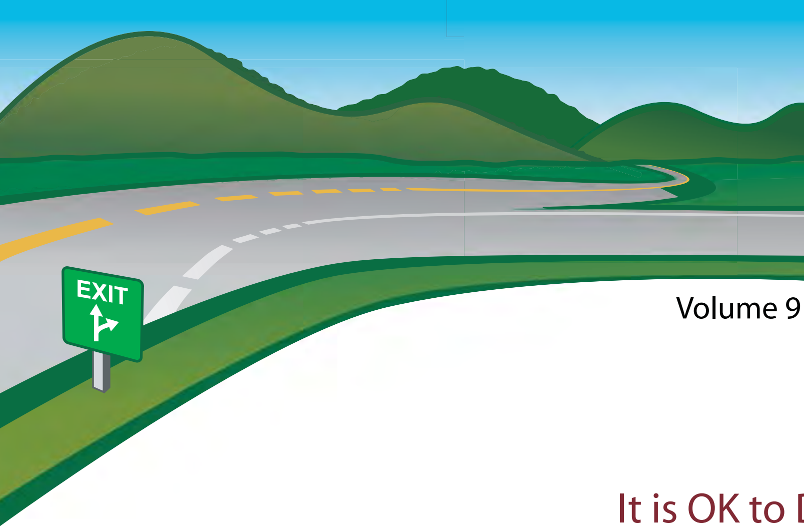

Changing Lanes

Transition planning for entrepreneurs and family businesses

Volume 9 | Issue 4

with compliments from

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It is OK to Drive in the Middle Lane

When mapping out their journey on the business highway, successful entrepreneurs know how to create multiple lanes heading in their chosen strategic direction - thus providing more opportunities for success. Not only do they diversify their product line until it is clear which track will deliver the greatest return on investment, they create ongoing demand and customer satisfaction by tapping into a variety of channels and markets.

A parallel philosophy applies when planning your ultimate strategic direction - the transition of your business to new ownership and leadership. The goal is to keep your options open until such times as the decision is obvious.

Our proven approach requires three lanes on your side of the highway. The left lane will ultimately lead to a new highway that represents an internal sale with next generation family or management at the helm. The right lane leads to the exit ramp with a sale to an external buyer. The middle lane is reserved for those who want to ensure a voluntary exit with the choice for either an internal transition or an external sale.

Driving in the middle lane during the planning stage is about creating that choice. It affords you the opportunity to enhance the value of your business while at the same time preparing your vehicle for a relatively quick lane change to whichever ramp turns out to be the better exit strategy for you, your family, and all other stakeholders.

This edition of Changing Lanes will outline some key considerations for driving in this middle lane - specifically protecting and preserving your physical assets while creating maximum choice for the future.

Inside....

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Creating the Choice

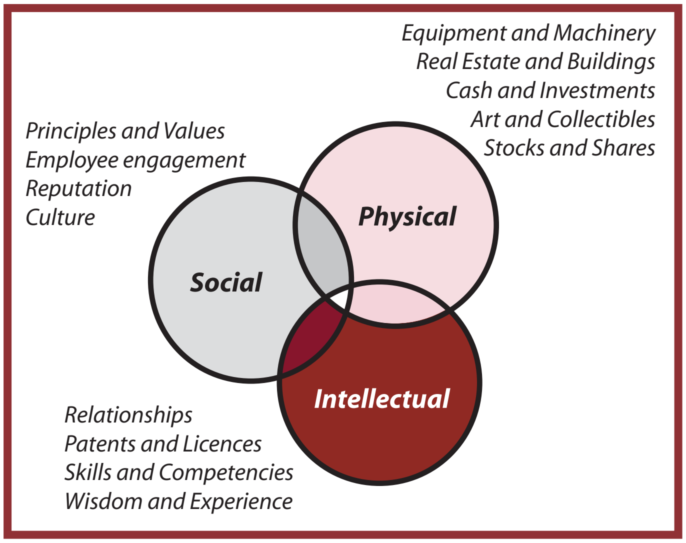
From the past eight issues of Changing Lanes, you have learned about the importance of planning ahead to protect and grow the **Three Types of Capital** and ensure maximum return on the significant investment you have made in your business. These strategies are all critical to creating the choice for either an internal or an external sale.

