HOW BABY BOOMERS ARE PLANNING FOR THEIR BUSINESS SUCCESSION

By Kevin Brown, partner Rosner, Brown Touchstone & Keller

At these stages in their lives, many "baby boomers" have begun planning for retirement and determining how to approach the next chapter in their lives. But for better or for worse, a business can't retire: and when a business owner decides to stop working, an effective succession is the only way to retain revenue and company assets. So, the question is: what is the best way to succeed business ownership while maximizing benefit and value?

The most important step is to start the process early. Not unlike the process by which individuals accumulate retirement assets, the earlier business owners start planning for selling or transitioning ownership the better. Of course, most owners could decide to sell their companies today and find a buyer almost instantly; but without adequate planning, quick sales often result in significant loss in value. By planning two to five years in advance, owners allow themselves time to strategically implement a transition plan.

Most of the time, such transitions occur through one of four methods:

- A third-party sale
- A merger with another company
- A transition to a family member
- A transition to a key member of the company.

In order to select the ideal method for each individual company, there are a few key issues and factors to consider:

- What is the business worth?
- What can be done to increase the value of the business?
- How much money do I (the owner) and my dependents need to live out our lives in comfort?
- What should the structure of the sale or transition look like to meet the goals of the owner?
- What are the tax options and consequences of potential structures?

Many business owners have an idea of what their business is worth -- but that idea doesn't always correlate to the company's market value. Business owners put their lives into the creation and development of company; and that connection builds incredible intrinsic, emotional, and financial value in the owner's eyes. On the other hand, the marketplace takes an unemotional and pragmatic approach to the price of a company: and according to market standards, each business will usually be valued and purchased according to net profits and production capacity – both of which will then be multiplied by an earnings multiplier. For example: if a business is producing adjusted profits of $1,000,000 and the earnings multiplier is determined to be 4, the value of the business will be $4,000,000. It is important to have an understanding of the potential value of the business very early in the process (2-5 years prior to anticipated transition) in order to minimize unpleasant surprises and allot time to implement plans and procedures to increase company value.

What can be done to increase the value of the business? There are two basic methods:

- Increase company profits
- Implement plans and procedures that increase the earnings multiplier.

The key is to begin planning early: with enough time, business owners can achieve both these goals through a combination of

- Strategic planning
- Revenue enhancement
- Profitability modeling
- Capacity planning
- Functionally structuring and operating the organization

In order for such planning to be successful, however, owners must determine how much money will be necessary to provide for their needs (as well as the needs of a spouse or any dependents) throughout a long and fruitful retirement – and remember to take that number into consideration when selecting the best transition strategy for the company.

A business transition can occur in a variety of forms. When a business is sold, for example, the process may focus on asset sales, stock sales or a merger. The structure of the sale will also be contingent on the amount of money paid up-front versus over time, and will likewise be affected by any warranties that the seller may need to make. The transition of a business to a family member or key employee will be influenced by the same variables; but unlike a sale, the owner's compensation will most likely come from the company's revenues rather than a set purchase price. By assessing the differences between sale and transition structures early on, business owners can ensure a smooth segue into their retirement years.

As with any financial transaction taxes will also be involved in any business transition equation. Depending on the structure of the transaction, taxes can vary significantly: for example, sale of the stock of a business will generally result in a capital gain for tax purposes, while the sale of company assets usually results in a combination of capital gain, ordinary income taxed at regular tax rates, and some income taxed at recapture rates. The total tax figure will necessarily impact the amount of cash available after the sale/transition, and is thus another key point of consideration when assessing the above-mentioned transition methods.

Retiring business owners will inevitably face challenges as they begin planning to sell or transition their companies; however, by planning ahead and seeking proper advice and guidance along the way, any owner can achieve a smooth, successful and lucrative succession for their company.

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