PRIVATE WEALTH MANAGEMENT

Business Transition Series: Transition Planning Process

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Business Transition Planning may best be described as the process of establishing the goals, priorities and strategies set in place to affect a successful transition of the business. A business transition can be an outright sale to a third party, a "passing of interests" to future owners, or numerous strategies in between. The following are critical steps an owner should follow regardless of the type of transition.

1. Establish the Owner's Goals & Priorities

When establishing goals and priorities, it is important to determine the who, what and when of the transition process. Key questions to consider include:

- Will this be an internal transition to family or employees, or an external sale?
- Is a full or partial transition desired?
- Financially, what does the owner need (want) from the transition?
- What is the transition "timeline" for the owner?
- What role would the owner like to play after the transition?

2. Determine the Owner's Financial Needs

In determining financial needs, there are several key questions to consider. These include:

- Will the owner's future financial lifestyle be dependent on the transition of the business?
- What level of lifestyle does the owner desire after the transition?
- Are there future business opportunities that need to be funded?
- Will proceeds of a sale be used to provide a legacy to children, grandchildren?

3. Conduct a Financial "Gap" Analysis – Scenario Modeling

A financial "gap" analysis may be the most important analysis a transitioning business owner engages in. The purpose of a "gap" analysis is to quantitatively determine if the transition, as structured, fully provides for the owner's financial objectives. Scenario Modeling helps to analyze the impact of different inputs and variables to the planned transition, including variations in price and timing. In turn, this modeling provides insight in determining the "Financial Gap" the transition needs to fill to support his/her financial lifestyle goal.

4. Determine the Business Value - Business Valuation

A valuation helps determine the fair market value of the business. Business valuation is an important component in determin-ing gift or estate tax liability and/or to engage in a sale of the business. Business valuation methods are generally categorized under three techniques: asset approach, income approach and market approach. It is important to identify the preferred transition strategy to ensure the proper valuation technique is applied.

Closely held businesses are challenging to value without an active market for their stock, making an independent valuation a critical step in the process. Valuation discounts for lack of marketability and lack of control may also be available to closely held business owners. The IRS carefully examines intra-family business sales. A business valuation by a qualified valuation advisor is strongly recommended to ensure compliance with IRS rules and regulations.

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5. Identify the Value Drivers of the Business

Identifying and strengthening the business' key value drivers may have a positive impact on value. Common value drivers include:

- Stable, experienced management in place
- A diversified customer-base
- Consistent, sustainable revenue
- Financial controls in place
- Succession and key employee development plans

6. Determining the Transition Structure

How to ultimately structure a transition has multiple options and considerations. Multiple paths may be prudent to hedge uncertainty. The following are transition directions that tie to the owner's goals and objectives:

- Full vs. Partial - Owner maintains an interest/control
- Asset vs. Stock Sale – Choice has tax and legal considerations
- Outright vs. Installment Sale – Payment and taxation structure
- Earn-Out Provision for Outgoing Ownership – Additional payout for achieving business metrics
- Gifting Shares / Interests – Leverage of annual gifting and/or lifetime gift & estate tax exemptions
- Voting / Non-Voting Shares – Transition with control and additional gifting capacity

7. Contingency Planning

Business owners will likely agree that a key to success is to "expect the unexpected". The purpose of a contingency plan is to identify and address potential problem areas with the transition. Key elements of a successful transition plan include:

- Development of "what if" scenarios including action plans (death, disability of owner or buyer, etc.).
- Buy-sell agreement review and necessary updates
- Access to liquidity to fund contingency planning needs

8. Implementation / Follow-Up

A business transition plan will continue to evolve with the marketplace and the goals and objectives of ownership. The following are important issues to ensure the plan implementation is effective:

- Establishment of a timetable and steps for implementing the transition plan
- Identification of specific milestones and individual responsibilities
- Maintenance of constant and consistent communications.

In Summary

Given the complexity of the transition options, an effective strategy requires a clearly communicated plan, a realistic time frame, the support of professional advisors, and a commitment to a successful outcome for all parties. A well developed plan provides for a smooth transition in ownership with a minimum of business disruption.

Speak to a Regions Wealth Advisor

As mentioned, there are numerous considerations in addition to the issues discussed in this summary. A Regions Wealth Advisor can work with you to build a long-term strategic plan to meet your unique needs and goals.

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