A successful transition of intangible assets such as those embedded in the Intellectual and Social capital circles *(shown right)* can take up to ten years to plan and implement. So it is important that these are addressed early in the process of preparing your business for sale.

Assuming you have worked diligently to ensure your business can run without you at the helm, and have taken the time to identify and enhance the critical factors that will ultimately determine your operation's sustainability and saleable value, you have completed the first two of the **Key Steps in Creating the Choice** *(see page 3)*.

It is now time to turn your attention to the third circle and focus on the preservation and transition of the **Physical Capital** which includes the shares of your business and any other tangible assets that enable the desired lifestyle of both exiting and successor shareholders. You should consider how you will structure or restructure the ownership in order to protect the **Physical Capital** from an involuntary sale and at the same time facilitate a smooth transition of ownership to either an internal or external buyer during a voluntary sale.

The Three Types of Capital



There are two main objectives in this third of the four key steps to **Creating the Choice**:

A. Develop a Contingency Plan to protect the Physical Capital and address the tax liabilities associated with either a forced or voluntary sale of your business.

B. Create an Ownership Philosophy that clearly aligns the entrance with the exit process alongside specific terms for when and how the business can be sold.

Continued on Page 3

Decision Time is Near

This edition of Changing Lanes continues our review of the steps to ensuring you have greater choice around how and when you "sell" your business.

Our objective is to prepare you and your business for both an internal sale to your family or management team, and an external sale to a strategic or financial buyer, through careful consideration of the strategies and tactics discussed in each hour of the countdown. As the hour hand approaches twelve, it will be clearer which is the better option for you. For now, review the recommendations for Hour Nine.

Hour Nine

Purpose

To put tax management strategies in place and structure the ownership for the impending sale or transfer.

Process

Utilize appropriate tax and financial tools to preserve the tangible assets and ensure a successful transition to the new ownership.

Payoff

You will not only have protected your estate but also created the choice to sell either internally or externally without having to time your sale to fit with a "better" economic climate.

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Creating the Choice continued

A. Develop a Contingency Plan

A Contingency Plan is designed to protect the physical capital in the event of an involuntary sale caused by death, disability, disagreement or any other forced change to the ownership of the business. Take the time to investigate common asset protection strategies and how they might each afford you a measure of wealth preservation and protection while you prepare for the long-term - a voluntary sale of your business. For example, ask us about the benefits of the following tactics:

A holding company is a business entity that does not generally produce any products or services itself but instead owns / holds other physical assets. This legitimate structure is not only a vehicle to minimize your exposure to legal liabilities but can also be used in tax planning.

Trusts are legal entities that allow business owners to defer the decision around who will ultimately own the shares of the business yet provide asset protection in the event their beneficiaries experience personal or marital disagreements. While the owner can transfer the growth in value of the company to his or her beneficiaries, he or she still retains control of the business.

In any business sale, there are three parties with a major financial interest — the seller, the purchaser and the government. Each party wants the largest share possible so, as the seller, it is important that you are proactive in minimizing the amount you are obligated to give away. While rules vary by jurisdiction, below are some of the most common options for effective tax management. Be sure to seek professional advice about the pros and cons of each option available in your area.

The sale of your business will likely trigger a tax liability resulting from an increase in value over the years — a capital gain. In Canada, individual shareholders may qualify for a tax exemption on a portion of that gain. Additionally they can conduct what is termed an Estate Freeze to cap the tax liability of the current owner(s) by stipulating that any future capital gain be attributed to one or more incoming beneficiaries.

In the USA, business owners should consider the differing tax liabilities associated with the various share structures (for example: S Corp vs C Corp) and the different ways the business might be sold (asset sale versus stock sale). They also have the ability to gift significant amounts of wealth as a component of their contingency plan.

