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MARKET INSIGHTS

Five Tips for Building a Successful Succession Plan

By Sam Brownell

As a business owner, have you identified the end goals of all your hours of hard work? Many business owners are so consumed with daily operational challenges that planning for a smooth ownership transition is often the last item on a never ending "to-do" list, if it has been considered at all. Building a successful succession plan requires you to begin preparing years in advance of the actual transition so that you can build and protect family wealth and cement your place in the community. As a first step, we suggest finding an expert who can help you build a succession plan that addresses these five critical areas.

1 Identify a list of future owners now. It can be difficult to pinpoint the specific person who is the right choice to carry on your legacy. We suggest you start with your closest relationships (e.g., children working in the business), then move to key, non-family employees and finally to third-party buyers. Developing a diverse list of potential future owners gives you the time to discuss ownership transfer with them, observe how they handle management responsibility and develop an appropriate timeline for transitioning operational leadership and company ownership.

2 Know the value of your company and create a plan to maximize that value. Most business owners do not have a clear idea of what their business is worth or how their business compares to their competitors, which makes it difficult to improve profitability, a key step to increasing your sales price. Therefore, we suggest you get an independent valuation of your business1, so you know your current worth and you can identify areas where you can improve profitability. We also recommend contacting your trade association (e.g., NRHA) to see if they publish industry studies on profitability and compensation so you can benchmark your business. Ultimately, your business is valued based on the productivity of your assets and net income produced; it is not a function of the number of years you have been running the business.

A rule of thumb to estimate the value of your business is to multiply your Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) by a sales multiple between 2 and 5, with the actual number depending on factors such as profitability and location.

3 Build wealth outside of your business. As a business owner, you focus on reinvesting cash flow into your business. However, we suggest you also have a plan to grow your retirement account, grow a family liquidity fund and use any real estate holdings for income. By not tying your wealth solely to the sale of your business, you will have more options for creating a successful succession plan.

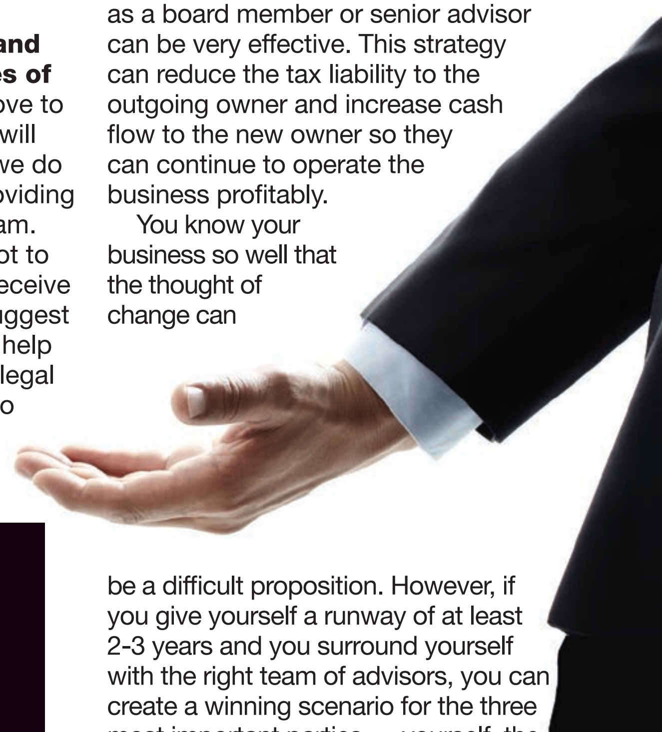
One asset that can be particularly useful in a succession plan is ownership of the real estate where you operate. We suggest holding this real estate in a legal entity that is separate from your business. This separation allows you to retain the real estate asset after the business is sold so you can continue to collect rental income.

4 Solidify your estate planning so your family and community legacy can continue. Chances are that as you have built your business you have also built a solid net worth foundation for your family and become an important part of your local community. In order to make sure that your legacy outlives you we suggest that you work closely with an estate attorney who can put the appropriate legal structures in place so your family and your community are in good hands long after you have stopped running your business.

As a starting point, we suggest you update your will and put in place trust documents. We also recommend drafting a solid buy-sell agreement that can be signed as soon as an ownership transition takes place. The buy-sell agreement protects your business and family in case an owner becomes disabled, gets divorced or dies unexpectedly.

5 Plan ahead for the tax and cash flow consequences of your sale. We would all love to sell our business for a price that will support us and our family but if we do not account for taxes, we are providing an avoidable windfall to Uncle Sam. The key to a successful sale is not to receive the highest price but to receive the highest after-tax price. We suggest that you find an advisor that can help coordinate the tax, financial and legal pieces of your succession plan so that you are properly rewarded for your years of hard work.

In our experience, a payout structure that compensates an outgoing owner as a board member or senior advisor can be very effective. This strategy can reduce the tax liability to the outgoing owner and increase cash flow to the new owner so they can continue to operate the business profitably.



You know your business so well that the thought of change can be a difficult proposition. However, if you give yourself a runway of at least 2-3 years and you surround yourself with the right team of advisors, you can create a winning scenario for the three most important parties — yourself, the buyer(s) and your customers. **HBSD**

Sam Brownell is the founder of Stratus Wealth Advisors. Stratus helps business owners in the independent retail industries determine, grow and maximize the value of their business as part of their long-term personal and professional financial plan”.

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