The Independent Business Owner's Essential Planning Kit: Continuity and Succession Planning Tools for Smart Entrepreneurs

Running a business isn't easy. Between managing inventory, employees, vendors, and customers (not to mention driving overall company strategy), there typically is not a lot of time left to think about your personal and professional future. What does retirement look like for you? What legacy do you want to leave in your community? How does your business align with your personal goals? What is your business worth and who represents the next generation of leadership?

At Stratus Wealth Advisors, the largest asset for most business owners we work with is the value of their company. It also happens to be an illiquid asset, meaning that if it is going to be turned into cash to support your retirement goals, a well thought out plan needs to be implemented years in advance so that when you are ready to transition ownership, your company can benefit the three most important stakeholders: you and your family, the incoming owner(s), and your loyal employees and customers.

Since most business owners will only transition ownership of their company once in their lifetime, Stratus Wealth Advisors has put together the following information to help you begin the process of succession planning. We believe that starting early and having the right team in place is key to maximizing the value of your business. Therefore, we are happy to share some tips and tools with you based on our years of work helping independent business owners coordinate and implement a succession plan that works for them, their families, and their business.

Stratus Wealth Advisors provides a unique combination of business valuation, succession planning, asset management, and financial planning services that empower our clients to run more profitable and rewarding companies. We quarterback a comprehensive process to provide you with essential data, knowledge, and advice to make the best decisions for your company and your family. As always, Stratus is here should you need to discuss your options. Feel free to reach out to setup a free consultation with us at anytime.

Sincerely,

Sam Brownell
Financial Advisor
Founder of Stratus Wealth Advisors

BUSINESS CONTINUITY PLAN CHECKLIST

Use this checklist to create a Business Continuity Plan (BCP) that can be adapted as economic, industry and company conditions change. It also recommends the best type of professional to work with (e.g., CPA, financial advisor, attorney) when creating certain documents. Finally, we recommend you have a trusted third-party advisor, such as Stratus, who can coordinate and synthesize all this information into one cohesive BCP.

Step One: Business Triage/Cash Flow Needs

1. **Cash Flow Analysis Updated Every 6 Months or When a Material Event Occurs**
   - Allows you to spot and mitigate potential financial problems before they occur.
   - Best handled by owner(s), bookkeeper/CPA, and/or financial advisor.
2. **Emergency Action Plan**
   - What will the company do when an unexpected event occurs (e.g., a computer hack, fire, or natural disaster)?
   - Best handled by owner(s) with input from all employees. Also check with local and national governments for info.
3. **Storage and Retrieval of Key Information**
   - Where are passwords, keys, bank accounts, and company documents kept and who has access to them?
   - Best handled by owner(s) and clearly communicated to all employees.
4. **Protocol Documentation for Business and Family**
   - Written by owner(s) to lay out which employees and family members will handle critical tasks, such as running payroll, hiring/firing, and taking out loans in case an owner dies or becomes incapacitated.
   - Best handled by the owner(s) and a business attorney.

Step Two: Proactive Planning

1. **Conduct an Activities and Services Assessment**
   - Determine your most and least productive activities and services. What products and services differentiate you and drive customer loyalty? Use the **Activities and Services Analysis** as a template (included in this kit).
   - Best handled by owner(s), employees, and a financial advisor or business consultant.
2. **Be Open and Honest When Discussing Your Operational and Financial Planning**
   - Solicit input from each member of your organization.
   - Best handled by the owner(s) and employees, but this can be moderated by a business consultant.

Step Three: Operational Assessment

1. **Identify Your "Red Flags"**
   - Have a third party conduct an analysis of your operations to look for weaknesses.
   - Best handled by owner(s) and a financial advisor or business consultant.
2. **Identify Areas for Growth**
   - Based on your Activities and Services Assessment (Step 2), narrow your focus for effective activities/services growth.
   - Best handled by owner(s) and a financial advisor or business consultant.
3. **Begin a Succession Planning Discussion and Revisit it Every 1-3 Years**
   - Identify who in your company is a potential successor. Get a business valuation. Review your estate documents.
   - Best handled by owner(s), a financial advisor/business valuation expert, and an estate attorney.
4. **Review Your Legal Documents and Revisit them Every 1-3 Years**
   - Schedule time every few years to review your contracts (internal and external), estate plans, and succession plans.
   - Best handled by owner(s), a financial advisor, and a business attorney.
5. **For a free initial operational assessment, please visit our website and click the "Take Survey" link.**

To help you with your BCP process, Stratus offers complimentary consultations to any independent business owners interested in discussing any aspects of their business or personal planning. Reach owner Sam Brownell at sbrownell@stratuswealthadvisors.com or 301-873-4602.

