Roadmap to a rewarding transition

Start early to transition with confidence.

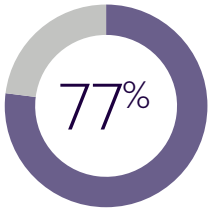
As a business owner, you'll likely come to a time when you think about moving on from your company to focus on the next phase of your life. Naturally, you'll want to capture the full value of your business and make sure you're leaving it in good hands before making an exit. How? By planning ahead. Having a transition plan in place early on ensures you receive maximum value for your business and have a smooth transition to whatever comes next.

Middle market transitions are common. Seventy-seven percent of companies have or will experience a transition within 5 years.[1] Many businesses are in great shape after recently reevaluating their strategies, tightening operations, and retuning their capital structures. Both companies and private equity firms want to put money to work. Valuations remain high, and investment capital groups are looking for businesses that are primed for growth.

Forty percent of middle market business leaders and owners are baby boomers,[1] and many are now having to consider their future, assess the risk-reward balance of their companies, and ask some tough questions. What can I get out of my business? How much do I need? Will my company continue to grow after I leave? What will I do when I retire?

Every company will transition at some point. It took hard work and careful planning to make your business a success—transition will too. Transition planning will help you take charge of your company's next phase and your own personal future. The best time to plan your next steps is in the Green Zone—when no transition is in play—where you have more control over how the transition process will play out. Start planning your company's transition in the Green Zone and finish it in the Red Zone.

Transitions are common.[1]



have experienced/will experience a transition within 5 years

TRUIST

Thorough preparation makes for successful transitions.

Take your time in putting together an effective transition plan for your business. "Planning for a transition doesn't mean a sale or transaction is imminent. In fact, it shouldn't be," explains Russell Sanders, managing director, Business Transition Advisory Group at Truist. "You need to start planning long before an acquirer or investor comes knocking on your door. Three, four, or five years before a transition, that's the Green Zone."

In fact, 98% of businesses that began transition planning 3-4 years in advance were pleased with the results of their transition. Only 33% of those who waited less than a year to prepare were satisfied with their outcome.[1]

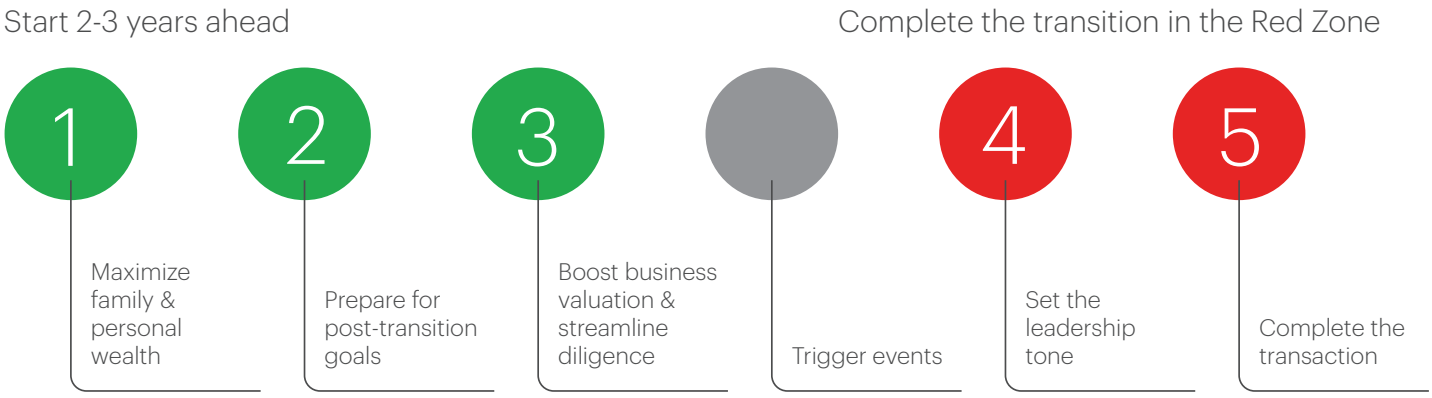
Planning ahead helps set you up for success when transitioning your business. If you wait until the last minute to plan your transition strategy, you won't have as many opportunities to maximize its value, nor will you be able to prepare your company for changes that need to take place.

Green Zone – Start planning 2-3 years ahead.

It can be difficult to predict changes in the market. What unexpected events—like health problems, family issues, or business challenges—could push your company into the Red Zone and force a transition?

Planning for a transition in advance will make sure that any potential transaction meets your personal and financial goals. Put a transition plan in place early during all three stages of the Green Zone to ensure you and your family retain more wealth to fund your life after the business.

