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Exit and Succession Planning

For the entrepreneur business owner, succession and transition planning is not only a complex proposition but also a difficult challenge. Deciding who will succeed the current generation in running the business, while also maximizing and preserving the value of the company built over years, requires careful deliberation and forethought. For the business seller, this can be the transaction of a lifetime.

Selling or transferring a business is a complex process entailing a transition plan setting forth goals, priorities and strategies for success. Given the inherent challenges of the process, it is imperative for owners to identify a team of professional advisers familiar with legal, tax and risk management issues in order to review available choices and make the best decision.

Planning Process

Remember that the sale or transfer of a business is a *process* and not an event. This process, from planning to execution, can take anywhere from three to five years and entails four phases:

- Pre-sale
- Positioning for sale
- Transaction phase
- Wealth management

Pre-Sale

The first step in the process is the development of a succession plan establishing the personal retirement goals and cash-flow needs of the retiree owner. The plan should seek to minimize estate and gift taxes but must also provide liquidity to pay these taxes and provide financial independence to the surviving spouse and dependents. The plan should also take advantage of wealth transfer strategies such as gifts, trusts and family partnerships, which can be used during the owner's lifetime to transfer assets to the family. Planning must also consider any children not involved in the business, to ensure equitable allocation of assets.

Determine the importance of continued family involvement in leadership and ownership of the company. Owners should have a candid discussion with key family members and work through the emotional and sensitive issues, establishing ground rules as to who will be involved and in what capacity, and identifying those who may not be involved in future management. This process has to be done early enough so that it becomes a planning conversation. This will greatly reduce the intense emotions often connected with business transitioning.

The outgoing owner must be committed to a transition timeline and, most importantly, must adhere to the planned departure date. This is critical to assuring the next generation of owner-managers, employees and customers that the founder's exit is his or her decision and that the transition is a well-thought-out plan and not a reaction to a crisis.

As a retiring owner, you will want to identify a team of professional advisers to help facilitate transition planning and execution. Consulting experts in a variety of specialty areas will ensure that you derive the maximum value from the sale of your business. Make sure that the professionals you select are experienced and qualified to assist you with the transition.

Positioning for Sale

Positioning the business will bring out the "hidden value" to maximize the selling price. It is important to start this process early to be better prepared for the sale.

Make strategic and operating improvements to increase value in the areas of sales, marketing, pricing and innovation. Take a close look at the balance sheet for unnecessary assets; for example, identify any excess, slow-moving or obsolete inventory the purchaser will not want to buy. This leads to estimating the scrap value of such inventory, often to the detriment of the seller. With proper planning, it's possible you can sell this inventory close to cost prior to the sale of the business.

Review fixed assets. What machinery and equipment are you carrying? Dispose of any assets no longer needed before the sale of the business.

Again, you can likely realize more from liquidating those assets than from incorporating them into the deal for your business.

Clearing the balance sheet of any unproductive assets will optimize the return on investment from the buyer's perspective, thereby maximizing the selling price. A clean balance sheet will also result in fewer items to negotiate.

Don't overlook the income statement. Identify and adjust for benefits paid to the owner and family members. Review expense classifications carefully and be knowledgeable about unusual or extraordinary non-recurring items. This will result in a better snapshot of the business's true value.

Review and restructure management to cull a team that is not dependent on the owner for business continuation. This will enable the acquirer to transition into the business while the existing management team effectively carries out the day-to-day operations.

Transaction

The selling process is complex and time consuming. The time invested in up-front planning will help realize the maximum value.

Have an audited financial statement prepared for at least the two years prior to sale. An audit will lend credibility to the financial information being used by the prospective buyer and shorten the due diligence timeline. This is also an opportunity to highlight achievements resulting from changes you implemented and will demonstrate a trend with "clean" financials.

Have a valuation prepared by qualified consultants. The valuation identifies the realistic market value of a business, and enables the owner to align his or her personal and financial goals through the sale. Remember that the valuation does not necessarily translate to the selling price. Much will depend on whether the buyer is a strategic acquirer, a private equity firm or an ESOP (employee stock ownership plan).

Determine the deal structure – is it an asset sale or corporate sale? The type of deal determines the tax consequences for both buyer and seller. This is where the parties need to compromise in order to maximize the tax benefit.

Wealth Management

Once the transaction is done, it's time to step back, take a deep breath and assess what you have put in place.

Review your estate plan strategy to minimize estate and gift taxes. Address liquidity issues and how wealth should be distributed at death. Consider wealth transfer strategies, such as maximizing annual gifts and use of lifetime exemption, trusts and other tax-efficient mechanisms. Because these planning decisions involve complex questions of tax and law, it is best to work closely with your lawyer and certified public accountant, who can advise you. The better informed you are about the choices available, the better positioned you are to make the best decision.

Consider holding family retreats. Involve and educate family members regarding investing, philanthropy and financial responsibilities. History has shown that in transitioning wealth to the next generation, some families have prospered greatly, while others have seen their hard-earned assets evaporate. The main reason for this is not a lack of estate planning but a failure to prepare the next generation for stewardship.

Conclusion

Selling a business is the final chapter of your years of hard work to build a successful enterprise and recognize the benefits of your investment of blood, sweat, tears and cash. Therefore, proper planning and positioning will not only enhance the value of the business but will also help protect both you and your loved ones.

About the Author

Armand E. Rossi is a partner in the Tax & Business Services division of Marcum LLP's New Haven, Connecticut, office. With more than 30 years of experience, he provides accounting, tax and consulting services to businesses, high-net-worth individuals and families. You can contact Armand at armand.rossi@marcumllp.com

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