Here we outline the basic steps of transition for the owner/seller and the buyers. Starting with organizational goals, business owners determine which business model they would like to adopt, their role and future owners, how the business is valued, what types of professionals to use during the process, and how all this affects current and future taxation for all parties involved.

Planning for your Succession



The general steps of transition to consider are:

- **Business Financial Planning**
- **Personal Financial Planning**
- **Management Succession Planning**
- **Estate Planning**
- **Ownership Transition Planning**

By focusing on these early, and understanding your strengths and weaknesses in each, you increase the likelihood of a successful management and ownership transition.

For each area, it's important to make a current plan, evaluate it and decide whether it's sufficient for you to continue as is, whether additional long-term assistance would be beneficial, or whether you need to take immediate action. Seeking outside expertise can help ease your path, strengthen your plan, and help your business remain financially healthy for generations to come.

Your organizational goals

There are many ways to approach ownership transition. How do you choose the best route for you, your business and your family? Owners that plan today enjoy a competitive advantage and a satisfying retirement. To better understand your options, you'll first need to establish your own personal goals and financial requirements. That will set you down a path to determine the value of your business, develop business cash flow models and identify potential management successors.[13]

Ownership & leadership roles

The decisions you make today won't determine every detail of your organization's future, but they will help define the range of your choices. Do you want to keep the same leaders in place once you sell? Is this an opportunity to change how the company is managed?

Potential buyers will have their own ideas, too – the main one being whether the business can be successful without the owner. The management team will be a big part of that answer.

The five main areas of leadership the buyer will be concerned with are:

- **Financial and accounting**
- **Sales and marketing**
- **Manufacturing/service**
- **Systems**
- **Overall management**

The abilities of the people in these positions will be a key part of any sale.

Developing your chosen successors

A company's current leadership is responsible for working to identify and prepare the next generation long before it's needed. In a very small company, the founder-owner may rely on personal, one-on-one interactions including special issues like family dynamics to identify and train his or her eventual successors. In some small businesses, management will be part of the process and should be an active voice. When stakeholders are excluded, they tend not to support the outcome.[14]

A set of guiding principles should be developed so key processes can be put in place to measure whether you're going in the right direction. The groundwork you lay now can make a difference between the succession you want and a succession you have to settle for.

There are two main tracks to take: assessing and developing talent; and compensation planning to ensure those rising leaders know you appreciate them. Early focus should be on difficult-to-replace employees/positions and their impact on the activities that affect the value of your product or service. If innovation is important to you

or the company's future, diversity of thought and perspective will be important principles to consider in the future leadership of the company.[15] (See Leadership Assessment Form, Appendix B)

Business valuation

The harsh fact is your business is monetarily worth whatever a buyer is willing to pay for it – and all the years of work you put into it do not matter to them.

Still, there are three basic ways that are generally accepted:

1. **Fair market value – the price at which the willing and able buyer and seller would make a deal for their business.**
2. **Investment value – an individual's measurement of the asset's value. Or an asset's specific value based on certain parameters.**
3. **Liquidation value – the value of the assets that remain if the company goes out of business; assets included in liquidation value are tangible assets like real estate, machinery, and equipment.**

Each of these requires professional help that is fair and unbiased.

The reality for many very small or micro-businesses, even the revenue the business earns probably won't matter in the business's valuation — only the amount of profit you earn as the owner does.

EBITDA – Earnings Before Interest, Taxes, Depreciation, and Amortization

SDE – Seller's Discretionary Earnings

Buyers may use EBITDA for small businesses or Seller's Discretionary Earnings (SDE) for very small and microbusinesses. SDE is all of your annual profit, plus any other benefits to the seller added back in. These benefits may include things like your salary as an owner, your company car payment, medical insurance for the owner, etc. They may multiply that number to come up with an offer

price. Your multiple will be determined by just a few factors like sale price of similar companies, the age of any equipment you may have, how many hours the new owner would need to work, how many clients there are and whether they have contracts, and whether you have documented how the business is run.

Using a broker

A good business broker can help you in virtually all aspects of selling your business. Many of the advantages of using one come down to their skill, saving time and hassle, and getting the best price. They can make sure that only serious buyers sign an NDA (Non-Disclosure Agreement) to get access to the details of your company.

