A business owner's guide to transition planning

Transform your vision into a plan for the future

RBC Wealth Management

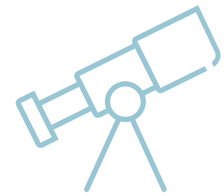
Planning for the milestones ahead

Every successful journey begins with a starting point, a destination and a plan to get there safely.

Congratulations on the contributions you, as a business owner and entrepreneur, have made to our nation's economy. Like many other business owners, you've poured your heart and soul into making your company a success. It likely represents your largest and most important investment, with your personal and family finances closely linked to the health of the business. Sometimes the lines can blur, making it difficult to separate your business interests from your personal interests.

This guidebook follows the life cycle of a business and its owner. It explores a range of subjects unique to business owners, including the development of a succession plan and your transition from the business into your next phase.

A new challenge emerges



The time will come when you are not running your business anymore. That's why every owner needs to create a succession plan to protect the future of their business.

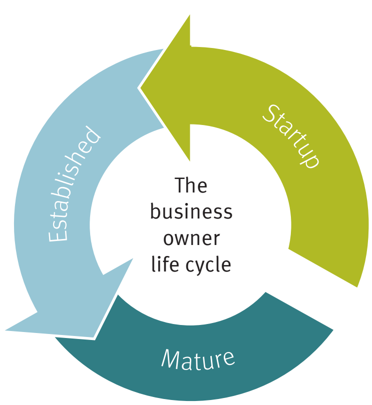
As a business owner, your transition plan needs to include a strategy about what happens to the company you've built. When planning your transition, the lines can blur, making it difficult to separate your business interests from your personal interests.

While many proprietors have informal transition plans in mind, few take the time to put a formal plan in place, while even fewer update their existing plans.

In reality, you may need a transition plan that identifies several possible scenarios for your business, along with the relevant risks and rewards. Your plan should help you to successfully navigate these issues and transition your hard work into the dream of a confident future.

Your starting point: ask yourself the big questions.

- What is your 3-year outlook for your business?
- What steps are you taking to achieve this goal?
- What is the biggest risk to your plan?
- How are you addressing that risk?



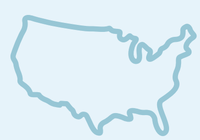
Where's your business?

- Startup: Begin retirement planning now
- Established: Develop your exit strategy
- Mature: Consider tax-efficient strategies for surplus assets

American business is overwhelmingly small business[1]

90%

Percentage of American businesses that are family-owned



31.7m

Number of small businesses in the U.S. (businesses with less than 500 employees)

30%

Approximate percentage of family businesses that make it to the second generation (and only 13% make it to the third generation)

Protecting the business you built

Contingency planning is important for every business. You need to prepare for unexpected events that might impact your transition strategy.

Consider putting the following strategies in place to safeguard against the unexpected and set the stage for your transition:

Successful businesses—including those best positioned for a sale—have adequate profits to meet four key objectives:

- Support the owner's lifestyle
- Sustain the business for several months in case of a slowdown
- Grow the business
- Fund a retirement that meets the needs of the owner

- **Leadership succession**
  As your business grows, expand the role of other contributors to the firm so that it becomes less dependent on your presence. This may put company leaders in a position to eventually take over the business. Keep these employees appropriately compensated and fully engaged in the operation of the business.

- **Shareholders' agreement**
  Create agreements to govern the relationship between shareholders, including:
  - Voting and other control provisions
  - Buy-sell agreements between major shareholders
  - Rules for how new shareholders, including children, are brought into the business

- **Disability planning**
  Have a plan in place in case you become incapacitated or disabled. Document the critical functions of the business and identify who will carry out these responsibilities. In addition, have an updated power of attorney and sufficient disability insurance coverage in force.

- **Adequate life insurance coverage**
  The death of a business owner is a tax-triggering event that may undermine your plans—or force family members to sell important assets. Life insurance may help your family cover living expenses, pay off business debt and keep the business running.

- **Diversification**
  During periods when your business prospers, consider taking some money off the table and diversifying into other assets, such as investments, real estate and life insurance.

- **Retirement planning**
  A well-structured retirement plan is the foundation of long-term financial security. Review your plan regularly to make sure it remains current with the changing circumstances in your life.

- **Updated will and estate plan**
  You should create and then regularly review your will and estate plan so that they are in sync with your business succession plan. This planning will limit disagreements among your heirs and successors.

Safeguarding from loss of top talent

Losing a valuable member of your team can be expensive and undermine the value of your business.

