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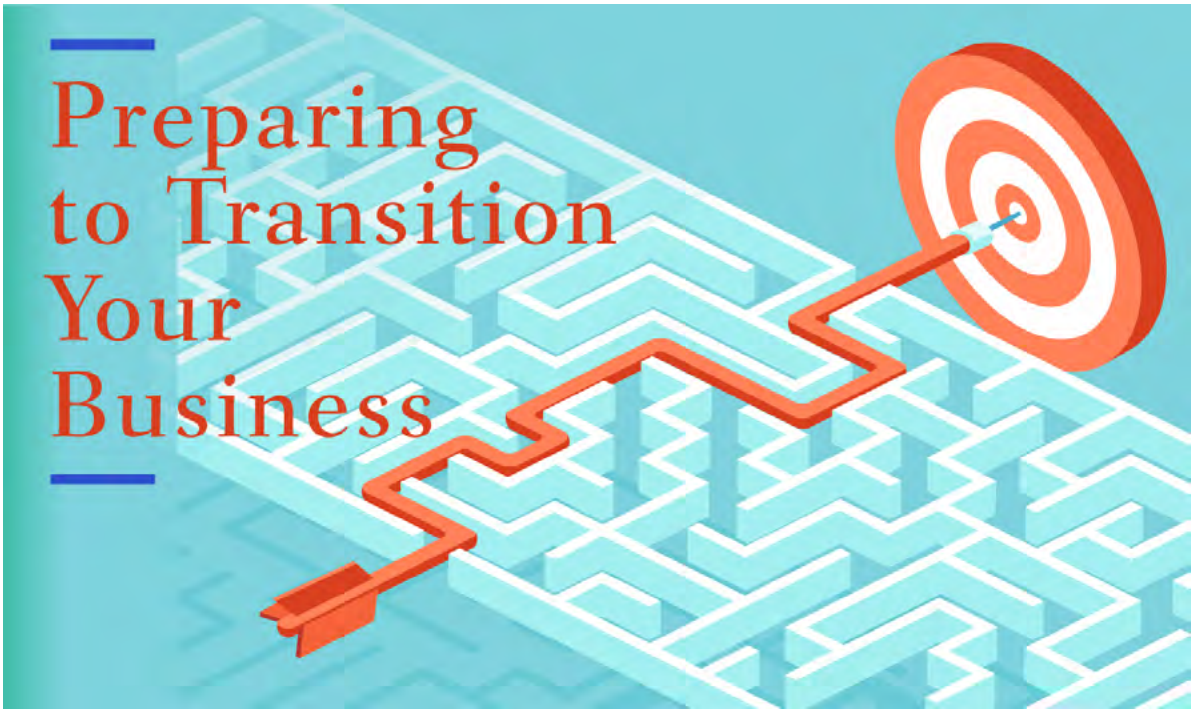
BLB&B Advisors, LLC
FINANCIAL GUIDANCE SINCE 1964℠

MONEY *notes*



Protect your family's interests and your company's continuity

A closely-held family business isn't just a major asset, it's the culmination of your life's work and your passion. Over the years, you perhaps imagined a scenario where you would one day hand over the reins to the next generation. However, whether due to lack of interest, lack of business vision, lack of leadership ability, fundamental technological or economic changes, or some other prohibitive factor, that dream often turns out not to be a viable solution.

> **12%** the number of family businesses that survive past the 2nd generation
>
> **3%** the number that endure beyond the 3rd
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> *

This can prove incredibly challenging. On the one hand, you want to ensure the continuity, sustainability and success of the business long after you exit. But as your likely single largest asset, you also want to monetize the equity you've built up in order to enjoy the fruits of your labor when you ultimately decide to pursue new ventures or retire.

Planning Ahead

The succession/transition planning process is not something you can afford to put off until you already have one foot out the door. Ideally, it's a strategy you should begin addressing at least five years prior to your exit. Otherwise, without a well thought-out and comprehensive plan in place at least two years before transitioning, you can expect to leave a good deal of your firm's potential value unrealized.

Keep in mind that sometimes succession doesn't adhere to your ideal timetable. What would happen to your business in the event you become unexpectedly incapacitated and unable to work either permanently or for an extended period of time? How would an event of that magnitude impact the value of the business as well as your

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* Gallup, "Solving Succession Problems in Family-Owned Businesses" April 2019

ability to monetize it? And what would happen to your employees and your clients?