Plan in the Green Zone to prepare for the Red



1. Maximize family and personal wealth.

Careful planning provides the financial resources to support your life after transition. You can accumulate the personal wealth you'll need from savings before the transition or from the proceeds of a sale, merger, or buyout. Before transitioning your business, be sure you have everything you'll need to fund your future.

Put personal financial strategies in place.

Putting together a transition plan early on can give you a better idea of how much you'll need after the transition and where to find those funds.

Planning ahead can also help you answer some important questions. How much do I need to put away from profits each year? How can I use funds from an outright sale or stock exchange? Where should I invest and manage cash taken out of my business? What's the best way to handle ongoing equity payments? "Working with owners well ahead of a transition allows us to identify strategies flexible enough to take advantage of opportunities while giving them the same level of control they're used to. We also have time to put in place the ownership and wealth structure necessary to deal with future uncertainties," explains Duncan Moseley, managing director, Business Transition Advisory Group at Truist.

Family businesses need to address wealth transfer for future generations. Selling a business often leads to a windfall for the owners, however the success rate of transferring wealth across different generations of the same family is low. Failure typically has nothing to do with poor estate planning or investment returns, but rather a breakdown of communication and trust within the family. "If you're looking at transitioning the family business and want to keep the family together, there are unique structures you'll need to put in place," Moseley explains. "You'll have to consider trusts and family managed entities like partnerships. You'll need to take the time to look over the full range of estate planning techniques. There are family specific strategies, like family councils and governance structures, that provide a safe forum for dealing with issues if mom and dad aren't around anymore."

How can you and your family combat issues that lead to failure and the erosion of wealth? Practice open and honest communication. Create a strategic plan to manage your family's wealth. Establish a governance system. Prepare the next generation for the responsibilities associated with their inherited wealth.

As you continue with your financial planning, keep these fundamentals in mind:

Address asset concentration – As a business owner, your focus is likely on one industry only—your own. How can you diversify your portfolio by investment type and risk level before transitioning? What about after the transition? You could hold on to one or two business assets to maintain your ongoing cash flow after the transition, while liquidating the others.

Anticipate tax implications – Planning ahead presents opportunities for charitable giving, business tax valuations, and upfront estate planning. Speak with your financial advisor to stay up to date on economic forecasts as well as legal, tax, and market changes that might affect your family's financial well-being.

As Sanders explains, "Understanding estate-planning techniques and how they're implemented, then managing assets once they've become liquid requires education and time. Rushed plans will not be as successful as plans started earlier. You need time to shift capital, build necessary structures, and manage processes to make this sort of wealth a positive for your family."

Tackle hard issues

- When should I/how can I let go of the business?
- How will my family adapt?
- What level of funds do I need to live-out my retirement comfortably?
- How much wealth goes to the family?
- How much of the sale proceeds are passed to employees?
- What percent of wealth goes to charity/community?

Address succession and family governance.

Creating a succession plan that designates leaders and assigns active and passive roles to others is one of the most important and often hardest steps in securing your company's long-term viability.

This is particularly true for family businesses. Deciding how to divide ownership between different generations of the same family can complicate a transition, leaving too few or too many family members interested in running the business. The pool of potential successors for some businesses could narrow as the next generation pursue careers, dreams, and passions that don't involve the family business, while others may have too many family members seeking roles in the business. Either way, finding a replacement to maintain the business as you and your family see fit is vitally important.

Be sure to communicate your succession plan clearly and firmly to your family, employees, managers, stakeholders, suppliers, customers, and advisors. Find a way to ease new leaders into their responsibilities to create management continuity throughout the transition. That leaves time to answer questions, address concerns, and adjust to new leadership.

2. Prepare for post-transition goals.

It's easy to push transition planning aside when you're still busy running the business. Preparing an exit strategy may not come naturally to you, especially if you've put your heart and soul into building your company from the ground up.

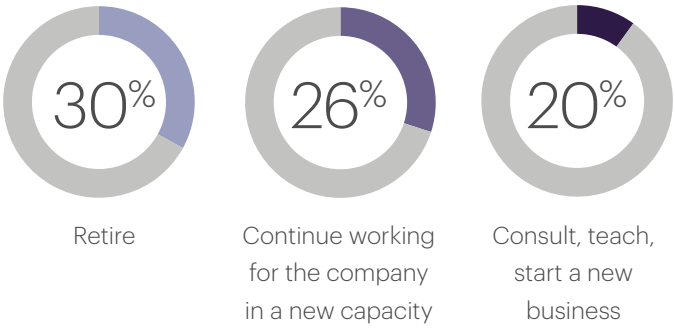
"Switching gears is one of the hardest things for business owners to do," explains Sanders. "It's critically important to take the time upfront to think past day-to-day business operations in order to focus on your life goals and your legacy beyond the business. In other words, begin with the end in mind to build a strong foundation for transition."

