Regions Wealth Podcast

Episode 42:
Transition Planning for Business Owners at Every Age and Stage

What happens when a business owner wants to retire, step back, or step away completely? Like death and taxes, transition is a certainty. 100% of businesses will transition — the question is who will control it, you or circumstances? In this episode, Senior Wealth Strategist Cindy Campbell joins us to discuss business succession planning, retirement and estate planning considerations for business owners, and how to prepare for the sale of your business.

Episode Transcript

Sarah Fister Gale, Host:

Welcome to Regions Wealth Podcast - the podcast that tackles life's challenges with financial experience. I'm your host, Sarah Fister Gale.

According to SCORE, a resource partner of the U.S. Small Business Administration, 34% of small business owners do not have retirement savings plans for themselves. Another study — conducted by Coutts — found that 64% of business owners underestimate the amount of preparation necessary to sell their business. But like death and taxes, business transition is a certainty: 100% of businesses will transition. Who will control that transition - you or the circumstances?

Joining me remotely is Cindy Campbell. She's a Senior Wealth Strategist at Regions Bank. Cindy, thanks for joining us today.

Cindy Campbell, Senior Wealth Strategist:

Thank you, Sarah.

Sarah:

So, Cindy, in this episode of Regions Wealth podcast, we're discussing retirement and transition planning for business owners. We've taken some frequently asked questions and have developed three characters in varying stages of business ownership, all of whom need your help. To get started, let's hear from Andrew, a 41-year-old with a long runway to retirement.

Cindy:

Great, let's get started.

Andrew:

"Hey. My name's Andrew. I'm co-founder of a large janitorial business. My buddy and I started it as a small operation, but over the last few years, we've scaled fast. We have about 200 employees and contractors working for us, and we're currently operating in three states, with plans to expand even further over the next two years. In short, business is great, no questions for you on that front. I guess my question pertains more to the personal side of things. My wife — who's played a huge role as COO of the company — has been bugging me to create documented estate and succession plans for like two years now. I gotta be honest… I am way *too busy to deal with that right now. I'm only 41, perfectly healthy, and retirement's at least two decades away, so I'm not really sure why she's so focused on this. I think Covid just kinda freaked her out and got her thinking. I own 50% of the business, so I assume that if something happened to me, my wife would automatically get my share as co-owner. With everything else I've got on my plate right now, is this **really** something I should be worrying about at this point in my life?"*

Sarah:

So Cindy, we know how important estate planning is for people of all ages. What is Andrew risking by not having documented estate plans in place, particularly given that he has a business partner?

Cindy:

Well thank you for the question, Sarah, and in thinking about this, my concerns are for what happens if Andrew were to pass away and the business would have to be managed or pass on to his family and what the potential risks are there. You know, as long as Andrew is alive and he's working with a partner, I think it sounds like they're doing very well and good for them. But the concern is if Andrew were to pass away without any planning in place, would there be potential conflict between his spouse and his partner? I wouldn't wanna see Andrew's wife in that position, nor his partner.

Sarah:

That's really interesting - you're saying it's not just about ownership but operations, right?

Cindy:

Right.

Cindy:

And that's the problem we have right there with the 50% ownership, right? So we don't know who is ultimately responsible for making the decisions. If you just look at it from the perspective of the percentage of ownership, it seems like nobody has the majority right to make those kinds of decisions. And if his spouse and the business partner are in conflict, they could be deadlocked.

Sarah:

Interesting. So is Andrew wrong in assuming that his wife would inherently become part business owner?

Cindy:

If you don't do an estate plan and you pass away, even if you don't have anything written up about what your wishes are, the state in which you live has laws that address that if you die without a will or a trust in place. So in most states, if a person passes away and they're married, all their assets will be inherited by their surviving spouse. So I don't think Andrew's necessarily wrong in thinking that his wife will end up owning the business's 50% interest, but I still see that potential for the risks and the conflict with the business partner if we don't otherwise have a plan in place, I don't think just by simply his spouse inheriting the business do we get rid of potential risk and conflict that could come up in the future.

Sarah:

Sure. If he were the sole owner of the business, would that change anything?

Cindy:

Well, I think it would eliminate that potential risk for conflict between the spouse and another partner since she would be the sole owner at that point, assuming Andrew hasn't done any estate plan otherwise, but I still think there's risks for her and for the family. Even though she's the chief operating officer, she may not be necessarily involved with decisions in terms of investments or buyers or things like that. That might be a whole new world for her actually running the business versus managing this business as a chief operating officer and being an owner.

My concern is sometimes in these situations, if there's no planning in place and someone inherits 100% of a business somebody else was the owner of, that their risk for potentially selling the business to an outsider or maybe to an internal employee at a much lower value than they really deserve and what the business deserves. We sometimes call that a fire sale because there's no preparation in place for the planning, an emergency arises and just to provide for Andrew's spouse and his children to provide liquidity for them, they end up having to sell a portion or all of the business at a value that might be a lot lower than it really deserves to be.