A carefully crafted and funded transition plan created today will not only serve as a road map for all these potential future contingencies, it will afford you an opportunity to better plan for, and ideally minimize, the tax impact of any sale – both from a timing of sale proceeds perspective, as well as an optimal deployment of after-tax proceeds to meet your family's retirement, estate planning and philanthropic goals.

Looking Internally

Given enough time and with careful planning, selling your interest to one or more partners (assuming you have them), or to next generation successors who you've carefully groomed for the role, can prove to be more lucrative and significantly less disruptive.

These types of arrangements typically involve some mix of an up-front cash payment combined with a longer-term annual payout in exchange for your equity. Other creative solutions (e.g., an extension of permissible company benefits to a certain predetermined age) could also factor into the deal. If you prefer not to have an extended payout, a combination of cash and debt financing may be a preferable solution. For example, if you own a $12MM business with another partner, your $6MM buyout could be comprised of $2MM in cash and a $4MM secured loan that the business finances over the next five years.

Partner Buy-Sell Agreements

These essential business agreements are designed to facilitate the orderly transition of your ownership interest (as well as the ownership interests of your partners) in the event of a planned or unplanned departure. In order to ensure continuity – and avoid all too common situations where a partner becomes incapacitated or dies and their ownership transitions to a spouse or child who has neither an understanding or interest in the business – the agreement needs to be carefully structured and FUNDED.

Frequently, these "buy-sell" agreements are funded with life insurance policies. So, the sooner an agreement can be put in place and funded (when both you and your partners are younger and healthier), the less costly the policy premiums will be. In many instances, having a buy-sell agreement in place:

- Ensures you have a buyer in place
- Provides your partners with the funds needed to purchase your ownership interest
- Helps you establish the business' actual value (enabling you to pre-plan estate and tax obligations)
- Reduces the chance of a forced sale to an unwanted buyer

Selling to a Third Party

If you don't have a viable family member, partner or successor employee, then an external sale to a 3rd party may be the most feasible option. At first blush, this may even appear to be the most lucrative option.

Price is an important consideration, but so are the terms of the deal, the alignment of both the buyer's interests and yours, your future post-sale role (if any), the seamless integration of your employees, and the cultural fit.

Any external sale may involve a promissory note with annual payments over a number of years. The final price paid may be predicated on the business' ongoing performance, client retention, revenue, and profitability.

Generating Liquidity without Relinquishing Control

Often, we sit down with owners who are still many years from exiting their extraordinarily successful businesses, but cash flow challenged. For years, these individuals have focused so intently on reinvesting to grow the business that they've been reluctant to take out too much cash. The business flourishes, but their personal liquid wealth outside the business lags far behind.

There are, however, ways to extract equity without selling the business or even giving up control. Three of the most common are:

- **Dividend recapitalizations** – by using a term loan, you have the ability to extract considerable equity from the business without draining cash reserves (assuming annual cash flow is more than sufficient to pay back the loan).
- **ESOPs** – employee stock ownership plans (ESOPs) are specifically designed to facilitate the transfer (over time) of some or all of your equity interests to your employees. By selling less than 50% of your ownership to the ESOP, you're still able to retain control while monetizing a portion of your equity. These tax-qualified retirement plans offer valuable tax benefits and liquidity for you, while at the same time serving as an important retention tool for valuable employees.
- **Working capital line** – Obtaining a well-structured line of credit with a strategically aligned bank to fund peak seasonal needs is relatively easy, and with today's historically low interest rates, extremely economical.

Ultimately, whether an internal succession or an external sale makes the most sense for your business will depend on a multitude of business and personal financial considerations (including potential tax implications). But, the sooner you begin the transition/succession planning process, the more options you'll have to choose from and the more time you will have to ramp up and thoughtfully and successfully execute your plan. Working together with you and your attorney, your BLBB advisor can help you identify, evaluate, and implement a solution that best meets the needs of you, your family, your employees and clients.

Questions can be addressed to Doug Huntley *(left)*, https://blbb.com/about/team/douglas-b-huntley/ or your BLBB Advisor. Additional entrepreneurial resources may be found at https://blbb.com/entrepreneurial-management/

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