

# BUSINESS TRANSITION PLANNING 101



All businesses will reach a point where the current owner will need to exit the company, whether through a planned sale or retirement, or as a result of an unexpected life event. Despite the universal nature of business transitions, few businesses dedicate time and energy to establishing a plan for an orderly transition of the business when the time comes. However, successful planning can help provide security for the owner's family and employees, increase the likelihood that the business will continue and typically also results in improved business profits.

There is no bad time to plan for the future. While it is optimal to being planning at least three years before the anticipated sale or transfer of a business, a plan does not need to refer to a specific period in time, but rather lays out a process for valuing the business and transferring ownership and management, and sets forth criteria for evaluating a potential sale.

## Common Misperceptions

Because individual business owners will likely only experience this process once in their life, there are many unknowns surrounding the transition process, and, as a result, many misperceptions. Some common misperceptions include:

- **Underestimating the time required to sell/transition.** According to the International Business Brokers Association, the average time to sell a 'good' business is 8-12 months. Businesses expecting a sale in a lesser timeframe will not receive an optimal price, and may be unable to find any qualified buyers.
- **Assuming that a transition to a family member or key employee is easiest/best.** If a primary goal of business transfer is family continuity, this may be the best strategy. However, a well-planned transition can take longer than a sale, and is also more likely to incorporate seller-financing with tax/retirement implications for the departing owner.
- **Small businesses can be valued and sold in a similar fashion to real estate or multi-million dollar corporations.** Buying and selling a business is not the same as buying a house or stock in a large corporation. There are few to no comparable sales or publicly available market data to provide buyers with an indicator of value, and sales multipliers are only useful if long-term accurate accounting exists and a future buyer intends to run a business in exactly the same manner. What a buyer is willing to pay is strictly based on what they intend to do with the business and/or its assets.

## Increasing Business Value

The market value of an individual business will depend on its customer base, location, sales track record, real estate and equipment and business practices. However, there are some ways to improve value. The further in advance planning occurs, the greater the ability increase the market value of the business.

## Business Planning Checklist – Things to Consider

- Needs and desires of the owner with regard to retirement and willingness to relinquish control.
- Presence of/desires of leadership team &/or family.
- Economic conditions and industry trends
- Individual & corporate financial implications of various sale types/timing.
- Current debt & anticipated capital requirements.
- Value of real estate, inventory and other assets.
- Business sales, revenues, trends and projections.
- What training will be needed to prepare for an internal transition?

- **Cash Flow & Inventory Maintenance.** Improved accounting systems and a reduction in excess inventory will improve the business's bottom line. Additionally, businesses should work toward 3-5 years of annual balance sheets which reflect a reasonable growth projection for the business. This will also likely require a more strict accounting of business and personal assets (i.e. vehicles and insurance), as well as structured accounting of owner salary, retirement and benefits.

- **Diversify Client Base & Product Offerings.** Companies which rely heavily on one product or client for a significant percentage of earnings are not seen as desirable targets. Additionally, single-product companies offer less potential upside for buyers to increase revenues. The goal should be for no individual product or client to represent more than 10-15 percent of annual sales.

- **Streamline & Document Operations.** Owners should strive to be able to illustrate and document how they operate the business on a daily basis. Having key employees that are familiar with the operations and capable of operating various facets of the business is also an important factor. However, employee salaries should also be evaluated in light of industry standards and earnings and paired with more accurate job descriptions, as long-time employees may have received regular raises with no added responsibilities.

- **Spruce Up Marketing & Appearances.** Closer to the time of sale, take a look at the physical appearance of the company's online, social media and physical presence. This is one area where selling a business does have similarities to buying a house. Curb appeal of a business is important for conveying an impression of care and upkeep. Businesses with fresh paint, updated marketing materials and website will be more compelling than a business which has not undergone any major changes for several decades.

- There are some types of businesses that are notoriously difficult to value under any scenario, including:
  - Primarily cash businesses such as restaurants, bars and small retail storefronts.
  - Businesses with a limited market size, seasonal market or inefficient real estate.
  - Businesses with poor industry ratios such as high inventory levels, high payrolls relative to earnings and increasing local or online competition.

Sellers of these types of businesses will need to focus on demonstrating the value of the business through solid fundamentals, including the items identified in the final section of this document.

#### Additional Resources

- UNH: <http://www.familybusiness.unh.edu/usefulinfo/HARCAPFamilyBusinessBooklet.pdf>
- Forbes: <http://www.forbes.com/sites/all/business/2013/08/28/5-steps-to-create-a-viable-succession-plan-for-your-family-business/>
- Family Business Institute: <http://www.familybusinessinstitute.com/index.php/Succession-Planning/>
- UMASS: [http://www.umass.edu/fambiz/articles/selling\\_your\\_business/position\\_company.html](http://www.umass.edu/fambiz/articles/selling_your_business/position_company.html)

## What NOT to do



Assume that your business is worth \$1 million.



Start planning less than one year before a planned transition (3 years is ideal).



Fail to consider the tax and insurance implications of your decision.



Rely on the proceeds from the business sale to fund your retirement.