Sarah:

Andrew also mentioned succession planning in his question. How important is it for a business owner to have documented succession plans in place, and how early should they even begin thinking about that?

Cindy:

So I'm an advocate of thinking of that as early as possible. And I'm sure a lot of business owners would just laugh and say to me, “Look, Cindy, I have to run my business. I can't think about what's gonna happen in the future of my business.” But there are so many unexpected things that can happen in anybody's life. Particularly in the life of a business owner. We talked a lot here about what happens if Andrew passes away and he doesn't have a plan in place, but of course there's other things that can happen while he's the owner and he's living, he could become disabled at some point, perhaps his partner becomes bankrupt. He might wanna retire from the business.

What I encourage business owners to think about, even though they're obviously involved with the day to day running of their business, is to think about the future and those possible contingencies that might come into play. So that way, what you've built, what you've created is protected from those potential risks and contingencies in the future. And through succession planning, we can't eliminate all those potential negative outcomes. We can certainly reduce them quite a bit if we talk about them when we plan for those potential contingencies that can arise in the life of a business owner.

Sarah:

So it sounds like the big takeaway for Andrew is that he should be actively preparing for the future - whatever that future might hold?

Cindy:

Exactly.

Sarah:

Perfect. Let’s hear from someone who’s grappling with a slightly different set of circumstances.

Carmela:

“Hello there! My name’s Carmela. I’m 52 years old, and I have four children, all of whom are young adults. Ten years ago, I became sole owner of my father’s manufacturing company after he passed away. It definitely hasn’t been my dream, but I simply couldn’t bear to sell the business off. Needless to say, I’ve been looking forward to retirement, and plan on doing so by age 60.

When it comes to funding my retirement, all is well - I have a solid retirement plan that doesn’t rely on the business. However, I’m struggling with how to handle my exit. For sentimental reasons, I’d really like the kids to inherit the business. My oldest son Hector - he’s 24 - he’s excited to step in… but the rest? Not so much. Then again, they’re still quite young, and I suspect they may have a change of heart in the future. Another complicating factor is Hector’s age. He still has a lot to learn before he’ll be ready to successfully manage a company of this size.

With all of that in mind, I'm wondering if I should transfer the business to my kids upon retirement, or if I'm better off leaving it in my will? And if I leave it in my will, is it fair to split it four ways knowing that Hector might be doing the lion's share of the work?"

Sarah:

Let's start with the logistics of Carmela's exit. It sounds like none of her children are fully prepared to take over the business when she retires. What are her options?

Cindy:

It sounds like she potentially thinks her son Hector might be interested in being involved with the business. I don't know if he already is or not, but one thing she might wanna consider for Hector - and if she decides this for the other children, she might wanna do it too - is giving them a position with the company. Perhaps a managerial position where she has the opportunity to see how they work in the business, how they interact with her employees, how they operate things without actually transferring any ownership interest to the children alone at this point. I actually spoke with a gentleman recently who I thought had a great idea for potentially bringing his son in. He hired the son for a managerial role, but he didn't transfer any of the ownership yet because he wants to see how the son does.

And he also hired a CEO to manage the company for him, but also teach his son how to be a really great manager. So that way he has the opportunity, like I said, to see how the son works within the business, without actually having given ownership up to the son. And what he told me was, I really hope it works out with my son, but if it doesn't, I have the flexibility to pivot, and if I wanna sell this company to an outsider or to my employees, instead of my son, I can do that in the future. I'm not tied to anything specifically. So I like the idea of bringing Hector and/or the other children in as employees to see how they do essentially.

Sarah:

Is that something that families should be talking about up front, or is that something Carmela should be doing behind the scenes?

Cindy:

I really encourage business owners to speak with their family members about what their thoughts are with business transition. I have worked with families and individuals who get concerned that if they start talking about the possibility of the business, transitioning to the child or children as owners, that this may disincentivize the children in terms of being able to work hard and be productive citizens, sometimes we call this the fear of having trust fund babies. But in my experience, the sooner you have those open conversations about what mom or dad have about how they wanna see their business progress, and what they'd like to see their children do. And they have an open dialogue about what that is and what that means, I think it works better for everybody in the end but I understand that there are some people who are, who are reluctant sometimes to have that conversation. I think in the end everybody's better off if there are honest and open discussions from the beginning about that.

Sarah:

What are the pros and cons of transferring her business when she retires versus leaving it in her will?

