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Business Transition: Reasons to Plan Ahead

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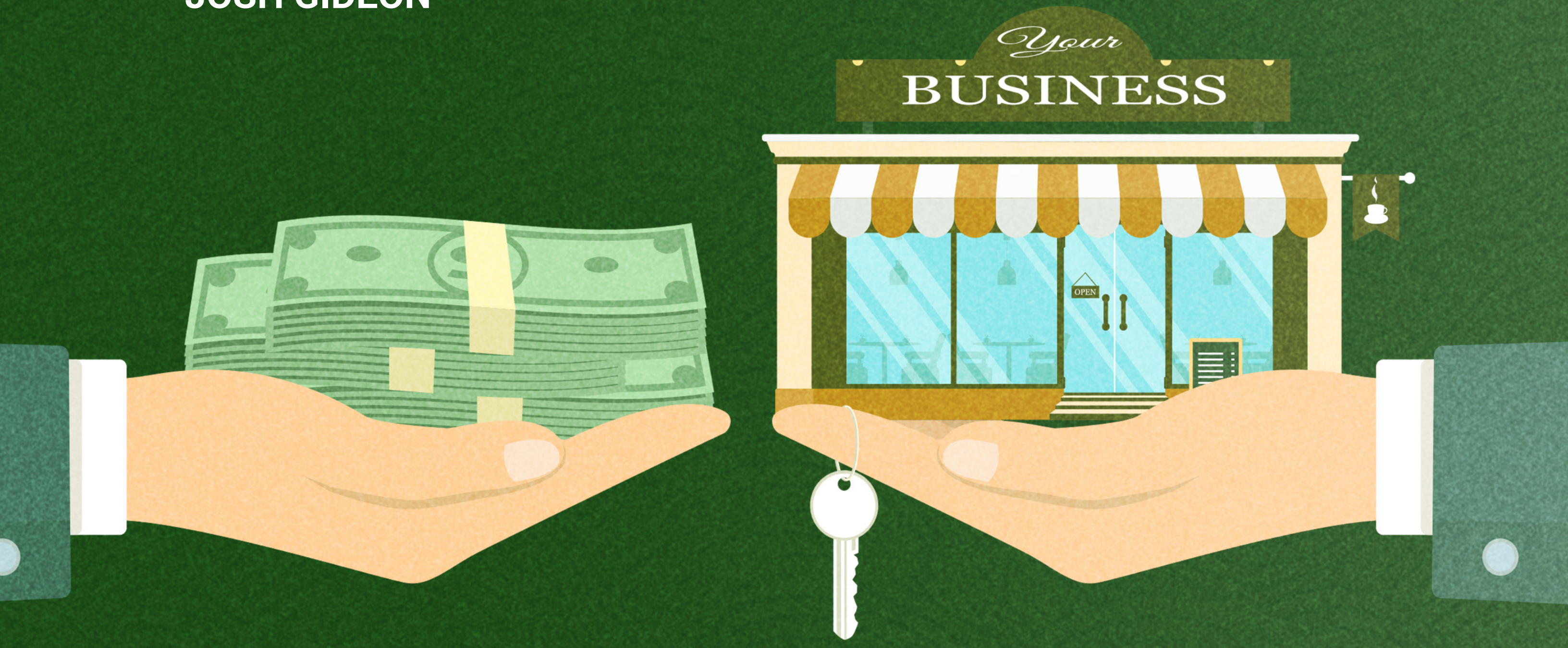

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Successful business owners are adept at running and growing their businesses, yet many don't stop to think about what comes after. While an unexpected exit is possible, for most it's a thought-out process, and there is immense value in having a purposeful exit planned. Preparing, as far as 3-5 years in advance, can help ensure you fulfill your goals when it comes time to sell. Whether you're exiting in order to have more spare time, or you're ready to move to the next challenge, there are some key preparations that will guide a successful transition.

Financial and Mental Readiness

When preparing to sell your business there are two main types of readiness: Financial readiness and mental readiness. Financial Readiness refers to the business being worth enough that the sale will meet your wealth and retirement objectives. The timeline for financial readiness can vary, depending on whom you are selling the business to, as well as how much you have already saved. Mental readiness is perhaps the more difficult component of the two and refers to the mental preparation required for walking away. Leaving behind a business you have devoted a large amount of time, energy, and effort to can be extremely difficult.

