SUCCESSION PLANNING: THE NEXT GENERATION OF YOUR BUSINESS

LANDMARK

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START YOUR BUSINESS WITH THE END IN MIND

Why Succession Planning is Important

A comprehensive strategy to get your business up and running should include **planning for your own exit.** As one of the founders, your departure will have a significant impact on the enterprise itself, your fellow business partners, your customers and your future. So, as counterintuitive as it may seem, how you plan to exit your organization is an important decision to make, even at your business's onset. Take the time to work with a trusted professional to outline your succession plan so that you are prepared for whatever future you encounter.

There are a **few questions** you should ask yourself as you create your succession plan.

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How Quickly do I Want to Exit the Business?

If you want to make a swift exit from your business, you can sell your assets or equity to a private investor or another business. Although there are times when quick exits make sense strategically, most small business owners hope for a different departure. You want to see your entity succeed even after you're gone, so if you sell to the highest bidder, you lose your ability to influence the company's trajectory and ensure its continued success.

Instead, you can choose to make a slower and **more purposeful exit** from the business. For instance, if your daughter plans to take over the company when you retire, you can progressively transfer ownership and responsibilities to her over time. By the time you relinquish your last bit of control, she will understand your vision and feel competent in her abilities to carry out your goals.

What Role do I Want to Play When I Leave the Business?

When it's time to leave the business, do you plan to sell your interests outright and invest in a new opportunity? Or do you hope to retain interest in the business throughout retirement? Depending on the type of entity you form, you may be able to hold onto voting or nonvoting membership interests, even after you've surrendered your operational responsibilities of running the business day to day. Your team of lawyers and CPAs will need to know your exit goals so they can form an entity that can provide you those options.

Who Will Take Over the Business When I Leave?

Choose your successor wisely. Selecting somebody who can competently run the business is important, but selecting somebody who will further your **vision for the company** is critical. You want somebody who shares your values who you can trust to carry on what you've built.

When first starting a business, some owners believe that their family members will fit that bill. Before making any assumptions, you should first confirm that your family member wants to take over the business. Even if they say yes, check in with them often to see if they've changed their minds. Only a willing participant will make a good successor.

How Long Will it Take my Replacement to Learn the Ropes?

On day one, you may not immediately know who your replacement will be, and that's ok. Instead, you can **create an employee training program** to groom key workers to take your place. When the time comes to put that plan into action, start small. Ask your candidate to take over one process at a time so you can see if they are up to the task. As you give them more responsibility, do they remain sharp and driven? Somebody who is not a perfect fit now can be groomed to excel as your replacement with the right training program.

Making a Succession Plan: Practical Steps

Your team of CPAs and lawyers should help you with the following practical aspects of creating a succession plan.

- **Identify key employees that you think would be good candidates to carry on your business and mentor them.**
- **Share your knowledge and experience with your key employees and other members of your management team to ensure that you aren't the only one with all the answers.**
- **Create well-defined career paths and identify the criteria that your employees will need to meet as they grow in their careers with you.**
- **Make sure staff members have skin in the game. You want your key employees to feel motivated to carry on the business with pride.**
- **Make your mission statement for the company public so employees know what your business stands for.**
- **Foster a positive working environment to avoid high turnover or employee complacency.**
- **Keep an eye on industry norms for working hours and promotion timelines. You don't want to lose employees over job dissatisfaction.**
- **Draft a will that details who will control your ownership rights when you pass.**

If you have questions about or want assistance with developing a succession plan, contact us today. We look forward to hearing from you.

HOW TO START THE JOURNEY OF SELLING A BUSINESS

The day you decide to sell your business is the day you embark on one of **your most important business ventures.** The process may try your patience, and if you're not careful, it can eat away at your time, your finances, and your sanity. One of the best ways you can start the journey of selling a business it is to familiarize yourself with the process. These seven steps will get you well on your way to a successful and pain-free exit.

