

An Owner's Guide to Business Succession

Local businesses provide crucial services and jobs for our communities. Throughout the life of a business, owners need to plan for a new generation of owners to continue and possibly expand their business. Owners and their families want the best sale price while retaining their net worth without undue tax consequences. Planning is needed 5-10 years prior to transferring to maximize the company's value. It is also important to make sure your key advisors are on board early in the process.

Why do owners need a succession plan?

- Address personal financial needs
- Minimize taxes and avoid tax pitfalls
- Provide time to maximize the company's value
- Allow for future growth
- Provide contingencies for the unexpected
- Retain valuable community products/ services

Preserve, protect and promote the value of your business. Start your business trek towards transition today.

Where Am I? Snapshot of Company Now

Consider the needs of your current operating business

- What stage is your business in currently?
Start-Growth-Mature-Decline
- Are you ready to sell your business?
- Have you set a date to depart your business?
- What is your timeframe for the sale or transfer?
- Are you running your business as a going concern or liquidating?
- Have you identified your key advisors and employees?
- Have you listed the internal strengths and weaknesses of the firm?
- What is the company's competitive advantage?
- Are the company financial statements a true indication of business activity?



- Is your reported income as an owner reflected accurately?

How Much? Business Valuation

Protect Yourself

A business valuation is needed to protect the owner from tax ramifications from an undervalued business. The Internal Revenue Service requires informed judgment, common sense and reasonableness in determining the value of a business. The business valuation does not always equal the sale price of the business.

Determine the Best Value for Your Business

There are different strategies for assessing value depending on whether you are selling to a third party or an insider. For third party sales, you will want to maximize your purchase price. Alternately, if you are selling to a family member or employee, you will want the price such that the business can cash flow and support payments to you.

Authenticate Your Company's Value

- Do you know the "value" of your business?
- If so, do you use "rule of thumb" formulas common in your industry?
- If so, is the value from a third independent party?

- If not, do you need help increasing the value to get your business ready to sell?
- Are you the most important asset in your business?
- What are the intangible assets in your business (goodwill or blue sky accounts receivables, supplier relationships, name recognition, patents, trademarks, etc.)?
- Does placing a value on goodwill deter potential buyers?
- Does the business own real estate? Has it been appraised within the last 90 days?
- Have you considered selling your business separately from the real estate?
- Is the business a franchise?
- Do you know your company's total fixed costs?
- Do you want to stay on to consult once the business is transferred?
- Transfer management control in ___ years?
- Transfer ownership control in ___ years?
- Retire at ___ years old?
- What relationships will be affected by the transition and what actions will you need to take?
- What are the needs and wants of self, family members, partners and employees?

When? Identify Personal & Financial Goals

Are you ready?

- Do you feel trapped?
- Are you prepared for the next phase of your life after the transition – physically, emotionally, intellectually and spiritually?
- What are you going to do with your time once you are out of the business?
- Can you financially afford to make the transition?

Think about your values and prioritize goals (BUSINESS AND PERSONAL)

- Do you want to work less now?
- How long do you want to stay active in your business?



Retirement Planning / Financial Security

- Are you trying to maintain your present lifestyle?
- What annual income do you need to live comfortably?
- Can you retire and be financially comfortable without selling your business?
- Are you looking to set money aside for yourself and your spouse for retirement?
- Is there enough value from the sale of your business to fund your retirement?
- Do you have adequate resources outside the business for retirement?
- What charitable and philanthropic plans do you have?
- Do you want to have money to pass to your children or a charity?

With Whom? Key Advisory Team

Bringing together your key advisors helps the experts (who are focused on their individual tasks and interests) see the “big picture.”

Who are the essential key advisors?

The team of advisors is comprised of a Certified Public Accountant (CPA), attorney with business and estate planning experience, certified financial planner, banker, insurance agent and certified business appraiser.

Who are your key advisors and employees to take you where you want to go?

Create a list of key advisors or a transition team. Consider those who are already familiar with your business and have the expertise necessary to address business succession issues.

How do you know if your current advisors can help?

- Have they asked you if you have considered exit planning?
- Have they encouraged you to plan or described how they can help the transition of your business?
- Have they offered to help create a team of experienced advisors?
- *OR – Have they kept silent?*

Do you feel more comfortable with local or outside professionals?

If you do not already have a team of advisors with the requisite special training, please contact the Iowa Western SBDC office at 712-256-6552 or your local SBDC or Chamber of Commerce offices.

Where Is the Money? Funding the Transfer

Financing Considerations

- Type of business entity
- Availability of funding
- Successor's ability to obtain financing
- Tax considerations
- Gifting your owner's interest
- Selling your owner's interest
- Redeeming your owner's interest
- What assets (cash) do you need from the business?
- What is the tax liability upon sale?

Structure of Financing

- Can you leave money in the business to fund the transfer?
- Have you identified lenders who can assist?
- Do you want to receive consideration at the time of transfer or through installment payments, after the transfer, or both?
- Which option will have the best tax consequences?

