ACCURATELY QUANTIFIED THE RESOURCES (BOTH BUSINESS AND PERSONAL) AVAILABLE TO YOU TODAY TO ATTAIN YOUR FINANCIAL SECURITY GOAL?

The business appraiser Francis hired estimated the current value of his business to be $1 million (pre-tax) versus Francis's estimate of $1.5 million. Additionally, the financial planner used a 4% withdrawal rate for lifetime income planning purposes, while Francis had used 7%.[3] Their differing opinions came from different interpretations of the headwinds: Francis's expectation of a 7% return was likely based on his investment experiences in past decades, not on the realities of today and tomorrow.

THE QUESTION TO ASK YOUR CLIENTS: What is the actual value of your business versus your estimate? How much non-business investment capital is available to you today? What is an appropriate rate of return?

THE QUESTION TO ASK YOURSELF: How comfortable are you in allowing a client—rather than the appropriate professional advisors—to answer these questions? The BEI Seven Step Exit Planning Process includes tools and processes to coordinate, guide, and facilitate a team of professional advisors in the creation and execution of an owner's Exit Plan.

[3] Tara Siegel Bernard, "New Math for Retirees and the 4% Withdrawal Rule," The New York Times, May 8, 2015, accessed June 8, 2017, https://www.nytimes.com/2015/05/09/your-money/some-new-math-for-the-4-percent-retirement-rule.html.

DO YOU HAVE AN ASSET GAP, A SHORTFALL BETWEEN THE RESOURCES YOU HAVE AND THOSE YOU'LL NEED TO ACHIEVE YOUR FINANCIAL SECURITY GOAL?

In Francis's case, the answer was a resounding yes.

THE QUESTION TO ASK YOUR CLIENTS: Have you *accurately* and *objectively* determined whether there is a shortfall between the resources you have and those you'll need to achieve your financial security goal?

THE QUESTION TO ASK YOURSELF: Have you created a stable of advisors that can help owners address issues that are outside of your expertise? (We find that most owners are pleased when Exit Planning Advisors have a stable of best-of-the-best advisors they can recommend when their situations call for outside expertise.)

HOW BIG IS YOUR ASSET GAP?

Using a 4% withdrawal rate, Francis's financial planner calculated that Francis needed at least $4.5 million in investable assets on his exit date (along with Social Security payments) to yield $200,000 in annual pre-tax income for 33 years. Contrast that with Francis's estimate: He thought he would need about $2 million in investable assets to generate $120,000 of pre-tax retirement income. By his calculation, Francis had no shortfall. Francis's actual shortfall was $2–3 million, not $0 as he believed.

Today, many financial planners view a 4% withdrawal rate to be a bit optimistic. Peter Florio (a financial planner) explains: "In the past, studies indicated that a portfolio would last 25 to 30 years if we utilized a 4% withdrawal rate. Given what we have experienced in the market in the past 10 to 15 years, the safety of this rate has come into question. Even taking into consideration projected income from Social Security, Francis would need a minimum of $4.5 million to $5 million to comfortably provide income for his and his wife's lifetimes."[4]

THE QUESTION TO ASK YOUR CLIENTS: What is your shortfall, and how did you calculate it?

THE QUESTION TO ASK YOURSELF: Does the financial advisor your client works with have the experience and credibility to advise your client in this area? If not, do you have a financial planner you work with who understands your role as an Exit Planning Advisor?

[4] Accumulating $5 million of investment capital would be less risky given the current yield on U.S. 10-year Treasury Notes (approximately 2.2% in June 2017) and an average return on the S&P of almost 4% (since 2000).

WHAT MUST YOU DO TO BRIDGE YOUR ASSET GAP?

Francis had three choices: (1) reduce his financial security goal, (2) increase the amount of his income-producing resources, or (3) exit at the price he could get, because he is just too burned out to stick around and build business value.

After a lifetime of hard work, Francis, like most owners, was not about to cut his post-exit standard of living. Nor was he burned out. By conducting his Gap Analysis well before he was ready to exit, Francis gave himself (and his advisors) time to develop and act on a plan to incrementally grow business value and personal investments by $3 million (net), which would allow him to achieve his financial security goal.

Armed with accurate data, Francis could move forward to construct and implement a plan to bridge his Asset Gap.