Non-Disclosure Agreement – a legal document saying that the potential buyer will not share the company's private information.

Working with brokers can be expensive. The average fee a broker receives is about 8- 10% of the selling price, or a flat fee as a minimum for very small businesses. If your industry is specialized, your insider information may be more valuable than their other abilities.[16] Small business owners are encouraged to start with the free nonprofit advice from business technical advisors listed below. They can guide you through the process and also refer you to other professionals for specialized needs.

Preparing financial documents

Preparing financial snapshots and projections will be critical to any sale; it's how the buyer understands the current value and potential future of the business. Buyers must have the most current information available and some documents will need to be updated regularly throughout the process. Examples of important documents include: trailing averages, value of assets, any current debt terms, cost of goods sold, as well as proof that the company is up to date with taxes. The seller and buyers will both want to make sure that sales, debts, and other key numbers are correct and can be confirmed. For the legal documents, each side needs to make sure their best interests and wishes are written down. This is another reason that technical

advisors are so crucial to success for both sides. Mistakes made in the documents can follow the business forever.

Finding a buyer

This is a critical step in selling your business and there are many options - from people you know to complete strangers. Here are some ideas:

Keep it in the family

The three main ways in which a business can be transferred to a family member are as a *gift*, through a *sale*, or through a *partial sale*. You might think that a sale would always be the obvious choice because you can make money that way, but there are other factors to consider, too. There may be a lot of complicated family dynamics at play that can affect what you do.

Depending on your retirement needs you can give family members the business as a gift all at once and usually pay a lot of taxes, or give a little at a time and pay no taxes. This is especially useful for a microbusiness where the dollar amounts are smaller. To sell it to family you can take a lump sum for a full sale, receive payments over time, or finance the sale yourself in a partial sale. You can continue to work there and earn monthly income or you can keep the physical assets (like a building or equipment) and rent them out.

Buy-sell agreement

This contract will say how a partner's share of the business will be reassigned if that partner dies or leaves, usually requiring that it be sold to the remaining partners. They also normally spell out how to put a dollar value on those shares. Many businesses buy life insurance on the partners so that the insurance payout would pay for their shares. If you are a sole proprietor, you can put in a key employee's name as successor.

Vesting - granting an employee a right to benefits, usually after a fixed period of employment.

Gifting shares

This usually means stock options. They are something that many companies can create without having to change the business structure. Owners can offer or increase stock-options to some or all employees, like only senior executives. Usually, there is a vesting schedule whereby employees are able to buy stock at a reduced price after that time. Often, the amount of outstanding shares available for stock option plans is only 10-15%; some companies use this type of employee ownership to get to higher percentages of employee ownership.[17]

Business trusts

Trusts are legal instruments that give a trustee the authority to manage a beneficiary's interest in a business. Trusts are widely used in estate planning, largely because they're very flexible. You can create and fund a trust during a lifetime or create one by the terms of a will or trust at death. In estate and financial planning, there are several common purposes for using trusts like lowering taxes, protecting your assets, privacy, avoiding probate, or special needs.

Management buyout (MBO)

This is a transaction where a company's management team purchases the assets and operations of the business they manage, so they will earn more and have more control. Managers gain much more responsibility and a greater potential for loss, so they must change how they think to be successful. Not everyone can do that.

The managers must find their own financing and it can be complicated and expensive. Usually, only larger companies do MBOs as it invites hedge fund operators to get involved and they may dramatically change the company.

Sell to outsiders

Many owners consider selling to competitors or outside investors. This can be a great option, but there are many risks to consider. There are several problems that can occur with revealing private

information during the due diligence stage to people who are most likely to use it against you or raid your best employees. They will also realize you want to leave and that your business may not be worth much if you do, reducing what they're willing to pay for it. Outsiders may also buy it just to shut it down. Outside investors may also change the company drastically or be inexperienced in your field, causing key employees to leave or ask for raises to stay.

Liquidation

Liquidation is the process of changing assets into cash. This could be selling off real estate or equipment after your business closes.