Cash Flow Requirements

- Do your financial projections show that cash flow can fund the transfer?

- Businesses may need to grow significantly to pay the costs of exchange (taxes, insurance, professional advisors, setting up trusts, purchasing business stock) or to pay out to the family.
- Are you able to grow by at least 20 percent more than the normal growth pattern to offset the costs without disrupting profitability and cash flow in the business? Over-estimate capital and the time needed to complete the change (due to unexpected costs).

Who? Select a Successor

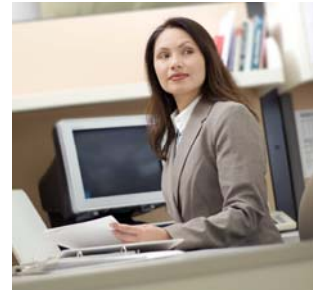
The "culture change" requires involvement, feedback and re-evaluation.

- Do you have a potential successor and have you notified him or her?
 - Are the qualifications of the potential successors what the business needs?
 - What training and preparation does the successor need?
 - Who will profile and pre-qualify buyers?
 - How will the transfer be negotiated and executed?
 - What are the personal and business goals of the potential successors?



Family Business

- Which comes first, the family or the business?
- Is the use of your business a refuge for family members?
- Will you be able to keep the business in the family?
- Can you transfer equally to children or treat them fairly and equitably?
- Which child will manage?
- Are you able to maintain family harmony?
- Have you thought about ways to compensate children who are not interested in owning the business?



Employee/Management

- Are you available to help management become the successor?
- Do customers, suppliers and bankers for the business believe managers can adequately replace the retiring owner?
- How will the operations proceed differently? (information flow, decision-making process)
- Will you renegotiate roles and responsibilities, promises and expectations, goals and action plans?

- Will any inherent problems be resolved prior to transfer to prevent conflict?

Employee Opportunities and Incentives
Including employees in the planning process increases their loyalty and your business value. Promote and reward employees and management.

Estate Planning
The goal is to develop strategies to transition assets to designated beneficiaries while mitigating federal and state gift and inheritance taxes.

- Does your will have provisions for the business transfer?
- Does your life insurance provide for your family?
- Have you considered a family limited partnership (FLP)?
- Is your estate tied up entirely with the business?
- Have you considered a financial transaction to separate out your personal assets from the business? (ex: a bank-loan financing a buy-out, a buy/sell agreement funded by insurance)

How? Active Transition Plan

The Active Transition Plan is a guide to continue future operations and to prepare for transfer.

- What are your plans for your business up until the transfer?
- Do you have a buy-sell agreement (give shares but retain control)?
- How does your will provide for the business transition?
- Do you have plans for loss of leadership?
- Do you have plans in case of premature death or disability?

Critical Time Frames

Estate taxes are due nine months from the date of death of the business. The IRS appraises the value as of the date of death of the business.

Communication

As the owner, you should have open negotiations and publicly acknowledge decisions among the new successor, management team and key advisory team.

Ongoing Health of Business

- Are you able to relinquish your status as owner?
- What are your plans to transition your key skills and responsibilities to new owners (relationships, networks, customers, suppliers, etc)?
- Can the new owners' competencies and capacities match the needs for the business to succeed?
- Do you have any unwanted partners or non-productive management or outdated equipment and machinery?

And then, How? Exit Plan

Owner options to consider to transferring his/her business:

- Sell the business to family
- Sell the business to employees (management)
- Sell the business to a third party
- Shut the business down and sell piecemeal

Liquidation

Liquidation is usually not the most rewarding exit strategy because it means the owner foregoes the value created by a lifetime of work. The goal is to maximize the return on the value of your business. In some situations, the liquidation results in higher profits than if the business continues to exist.

Employees/Management

- Do you feel you owe deserving employees a chance to buy the business?
- Is the employee really interested in buying the company?
- Can your employees afford to pay the amount you are asking for your business?
- Are the employees capable of running the business?

Third Party Sale

- How do you find a buyer who is willing to pay?
- How do you minimize your taxes with the sale of your business?
- How do you protect the confidentiality of your business once you decide to sell?

Family Members

- Do family members want to take over the business?



- Are family members capable of running the business?
- What impact do business dynamics have on the family?
- What impact do family dynamics have on the business?

Overall Financing Considerations

- Does the successor have access to enough of their own – capital to purchase their ownership interest?
- If they need to borrow the capital, how will the financing be arranged and what will the impact be on future internal operating cash flow?

NOTE: The information in this document was taken from “Will You Be Ready for the Finish?” published by the Federal Reserve Bank of Kansas City, Omaha Branch, in partnership with Creighton University School of Law, Community Economic Development Clinic and Nebraska Business Development Center-Wayne State College.

For additional information, visit www.KansasCityFed.org, community development.



For more information on or assistance with your business transition planning, contact the Iowa Western Community College Entrepreneurial Center at 712-256-6552.

www.iwcccenter.com