As Exit Planning Advisors, we must always be aware of our clients' emotional states. Consider Francis: Because he was not burned out, he was willing and able to continue his efforts to reach his financial finish line for several years. Many owners aren't so lucky, and you must be able to determine where your clients are, mentally, before committing to a specific Exit Path.

One of the greatest challenges to owners in the Exit Planning Process is realizing that their assumptions put them under the thrall of the Misperception Spell. Francis was the poster child for this condition: The $3 million gap in the after-tax cash he needed to generate from his business was far greater than he expected.

Francis held several of the most common assumptions that encourage and foster complacency:

- A rosy estimate of business value.
- A rosier estimate of future business growth.
- An even rosier estimate of the investment income rate he could expect.
- An underestimation of the income stream necessary to support his post-exit lifestyle.
- A significant underestimation of the length of time he and his wife would likely live post-exit.

The total amount of capital (or investable assets) that Francis would need on his exit date—at least $5 million—surprised him, as it does most entrepreneurs.[5]

A BEI OBSERVATION

If owners wait until they are ready to exit before beginning to plan their exits, they run the serious risk that they will have exhausted their energy, drive, and patience, and find themselves unwilling or unable to exert the effort required to achieve success. Address this issue with your clients, early and often.

[5] Recall Stevenson's definition of entrepreneurship from earlier in the guide. Entrepreneurial optimism has its downside when estimating post-ownership income from investments outside of your clients' control.

Calculating what owners have and what they'll need is straightforward and accurate when they use the right advisors.[6]

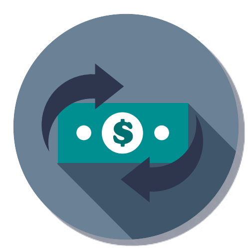
THE QUESTION TO ASK YOUR CLIENTS: Are you willing to exit your business without the assurance of financial security?

THE QUESTION TO ASK YOURSELF: If your client answers "no" to the question above, are you prepared to develop and execute a comprehensive Exit Plan with the support of your team of expert advisors?

Peter Florio sums the discussion up nicely:

"The morals of the post-exit financial security story are:

- *The distribution phase of an owner's life is very different than the accumulation phase.*
- *Given today's economic environment, longevity, and health/long-term care needs, it may be unrealistic for business owners to exit their businesses prior to age 70.*
- *If business owners do not start the process of preparing their businesses for sale long before their desired exit dates, they may never be able to retire at all."*



[6] We have simplified the amount of work and analysis performed by the business appraiser, financial advisor, and Exit Planner.

THE ASSET GAP AS A MAP

To bridge an Asset Gap, owners must address the same questions Francis did. Upon doing so, you, your Advisor Team, and your clients can begin to construct a plan based on four important planning elements. Let's look at how Francis addressed them.

A Starting Point
A Destination
The Distance Between Start and Finish
The Map

A STARTING POINT

Francis's business was worth $1 million (or $800,000 after tax). His non-business investment assets were worth $1.2 million, and his Social Security benefits would provide $30,000 annually beginning at age 70.

A DESTINATION

Based on his and his wife's life expectancies, current rate of spending, and anticipated rate of spending, Francis and Rita needed between $4.5 million and $5 million in investable assets to begin their post-exit lives. Francis and his advisors could further refine this amount as Francis neared his exit date.

THE DISTANCE BETWEEN START AND FINISH

Francis needed to increase the amount of money he received from two business-related sources—the future distributions of excess business cash flow and the proceeds from the sale of his business—from $800,000 to $2.5 million. In addition, Francis needed to increase the value of his non-business investments from $1.2 million to $2 million, a rate of growth that his financial planner believed was achievable, but not without some risk. Francis knew the distance to his finish line; he just needed a plan and execution strategy to get there.

THE MAP

Like Francis, your clients will work with you and your Advisor Team to map out a step-by-step plan to take them from their starting points to their destinations. Future guides will describe the various Exit Paths and specific steps you, your Advisor Team, and your clients will include in your map.

These four elements (starting point, destination, distance between starting and finish line, and map) can be phrased as questions for your clients:

- Where are you?
- Where are you going?
- What is the distance between where you are and where you need to be?
- How do you get from where you are to where you need to be?

