BUSINESS SUCCESSION: PLAN NOW FOR SUCCESS

6 STEPS TO ACHIEVE YOUR VISION

As a business owner, you've invested time and effort to build a business that supports your family and many others, including employees, vendors, customers and your community.

Whether it's a few years from now or decades away, there will come a day when you will leave your business. To ensure your business passes successfully to its next owner, it's important to begin planning now. Succession planning should be a part of your overall business plan and your personal financial plan. After all, the three go together.

In addition, customers and suppliers often prefer working with businesses that have strong succession planning in place. Your planning gives the companies you do business with confidence in the stability of your business.

As you build your succession plan, you can take control of the process and leave on your own terms by following the six steps outlined in this white paper.

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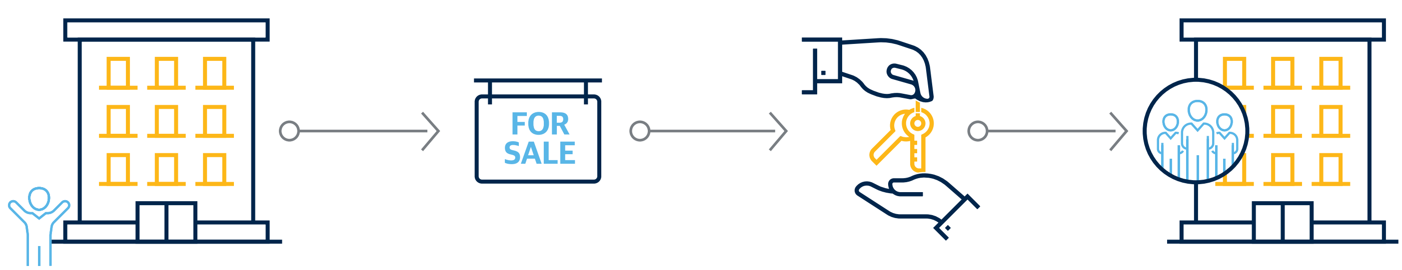

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STEP 1. START NOW.

You run your business based on a plan. It's important to make time now to create a plan that will guide you when it comes time to transition your business to a new owner, whether that's in a few years or a few decades away.

Some strategies for business succession can take years to fund and implement. The sooner you start thinking about how you want to transition your business, the sooner you can start putting in place the plan that will get you there.

Business succession can be complicated. By starting now, you can assemble a team who will understand your business and personal goals. They can work with you to develop a solid plan to achieve them.

WHY PLANNING MATTERS

30% of family businesses pass successfully to the second generation

10% pass successfully to the third generation

Harvard Business Review, January/February 2012.

STEP 2. CLARIFY YOUR GOALS.

Before you build your plan, it's important to think through some questions. The answers will help determine who will take over your business and the strategies you will use. These questions can help you create your desired future and help you clarify your goals:

WHEN DO YOU WANT TO LEAVE?

How much longer do you want to be in control of the business? Are you planning to leave at a certain age or when your business reaches a certain stage or milestone? Do you want to transition out slowly or all at once?

HOW MUCH DO YOU NEED FROM THE BUSINESS?

How much money do you need from the business to accomplish your goals? How important are estate, gift and income tax minimization? How much of a financial burden are you comfortable passing on to your successor?

WHO WILL TAKE OVER THE BUSINESS?

Do you want a co-owner to buy you out? Do you want someone in your family to take over? Do you want to transfer the business to a key employee? Do you want to sell to a third party?

PLANNING YOUR BUSINESS VALUE TO MEET YOUR SUCCESSION STRATEGY:

When selling to third parties, **maximizing the value** is appropriate to get the best sales price. On the other hand, if you're planning to gift your business to family members, there are strategies for **minimizing the value.**

Depending on your goals, your succession planning team can suggest strategies to increase or decrease your business's value.

WHAT'S NEXT FOR YOU?

Are you interested in starting another business? Are you interested in enjoying the fruits of your labor, reducing stress and scaling back on your time commitments? Do you want to retire? Do you want to help the next generation of family or employees take over?

These are just some of the questions that need to be addressed. A full discussion with your succession planning team will provide more depth and help you determine the best way to create and implement a succession plan.

STEP 3. BUILD YOUR PLAN.

