

Negotiating the Rapids of Business Transitions



Heidi G. Clute, CFP

For many business owners – especially women – their businesses and their lives are practically interchangeable. Two-thirds of small business owners say their business is their greatest personal asset and primary source of family income. If you are one of these owners, protecting your company and ensuring your financial security are often the same thing.

You Women who are planning to sell a business – or who are planning for a successor – face a string of financial and emotional hurdles that can impair their ability to make optimal decisions for the business. The best way to successfully navigate those barriers is with advance planning.

Planning equals agility

Small business owners are likely to have most of their money invested in their company, unlike investors with more traditional portfolios. In this light, converting your life's work into a successful retirement income requires a well-crafted strategy.

Many small business owners don't have an exit strategy. Without a plan to know how you'll leave your business, or to whom you'll leave it, it's difficult to adjust your strategy if and when that time comes. When you encounter a sudden change that requires you to exit quickly or when you're ready for retirement, having a plan in place will be key for a successful transition. Even if you have no plans to retire, succession planning is needed in the event something dire happens to you, your family or a business partner – death, serious illness, divorce or disability.

Just as in making plans for your family's financial security should something happen to you, it's never too early to make plans for the transition of your business. Smart exit planning is measured in years; it takes time and help from both professional and informal advisors to determine your company's value and your strategy and timeline for exiting.

When you're caught up in the day-to-day craziness that running a business entails, it's hard to pull yourself away long enough to plan very far ahead. A

professional advisor can help you focus on the longer term.

Selling a business

Nolo.com estimates that some 700,000 businesses change ownership each year. While women and men are equally motivated by a profitable sale, a 2006 Center for Women's Business Research study found, female business owners are much more likely than their male counterparts to consider the future of the business and the effect of the sale on their employees. Many women are surprised to experience grief from the sale of their business, although for most small business owners, male or female, selling that business marks a radical life change. Letting go of power, responsibility and perhaps independence evokes powerful emotions.

Separating the financial from the emotional is another benefit to working with a professional when looking to sell your business. An objective third party can help ensure that you're making educated business decisions so your emotions don't override your financial interests. You may want to consider naming a corporate trustee to oversee the transfer as a neutral party.

Here are things to watch out for:

1. Make sure you're ready to sell. Not only do finding the right buyer and getting the right price take a lot of work, you want to make sure that you're selling for reasons that are right for you. How will you make your sales proceeds work for you so that they pay your bills and fund your retirement? How will you spend your time? Have you laid the proper groundwork for a smooth transition? Once you've let go, you may never have the chance to go back.

www.clutewealthmanagement.com

PLATTSBURGH, NY OFFICE
152 Tom Miller Road • Plattsburgh, NY 12901
Tel. (518) 561-5707 or (877) 561-5707 • Fax (518) 561-5809

SOUTH BURLINGTON, VT OFFICE
1233 Shelburne Road, Suite 202 • South Burlington, VT 05403
Tel. (802) 864-5707 or (877) 561-5707 • Fax (802) 864-7007

2. Your involvement in the business must end one day. Have you accomplished what you wanted when you started in the business? What do you hope to take away from it?

3. Put a realistic dollar value on your business. Just like in selling a home, if you put too high a sales price on your company, you'll scare buyers away. If you list too low, you're missing out on the value of your hard-earned work and income you may well need to live and retire on. The best way to sell your business for what it's truly worth is to be able to take your time and sell it – or transfer it within your family – as a going concern; selling in an emergency because of inadequate planning often forces you to sell low.

4. Don't overlook tax implications. Your company's structure and what's being sold dictate whether your income from its sale is subject to personal or capital gains taxes. When selling, you can negotiate for terms that increase your tax advantage. Because the tax code is so complicated and changes frequently, consult with your accountant regarding your specific situation.

5. Get your books and your premises in tip-top shape. There are many ways to present financial information that will make buyers consider the added value of your business and assets that might not be obvious. You should put the best face possible on your facilities without hiding important shortcomings that buyers should be aware of.

6. Dot your i's and cross your t's. If there are conditions of the sale that are important to you, make sure they are part of the formal sales agreement. Get all details of any agreement or promises in writing; if you write the agreement yourself have it reviewed by a business lawyer. After the sale, make sure you've filed all the necessary paperwork with local or state government and the IRS.

7. Protect your income stream after the sale. If something happens to the buyer – or if the new owner runs the business into the ground – your payments can end abruptly. Request duplicate notices be sent to you when key man life insurance and disability insurance premium payments are made. If possible have a funded buy/sell agreement (see sidebar). Be wary of holding long-term notes yourself; either get cash up front or bank financing. Another way to protect yourself is to negotiate a contract that allows you to

remain in the company in a leadership role and share the profits. Not only will this ensure you continue to have income, but a step-rated sales price can increase your profit if you stay on. Gradually phasing out your involvement can also ease your personal transition.

8. Once an agreement is reached, pave the way with customers, employees and/or suppliers.

Continuity planning is essential; if client retention is a significant part of your sales agreement, failure to plan may affect your sales price. Your attitude and communication can go a long way to ensuring the business's continued success even after you're gone.