REALISTIC EXPECTATIONS

THE COSTS AND BENEFITS OF REALISTIC EXPECTATIONS

Owners are naturally concerned about the costs involved in obtaining a professionally derived Gap Analysis, so let's look at what it cost Francis to obtain:

- The current value of his business and a realistic estimate of future cash flow.
- A sound estimate of expected investment performance.
- A calculation of likely taxes due upon the sale of his company.
- A realistic estimate of the amount of post-exit income Francis would need to support his desired post-exit lifestyle.
- An actuarial-based calculation of the length of his and his spouse's post-exit life expectancies.

Francis "bought" a fact-based determination of the size of his Asset Gap. The invoices from the professionals Francis retained were as follows:

Business Appraiser (Calculation of Value)	$2,500
CPA	$1,000
Financial Planner	$1,500
Total	$5,000

For $5,000, Francis created the contours of his business-exit road map. He knew where he was (his starting point) and where he needed to go (his destination). Of course, the cost of these services will vary considerably based on business complexities, geographic location (e.g., Manhattan, New York vs. Hastings, Nebraska), and the fees you and your Advisor Team normally charge.

The success of your clients' exits and their ability to leave on their terms begin by accurately assessing their available resources: business value, future cash flow, and income from non-business assets.

We again asked Peter Florio to outline the planning he does to determine an owner's Asset Gap.

> First, we highly recommend that owners take the first step to determine the size of their Gap, that is, begin the process of writing a formal financial plan to determine what their assets will be and how much income their non-business assets will provide. This financial plan will incorporate any anticipated large expenses, such as a vacation home, and it will include analyses of cash reserves, risk and debt management, and estate-planning issues.
>
> Second, we encourage owners to have a business evaluation created that will provide a fairly accurate estimate (usually within 10%) of what the business is worth. The cost of this analysis is far less than a formal business appraisal and gives the owner a good yardstick to use during the planning process.
>
> Using a variety of tools (including assessments and [*The Exit Planning Workbook for Business Owners*] from BEI), we will determine which areas of the Exit Planning Process need to be addressed to close the Gap. Only then do we recommend various exit strategies to meet the owner's goals.

Remember, once the Gap Analysis is complete, your clients may need to re-examine or adjust their departure date and/or definition of financial security.

Speaking of adjustments, neither your clients' financial plans nor Exit Plans are written in stone. You and your Advisor Team will adjust your clients' plans as external and internal factors change. These factors may include the investment market, or your clients' income needs, health, and the success (or failure) of the actions they take to build value in their companies.

In short, your clients are better served determining their Asset Gaps *now* rather than *when they are ready to exit*. Waiting until they are ready to exit gives them little to no time to assure that their businesses are ready for their exits.

BACK TO FRANCIS

At this point, Francis, with input from his wife and advisors, had carefully thought through his foundational, universal, and values-based goals. With accurate, fact-based information, Francis could refine his departure date window from a soft range of "tomorrow to 10 years" to a hard goal of six years. Most importantly, the Gap Analysis made a real difference in how Francis would proceed in planning and executing his exit. He and his advisors were able to create and implement a step-by-step plan to reach his specific goals. The efforts of his entire Advisor Team focused on achieving quantifiable goals in time for Francis to exit on the date he chose.

CONCLUSION: BE THE EXCEPTION

You can help your clients avoid the fate of so many owners who learn, just before they want to exit, that what they have varies dramatically from what they need. Your clients may be tempted to wait until they are ready to exit before they begin planning, and you need to stem the tide of that temptation.

As an advisor, you need to make sure that you are asking your clients the questions included in this guide. Doing so will not only show your clients that you are proactive in addressing their needs as they exit their businesses but also give your clients the best chance to leave their businesses when they want, for the money they need, and to the person they choose. Of course, BEI trains and assists advisors in asking these questions and establishing Asset Gaps.

For more information or in-depth training, we urge you to call us at 303-321-2242 or contact us at info@exitplanning.com with the subject "eBook 2: Asset Gap Help." Our methods aren't just theoretical: They work in the real world.

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BEI is the leading innovator in the Exit Planning industry. We offer comprehensive Exit Planning training, marketing support, and plan-creation tools to our Members. Members of BEI have access to an established, systemized process that allows them to easily help their clients with their business-transition planning. Professionals in a variety of disciplines leverage Exit Planning to attract and keep high-caliber business clients in their practices. BEI trains and supports business advisors to be the preeminent Exit Planning resource for business owners in their communities. Our Members ultimately seek to help business owners and their families benefit from their lives' work.

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