Sale Types and Considerations

For many different reasons, most small businesses eventually get sold, and there are four common ways this transition may happen. Your key considerations and preparations will change, depending on the sale type.

1. Sell to a Third Party

This is commonly a transition to someone outside the business, such as a competitor or someone buying the business for synergistic value (distribution, expansion). When selling to a third party, you're aiming to value the business at the correct price that both minimizes taxes and accomplishes your goals. It's important to keep in mind the purchaser (and their future performance running the business) will in many ways dictate the range of values. Outside professionals can help you land at the correct number. Business brokers and appraisers can help you determine the range of values, and working with an accountant who specializes in business sales can help you structure the deal in a way that keeps as much in your pocket as possible. In the end, it isn't how much you sell the company for, it is how much you take home.

2. Private Equity Acquisition

This transition occurs when a company or group with private capital comes in to grow, and eventually resell, the business. Generally, a private equity firm provides a lump sum upfront, becomes the majority owner, and works with the seller as a business partner (and shareholder) in the short term. Key considerations include the period of time you stay after acquisition. You should also consider if staying on board as a partner or subordinate, after working for yourself, is a viable option. There is also some risk involved; if the deal involves shares, your profits become contingent on company performance beyond the initial transaction. There are also considerations for taxes and capital gains.

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3. Transfer to Family

Slowly transferring funds by selling or gifting shares to someone in the family who will run the business down the road can be the most personal of the sale options. Key considerations include which family member will take over, the timeline for the transition, their readiness to take charge, and utilizing gift exclusions to minimize impacts related to taxes. It's also common for owners selling to family to discount the value of the business making it very important to have a high level of financial readiness prior to the transaction.

4. Transfer to Employees

Transferring to someone already working for the company has its own benefits and can be done in several different ways. Transitioning to an employee allows you to support the person, or people, who helped grow the business in the first place. It also typically means you're passing it to someone you trust to maintain the brand and its values. Considerations include whom you will transfer the business to, as well as the timeline and passing of responsibilities.

Benefits of Planning Ahead

No matter the type of sale or considerations involved, planning ahead for your exit as much as possible is the best approach. Planning ahead allows you to:

Achieve Your Goals: Allowing enough lead time means it's more likely you'll achieve your financial goals, especially with proper planning and enlisting the help of experienced professionals.

Take Care of Employees: Planning ahead allows you to determine your priorities, and ensure you're able to take care of those instrumental in growing your business.

Save Money in Taxes: Tax planning may well be the biggest consideration. By beginning to prepare years in advance, you can structure your business and entities in a way that saves a potentially large sum of money on the tax side. If the business is big enough, you can achieve similar benefits on the estate side.

Avoid Pitfalls: Planning ahead will reduce your likelihood of falling into pitfalls, such as making rash decisions or having a small, last-minute discrepancy or disagreement impact the sale.

Maximize Value: Planning in advance allows for an appropriate valuation, plus the potential to save millions of dollars through tax preparations. It also allows for adjustments to management systems, processes, and accounting practices that can make the business more attractive to buyers.

If you've thought through priorities in advance, it's more likely you'll get through the transaction and walk away with maximum financial gain.

A Wealth Manager Can Help

If you're thinking about selling your business, a wealth manager can help. At Richard P. Slaughter Associates, we are adept at helping business owners make this important transition decision. The sale of a business wraps into the long-term strategic planning we do within the context of broader financial goals.

We also recognize that selling a business is a complex process that requires more than a singular person. We'll help manage the process and work with each of the necessary outside parties, including estate attorneys, M&A attorneys, business brokers, business valuators, accountants, and so forth. A key component of our role is to coordinate all the pieces to ensure everyone is on the same page regarding your personal goals and that no piece is missing from the "puzzle."

When it comes to selling your business, it can't be overstated how important it is to have someone in your corner that understands your future goals and how the sale of your business fits within your plan. We can also assist with the mental readiness piece of the sale. We help our clients to ensure that when the time comes, they are prepared to proceed with a sale that works for them personally and financially.

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