Succession planning

Whether you want a partner, employee or family member to assume responsibility for your business should something happen to you, there are several things you need to keep in mind when planning for succession:

1. Pick the right successor. Just because it's in your plan doesn't mean it's in someone else's. It's also important to make sure your chosen successor knows how to be a leader. If you have difficulty picking a successor, seek the advice of your board of directors or put together a search committee to help you decide. There are thousands of things you know about your business, instinctively or through years of experience. Start training your designated successor early – that knowledge takes significant time and the deep day-to-day involvement of your successor to learn.

2. Research estate tax options specific to your type of business. If something happened tomorrow and your business was operating at full value, will estate taxes force you or your successor to sell the business to pay them?

3. Have financial backups. You can provide adequate funding for your business to continue when your involvement with it is finished through life insurance, individual disability insurance and disability overhead expense insurance. Consider business interruption insurance, or an ILIT – an irrevocable life insurance trust, a separate trust that buys life insurance and can help cushion the blow of estate taxes by providing tax-free income to pay estate taxes.

4. Establish a timeline for succession. While it may ultimately shift, it will give you a place to start and

www.clutewealthmanagement.com

PLATTSBURGH, NY OFFICE
152 Tom Miller Road • Plattsburgh, NY 12901
Tel. (518) 561-5707 or (877) 561-5707 • Fax (518) 561-5809

SOUTH BURLINGTON, VT OFFICE
1233 Shelburne Road, Suite 202 • South Burlington, VT 05403
Tel. (802) 864-5707 or (877) 561-5707 • Fax (802) 864-7007

provide deadlines for forward progress.

5. Don't forget to plan for you. What will you do after relinquishing control of your company? Are your own financial plans solidly in place? Your transition will be made easier by having your post-ownership goals clearly in sight. (See "Seven Pitfalls on Your Way to Retirement.")

Protect your heart and your investment

Leaving an enterprise behind can be like losing a family member. This is your creation – an entity you may have nurtured, struggled to grow and built over time. Here are some ways that you can prevent your emotions from endangering your financial investment:

1. Don't mix rapid growth and inexperience. That often means not transferring a rapidly growing business or one to which you have devoted your life to your inexperienced family members or employees. Uncontrolled growth in the wrong hands can quickly dissipate corporate assets.

2. Seek out a kindred spirit. Finding a buyer who shares your vision can blunt some of the emotional shock of parting with your creation, as can passing the business on to someone with an appropriate skill set for your industry. Don't be afraid to leave your business to a non-family member; dealing with someone not related to you can eliminate many emotional minefields. Working with an advisor who understands your vision can keep everyone on the same page.

3. Avoid emotional decision-making regarding assets. Don't let feelings of loss or guilt lead you to make succession or business decisions that erode what was intended to provide for your or your successors' financial security.

4. Don't make decisions by default. Not looking honestly at your financial situation can cause unintended outcomes and missed opportunities, or unintended tax consequences.

5. Diversify your investments. Don't bet the farm on your business. Diversify the proceeds of the sale; keep part of it liquid. Business owners whose enterprise represents a disproportionate percentage of their estate

can lose more than their business should things not work out as planned.

Advance planning, clear goals and a competent, objective advisor can help you navigate the choppiest of transitions. As a business owner you are likely to face many challenges along the way; so start planning now.

For better or worse: Buy-sell agreements

A buy-sell agreement is a contract among shareholders or business partners that is created to outline terms and conditions for both unexpected and planned key-person departures. This binding contract can also stipulate buyout provisions for businesses with multiple owners and sole proprietors with a designated successor (usually a family member or key employee). In the sale of a business, a buy-sell agreement preserves continuity of ownership and ensures that the buyer and seller are treated fairly.

The buy-sell agreement addresses issues that include:

1. What events will trigger a buyout (usually death, disability, departure or retirement)
2. Who can buy or inherit the business
3. What price will be paid for the departing owner's share of the business
4. What are the terms of the buyout (i.e. funding)
5. How the business is to be valued

Financial planners often recommend funding a buy-sell agreement by utilizing sophisticated life insurance strategies insuring the owners' and/or key-persons' lives. This approach may provide adequate funding of the buy-sell agreement at a relatively low cost; and is fairly accessible within a short time period after the triggering event. As an added benefit, most life insurance death benefits (and disability) are considered tax-free.

Heidi Clute is the owner of Clute Wealth Management in Plattsburgh, NY, and South Burlington, VT, an independent firm that provides strategic financial and investment planning for individuals and small businesses in the Champlain Valley region of New York and Vermont.

www.clutewealthmanagement.com

PLATTSBURGH, NY OFFICE
152 Tom Miller Road • Plattsburgh, NY 12901
Tel. (518) 561-5707 or (877) 561-5707 • Fax (518) 561-5809

SOUTH BURLINGTON, VT OFFICE
1233 Shelburne Road, Suite 202 • South Burlington, VT 05403
Tel. (802) 864-5707 or (877) 561-5707 • Fax (802) 864-7007