Your key employees' contributions may be difficult to measure, but more important than you might think. The right plan gives you the cost-effective liquidity you need to retain or replace a key employee.

Where do you start?

First, identify your key employees. Consider all areas of your company—operations, relationship management, customer service and sales. Do you want to protect your business from their death, disability or departure? Maybe it's all three. Keep in mind that a departure could be planned, like retirement, or, unplanned, like going to a competitor.

Which event concerns you most?

In the chart below are several potential solutions to employee retention scenarios, along with relevant funding options and considerations.

EVENTS	SOLUTIONS	FUNDING OPTIONS AND CONSIDERATIONS
Death	Key person insurance	Provides immediate benefit when the key employee dies
Disability	Key person disability insurance	Provides immediate benefit at disability
Retention	Retirement plan Bonus plan Deferred compensation	Many retirement plan providers offer low-cost options and products tailored to small businesses

Notes:

An investment in your people and your future

One of the best ways to prepare for tomorrow is through an employer-sponsored retirement plan.

Employer-sponsored retirement plans are an important component of employee total compensation packages. Employers who provide a solid retirement plan are better positioned to attract and retain the quality people needed to keep a business competitive.

Notes:

Advantages of creating a retirement plan for business owners

A benefit that once seemed accessible only to the largest employers can now be implemented for any company, regardless of its size. Even a one-person business can and should establish an employer-sponsored retirement plan.

If your company doesn't offer a plan today, implementing this important benefit will provide enhancements to your total compensation plan—enhancements that your current and prospective employees will appreciate. At the same time, you'll benefit from:

- **Tailor-made approaches**
  You can choose to implement one, or more, of many different plan options.
- **Employer empowerment**
  Most plans give employers the opportunity to determine the amount and type of contributions that are affordable and most appropriate for their firm. You make the final decisions on what to provide to your employees. You have the flexibility to offer a retirement plan only to those who have completed minimum eligibility requirements.
- **Tax benefits**
  Contributions to a retirement plan enhance the total compensation you provide to employees, without increasing the tax burden for you or them. All contributions are immediately deductible by the company and employees are not taxed on the proceeds until they are withdrawn.

Advantages of creating a retirement plan for employees

Achieving a comfortable retirement is regularly cited by investors of all ages as a major financial goal. One of the best ways you and your employees can prepare for this is through an employer-sponsored retirement plan. These plans can offer significant advantages, including:

- **Current tax savings**
  No matter how much you or your employees earn in taxable income, eligible contributions to a retirement plan avoid current taxation.
- **Tax-deferred growth of investments**
  Dollars invested in a retirement plan grow tax-deferred. This can make a difference of thousands of dollars to each investor at retirement.
- **Matching contributions**
  Under certain plans, employees can contribute some of their own salary, and take advantage of matching dollars from you, the employer. This provides them with an instant, tax-deferred 'return' on their investment.
- **Flexible vesting schedules**
  Under some plans, employees are vested either immediately or within several years of joining the plan. You determine the plan that best suits your company's needs.
- **Special purpose loans and withdrawals**
  With some plans, employees can take advantage of their retirement assets as a basis for loans to meet other short-term needs, like a first-time home purchase, medical expenses or educational costs.

Six popular retirement plan options for businesses

A retirement plan is simply good business on many levels. It has benefits for you, your employees and your business.

The plan you choose depends on the size of your business, how it is structured, and how much money you can afford to put aside. Self-employed individuals can take advantage of the fact that they're considered both employer and employee.

	401(K)	SOLO 401(K)	SAFE HARBOR 401(K)	SIMPLE 401(K)	SEP IRA	SIMPLE IRA
Plan type	Defined contribution	Defined contribution	Defined contribution	Defined contribution	IRA based	IRA based
Common among	Corporations, partnerships, limited liability companies	Sole proprietorships, partnerships and limited liability companies	Corporation, sole proprietorships, partnerships and limited liability companies	Corporation, sole proprietorships, partnerships, limited liability companies and corporations with 100 or fewer eligible employees	Sole proprietorship, partnerships and small business owners	Sole proprietorships, partnerships, limited liability companies and corporations with 100 or fewer eligible employees
Can employer sponsor other qualified retirement plans?	Yes	Yes	Yes	No	Yes	No
Who can contribute	Employee; employer contributions are optional	Employee; employer contributions are optional	Employee and employer	Employee and employer	Employer	Employee and employer
Maximum employee deferral contribution	$19,500 in 2021 Employees who are age 50 and older can defer an additional $6,500	$19,500 in 2021 Employees who are age 50 and older can defer an additional $6,500	$19,500 in 2021 Employees who are age 50 and older can defer an additional $6,500	$13,500 in 2021 Employees who are age 50 and older can defer an additional $3,000	Contributions are generally by employer, up to 25% of employee's compensation. Maximum annual contribution = $58,000	$13,500 in 2021 Employees who are age 50 and older can contribute an additional $3,000 per year

Know the value of your business

It's not enough to build a business worth a fortune; you have to make sure you have an exit strategy—a way to get the money back out.

