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WEALTH MANAGEMENT

Eight Steps to an Effective Business Transition

If you are considering transitioning out of your business at some point in the future, it pays to be strategic years before you actually engage with potential buyers. Here are some of the steps you can take to ensure that your transition will be as smooth as possible.

Step 1: Assess the Marketplace

When evaluating the market, start with your own industry, then look at the broader economic climate. What's happening with capital markets and consumer confidence levels in your community, your region, throughout the country and even around the world that might impact a future sale of your business?

Are your balance sheets getting stronger? Is the valuation of your business rising? Taking a close look at the growth of your business—and the industry overall—can inform your opinion on whether there is potential for continued growth.

You should also make an initial list of potential buyers to consider, including family members, managers and competitors, or other businesses if you want to consider a merger. Another option you may want to consider is an employee stock ownership plan (ESOP), which can be used to create a market for your shares and provide some tax benefits.

Step 2: Assemble Your Team of Advisors

You likely already have certain professionals in place to guide your business, such as a CPA, an insurance agent and a wealth manager. When preparing for a transition, an estate planning attorney and business attorney are valuable additions to the team. Choosing one key advisor to lead the group is also advisable, to coordinate efforts and help ensure that you have the appropriate team members in place.

Assembling your team early in the process allows you to select knowledgeable professionals who you feel comfortable with. Your advisors will also have more time to get up to speed on your business, its history and its financial picture.

While every member of the team is important, don't underestimate the importance of having competent tax professionals in place to make sure you structure the sale transaction in a tax-efficient manner. Your tax professionals will also be invaluable when reviewing proposals and letters of intent.

Step 3: Prepare Your Business

With your team in place, you're ready to begin preparing your business for sale with a goal of maximizing its value. This includes a thorough review of fundamental metrics and important documents; a talent management assessment; and an in-depth look at the reputation of your business. You'll want to leverage your advisors' skills and expertise to handle many of these specific tasks.

Evaluate Your Business

One of the first things you should do is look for any potential issues that might delay or adversely affect your sale. Have your business and personal tax returns reviewed by a professional. Consider any state and local tax issues, as well as any "tax nexus" issues if you do business in other states. Prepare a sell-side quality-of-earnings report to provide transparency for potential buyers, and check to make sure there are no liens or encumbrances affecting the company's assets.

This is also a good time to evaluate your corporate structure. If you are a C-corporation and are considering converting to a sub-chapter S-corporation for tax purposes, consult with a professional on the potential benefits and drawbacks of this option.

Review and Organize Important Documents

Make sure the business's financial records and corporate documents are accurate and up to date. This may include state incorporation documentation, equity ownership records, minutes and other corporate formalities. Check if any equity holders are entitled to rights of refusal or other rights that could impact a sale, and confirm that key intellectual property is properly owned and registered.

You should also review existing contracts for expiration dates and ensure key relationships are covered. Check if there are any change-of-control or antiassignment provisions that could be triggered by a sale. These include agreements with key suppliers, licensers of intellectual property, lessors of capital equipment and, very often, lenders. In addition, employment contracts for senior management may contain provisions that trigger a payment and/or termination if the company is sold.

Make sure you have all of this key information in a safe place that is easily accessed when needed.

Step 4: Obtain a Valuation

Work with a business broker to conduct an informal valuation of your business. Often, you can get an estimate or a range of probable sales prices early in the process, which will give you an idea of the value and allow some time to make adjustments to address issues.

When you are ready for a formal valuation, make sure you hire a qualified, credentialed and experienced business appraiser.

Work with your tax and accounting professionals to track and confirm the accuracy of basis calculations, and to work through any adjustments to your business's earnings before interest, taxes, depreciation and amortization (commonly referred to as EBITDA) now rather than closer to the sale.

Armed with the valuation and basis figures, you can determine a reasonable range for potential offers.

Step 5: Prepare Personal Financial Forecasts

Having a valuation prepared provides you with a reasonable range for bids, but the next step is making sure those numbers represent at least the minimum amount you need to feel good about the sale.

Start with your living expenses, other anticipated spending (including a cushion above your known spending needs)—and don't forget your goals for leaving a legacy for your family. Determine how much money will be enough to meet your needs and goals—that will have a big influence on your bottom-line figure for the sale.

Look at anticipated net-cash proceeds, after debt payments and expected tax obligations. Too often, in the thick of negotiating the deal, sellers focus on the gross proceeds, forgetting the cut that debt payments and taxes will take. To have an accurate idea of the lowest acceptable sales price, it is critical that you engage your accountant in forecasting the myriad taxes that you and the company may incur.

Step 6: Advise and Prepare Your Family for the Transition

If you have family members who are involved in the business, inform them of your plans sooner rather than later. When this step is overlooked, the eventual sale can be a source of contention and ill will among family members for generations to come. Once you've shared your plans, we encourage you to maintain communication and keep your family involved as key decisions are made.

Consider whether it is appropriate to make family wealth transfers at this point in the process. This is often viewed purely as a tax-saving strategy, but it can also help prepare the family for the money. The same approach can be taken with ownership interests if the business is staying within the family, prior to the final transfer of management and control.

Step 7: Engage with Prospective Buyers

When you have been deliberate about all of the planning steps leading up to this point, you have the luxury of being able to interview prospective buyers and entertain bids based on more than just the offer price alone.

For many business owners, knowing their employees will still have a job after the sale is important. You'll also want to consider how a sale to various potential buyers could impact your business's reputation in the future. Finally, consider whether you want to continue to have some sort of role in the business after the sale.

All of these factors may influence your decision as you consider potential buyers—in addition to who can meet your bottom line sales figure.

Step 8: Structure the Transaction

Once you have identified a buyer, you'll need to ensure the deal is structured in a manner that considers all of the tax and financial implications in play. Consider the following questions:

- Will the business's form of organization be changing?
- Will the deal be a buyout or a reorganization?
- How will payment be structured?
- Is a stock sale or an asset sale more desirable?
- Will you maintain an ongoing consulting role?
- Is there a need to have non-compete agreements in place after the sale?

Remember that you've put valuable time and effort into your business and into this process. Be true to your goals by structuring a deal that is truly in your best interest.

Looking at the Big Picture

Selling or transferring ownership of a business is an intricate process. While certain steps may look slightly different for each business owner, this list provides an overview of each action item, as well as the timing and key players you'll need to be successful.

At BNY Mellon Wealth Management, we are here to help business owners with all facets of this process—from the practical steps to the emotional decision-making. We would welcome the opportunity to serve you and your family through this transition.

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