Frame your transition plan around these two questions:

What's your personal legacy? – As a business owner, it can be difficult to view yourself separately from your company. Transition planning requires you to look beyond your business and consider your personal legacy. What will you be known for after you leave the company? Philanthropic efforts? Educational foundations? Entrepreneurial endeavors? Charitable deeds?

Your personal goals will inform your wealth management tactics. Take the Bill and Melinda Gates Foundation for example. Born from Gates' desire to promote equality and empowerment, this charity is supported by earnings divested from his Microsoft holdings.

What do you want to do in the long-term? – Can you picture life without work? Thirty percent of owners and executives plan to retire after transitioning their business, 26% want to continue working for their company indefinitely, and 20% plan on consulting, teaching, or starting another business.[1] What does your future hold? Knowing exactly how you want to spend your time after your company's transition helps provide direction for your wealth management planning.



3. Boost business valuation and streamline diligence.

Long-term business and personal financial planning work in tandem. Position your company for a successful transition with these six steps:

Maximize value.
Your business valuation measures your company's current and projected economic performance and capital utilization. You can improve your company's value by increasing your market share, profits, and capital efficiency. The results will show up when you begin transitioning your business.

Protect value.
Don't risk losing business value after working so hard to build it up. Unplanned transitions, loss of vital managers and employees, or funding an unexpected owner buyout are a few transition risks that could damage your company's value. Key person insurance is corporate-owned life insurance that can fund buyouts to help you mitigate risks, avoid disruption, and preserve your business's value.

Prepare early.
Collect all the information you need and make sure it's up to date and readily available so that you'll be prepared for transition. Key elements include:

- Financial overview – Keep your books in good order. Prepare documents outlining your business financials including your accounting policies, summary overview, 12-month budgets, projected performance, and balance sheets. Consider using a Qualities of Earnings evaluation to help substantiate the sustainability of your earnings.
- Internal due diligence – Update and document your operating processes with a basic overview, regulatory compliance reports, and detailed financial projections.
- Owner buy-in – Keep those that need to know about your potential transition plans informed. Discuss the planning process in great detail and ensure affected management, owners, and family members buy-in early on.
- Build an advisory team – Create a sounding board for your current and long-term business plans. A strong advisory team would consist of your company's executive team, business advisors, CPA, attorneys, bankers, and M&A advisors. Your personal financial advisors can help guide your individual wealth management after the transition.

> "There are many facets on both the personal and business side that can benefit from expertise. With virtual meetings, it's easier to gather a team of advisors that's deal savvy and has transition experience. You've got one shot to do this right."
>
> Russell Sanders, managing director, Business Transition Advisory Group

Define your business legacy.
Your business legacy will reflect your approach to making your company stronger along with how you handle success and failure. It shows your company's purpose and demonstrates your values. What does your business stand for? What will you leave behind for the next generation? Consistently communicate your ideals to ingrain them within your company's beliefs.

Are you the business?
Strong leaders are often closely aligned with their company's identity. Steve Jobs was Apple. Jeff Bezos is Amazon. What will happen when you separate yourself from your business? How intertwined are you with your business in the eyes of your community, customers, and partners? Put a reliable team in place early on to position your company for a smooth transition when the time is right.

Use insurance to fund owner buyouts.
An owner buyout can force you to take on an unwanted investment or to sell your company outright. Don't get pushed into an unexpected transition. Use insurance to fund buyouts for departing owners. "Corporate-owned life insurance can create a sinking fund for potential buyouts or cover an untimely death. That'll keep you focused on the business when it needs you most," explains Moseley.

Trigger events

Every transition begins with a trigger event. Some trigger events are predictable, like a planned family business transition with a chosen successor and a fixed changeover date. Most transitions are started by unexpected events, like an attractive offer from an investor, a sudden change in economic conditions, or a family crisis or health issue.

By preparing for a transition in the Green Zone, you've already set your business up for success. Continue planning knowing that you've done all you can to assure your stakeholders of the best outcomes.

What if your company is met with an enticing offer but haven't thought about a transition? You'll be stuck in the Red Zone scrambling to catch up on Green Zone work under pressure with little time and fewer options. Don't get caught panicking in the Red Zone. Begin transition planning well in advance. Every transition takes place in the Red Zone, although timelines may vary depending on level of preparation. From start to finish, most transitions take anywhere between 3-12 months to complete, but some can take well over a year to finalize.