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Step 1: Clarify Your Goals

Your exit plan will hinge on what you think a successful outcome will look like. **Be explicit** with what you want. Think about your goals with respect to the following:

- Your legacy
- Your needs in retirement
- Your future association with the business (if any)
- How involved you want your family to be in the organization's future
- Your employees' experiences during and after the transition
- The organization's continued relationships with its clients and vendors
- These goals will influence every other step you take when selling a business.

Step 2: Define Your Ideal Purchaser

You do not need to identify a specific business or individual, but know what type of buyer you want to acquire your business. Think about the **traits** you want the buyer to have – business size, temperament, potential for growth, experience in the industry, reputation – and weigh those traits against your goals and aspirations for your organization after you exit.

Step 3: Get Your Accounts in Order

In other words, clean up your records. The value of your business will be determined based in large part off your financial records, so they should **be reliable.** If a potential buyer discovers you've made accounting errors, they may lose interest in acquiring your organization. You want the sale to go smoothly, so earn the trust of your buyer by reporting accurate numbers.

How long should you keep your records?

Download our record retention guide now!

Step 4: Update Your Processes and Protocols

The buyer should be able to see themselves in your shoes. If they anticipate the transition will be simple, they will be more interested in moving forward. Update your processes and write down your business protocols so the next owner can easily pick up where you left off.

Step 5: Enlist the Help of Professionals

Selling a business yourself may save you money upfront, but there's no guarantee it will be the best decision in the long run. There are a few professionals you can – and should – reach out to for help. A **valuation consultant** can show you how to boost the most important performance markers in anticipation of the sale. A **lawyer** can give you the peace of mind that the sale documents are comprehensive. A **broker** can free up your time by finding potential buyers. An **accountant** can help you clean up your books and tax filings. A **business advisor** can make recommendations about asset sales or business restructuring that can boost sales price. Professionals are professionals for a reason. Trust they know their stuff.

Step 6: Make Yourself Redundant

Prepare your organization (and your psyche) by letting go of your responsibilities. Your business must be able to survive without you, so work out the kinks before you legally step away. **Delegating your tasks** to your trusted managers and leaders will also show future buyers that you are ready to walk away, and that the transition will be smooth and efficient.

Step 7: Perfect Your Sales Pitch

Your story is important, your story is interesting, and your story may be the thing that sells your business. When pitching your business, **tell your story** so the buyer can see how you got started and how you've grown. Buyers want to know what they would be walking into, and you can make your organization appeal to a certain audience by crafting your sales pitch to pique their interests.

Landmark offers business advisory, tax and accounting services and performs business valuations to prepare small business owners for selling a business. If you'd like to learn more, contact us soon. We look forward to hearing from you.

EXIT STRATEGY FAQS

Thinking about exiting your business should not stir up doubt and trepidation. With a solid exit plan, you can head into the next chapter of your life with confidence, ready to take on whatever comes. We understand that exit plans can be enigmas if you have never considered one before, so let's go over some questions you may have.

Why do I Need to Have an Exit Strategy?

Having a plan is important for a few reasons. When you exit your business, you will need to think about income, capital gains, and gift and estate taxes, and **a good strategy** can help you minimize those cash outlays. An exit strategy can also improve your investment outcomes. If you know when you'll be leaving the business, you can plan your long-term investments with that deadline in mind. An exit strategy can also help you boost your business valuation. You and your advisors can implement operational changes, sell assets, negotiate debts or do anything else that will enhance your business value.

When do I Need to Create an Exit Strategy?

Ideally, you will begin strategizing for your exit the day you start your business. For those already in business, we recommend you have your strategy outlined and operational **a decade before** your anticipated transition. This will give you time to build value, find a successor, discuss the changes with clients, tie up loose ends and mentally prepare yourself for what is to come.

How Will my Business be Valued?

Your business can be valued in many different ways. Some methods look to the value of your underlying assets. Others focus on earnings. Others compare your business to industry benchmarks, and others look at cash flows. If you know how your business will be valued, you can focus on what truly matters to the calculation to ensure the best result. The best valuation method for you will be the one that most **accurately reflects the economic value** of your business, and your tax advisor can help make that determination.

With a solid exit plan, you can head into the next chapter of your life with confidence.

What Factors Should I Consider When Exit Planning?

