

William Blair

Private Wealth Management

Business Owners Focus

Considerations for Every Entrepreneur



You put time, energy, and passion into growing your business.

Let us help you get to what comes next.

At William Blair, we have guided many startup entrepreneurs and executives through liquidity events, both from investment banking and wealth management perspectives. Our wealth advisors can help you identify the most important questions to ask to determine if you are truly ready for a liquidity event. There are many different personal and financial considerations to keep in mind, and we are here to help you get started.

PERSONAL CONSIDERATIONS

- Liquidity: Personal Questions to Consider

FINANCIAL CONSIDERATIONS

- Liquidity: Financial Questions to Consider
- Financial Planning Following a Liquidity Event

Liquidity: Personal Questions to Consider

There are many ways for entrepreneurs and executives to generate liquidity from the high-growth businesses they have built, such as:

- Recapitalization through venture funding or private equity investment
- Selling the business
- Selling private shares on secondary markets

Each of these transactions raises its own set of questions. We believe the biggest question you face is: Are you ready? On the surface, this might seem simple. Of course, you are. You are ready to generate some cash and unlock the wealth you have worked so hard to build. But it can be more complicated than that.

Having guided many startup entrepreneurs and executives through these events, William Blair has identified the most important considerations to determine whether you are ready for a liquidity event. These questions generally fall into two categories: personal and financial. Here, we start with the personal questions to consider before entering a liquidity event.

Do You Have the Right Foundation in Place?

Many executives at high-growth companies think about their wealth from a long-term perspective for the first time and have not yet established some of the basics of a solid financial plan. From budgeting for cash flows and estate planning to tax-advantaged retirement accounts and insurance and risk management, there is plenty to consider when it comes to personal wealth.

As you raise capital and generate liquidity, your financial life will get more complicated. You need to have a team of trusted advisors in place to help you navigate these complex decisions, including an accountant, estate planning attorney, investment banker, and insurance and wealth advisors. You also need to ensure you have someone to coordinate the team and make sure all the pieces are working together in unison. Often, a wealth advisor is in the best position to take on this role.



Liquidity: Personal Questions to Consider (continued)

What Are You Looking to Accomplish With Your Wealth?

First, identify your short-term and long-term wealth goals and quantify what you will need to accomplish those. From there, you can differentiate between core and excess wealth, and think about new opportunities.

Often, high-net-worth individuals identify four high-level areas for the distribution of their wealth: taxes, core wealth (lifetime spending), a wealth transfer, and philanthropy. But for startup executives, there is often a fifth category: funding the next venture.

This next venture could be starting another company, becoming an angel or venture investor, or establishing a non-profit or foundation that looks to drive social change. Regardless of what that next chapter looks like, the more planning you do on the front end, the more opportunities you will have in the future.

Do You Have Realistic Expectations?

Having realistic expectations about how much your equity is worth is critically important to make the most out of your opportunities. One of the biggest problems plaguing executives at private, high-growth companies is unrealistic expectations.

Some executives assume that the most optimistic projections of the company's growth will naturally come to fruition and result in sky-high valuations that will be easy for them to monetize. Others take the opposite approach and believe that projections about the company's growth and valuation are not of value.

Making good decisions requires an honest, realistic, accurate, and data-driven assessment; and understanding your personal risk tolerance and risk capacity is an important part of this assessment. This is where scenario planning can be helpful.

How Will You Maintain Your Identity After the Transaction?

Selling a large portion of equity in a company that you have helped build can be difficult. Beyond the fear of giving up financial participation in the company's continued growth and some level of control in how the business is managed, entrepreneurs and executives often struggle with the prospect of losing something that has defined their identity and fueled their passion for years.

It is important to realize that these feelings are normal and understand that change is a natural part of life. When major life changes occur, it takes time to work through them; you do not need to have all the answers about what your next phase will look like right away. Stay focused on your long-term goals and give yourself time and space to work through the transition.

Are You Prepared to Deal With the Pressure That Comes With Your Next Level of Wealth?

Achieving a new level of wealth opens new opportunities and subjects you to new levels of visibility and scrutiny. Many executives are surprised by how much active interest they receive once news of the liquidity event becomes public. Wealth will also bring heightened visibility, so make sure that you conduct a security and insurance assessment to protect you, your family, and your assets.

You will want to have your long-term plan and trusted team in place before these opportunities arise. This allows you to be proactive and intentional, rather than reactive, in how you assess these opportunities.

After the liquidity event occurs, your wealth goes from theoretical to tangible. In the case of selling a company, you transition from having a steady income to relying on your portfolio to generate a paycheck; this requires adopting a new mindset, managing your expectations about market fluctuations, and remaining focused on your long-term goals.

Liquidity: Financial Questions to Consider

If you are considering a liquidity event, it is time to ask yourself some important questions, from both a personal and financial perspective. At William Blair, we have worked with many startup executives and entrepreneurs. Through this experience, we have identified important considerations on both ends of the spectrum. Once you have answered the personal questions to consider before entering a liquidity event, it is time to ask yourself these financial questions.

How Much Should You Sell?

From a business perspective, the first consideration may be how to take your company's growth to the next level. This could mean selling a minority interest to an institutional investor who has the right balance of capital and expertise to be a great partner. Alternatively, it may be finding the right strategic partner who may acquire the entire business. From a personal perspective, this can be one of the most challenging decisions executives—and founders in particular—face. Generating the liquidity necessary to achieve portfolio diversification and accomplish other wealth goals often means selling a portion of the company's equity. While this helps limit your risk, it also means giving up some opportunities to participate in the company's future growth.