Red Zone – Complete the transition

Planning for your personal and business needs in the Green Zone gives you the flexibility to pick investment and payout structures that best fit your transition plan.

4. Set the leadership tone.

What are your priorities for yourself and your company? Where do you want to leave your business, management team, employees, partners, and customers after the transition? What compensation do you expect to receive? On what terms? At a minimum, you need to clearly articulate your priorities for the business to guide the transition process. Set boundaries with your family and make sure you understand the timing and requirements necessary to achieve your personal goals after the transition.

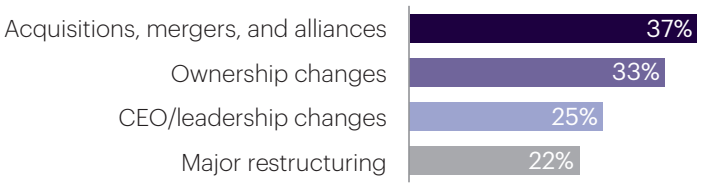
Rely on your advisors for help. Your transition team will support you through every step of the deal, including communications to all parties involved. Peers can provide you with sound judgement and advice, as well as access to others who may have relevant business sale experience.

Communication is key to keeping a sale or transition on track. Managing day-to-day operations and due diligence—like preparing documents, integrating new management, and handling divergent stakeholder needs—may prove to be less stressful when all parties—including your owners, employees, managers, and family members—are up to date on the deal progress. Create buy-in and acceptance by reinforcing the reasons for transition, especially the personal and business goals agreed upon in earlier planning.

5. Complete the transaction.

Transitions take many forms. Almost two out of every five are acquisitions, mergers, or alliances. One-third are ownership changes. One-quarter are either leadership or major restructuring transactions.[1] Each of these structures affects transitions differently. Groundwork laid in transition planning will help you find the best deal structure for your business.

Types of transitions experienced



As you're negotiating to close out the final stages of your transition deal, consider the following:

Business legacy when merging or selling – Will the acquirer/investor fit the culture of your business? How will the two be integrated? Does the acquirer/investor plan on taking your company in a different direction? How would that affect the longevity of your business, your employees, and your legacy?

Continued owner involvement – Do you need to stay involved in the business? If so, for how long and at what level? How will sharing control of your company with new management affect you?

Lump-sum payments – Would staging an equity sale over time improve your tax situation versus a single payment? Could sharing proceeds with employees boost your company's retention rate?

Payouts and debt – Will the transition drain too much cash from your business or create too much debt?

After the transition

Once the transition is over, focus on your retirement financial planning.

Keep your money working.

No investment strategy should be set in stone. Markets fluctuate, and your financial needs will likely change as well.

Your personal wealth advisor can help protect and expand your means. Tax and estate planning considerations might lead to additional trusts or foundations. Shifting liquidity needs may require adjustments to your asset mix. Frequent review ensures you're able to keep your funds working for you well into the future.

Reach your life goals.

Are you ready for a life without your company? Seller's remorse is all too common among business owners that don't stay focused on their personal goals.

Remember your transition planning discussions, including why you decided to transition your company in the first place and your vision for life after the business. "Time is an asset," Sanders explains. "When owners don't have enough time to plan, the transition can feel rushed. Discussions that have taken place over an appropriate amount of time leave you in a much better psychological state to accept the changes taking place in your life."

Stay busy—or not. Find balance.

The key to accepting a transition is finding the right balance between retirement and active engagement in your company. If you're at your best when busy, you could stay involved in the business for a period of time after the transition. Or, you may want to find other work, whether it's a new company, charitable pursuit, or some other venture that suits you.

"We see a number of cases where the head of the company has transitioned out, but still has some sort of ownership share," explains Moseley. "They have liquified to some degree and are out traveling the world. But they still have an office, and while they aren't there every day, they're still involved in certain decisions and fill a chair in some capacity."

Reach out to the experts.

Transition will happen. Make sure you're prepared to take advantage of the opportunities it can provide.

The Business Transition Advisory Group at Truist offers personal and business transition knowledge and experience. Our teams can help you and your business "begin with the end in mind" to make smart transition planning decisions, maximize your company's value, and fund your life's next chapter.

> "After a liquidity event, owners will take control of significant amounts of wealth. To some extent, managing assets after the liquidity event is like starting another business – a 'second' family business – where owners can exert the same control and stewardship as they did with the original business."
>
> Russell Sanders, managing director, Business Transition Advisory Group

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Put yourself on the road to a rewarding transition. Speak with your Truist relationship manager or wealth advisor to map out the best transition route for you and your business.

Truist.com

[1] National Center for Middle Market Report, 2020.