Many business owners believe that the quality of their retirement hinges upon a big payoff when the business is sold. Since owners tend to invest the bulk of their resources back into the company, they're less likely than their employees to have built up significant savings in a workplace retirement plan. Therefore, as the starting point in the process, it's vital to understand what your business is worth.

Your business valuation needs to include:

- The value of your business assets.
- The value to an outside party in terms of revenue, profits or brand.
- The value of similar businesses based on comparable sales figures.

Popular valuation options include: book value, comparable analysis and discounted cash flows/projected earnings (see chart below).

Finding a buyer: consider your options

Many business owners dream about cashing in when a buyer comes along who is excited about the future prospects, eager to take over the business and ready to pay a premium for the opportunity. Reality is often quite different. In fact, the buyer may be someone inside the organization or within your family.

There are several ways to transition the ownership of a business. You should work with your accountant and attorney to determine an approach that's right for you.

- If you sell to a third party, proceeds from the sale could take the form of stock, cash or a combination of both.
- If you sell to your current employees or management team, the terms may involve installment payments.
- If you sell to family members, the transition may be handled as an estate-planning strategy, with all or part of the ownership position gifted to children.

Popular valuation options:

- Book value
  Compares the net value of your business assets with your liabilities.
- Comparable analysis
  Uses multiples of revenues, earnings or assets based on precedent merger and acquisition transactions and/or publicly-traded companies.
- Discounted cash flows/projected earnings
  Projects a realistic estimate of future earnings by using adjusted earnings history as a guide.

Many valuation methods are available.

An informal valuation is a great way to start the planning process, but be sure to choose a reputable organization with expertise in your industry.

Knowledge is power, and knowing your business's true value can help you see that you're on track to meet your personal and professional goals.

There are many benefits to knowing the value of your business. Knowledge is power. Yet a common refrain among business owners is that the valuation process is too expensive, time consuming and complex.

Like other business owners, you've probably spent most of your career building your business with the intent of selling it one day to fund your retirement. Yet, only a fraction of small business owners know their business valuation.

Many owners wait until a life event requires them to have a valuation performed, which is often the most inconvenient time.

A formal business valuation report will give you a deeper understanding of how your business is performing.

Worth
Deeper understanding of your largest asset

Protection
See that you have the right amounts of insurance

Plan your future
Know the facts for a more accurate retirement or estate plan

Make better decisions
Guided by facts

Know your potential
Understand the ways you can increase the value

BizEquity: An innovative approach to business valuations

RBC's BizEquity can generate a business valuation to give you the facts you need to make sound financial decisions. Our technology utilizes over two dozen data sources, providing access to the most accurate information on comparables. This means that your valuation takes more factors, data sources, and industry standards into consideration than the typical business valuation. The process yields four distinct and useful valuations.

1. Equity value

Includes inventory/supplies, fixed assets and intangible assets, plus liquid financial assets less all liabilities. This value involves the full transfer of the legal entity including all account balances and current tax attributes.

2. Asset sale value

Includes only inventory/supplies, fixed assets and all tangible assets. Excludes all liquid financial assets and all liabilities. Buyer operates from newly formed legal entity.

3. Enterprise value

Enterprise value is a reflection of the firm's value as a functioning entity and it is helpful in that it facilitates the comparison of companies with varying levels of debt.

4. Liquidation value

Based on the assumption of insolvency and the immediate sale of all assets on the balance sheet coupled with the satisfaction of all debts. This figure does not include accounts receivable.

Smooth ownership transitions

It's easy to think you'll have plenty of time to prepare for a transition in business ownership. But time passes faster than you think, so now is the time to start planning.

Business owners often underestimate how long it takes to create a plan. Now is the best time to start thinking about succession planning for your business. Begin by writing down your goals and getting professional legal, tax and accounting advice on setting up a succession plan.

Don't leave the planning to the last minute

Be conservative when you're planning for retirement. It's natural to be optimistic, particularly if your business has always provided for you and your family and you've assumed that it will be your main source of retirement savings. Allow time to find potential buyers to help you get the best possible offer for your business.