You and your business advisor should take into account the following factors when establishing your exit plan.

- **Timing:** Know when you want to leave your business. You and your advisor can then reverse engineer objectives that will help you reach that conclusion.
- **Desired Outcome:** When the time comes, will you want to walk away with no ties to the organization? Will you want to stay on in an advisory role? Would you prefer to slowly transition ownership over many years? Your exit plan should begin with the end in mind.
- **Business Cycle:** Pay attention to your business cycle. If you exit when business is trending up, you can demand a higher valuation.
- **Market Desires:** If mergers and acquisitions are common in your industry, you will have plenty of buyers to choose from and may be able to demand a high selling price.
- **Flexibility:** Your exit strategy does not need to be written in stone, but some strategies will function better if you see them through to the end. If you think your goals or financial needs may change, opt for an exit strategy that is more forgiving.
- **Feedback from Others:** Get feedback on your plan from your co-owners, your successor, your employees and your trusted business advisors. Their buy-in and input will help ensure that the exit goes smoothly.
- **Your Post-Sale Needs:** What adventure will you be embarking upon once you exit your business? Your exit plan should address your future cash needs and future tax position.

How do I Determine the Optimal Exit Strategy?

There are countless ways to exit a business, and each method will produce different financial outcomes. If you want to pass your business on to the next generation, consider gifting your ownership interest to your children or grandchildren. If you want to bring others on board as you slowly transition out, you can consider an ESOP or an Initial Public Offering. If you want a quick exit, you can liquidate your company or sell it to an interested buyer. Only you and your business advisor can determine the best path forward, so do some digging now to ensure that you'll be ready when the time comes.

SELECTING THE BEST EXIT STRATEGY FOR YOUR BUSINESS

Before you open for business, consider your exit strategy. Such long-range planning may seem like overkill, but it can be invaluable to small business owners. How your business is incorporated (and how you are set up for tax purposes) will affect how easy it will be to leave your organization and move onto your next project. Here are three exit strategies to consider.

Exit strategies should be tailored to each individual business owner.

Exit Strategy 1: Wind it Down

You can close your doors relatively quickly, with a good bit of planning. Liquidating your business will require you to do some of the following:

- **Inform employees, customers, vendors, and creditors of your plans to close**
- **Stop taking new clients or projects weeks, months, or years in advance of your close date**
- **Negotiate early termination of long-term projects or contracts**
- **Sell inventory and assets**
- **Pay outstanding debts using company funds or – if necessary – personal funds**
- **Distribute any remaining company assets or liabilities among co-owners**
- **Legally dissolve your business and cancel business licenses, registrations, and permits**

Liquidating a business can be difficult from an operations standpoint, but also from a social standpoint. Your employees and customers may feel left in a lurch. Winding down your business may also not be the best strategy for you financially. When liquidating your business, the only value you extract from it is the value of your assets. Any goodwill you generated with your customer base will be lost.

Exit Strategy 2: Pass it Down

To ensure the value you built into the business survives your departure, consider **passing the company to somebody you trust.** Whether you select a family member, a friend, or your employees, start by getting an independent valuation. Valuations take all aspects of your business – both the tangible and intangible – into account before settling on a number. Here are two ways you can pass down your business:

GIFTING IT TO A FAMILY MEMBER OR FRIEND

Gifting your business to a family member can help with a smooth transition for the other owners and employees, and it may allow you to stay involved in the business even after you're transitioned ownership. Two years ago, Congress nearly doubled the lifetime exemption making it easier for taxpayers to make tax-free gifts. In 2019, the lifetime exemption is $11.4 million (or $22.8 million for married taxpayers). If your business is valued at less than this amount, you can gift your ownership interest without tax consequences.

DISTRIBUTE IT TO YOUR EMPLOYEES

Employee stock ownership plans (ESOPs) are built for just this purpose. ESOPs are qualified retirement plans in the eyes of the IRS, but unlike 401(k)s or 403(b)s, ESOPs hold company stock rather than outside investments. When you are ready to leave, the ESOP will purchase your stock shares and pay you out in cash. The plan then holds onto those shares and distributes the stock in accordance with the plan document.