Balancing these factors is challenging but having a clear picture of your true risk exposure and the potential outcome under various scenarios makes this decision much simpler. In many cases, entrepreneurs will sell a portion of their equity, allowing themselves to benefit further down the road as the company continues to grow.

What Are the Tax and Cash Flow Implications?

When planning for a liquidity event, one of the most important considerations is understanding the amount and timing of cash you will receive after taxes have been paid.

The earlier you and your advisors begin doing this the better. You want to give your advisors enough time to assess the tax and cash flow consequences of potential transactions and create projections for how much after-tax wealth you will receive under a range of valuations for the business and transaction structures. This work is especially important for transactions that involve equity compensation, vesting schedules, or earn-outs rather than all cash.

You will need to identify how much of the proceeds will be treated as ordinary income versus long-term capital gains. A major part of this is understanding how the company is structured.



Liquidity: Financial Questions to Consider (continued)

Is There Anything You Can Do to Minimize Taxes?

While taxes should not be the main driver of your decision regarding how and when to achieve liquidity, they are a major factor in how much you can achieve with your wealth.

One of the main benefits of working with your wealth advisors early in the process to understand the potential tax consequences of a liquidity event is that it gives you more time and more options for implementing strategies to lessen the tax bill and maximize the amount of your wealth. You also want to give your wealth advisors adequate time to lay the groundwork for establishing any trusts, foundations, and other legal structures that will be used in executing your wealth-management strategy.

Some tools for managing the tax consequences of a liquidity event include:

- Qualified small business stock exemption
- Pre-transaction valuation discount for wealth transfer
- Offsetting gains with charitable gifts

Also, if you are rolling equity into the acquiring company, that equity presents an ideal asset to consider for longer-term wealth transfer planning.

What Are Your Paths to Future Liquidity?

Assuming you did not liquidate all your equity in the transaction, it is important to start thinking about how you can eventually maximize the value of your remaining equity and convert it to liquid wealth in the future. Completing another recapitalization or selling the company may certainly be an option.

While going public is the outcome that many entrepreneurs anticipate, an IPO (initial public offering) is a reality for only a handful of companies. In most cases, it is difficult to generate liquidity from stock in private companies because the stock is not registered with the U.S. Securities and Exchanges Commission and the company imposes restrictions on reselling the stock.

As companies are staying private longer or delaying sales, they are looking for ways to allow executives and other employees to cash in on the value of their equity. Pre-IPO companies are increasingly taking steps to facilitate mechanisms that allow employees to unlock liquidity from their stock through:

- Stock buy-back programs
- Internal company stock exchanges
- Opportunities for employees to sell shares directly to outside investors
- Sales through private secondary exchanges

Often, when companies create opportunities to sell the stock, participation comes with additional restrictions on what can be done with the remaining stock.

Financial Planning Following a Liquidity Event

Selling or recapitalizing your business may dramatically increase your level of wealth, which allows you new opportunities. When navigating your way through a liquidity event, it is vital to consider your new financial reality. Whether you are retiring, shifting your focus to philanthropic endeavors, or investing in a new venture, you will want to have a long-term plan in place.

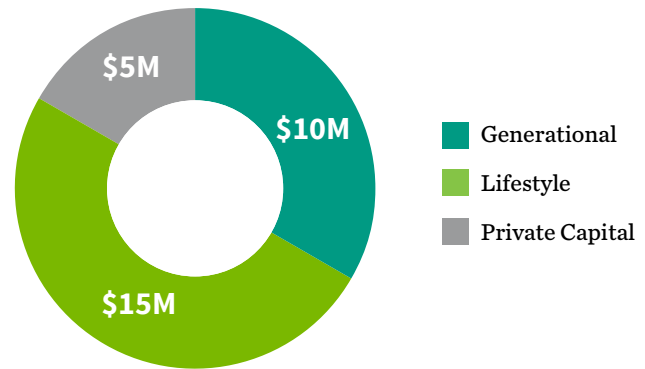
The financial modeling around your transaction aims to estimate the net after-tax proceeds you will receive from the transaction. As you approach a liquidity event, your wealth advisor will refine the terms of the transaction and more accurately estimate the net proceeds amount. This can then be used to address your primary planning objectives.

In many situations, your wealth advisor may consider financial independence as a primary goal, regardless of whether you will continue to work or earn income. You may want to understand how much capital would be needed to recreate a paycheck while factoring in the impact of inflation, income taxes, and market volatility. After understanding your current lifestyle spending requirements, your wealth advisor can solve for this “lifestyle capital” with a high degree of confidence. This process will then reveal if additional capital may be available for other planning objectives, including gifting to family members, earmarking funds for future business investments, and charitable giving.

EXHIBIT 1

Wealth Planning Buckets

Example: A business sale that results in \$30 million in net after-tax proceeds.



Here, we illustrate a transaction that results in \$30 million in net after-tax proceeds. This founder had a lifestyle spending objective of approximately \$600,000 after tax. Solving for an inflation-adjusted spending goal, we identified approximately \$15 million that would be needed for a sustainable income stream. The excess proceeds could be set aside for two additional goals, funding wealth transfer trusts for children and allocating funds for future business ventures and direct investments.

Liquidity events can be transformative to your financial situation, as you shift from an opaque and illiquid balance sheet to one that is liquid, very transparent, and potentially volatile. Choosing the right wealth advisor to help you manage your personal wealth is the first step in taking a highly sophisticated and comprehensive view of your total wealth profile. Contact your William Blair wealth advisor and start the conversation today.

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