WHO:

Think about whom you want to take over the business. Here are some pros and cons to consider:

PROS	CONS
FAMILY MEMBERS	
• Keeps the business in the family • Helps support family members • Family members likely understand your vision • You may stay involved on a limited basis	• Family members may not want to run the business • Family members may not be capable of buying or running the business • It may be difficult to divide the business among all family members • Some family members may feel treatment is unequal
CO-OWNERS	
• Co-owners are committed to the business • They understand the business • Transfer to co-owners provides continuity with employees, vendors and customers	• Limited market may reduce negotiating leverage and sales price • Co-owners may lack liquidity for purchase
EMPLOYEES	
• Key employees may be groomed on the job • Incentives can align employee compensation with business goals	• Limited market may reduce negotiating leverage and sales price • Employees may not be ready to run the business • Employees may leave the business before transition • Employee succession may upset family dynamics
THIRD PARTIES	
• Possibly higher sale price from a third party • Avoids difficult discussions regarding favored employees or family members	• Difficult to find a buyer in some industries • Creates uncertainty for employees and customers • Surrenders family succession
NOBODY (LIQUIDATE)	
• No need to choose successors • No need to arrange for financing • Receive sales proceeds upon liquidation	• Elimination of family business • Employees lose jobs • Customers must go elsewhere • Loss of intangibles, such as goodwill • Generally results in lowest value for the business

HOW:

Once you know whom you want to transition your business to, work with your business succession team to consider strategies to transfer the business. The following chart lists commonly used strategies that could work for your unique situation:

SERP (Supplemental Executive Retirement Plan) COMBINATION

In addition to receiving proceeds from the business sale, you may also receive payments directly from the business through a supplemental executive retirement plan. The amount of these payments and time period over which they will be paid as well as the frequency of payments can vary.

Advantages:	Keep in Mind:
• You receive desired amount through a combination of sale proceeds and SERP payments • Reduces the overall taxes for both you and the buyer • May lower the value of the business to facilitate a smoother succession plan • SERP payments from company are tax deductible	• SERP payments are subject to ordinary income tax rates (not capital gains rates) for sale proceeds • Company needs adequate time to establish a SERP plan to build funds to later make SERP payments

STOCK BONUS

A business can give a bonus to employees in the form of company stock.

Advantages:	Keep in Mind:
• Employees have incentive to grow the value of the business • Transfers ownership interest without capital gains or gift tax • Stock may be subject to restrictions • Stock bonus is deductible as form of compensation	• Employees who own stock have shareholder rights

INSTALLMENT NOTE

The buyer promises to make installment payments of principal and interest over a period of time.

Advantages:	Keep in Mind:
• You recognize capital gain over time • Buyer doesn't have to pay the entire purchase price up front	• Risk that the buyer will not make future payments • May be limited recourse if the buyer defaults • Installment payments are not tax deductible

DEFERRED COMPENSATION

The business agrees to provide a future benefit to an employee. The benefit paid to the employee can be timed to coincide with the business sale and used by the employee as a down payment for the purchase price.

Advantages:	Keep in Mind:
• Provides incentive to the employee to stay with the business • Employee is taxed only when the benefit is paid	• The business gets an income tax deduction only when the benefit is paid in the future

INSTALLMENT SALE TO GRANTOR TRUST

You sell all or part of the business to an irrevocable grantor trust in exchange for an installment note. This strategy typically works best when you are transferring the business to family.

Advantages:	Keep in Mind:
• No gain is recognized on the sale to the grantor trust • Any business income and appreciation after the sale that exceeds the interest paid on the note is outside the owner's estate • The trust can use the business income to pay the installment note	• Requires initial gift to fund the trust • Business earnings inside the trust are taxed at the grantor's tax bracket while the grantor is alive.

ESOP (Employee Stock Ownership Plan)	
An employee stock ownership plan is a qualified retirement plan that invests primarily in company stock. The company may make contributions of stock or cash to the ESOP.	
Advantages: • Provides a buyer for stock when a shareholder wants to leave • Contributions are tax deductible	Keep in Mind: • ESOPs are complicated, expensive and require the help of experts • As a qualified plan, must be available to all employees • Dilutes the remaining shareholders' ownership interests

GIFT	
All or part of the business is transferred by gift, either all at once or over time. This strategy is typically used when transferring the business to family. There are strategies for reducing the value of business-interest gifts while still maintaining control, such as through limited partnerships, minority interest discounts and nonvoting stock.	
Advantages: • No need for recipients to borrow money or make payments • You transfer the business on your terms	Keep in Mind: • May be subject to gift taxes • May cause family discord if gifts are not equal • You receive no sale proceeds

