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# Transition Planning

Key steps for a successful exit from a closely held business.



Executives of closely held and family-owned businesses are often so focused on running their businesses that they do not plan for the inevitable — the transition of ownership and/or leadership. It is not a question of “if” as much as it is “when” the transition will occur.

Failure to plan for a transition usually leads to one of two outcomes: Either the business owner will “die in the saddle” or an unexpected tragedy or simple fatigue will cause the business owner or heirs to unload the business and get whatever they can. In either case, this approach is not the optimal way to proceed if the objective is to transition the business successfully.

Another factor business owners should consider is the demographic change that will result in a monumental transfer of wealth during the next 10 to 20 years. Baby boomers have created more businesses

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than any other generation in U.S. history and they are retiring in unprecedented numbers. The Exit Planning Institute estimates that 66 percent of all business owners are considered baby boomers. As a result, there will be many more sellers than buyers of closely held businesses during the coming decades as these boomers retire.

Confronted with this demographic statistic, those business owners who have strategically planned for transition will be in a much stronger position to achieve their objectives and extract the greatest value from their business. In many cases, 80 to 90 percent of a business owner’s net worth is represented by the business. Consequently, the success or failure of the business transition will have a huge impact on retirement, family legacy and peace of mind.

## The Business Transition Plan

A business transition plan sets forth the terms and timetable for exiting the business in a manner that achieves the business owner’s goals and objectives. There are eight possible business transition alternatives, and each one has its own advantages and consequences. *Internal* transitions include transfers to family members, management buyouts, selling to existing shareholders, selling to an employee stock ownership plan or liquidating the business. *External* transitions include sale to a strategic buyer, sale to a financial buyer, such as a private equity firm, or going public. Basic steps for creating a business transition plan include:

**1. Evaluation of Goals/Objectives.** Objectives need to be determined

- and properly aligned with the selected business transition alternative.
- 2. Business Valuation.** It is surprising how many business owners do not know what their business is worth. A valuation establishes a benchmark for determining how much value can be extracted from the business in the current market.
- 3. Personal Financial Planning.** Assess retirement and long-term financial needs to determine if there is a value gap, which is the difference between what you need for financial independence and what you can reasonably expect to receive upon transition of the business, plus other personal assets.
- 4. Value Enhancement Strategies.** If there is a value gap, value enhancement strategies can be implemented to close the gap. This takes time, but if done correctly, it can result in a huge multiplier in terms of the value of the business.
- 5. Business Action Plan.** Evaluate business and legal risks inherent in the business and take steps to mitigate them to make the business more attractive to a buyer.
- 6. Personal Action Plan.** Engage in comprehensive estate planning and factor the consequences of the business transition into the estate plan.

## The Discount Factor

The more risk associated with a business, the less a buyer will pay for it. For example, if business owners have neglected to properly protect intellectual property or have misclassified employees as independent contractors, these actions could create a significant contingent liability for the business. The value of the business will then be discounted to reflect the risk no matter what the normal earnings before interest, taxes, depreciation and amortization (EBITDA) multiples are for businesses in the industry.

To achieve the best result, a business owner should create a business transition plan at least two to three years prior to the intended transition. Certain business transition strategies can take years to implement and this period allows time to fix problems inherent in the business and minimize the discount factor. The business transition plan is the key to achieving optimal results for the lifetime of hard work put into the business.

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