Cindy:

I think the pro of transferring the business when she retires, she has the opportunity to see how things are going and see where she can provide support for her children. Maybe some kind of issue arises where she's had a lot of experience with it, but Hector or the other children have not, and she can lend support to them and her ideas. So, I like the idea of her being able to participate in the business, even after she's not really necessarily a part of the day-to-day operations. But from a tax perspective, it probably is better for the children if they were to inherit it through her will versus getting it during her lifetime. I don't need to go into the details of it, but essentially if the children decided to sell the business at some point, their tax consequences would probably be less if Carmela waited until she passes away to pass the business on, versus if she passes the business along while she's still alive.

Sarah:

That's interesting. Do you feel like most business owners are aware of that, especially in a family-owned business? Or is that not common knowledge?

Cindy:

They've got so much going on that they don't have the time to be learning about tax law, (laughs) and the nuances that go along with it. And that's where advisors within Regions or your outside advisors, like your lawyers and accountants, that's where they can provide that help to the business owner. Because you know, they don't have time for that. They're running a successful business.

Sarah:

Right, right. So according to one study, 60% of family business owners plan on dividing ownership evenly among their heirs. Is this always the right approach, particularly in situations where one child like Hector may be more actively involved than the rest?

Cindy:

I don't envy Carmela for the situation she's in, because I think a lot of business owners think that in order to treat their children fairly, everything has to divide it equally, including their business that they might have. Sometimes what's fair is not always what's equal in terms of an inheritance. I would talk to Carmela and see if it makes more sense to really have Hector inherit the business, her other assets, like her retirement, accounts or investments - can this provide sufficiently? Does she have maybe life insurance that can provide an inheritance to the children who are not involved with the business as a way to make up for whatever they're losing out for not being owners of the business.

Sometimes what I've seen where business owners have children who are not involved in the business is to divide the ownership into voting and non-voting shares. So in this case, she might give voting shares over to Hector because he's gonna be the one who's running the business, but she's given equity to her other children the non-voting interest. So they can share in the benefit of the economic appreciation, but they can't come in and tell Hector what to do in terms of running the business. And, you know, it may be a situation where eventually the children who are the non-voting owners, who don't really make the decisions that Hector's making might say, "You know, I really don't wanna be involved with the business anymore. I'd like to be more liquid." Or vice versa Hector may say, "You know what, I really wanna run this business on my own. I don't really want anybody else interfering." We can provide some kind of solution where perhaps Hector buys the non-voting shares or the children who are not involved with the business ask Hector to buy their shares so everybody is happy in the end and they get fair value. I think there's a lot you can do in terms of planning when you're a business owner and I'd like to be able to talk to someone who's in Carmela's situation about the different planning options that are available to them.

Sarah:

And does the size of the business play into this decision? For example, a small business may not have the resources or revenue to support three or four children, whereas a mid or large size company - that seems like it's less of an issue.

Cindy:

That's true. Yeah. I mean, this may be a situation where even if the children who are not running the business like Hector do have some ownership interest, it really doesn't provide for them sufficiently. So those other options can come into play, that we talked about depending on what the size of the business is. The business, for example, might not pay out dividends to shareholders. And maybe that's something that the children who are not directly involved with operating the business are looking for. So that's a good point; it can depend on the size of the business as well.

Sarah:

So, for someone in Carmela's position, it sounds like working with an advisor will be key to finding the right solution.

Cindy:

Exactly.

Sarah:

Great. So Cindy, to round out this episode, we're going to hear from a business owner who is ready for retirement, but like many business owners, doesn't have a solid retirement plan in place. Let's listen.

Ingrid:

"Hi. My name is Ingrid, and I've been a small business owner for 26 years. I always assumed I'd retire closer to age 70, but the last few years have really taken a toll on me, and I'm really hoping to retire as soon as possible. Admittedly, I'm woefully unprepared. Not only are my savings tied up in the business, but at age 61, I have years before I'm eligible for full retirement benefits. I do have a small retirement fund, but it's not enough to sustain me for more than five years or so.

However, there is a silver lining: business has been phenomenal. In fact, the last two years have been the highest grossing in the history of my business. Also, while I'm the sole owner of my business, I have a lot of support: I've been blessed to have a talented leadership team, all of whom have been with the business for nearly as long as I have. My team is well-prepared to keep it running after my departure, which certainly helps put my mind at ease. With both of those factors in mind, I'm quite confident in my business's valuation. I'm just not sure how to make my retirement goal a reality, particularly on such short notice."

Sarah:

So it sounds like Ingrid wants to retire as soon as possible, but it doesn't sound like she's fully prepared. What are her options?

Cindy:

Well, I think the first thing is to find out from her is she truly relying just on the business to provide for her retirement? And if so, we need to get a value of what the business is. And a lot of times when I talk to business owners, they'll give you a valuation, but we check it against the market or with a professional appraiser, they're way off. So if she truly is looking to the business to provide for her retirement, I think we really need to get her in a situation where she knows what the potential value of her business is. And if so whatever the value turns out to be, we can start planning then from, if she sells the business, what she needs to make retirement work for her.