These plans can be costly to start, but plan expenses are deductible. ESOPs are great ways for existing employees to slowly take ownership, and your long-standing employees will be rewarded for their loyalty. Just keep in mind that ESOPs must be nondiscriminatory, so all employees enrolled in the plan will receive stock options. You cannot pick and choose who gets what shares.

Exit Strategy 3: Sell it

If neither liquidating nor gifting your business is ideal, you can sell it. You can sell it in the open market, or you can sell it privately, perhaps to somebody you know. It is **very common** for other owners to buy out an exiting shareholder. This keeps the organization running under similar ownership.

An independent valuation will be essential when you sell your business. If you choose your valuation firm wisely, they can even give you tips to optimize your business operations in the months leading up to the sale so you can ask for the highest selling price possible.

When selling to a third party, you give up all rights to how the business runs going forward. You may even find that your competitor purchases your business for its assets and then promptly shuts down operations. Keep this in mind before you enter a sale.

You may alternatively decide to sell your company on the public marketplace by issuing an Initial Public Offering (IPO). Going public will require your organization to comply with new accounting standards, issue new reports, and pay for costly attestations and audits, but it is an option.

Choose What Works for You

Choose the exit strategy that works best for you. The option you select may not work for other businesses in your industry, and that's okay. Exit strategies should be **tailored to each individual business owner.**

Landmark offers business advisory services and performs business valuations to prepare small business owners for their exit. If you'd like to learn more, reach out to us soon.

HERE'S WHY YOU NEED A BUSINESS VALUATION

A business valuation is a critical component of a successful exit strategy. Without knowing what your business is worth in the marketplace, it would be difficult to determine a sales price. A business valuation can also help you **reveal and tackle obstacles** that might jeopardize your sale. Performing a business valuation well before you stake up that "for sale" sign will give you the opportunity to address those issues so you can attract your ideal buyer.

A business valuation can help you reveal and tackle obstacles that might jeopardize your sale.

Three Common Business Valuation Methods

A business can be valued in many ways, but three common methods are:

INCOME APPROACH

By using the income approach, future financial metrics are converted into present values. An example of the income approach is the discounted cash flows method. Projected cash flows are discounted into present values to see what your future cash flow is worth today.

COST APPROACH

The cost approach seeks to determine the how much it would cost to recreate your business from the ground up. This method is often referred to as the "asset approach" because your assets' market or replacement values less liabilities are used as a basis for determining your business' worth. This approach is generally considered to yield the maximum benchmark of value.

MARKET APPROACH

The market approach bases business value off similar sales transactions. Public sales records about sales of private companies can be used to determine a going rate. Looking to the market is a reliable way to estimate what sales price will be acceptable to interested parties.

Reviewing Purchase Offers

If you have a good relationship with your accountant, they can help you during the negotiation process. If your purchaser takes issue with the asking price, your accountant can **present the testing results** that support your valuation. And when an offer is good enough to be considered, they can analyze the offer to be sure it is in your best interest.

Some purchase offers are for buyouts over a period of years. If your exit from the business is gradual, you may want a buyer whose current business practices complement yours. In this instance, your accountant can look at the acquiring company's processes and controls to see if they will harmonize with your current operations.

Choose an Expert

Landmark has business valuation experts on staff to prepare small business owners for their exit. We can also help you during the negotiation process by **reviewing terms** to determine the potential impact of the planned sale on your tax situation. If you would like to learn more, contact us soon. We look forward to hearing from you.

TAX IMPLICATIONS OF YOUR EXIT PLAN

Determining an exit plan for your organization will be one of the most **difficult decisions** you make as a business owner. You have a lot to consider, including (but not limited to) business continuity; transition plans; the wellbeing of your employees, customers, and vendors; and – of course – taxes. While the future stability of the organization will be out of your hands once the new owner steps in, you can **guarantee a certain tax outcome** for yourself if you have the right exit plan in place.

The tax implications of your exit plan will vary depending on the strategy you choose. Here are some common exit plans.

You can guarantee a certain tax outcome for yourself if you have the right exit plan in place.