Stratus
WEALTH ADVISORS

ACTIVITIES AND SERVICES ANALYSIS

Provided By: Sam Brownell, CVA, CFA, MBA of Stratus Wealth Advisors

At Stratus Wealth Advisors, we believe that it is important to be proactive once you have analyzed critical cash flow issues and decided on the best mitigation strategy. In our opinion, one way to be proactive is to analyze your current activities and/or services. We think this exercise will help you target your core money-making operations while shining a light on operations that could be discontinued or reduced. An honest discussion about the value deriving from your activities and/or services can save you money now and position you for long-term growth. We hope this chart will help spark creative discussions in your organization.

Instructions: List your primary activities and/or services in the far left column. Then rate that activity or service on how easy it is to teach to someone else, whether it differentiates you from your competitors, and whether it creates customer loyalty. Use a scale of 1 to 10 for each column. The top score for any single activity or service is 30. After you have discussed and rated each activity and/or service, you will have a basis for comparison and decision making.

Goal: Find the one or two activities and/or services that are easily teachable, find a way to differentiate them (if you haven't already), and build a plan so the activities and/or services create customer loyalty - which in turn leads to recurring sales.

Activities/Services	Teachable?	Differentiator?	Loyalty Creator?	TOTAL

***Stratus is happy to discuss any questions, comments, or concerns that come out of your analysis. You can reach Sam Brownell via email (sbrownell@stratuswealthadvisors.com) or phone (301-873-4602).**	How easy is the activity or service to teach to someone else?	Does the activity or service differentiate you from your competitors?	Does the activity or service create recurring revenue through repeat sales?

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HYPOTHETICAL OWNERSHIP TRANSITION TIMELINE

Prepared For: Independent Business Owners

A good succession plan requires you to begin planning years in advance of the final sale. The timeline below is based on a 3-year pre-sale transition period and highlights some of the major succession planning milestones. Keep in mind that a buyer will typically ask for 3 years of tax returns and 3 years of financial statements to begin their due diligence, so by implementing your succession plan at least 3 years before a planned transition, you can present a potential buyer with clean financials that may help alleviate questions that could derail a future sale.

Year 1

- Review your internal employees (e.g., family members and/or key employees) to see if there is anyone who could be the next owner. If so, develop a plan to gradually increase the involvement of this person(s) in operational and strategic discussions and decisions.
- Work with a valuation specialist (e.g., Certified Valuation Analyst®) to determine the current value of your business and to identify areas where you can grow your revenue and profit.
- Work with a succession planning specialist, like Stratus, to analyze your current net worth, your current personal expenditures, and the amount of asset growth you need to fund your future goals.
- Evaluate your current advisors (e.g., CPA, investment advisor, attorney) to make sure you have the proper succession planning team in place.
- Work with a succession planning specialist, like Stratus, to create and implement a multi-year growth plan so you can maximize the value of your business.

Year 2

- Review the progress of your internal successor(s) and decide whether you should continue their development or if you need to look at outside buyers. If you decide to pursue an outside buyer, create a business "listing presentation" that shows how an outside buyer can make money with the tools you have developed.
- Review the progress of your growth plan and decide if you need to make adjustments.
- Draft and execute a buy-sell agreement to cover ownership transfer(s).
- Review your estate documents and insurance (especially if there are multiple owners) to make sure they reflect your current succession plans.
- Discuss how you want to interact with the business following the final ownership transfer.
- If you own the real estate where your business operates, will it be included in the sale?

Year 3

- Meet with your succession planning team to finalize tax strategy, legal documents, and post-succession plans.
- Have your business re-valued and update the cash flow projections to finalize payment options.
- Make sure the building and property where you operate is clean and all outdoor lighting works.
- If the buyer is internal, they should now be running all operations while you provide support.
- Finalize the sale price, financing, earnout provisions, outgoing transition timeline of the seller, and legal documents. Set a date for the full ownership transition and sign the paperwork.

6-18 Month Post-Sale Period

During the initial post-sale period, you may be involved in daily operations if your payment structure includes deferred compensation, a consulting position, and/or a board position. As time passes, your involvement in the business should decrease. During this period, make sure you are discussing retirement planning with your investment advisor so you can focus on building passions outside of the business.

