Key Private Bank

# Three mistakes to avoid when rightsizing the risk in your business

## Descending is the real climb

Building a business is like climbing a mountain and, while growth is critical to get to the top, it's equally important for business owners to consider their "descent" from that trek. Yet, 4 in 10 advisors surveyed in Key Private Bank's Quarterly Advisor Poll, say very few or none of their new business owner clients have thought through the wealth implications of their business succession strategies. In fact, nearly half (48%) say business owners have unrealistic assumptions about their company's valuation.

To maximize wealth in retirement, it's critical that business owners determine how to increase the value of their companies. Business owners often lose objectivity when estimating the amount of risk in their companies. Rather than taking a risk-reduction approach, they often focus on pursuing a single-minded strategy to grow revenue or reduce costs – a method that can produce challenges when looking to exit the business.

Mistake #1:

## Focusing solely on growing sales

Growing revenue typically starts by investing capital in hiring more employees or opening offices to expand into new segments. But additional sales can place stress on operations and employees, leading to dissatisfied customers. This can cause a ripple effect, resulting in a damaged company reputation and plummeting profit margins. Ultimately, additional sales have the unintended consequence of making revenues and profits riskier – decreasing the company's overall value and increasing the odds for impacting personal wealth.

**Unintended Consequences**

- Consumes capital
- Strains organization
- Damages reputation
- Increases business' risk

Mistake #2:

## Cutting costs

When a company attempts to grow its value by implementing a cost reduction strategy, three popular actions – streamlining processes, reducing headcount and cutting external spend – are easy to implement and often yield immediate results. Yet, after multiple rounds of cost cutting, the potential for long-term cost savings is limited. Rather than solving cost inefficiencies, which are harder to identify, employees are often the first to get cut. With fewer bodies, however, quality suffers, customer service weakens, and workforce morale deteriorates. Unhappy, overworked employees won't foster great customer relationships, causing customers to jump ship.

**Unintended Consequences**

- Quality suffers
- Service weakens
- Morale deteriorates
- Relationships break

Mistake #3:

## Growth by acquisitions

Sometimes, business owners attempt to “buy” their way to greater value by making acquisitions. Yet this strategy often backfires by raising the risk and lowering the worth of the company. Acquisitions are time-consuming – over half of buyers spend 10 to 20 hours a week for up to a year searching for a suitable prospect. “Deal fever” – in which the buyer invests so much time, energy and emotion into a deal that his or her focus shifts from doing the right deal, to simply getting a deal done – can cause culture clash, expose weaknesses in the business and lead customers and employees to defect.

**Unintended Consequences**

- Deal fever
- Pressure exposes weaknesses
- Cultures don’t mesh and synergies aren’t realized
- Customers defect

## How can business owners avoid these mistakes?

More often than not, business owners emphasize the journey to success but fail to consider the work it takes to wind down. This can carry strong implications, especially since the most common wealth management challenge facing business owners is having most of their personal wealth tied up in the business, say advisors.

With this in mind, it’s important to think carefully about the potential for introducing risk into a business before implementing plans for streamlining costs or rapid growth. Only then will business owners be well-positioned to develop a comprehensive business transition plan to maximize wealth in retirement.

For more information, please contact your Key Private Bank Advisor.

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