SINKING FUND	
The prospective buyer systematically accumulates funds to purchase the business in the future.	
Advantages: • The buyer is able to accumulate all or part of purchase price over time • Accumulation vehicle may offer tax-deferred growth	Keep in Mind: • May not be sufficient time or resources to accumulate adequate cash • Generally involves an installment note for the remaining purchase price

THIRD-PARTY FINANCING	
The buyer obtains third-party financing, such as a bank loan, for all or part of the purchase price.	
Advantages: • You receive all or the majority of the purchase price at once • You bear no risk that the buyer will default on future installment payments	Keep in Mind: • May be hard for the buyer to obtain favorable financing • Installment or loan payments to lender are not deductible

ADVISORS CAN EVALUATE VARIOUS STRATEGIES

These are just a few of the potential business succession strategies. Your business succession team can help you determine strategies that make the most sense for your unique situation. Your advisors can help you evaluate options and create a plan that satisfies your personal, business, retirement, estate planning and succession needs. Your advisors can then help you draft documents like buy-sell agreements that will spell out how you will transfer the business. And they can recommend the best way to fund those agreements through vehicles like bank financing or life or disability insurance. Your succession planning team should be coordinated by a lead advisor experienced in business succession planning.

STEP 4. MANAGE YOUR RISK.

A strong succession plan should take into account risks that could derail the plan. Here are some common risks and ways you can protect yourself:

- **What if a key employee leaves to join a competitor?** Could the loss of a key employee derail your succession plan? What might it do to the value of your business? You can manage such a risk by providing incentives for that key employee to stay. Incentives could include deferred compensation, a bonus plan or other benefits.
- **What if a key employee becomes disabled or dies?** Key person disability insurance and life insurance can provide cash so that your business is able to pay for expenses or lost revenue that may result from the death or disability of a key employee. In addition, you could use the money to recruit a replacement to help keep your business and your succession plan on track.
- **What if you or a co-owner becomes disabled or dies?** In such an event, buy-sell agreements funded with a vehicle such as life or disability insurance can spell out what will happen with your business. The insurance can provide the funding necessary to carry out your wishes.

STEP 5. VALUE YOUR BUSINESS.

As you build your succession plan, you will want to know what your business is worth.

Depending on whether you have chosen to maximize or minimize the value and what strategy will best meet your goals, when it comes time to implement your plan, it's likely you will need a more formal valuation. A variety of methods can determine the value of your business. Some common valuation methods include:

- **Book Value.** Book value is generally based on assets minus liabilities. This method is useful for asset-based businesses.
- **Multiple of earnings.** The value is estimated based on a multiple of net earnings. This method is commonly used by businesses to begin the planning process.
- **Formal appraisal.** As your transition nears, a business valuation expert can provide a formal business appraisal based on a variety of factors, including business operations, the economic outlook and sales of similar businesses.

Your advisory team can help ensure that the documentation and funding are coordinated with your overall goals.

MANAGING A PAYOUT

Are you counting on using the cash from the sale of your business to fund your retirement or begin a new business?

Whether received in a lump sum or over time, the cash produced from your business should be integrated into a comprehensive plan that accomplishes your personal, retirement and estate planning goals. Your financial advisor can coordinate your team of advisors to design strategies that will meet your current needs as well as your retirement and estate planning wishes.

STEP 6. REVIEW YOUR PLAN.

The only constant is change. You will want to review your business succession plan yearly for changes in your situation, including:

Changes in your goals. If you decide you want to continue running the business longer or start reducing your hours earlier than you had intended, revisit your plan and agreements.

Changes in your family situation. Anything from the birth of a new child or grandchild to a divorce or untimely death could impact your succession planning.

Changes in management or employees. If a partner or key employee leaves or an employee or family member steps up and shows exceptional interest and initiative, you may need to rethink elements of your plan.

Changes in value. Major new client contracts, product innovation or changes among competitors are just a few examples of how your business value may increase and warrant a revision to your succession plan.

Your advisors can assist in your review process and can help you adjust your plan based on any changes in your situation.

START THE PROCESS TODAY.

Whatever stage your business is in—whether you are planning to leave your business soon or years from now—start thinking about business succession planning with these six key steps in mind.

Talk to a financial advisor who can coordinate your team and help you create a comprehensive plan that will take into consideration both your business and personal goals. You'll sleep better at night knowing that your business succession plan is in place.

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