Key Steps in Creating the Choice

1	**Ensure the business is more than the owner by implementing a gradual transition of the day-to-day management of the operation.**	***Early in the transition process. See Hours 1 and 2.***
2	**Increase the value to a prospective buyer by growing the business and preparing it for a voluntary sale.**	***Early in the transition process. See Hours 3 through 8, 10 and 11.***
3	**Structure the ownership to protect the assets and create a clear entrance and exit process.**	***Relatively early as a contingency plan or after significant growth. See Hour 9.***
4	**Finalize the terms and agreements before transferring legal control.**	***At the midnight hour. See Hour 12.***

While it may not be possible to eliminate it completely, planning ahead affords you the opportunity to create the liquidity needed to manage the tax liability resulting from either a voluntary or involuntary sale. One practical solution is a permanent life insurance policy, the proceeds of which can be earmarked to pay off the resulting tax bill or long-term debt. The earlier you plan, the more affordable such insurance will be.

B. Create an Ownership Philosophy

An involuntary sale resulting from a shareholder disagreement or a lack of a common vision happens all too often. Similarly, many voluntary sales, both internal and external, are derailed because of a lack of clarity or agreement around the terms for the sale or transfer of the physical capital. Be sure to engage your trusted advisor to help you clarify what is important to you — for both an internal and external sale — so you can then discuss and define your terms. For example, you should consider your preferences around an asset sale versus a stock/share sale, whether or not key persons will be retained and how they will be compensated, how existing shareholders will exit and new shareholders will enter ownership, how decisions will be made, and how the sale will be structured and financed.

There is no doubt that driving in the middle lane has more advantages, but remember that whatever lane you choose, you need to signal your intention well in advance of your target exit date to allow enough time to put wealth protection and tax minimization strategies in place.

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What is Alex Up To?

Remember Alex Greene?

Since the realization that his inevitable exit from his manufacturing business will have a "big impact on the livelihood of nearly 60 people" Alex Greene has been consumed with developing a plan that, within five years, will see his business sought and bought by the global leader in his industry.

It was an ambitious plan that began with the need to build a relationship with this prospective buyer. Nevertheless, it somewhat shocked his trusted advisor when Alex created a new position called VP of North American Sales and headhunted Kevin, long-time sales manager for that global leader, for the role. Kevin accepted Alex's offer which came with a bonus equal to 10% of the gain in company value at the end of the 5-year period. While this offer was designed to motivate Kevin to ensure the sale was a success, how could this strategy possibly align with nurturing a good relationship with the global leader? What was Alex up to?

Was Alex maybe creating a middle lane strategy?

With his children still in their early teens, Alex was very clear that passing the baton to the next generation in five years was not an option. His stated objective for an external sale was to increase the value of the company significantly and attract a buyer who would continue to operate in the community and provide employment for long-standing employees while maintaining relationships with loyal customers and suppliers.

But it's not so clear if Alex understood that an internal transition could also deliver on this goal – with less concern about where he might be in the business lifecycle, or whether supply might exceed demand at the time he is ready to sell. Likely he doesn't realize that grooming an internal buyer would offer more options for the eventual sale and at the same time provide a contingency plan should something untoward happen to him before it was time to sell.

On the other hand, he may have figured out that an internal sale option would create competition for an outside buyer and therefore enhance the demand and ultimately the selling price. Maybe he truly is working on creating more choice rather than putting all his eggs in one basket.

Alex is holding his cards close to his chest - a little too close as it turns out. He didn't go back to talk to his trusted advisor who would no doubt have suggested Alex augment his life and disability insurance so he could protect the enhanced value of the business in the event of an involuntary sale, and checked that Alex understood the importance of managing the tax liability that would undoubtedly result from the preferred voluntary sale.

Was Alex adequately protected? Did he sell the business voluntarily or succumb to an involuntary sale? Tune in next time to find out!

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