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COMPARISON OF OWNERSHIP TRANSITION OPTIONS FOR INDEPENDENT BUSINESS OWNERS

Transition Option	Market Value at Sale	Retirement Cash Flow	Tax Factors	Estate Planning	Preservation of Legacy and Culture	Employee Retention
Internal Transfer (Family Member)	Typically lower than external sales due to the desire of both buyer and seller to see the business succeed. However, strategies to increase value can be implemented because these strategies should increase cash flow as well.	Sales can be structured with a seller's note or deferred compensation to spread payments over multiple years. This can also ease the cash flow crunch on the incoming owner.	These sales are typically stock sales and in most instances will qualify for long-term capital gains treatment. Owners who will not need 100% of the purchase price to fund their retirement can gift a portion of the business to their children.	It is important that all family members, both current owners and future owners, update their estate documents. If a transfer will involve multiple owners, a buy-sell agreement or operating agreement needs to be drafted or updated.	By starting early, the current owner(s) have the opportunity to teach the next generation the values that define the business.	By starting early, the current owner(s) can work with the next generation so they can learn the business and gain the respect of employees at all levels.
Internal Transfer (Key Employee)	Typically lower than external sales due to the desire of both buyer and seller to see the business succeed. However, strategies to increase value can be implemented because these strategies should increase cash flow as well.	Sales can be structured with a seller's note or deferred compensation to spread payments over multiple years. This can also ease the cash flow crunch on the incoming owner.	These sales are typically stock sales and in most instances will qualify for long-term capital gains treatment. Owners who will not need 100% of the purchase price to fund their retirement can use a Section 83(b) election to grant a portion of the business to a non-family employee.	It is important that everyone involved in the transfer updates their estate documents. If a transfer will involve multiple owners, a buy-sell agreement or operating agreement needs to be drafted or updated.	Key employees have typically worked for a long time and therefore have a solid understanding of company culture. However, the current owner(s) should continue to discuss culture and legacy with the incoming owner(s).	Current employees will likely be familiar with key employees and this will be helpful for retention. Further, key employees are unlikely to drastically cut jobs because they understand the value of the business to the local community.
External Transfer (Competitor)	Typically higher than internal transfers if the business is a good strategic fit for the buyer and the buyer will not have to make large investments in the operations, processes, and/or people.	Most sales are structured with an earnout or seller's note to incentivize the outgoing owner to help make the transition successful. Earnouts should be based on gross margin.	These sales are typically asset sales, which means a portion of the sale will be taxed as ordinary income and a portion will be taxed as long-term gains. It is important to have a good understanding of how purchase price allocation impacts tax liability.	The outgoing owner needs to make sure their estate documents are updated. Further, the selling documents need to be specific about how the family gets paid if the owner dies during an earnout or seller's note.	Owners need to be careful when completing their due diligence on a buyer. Competitors or holding companies should be committed to maintaining the culture and legacy of high performing businesses.	Similar to preserving legacy and culture, owners need to do their due diligence on a buyer to understand how they have treated employees during previous acquisitions.
External Transfer (Financial Buyer)	Typically higher than internal transfers if the business is a good strategic fit for the buyer's exit strategy. Financial buyers are typically an option during periods when your industry is outperforming other industries.	Earnouts are typical to help the buyer maintain the value of their investment and these earnouts should be based on gross margin.	These sales are typically asset sales, which means a portion of the sale will be taxed as ordinary income and a portion will be taxed as long-term gains. It is important to have a good understanding of how purchase price allocation impacts tax liability.	The outgoing owner needs to make sure their estate documents are updated. Further, the selling documents need to be specific about how the family gets paid if the owner dies during an earnout or seller's note.	Owners need to be extra careful when completing their due diligence on a financial buyer. Most financial buyers are thinking about their own exit strategy and are happy to overlook culture and legacy for a higher return on investment.	Owners need to be extra careful when completing their due diligence on a financial buyer. Most financial buyers are thinking about their own exit strategy and are happy to reduce headcount for a higher return on investment.
Employee Stock Ownership Plan (ESOP)	ESOP values are competitive with the other transition strategies. Cash flow sustainability, payroll, and ongoing valuation and compliance costs are important variables to consider with this strategy.	ESOPs are quite flexible and can be structured to buy out the owner's shares over a period of time through tax-deductible contributions to the ESOP.	ESOP tax benefits for the seller begin when at least 30% of the business is sold to the ESOP. Tax benefits include potential lifetime deferral of capital gains for the seller and low to no federal income tax for the corporation.	Owners that use a 1042 rollover can defer capital gains indefinitely and potentially receive a step-up in basis upon their death. It is important that the proper documents are in place so these payments will continue even if the owner dies.	This is a great option for preserving the legacy of the owner and their family because the business is run by the people who know it the best - the employees.	Employee retention is typically high because the employees become owners and their purchase of company shares builds their retirement savings.
Worker-Owned Cooperative	Worker-Owned Cooperative values are competitive with the other transition strategies. Financing options and number of participating employees are important variables to consider with this strategy.	Similar to an ESOP, the buyout can be structured to allow a multi-year payout to provide an outgoing owner cash flow in the early years of retirement.	Cooperative tax benefits for the seller begin when at least 30% of the business is sold to the worker-owned cooperative. The profit that is paid as a patronage is tax deductible to the cooperative.	Owners that use a 1042 rollover can defer capital gains indefinitely and potentially receive a step-up in basis upon their death. It is important that the proper documents are in place so these payments will continue even if the owner dies.	This is a great option for preserving the legacy of the owner and their family because the business is run by the people who know it the best - the employees.	Employee retention is typically high because the employees become owners, improve their job security, build their retirement savings, and have a direct voice in how the business is operated.
Liquidate the Business	Typically the owner receives a discounted price for the inventory and furniture, fixtures, and equipment that is usable.	The owner is at the mercy of what the market will pay for their inventory and furniture, fixtures, and equipment.	One bright spot may be that the owner is able to take a loss on the assets they sell.	Owners who close and liquidate their business should still update their personal estate planning documents.	The business is closed so the legacy and culture of the firm will not continue.	The business is closed so employees will lose their jobs.