Here are some tips to consider:

- Start working on your succession plan as early as possible
- Set realistic goals
- Review your plan regularly
- Identify the qualities you're looking for in a successor
- Assemble a team of professionals

There are many succession strategies to consider

Start with a simple question to narrow down your options. To whom will you transfer or sell your business?

When should an owner think about creating a succession plan?

Perhaps the real question is, "When should an owner think about creating a sustainable business?" Because once a business is truly sustainable, then it will be ready for sale.

Family

- Gift to family
  - Gifting
  - Grantor Retained Annuity Trust (GRAT)
  - Inheritance equalization
- Sell to family
  - One-way buy-sell
  - Sole owner transition
  - Select buy-out
  - Installment sale
  - Interest-only note
- Bequest to family
- Combination of gift, sale or bequest

Non-Family

- Sell to co-owner or business
  - Cross-purchase
  - Entity purchase
  - Multi-owner buy-sell
  - General partnership
  - Installment sale
  - Wait and see
- Sell to third party
  - Select buy-out
  - One-way buy-sell
  - Sole owner transition
  - Installment sale
- Sell to employee
  - Select buy-out
  - One-way buy-sell
  - Sole owner transition
  - Installment sale
- Sell to an employee stock ownership plan (ESOP)

Family business, family harmony

Running a family business is a delicate balancing act. You must plan deliberately and carefully how to transition the business to your children.

For many business owners, transferring ownership to their children is a fundamental, almost instinctive, exit strategy. In fact, nearly a third of business owners take this route, and with good reason.[2] A sale to a family member gives you peace of mind about the future and your own retirement.

However, while many business owners have the dream that the business they have worked so hard to build will one day be passed on to future generations, there are disadvantages to this strategy.

For instance, if one sibling is tapped to take over as owner and another as manager, tension may arise between them. Also, think about whether your children are not only capable of running the business, but interested in it. It's not going to be good for them, you or your company if the interest and ability simply isn't there.

If you're concerned about your ability to step away from the business, this might be a challenge when someone or a group of people you know very well are at the helm. You might be tempted to get involved more often than you should, or be critical of your children's decisions.

Notes:

Beyond the numbers

The emotional challenge of leaving your business

Chances are that you've devoted your life to building your enterprise, so it stands to reason that you're financially and emotionally invested in its success. Mentally preparing to let go is an important part of the transition process, and often the most challenging issue of all. Here are some things to think about before setting your strategy in motion:

- How will it feel to watch someone else run what used to be under your control?
- If the transition of your business to family members is your goal, you'll need to determine if they are interested and capable.
- Would it ease your transition to remain involved in the business as a consultant or by serving on the board of directors?
- Can you be objective and accept decisions that may take your business in a new direction?
- How will you keep busy once you step away from the business?
- What's next for you?

Farm and ranch owners

Like other entrepreneurs, farm and ranch owners are attached to their businesses. The difference lies in the fact that your land and equipment may be options for funding your retirement.

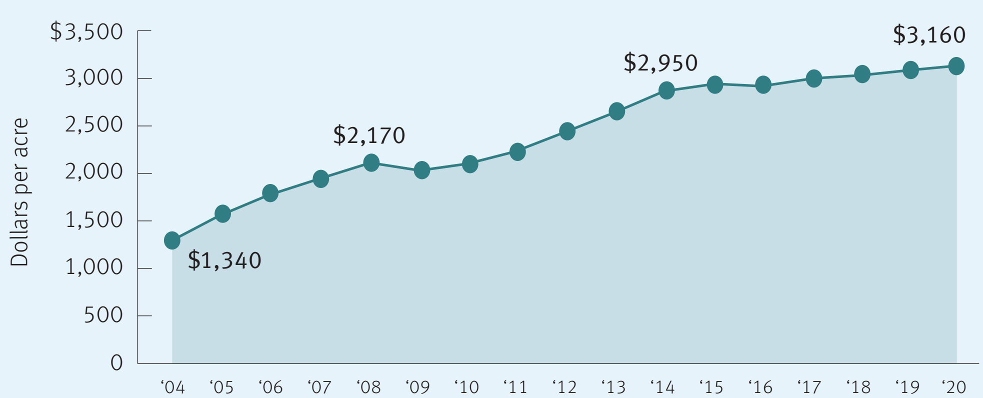
Family farms account for 98% of all farms in the United States, and 86% of its total agricultural output. It is estimated that 70% of all U.S. farmland will change hands in the next 20 years.[3]

A major challenge for these successors is the ability to afford and secure farm or ranch land. What was once a simple generational hand-off is now more complicated because of the increase in land value. The next generation likely cannot afford to buy expensive land. At the same time, farm and ranch operations are more capital intensive—the need for labor is reduced, but the cost of sophisticated equipment has sky-rocketed. All of this can weigh heavily on the mind of a farmer or rancher who is considering when and how to retire.