Sarah:

If Ingrid decides to maintain control over her business, what are the strategies that would give her the ability to do that?

Cindy:

I think that's something that comes up a lot for business owners, that they want to be able to start moving the value of the business away from themselves to whomever is going to be the new owners, but they don't like the idea necessarily of giving up that control. So depending on what's being transferred over, she can structure it in such a way where the economic value of the business is starting to be transferred over to these potential new owners, but she can still be in charge of the day to day operations of the business and managing things, and all those kinds of things that involve being in charge of the business. She can get input from the other people, but she doesn't really have to necessarily give up the control. So I think for a lot of business owners, they like the idea, like I said, of moving the economic value over to potential new owners but they do not like the idea of transferring control over. And there are definitely a lot of options in terms of planning to accomplish that.

Sarah:

Now, would that be a permanent situation? Where she's transferring the value, but maintaining control until the end? Or is it more of a transitioning of power over time?

Cindy:

I think she should consider transitioning the power over time when she's ready, because it's one thing to transfer equity over to someone and they don't really manage the day-to-day operations of the business. I think if she really wants this business to continue and be successful, even after she's not a part of it, she needs to start sharing the power over time, but it can be on her timeline. Otherwise, the business will end up in the hands of people who don't really know how to actually run the business. And I wouldn't wanna see the business fold because of that.

Sarah:

So, let's say Ingrid does decide to sell the business. What should her next steps be?

Cindy:

So, as I said, I think the first thing she wants to do is really get a good idea of what her business is worth to an out outside buyer. As I said, she might have an idea in her mind, but that might not be actually what is marketable for her business. So, I think she needs to get a business appraiser or work with lawyers and accountants to come up with a number that truly represents the value of the business. And then figure out from there, we have that number, what's the number that she needs to retire? So, I think we need to do some kind of analysis to show what she actually needs from her retirement versus what she has now and what she could potentially have if she did sell her business and work with some financial planning software to figure that and run scenarios for that. So, I'd say again, get that true idea of what the business is worth, and then we can figure out what she needs versus what she actually has available to her to have a long happy retirement.

Sarah:

And is this something that her Regions wealth advisor could help her with?

Cindy:

Yes. We have financial planning software that can run analyses with regard to retirement.

Sarah:

Are there any tax considerations she should be aware of?

Cindy:

If she's going to sell the business to an outsider, there may be a tension between what she's looking for for tax purposes versus what the buyer is looking for. Typically the seller of a business wants to sell their ownership interest to the buyer so they can get preferential tax treatment. On the other hand, the buyer often is looking to buy the assets of the business because they'll get preferential tax treatment for that, and that might not be so beneficial to her. So she needs to be aware of that. It's something that can definitely be part of the discussions with the buyer, but she should be informed that that's something that potentially can arise in the negotiations.

Sarah:

Thank you so much for those great insights, Cindy. So as you know, at the end of each episode we like to ask our guests for some key takeaways. So when it comes to retirement planning, what are key takeaways and best practices we can share with all business owners, regardless of their age, circumstances, or the size of their business?

Cindy:

Great question. I truly feel like it's never too early to start this process. I tell people day one, you open your business, day two you start thinking about how to transition that business, because business transitions happen to all businesses, whether the owner has control over it or has made decisions about how that transition is going to happen. Thinking about it from the beginning enables you to have the ability to anticipate potential contingencies that can happen along the way. I think if we learned anything in the last couple years, that life can throw a lot of unexpected curve balls for us, particularly for business owners. And as much as you can prepare ahead of time for those potential outcomes that could happen the better off I think you are in the end. I think the better off not only is the business owner, but their family and their employees and potentially those outside buyers that they might have.

The other takeaway I'd give to business owners is to be prepared to be flexible with your business transition plans. What you decide today about transitioning your business may not be how you see it five years from now. So know that things can be changed and be flexible about it and work with your Regions advisors and your outside advisors to help you through that process. Let us run analyses for you to figure out what works today or what's the best avenue for business transition. And then a couple years from now, if that's not working out for you, depending on life circumstances, let's figure out together, what are the other potential options for you? 'Cause you always have options available to you, but you might be looking for help from others about how to figure out which options work best and the best way to implement and that's where we can come in. So be prepared for change, but know that we're there with you along the process as your business evolves and grows and your thoughts on business transition evolves and grows.

Sarah:

Excellent, excellent. Cindy that was great. Those were some great insights and we appreciate you taking the time to speak with us today.

Cindy:

Thank you.

Sarah:

And thank *you* for listening. Don't forget to subscribe to Regions Wealth Podcast on your favorite podcast platform. For more, visit regions.com/wealthpodcast.