Before liquidating your life's work and leaving your employees without a job, you may want to consider some of the following employee-owned options:

Sell to ESOP

Employee Stock Ownership Plans (ESOPs), the most common type of Employee-Owned companies, are instituted primarily as an ownership succession strategy. ESOPs are qualified retirement plans used to transfer all or part of the company's shares to a trust fund administered on behalf of the employees. This fund, or ESOP, borrows money from a bank and passes it to the company as capital. Employees earn their shares over time to be distributed upon retirement, although they are not legally company owners. If an employee leaves prior to retirement, the company buys the stock back at a fair market value. ESOPs are good for younger and lower-income employees because they usually cover more employees than a 401(k) would. Many ESOP companies are majority or completely owned by the ESOP trust.

Compared to other options, ESOPs have higher setup costs, ongoing administrative costs, and difficult compliance requirements, but due to their advantageous tax regulations ESOPs can still be a fit for companies with more than 40 employees and over $2M in revenue.[18]

Sell to employee ownership trusts

Employee Ownership Trusts (EOTs), are another type of employee-owned company where the owner creates a trust that owns some or all of the business with the main purpose to preserve the business over the long term for the benefit of the employees. The company contributes cash to the trust, which uses that cash to buy shares from the current owner. By selling to a trust, the owner may not get as high a sale price as bidding it out to several potential buyers but their legacy or other considerations may be more important to them.

EOTs are similar to ESOPs in that employees don't pay for their ownership benefits, but they receive a share of the company's annual profits quarterly, so it is less of a retirement plan than an ESOP is and more of a profit-sharing option.

EOTs have lower setup costs and much less regulation than ESOPs but also don't get the same tax benefits. EOTs are also more flexible. Some are set up so that employees either serve in a governance role on the trust or have a role in selecting who does.

Sell to your workers

Worker-Owned Cooperatives or co-ops are 100% owned, managed, and run by the people who work there. There are several models, but generally, employees pay a small amount to buy in to become co-owners. A board of directors is then made up of majority employee-owners. Elections are held by the full membership on a one-person, one-vote basis. In contrast, sometimes boards of directors in ESOP companies are elected on a one-vote-per-share basis.[19] Co-ops have fewer tax advantages than ESOPs under today's

regulations, but they are less expensive to set up, even cheaper to maintain, and add transparency for the worker-owners. Sharing of profits and losses is built into the model and can be distributed based on hours worked, seniority, or other factors unique to your business.

Non-extractive financing — personal financial information and assets are not required to secure a loan.

Financing on behalf of the workers is another avenue for potential employee-owners through Detroit Community Wealth Fund (DCWF). This is a non-extractive financing option. This means that they do not ask worker-owners for personal financial information or seek personal assets to secure a loan. Instead, the business owner and DCWF agree upon a certain percentage of monthly profits from the business after workers have been paid. Their interest rate is not compounding and payments don't begin until the business breaks even so DCWF is invested in the success of the business. They strive to be partners with you by supporting your business on an ongoing basis until the loan is completely repaid.

When employee-owners are vested over 30%, it is important to consider that they generally:

- **Offer better pay and benefits**
- **Grow faster, innovate more, and enjoy higher productivity**
- **Survive longer, and are less likely to lay people off in a downturn**
- **Provide greater opportunity for younger workers**
- **Provide an ownership stake that significantly supplements other retirement income[20]**

Legal and tax considerations

Both seller and buyer will want experienced and reputable technical advisors for these areas. The number one legal mistake is postponing proper legal action and advice.[21] These attorneys, accountants and business advisors can explain the differences between

legal structures for the company and how that will affect each party, including the team left behind after the sale. For example, many states have trust laws that limit the time period for when a non-charitable purpose trust can be established, so expert advice is needed up front.

For tax considerations, each party must decide what is most important to them. This will help them decide which path to take. Does the owner need cash now? If the owner can live on only some of the money for the current tax year, their smaller earnings mean lower taxes when the payments are spread over multiple years. Does the owner want to buy something with the money? If so, the 1042 rollover is a common way to defer taxes or avoid them all together if they sell to an employee-owned business with a C-corporation entity structure and buy a qualifying investment within a year.