While selling land may create the needed income, it can complicate transferring the farm or ranch to the next generation. These choices become more emotionally difficult when the land has been in the family for a long time. The retirement process can be complex and time-consuming for farmers and ranchers, so it's reasonable to put a plan in place as many as 10 years before the actual transition happens.

Average farm real estate value in the United States

The U.S. Department of Agriculture reports that U.S. farm real estate value averaged $3,160 per acre for 2020, up $20 per acre from 2018. The highest farm real estate values were in the Corn Belt region at $6,430 per acre. The Mountain region had the lowest farm real estate value at $1,140 per acre.



USDA National Agricultural Statistics Service Information, Land Values, 2020 Summary

Business transition and exit strategy

Every business owner needs a transition plan—especially those who are preparing for retirement. Here are some important things to consider:

Key employees

- Do you have key employees who are vital to your business and who would be capable of taking it over?
- What plans are in place to keep these employees?
- How would you replace these people in the event of separation of service, disability or death?
- Have you discussed whether this employee or group of employees would want to take over the business? Does this employee or group have the financial means to take over the business?

Family business

- What role does your family have in the business?
- Do your family members expect to take over the business? If yes, how? Through a gift or by purchasing it?
- Are all family members on the same page with your decision?

Your next adventure

- What are your plans once you step away from your business?
- Do you plan to stay involved?

Action steps

- ☐ Take a hard look at your business and evaluate what makes it valuable.
- ☐ Review the key players (employees and family members) to determine who would be able to continue the success of the business.
- ☐ Once you have identified possible successors, have a conversation with them to make sure their career goals are in line with your vision for the company.
- ☐ Meet with your financial advisor to determine your overall financial health and how your business impacts your financial well-being.
- ☐ Once you know what you need from your business, discuss how you will get there with your team of advisors—attorney, CPA and financial advisor.

Prepare for your transition by addressing these key topics:

	Completed	In process
Shareholder's agreement	☐	☐
Retirement planning	☐	☐
Disability planning	☐	☐
Life insurance	☐	☐
Diversification	☐	☐
Leadership succession	☐	☐
Updated will and estate	☐	☐

The next phase of life is just around the corner

As a business owner, the challenges you face in planning for retirement are far more complex than is the case for most people. Successful planning is critical, and it isn't a "do-it-yourself" process. Don't hesitate to leverage outside expertise, including trusted financial, tax and legal professionals.

Your business is most likely your greatest asset. Creating a personalized plan for what happens next builds confidence and helps you capitalize on opportunities.

A step-by-step approach to transition planning:

STEP 1: Create a vision	Clarify your retirement plan and set goals for your transition from the business. These can start as general statements, but eventually evolve into more specific objectives you hope to achieve.
STEP 2: Gather input	Evaluate the capabilities of potential successors and assemble your team of trusted advisors, including your CPA, attorney, appraiser, financial advisor and banker.
STEP 3: Know the value of the business	Understand the value of your business through a formal or informal business valuation. Consider ways to improve on that valuation to meet your financial goals at the actual point of sale.
STEP 4: Implement a plan	Using the input you've gathered and working with trusted advisors, begin developing a formal succession plan. Make sure it truly fulfills your vision while anticipating any potential issues that could arise.

Get started today

No matter where you are on your journey, now is the time to focus on the next phase and your ultimate destination.

With so much on the line and so many potential stakeholders involved, you need to allow sufficient time for this process. It is never too early to start planning.

The information provided in this guide can help you begin thinking about the issues you need to address and offer a process to follow. Talk to your financial advisor at RBC Wealth Management to begin discussing your plans for retirement and the transition of your business.

Contact us today to get started

The real value of a wealth plan lies in the clarity you get when you have a comprehensive picture of your financial life, and the confidence that you have in a plan for your tomorrow.

Your RBC Wealth Management financial advisor works closely with you to find out where you stand today and set a course to help you achieve what is most important to you, to help give you peace of mind to enjoy the life you envision.

About Wealth Insights

Your financial journey is informed by both a clear understanding of where you are today and the strategic options that can fuel your tomorrows.

At RBC Wealth Management, we are committed to delivering insights that educate, equip and engage you for that journey.

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[2] BEI Business Owner Survey Report, 2017

[3] Fast Facts About Agriculture and Food, American Farm Bureau Foundation for Agriculture's Food and Farm Facts book, 2019

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