If you Sell Your Business

A business sale (or liquidation) can be structured in one of two ways.

AS A STOCK SALE

If you are a C or S corporation, you can structure your exit plan as stock sale. You will recognize a capital gain or loss on the sale of your ownership shares.

AS AN ASSET SALE

If you decide to sell the assets of your business, you will allocate the sale price to each asset and calculate gains and losses separately. The holding period and character of the gains will be determined by how the assets are used in the business. For example, a car dealership would recognize ordinary income when selling their fleet because their vehicles are considered inventory. For the sale of the dealership's commercial building, the prior depreciation taken would be a Section 1250 gain taxed at 25%, and the sale of the dealership's land would be a Section 1231 gain generally taxed at capital gain rates.

If you use Your ESOP

If your company has an employee stock ownership plan (ESOP), your exit plan will look a little bit different. In general, owners will recognize capital gains from the sale of their ownership shares just as they would in a straight stock sale. However, C corporation owners have the option of deferring their gains by reinvesting their proceeds in securities of other domestic companies. This can allow owners to defer taxes for years or even decades, and if those replacement shares are held until death, the gains will be permanently excluded.

Owners of ESOP companies – both C and S corporations – will have the option to sell their shares back to the company over several years, enabling them to gradually exit the business. This will not eliminate capital gains taxes, but it will spread out the gain recognition.

If you Transfer Ownership to Family Members

Owners of closely held businesses often want to transfer ownership to the next generation. There are a few ways you can do this.

TRANSFER NOW

If you transfer ownership shares or business interest to family members while you're still alive, you will need to file a gift tax return. When you file your gift tax return, you have the choice of paying gift tax now or reducing your lifetime gift/estate tax exemption, which is currently $11.58 million. Unless the value of your business is more than the lifetime gift/estate tax, you will not owe gift taxes. Reducing your gift tax exemption will also reduce the available estate tax exemption you can apply to the assets you bequeath at death.

TRANSFER AT DEATH

Some business owners draft their will so business interests are transferred to their heirs when they die. If your business and other assets in your estate exceed the gift/estate tax exemption, your estate will owe taxes on that transfer. In 2020, the estate tax exemption is $11.58 million, but this amount has changed drastically over the years, and there is no guarantee it will stay at such a high number.

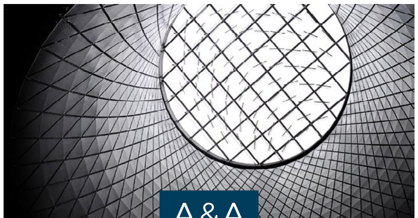
TRANSFER OVER TIME

To reduce your reliance on the gift and estate tax exemption, you can transfer your business interests into a trust during your lifetime. For example, if your business is an S corporation, you can transfer your shares into a Grantor Retained Annuity Trust (GRAT). With a GRAT, you can control the assets until your death, receive annuity income from those shares during your lifetime, and transfer the remaining interest to your heirs. The GRAT will be excluded from your estate and only future incomes will be taxable to your heirs. There are many other trusts that can hold your business interest, so talk to your business advisor to select the one that's right for your business and for your long-term goals.

Creating an Exit Plan

Be familiar with the **tax consequences** of your exit plan. If you have questions about your current plan or want to create a more thorough strategy, please reach out to us. Our CPAs would love to help you develop a plan that is right for you. [Contact us] today to learn more.

OUR SERVICES



A&A

Our teams are trained to search for overlooked trends and identify opportunities specific to your operations.

ACCOUNTING SERVICES

Keeping you on track with personalized, comprehensive solutions including accounts payable/receivable and bookkeeping.

TAXATION

Our tax experts can help you find the right solution for your unique situation.

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Our IT team can guide you through the technology maze.

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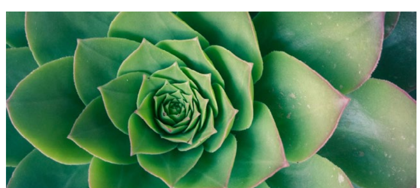
Get a clear definition of the value of your business from our specialists.



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