Notes and Sources: Information about ownership transition options is provided by Stratus Wealth Advisors. All owners should consider every available option, including an ESOP and Worker-Owned Cooperative, because no ownership transition is ever perfect and the more options we consider the better chance we have to create a successful transition for the three key stakeholders - the outgoing owner(s), the incoming owner(s), and the employees and customers.

INITIAL DOCUMENTS FOR YOUR BUSINESS VALUATION

The list below is meant to help you compile the documents that will be important for valuing your business. This list is not meant to be exhaustive, but to give you an idea of the key documents that are needed in a business valuation. Please remember, a large part of the valuation process is qualitative and involves discussions with the owner(s) and visits to corporate headquarters.

_____ Annual income for you and any other owners, family members, and/or key employees for the past 5 years (e.g., W-2, owner draws, etc.)

_____ Copy of your business tax returns or individual Schedule C's for the past 5 years

_____ Copy of your financials (Balance Sheet, Profit & Loss, Statement of Cash Flow), audited or unaudited, for the past 5 years

_____ List of tangible assets (land, buildings, cars/trucks, furniture, computers, etc.) including applicable depreciation schedules

_____ Any projections you have made for your business (e.g., revenue growth, margins, etc.)

_____ Current ownership interest(s) and the interest to be valued for this engagement

_____ The valuation date for this engagement (e.g., date of death, anticipated buyout date, etc.)

_____ Copy of your current Operating Agreement, Corporate Charter, Buy-Sell Agreement(s), and/or any previous written offers to buy or sell company interests

_____ Copies of any previous valuations of your business, tangible assets, and/or intangible assets

_____ Copies of client/customer contracts that will impact your future operations

_____ Copies of all insurance policies, history of claims, and premiums paid for the past 5 years

_____ The industry SIC and/or NAICS code(s) that you believe describes your business

_____ Name(s) of industry trade associations

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BUY-SELL AGREEMENT CHECKLIST

Having transparent and well thought out language in your buy-sell agreement can allow for easier decision making when you are transitioning ownership. Here is a list of pertinent information to consider when drafting or updating your buy-sell agreement.

_____ Do you currently have (or do you want to have) discretion to sell your shares back to the business/entity at a time of your choosing?

_____ Does your buy-sell agreement state that the portion of the business in question will be valued by an independent appraiser or by another method (e.g., formula)?

_____ Does your buy-sell agreement stipulate the business will be valued at Fair Market Value?

_____ Is the valuation date flexible so your business can be valued as close to the trigger date (e.g., divorce, disability, death, etc.) as possible?

_____ Does your buy-sell agreement state that the value to be calculated is equity (and not enterprise) value?

_____ If your buy-sell agreement does state that enterprise value will be used, does it discuss how to adjust for cash and debt to arrive at equity value?

_____ Have you specified what discounts, if any, will be used in the valuation of your business (e.g., lack of control, lack of marketability)?

_____ How will key-employee insurance proceeds be considered in a transaction? Will the surviving partner(s) be allowed to sign a promissory note to pay for the remainder of the purchase that was not covered by the life insurance policy?

_____ Are your financials prepared using the cash or accrual method and can this be changed when a trigger event occurs?

It is important to review your buy-sell agreement to make sure it is clear to all parties and that all stakeholders understand why each element related to ownership transfer is included. We suggest a review of your buy-sell agreement every 2-3 years or when a material change to your business occurs (e.g., acquisition, bringing on a new partner, buyout of existing partner, etc.).

Stratus is happy to help you with ongoing reviews, so please feel free to contact us.

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