When Deciding Whether to Sell the Business is a Family Affair

By Caitie Burkes - Insider

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As many baby boomer business owners make plans to retire in the near future, their mostly millennial children—who would be second-, third- and, in some cases, fourth-generation owners of the family business—are weighing their options.

THREE STRIKES: Camm Morton, a certified exit planning adviser in Baton Rouge, says it's "staggering" how few businesses survive the third generation. (Don Kadair)

Maybe a company's heirs-to-be don't want to have to pack up and return to their hometowns in order to run the business. Or perhaps they've already tested the waters and determined that they simply aren't passionate about their family's line of business. What's more, the potential successor could resent their parents for seemingly forcing them to follow in their footsteps, instead of forging their own career path.

Whatever the reason, Camm Morton, a certified exit planning adviser based in Baton Rouge, has heard them all and more.

"It's staggering how few businesses survive the third generation," says Morton, owner and principal of VR Business Sales | Mergers and Acquisitions.

To be specific, some 30% of family businesses survive into the second generation, while 12% make it to the third generation and only about 3% of all family businesses operate into the fourth generation and beyond, according to The Family Business Institute.

Yet despite these statistics, Morton says less than 10% of business owners have a written exit plan. That's a scary thought, he says, with roughly 80% of U.S. businesses owned by baby boomers who could retire within the next few years,

Further complicating matters are the family dynamics that can come into play during the sale of an heirloom business. And when a business does go to market, only 20% to 30% actually sell, according to the Exit Planning Institute.

All of which goes to show that, for many local business owners, adequately preparing for the sale of a family business is no longer a recommended option, but a necessity.

"It's never too early to plan your exit," Morton says.

Why now?

Some Baton Rouge business owners looking to sell their companies are accelerating deal timelines in order to avoid a potentially bigger tax bite under the new presidential administration.

President Joe Biden wants to raise the current 20% tax rate on long-term capital gains to the rate applied to ordinary income for those making more than $1 million. His proposal would also raise the top rate on ordinary income to 39.6%, up from 37%. After a sale, higher-income business owners would face nearly double the taxes.

"More and more owners are looking to see whether now is the time to exit," says Mawe Takyi, a certified financial planner at Dent Wealth Advisors who predicts a "rash of business sales" within the next year. "People have been calling us, asking if they need to work through their processes now." At the same time, there's been a lot of liquidity in the financial system in recent years, with the free flow of private equity money helping close sales of businesses throughout the Capital Region and nationally.

More recently, there's been a meteoric rise in special purpose acquisition companies, or SPACs, over the past year. Essentially, they're publicly traded shell companies set up specifically to acquire a private company and make it public.

"There's a lot more cash looking to find a home right now," says Pete Bush, owner of Horizon Financial Group. "Some of these second- and third-generation owners are being approached with offers that they wouldn't have seen before."

Exit planning 101

Whenever a business owner ultimately decides it's time to sell, they should prepare for a long road ahead—regardless of the size of their firm.

"If you don't have a ton of employees or multiple locations, you'd think it would be simple and take a few weeks, but that's almost never the case," says Amanda Bourgeois, a partner at Kean Miller who specializes in mergers and acquisitions. "Even for a small business, I would plan for at least three to six months."

For a business worth $500,000 to $1 million, Morton says the process—which also involves him helping a business raise its value organically—averages six to nine months. But if an owner starts planning his or her exit strategy early enough, Takyi says it could take 10 years before a sale occurs.

To help facilitate the process, Bourgeois recommends sellers pour through their financial records, clean and organize their books and ensure everything is digitized on the front end. Before a contract-heavy business goes to market, an owner might also have to obtain written consent from its third-party vendors, which can also add to the sale timeline.

Generally, sellers should try to secure buy-in from all stakeholders and shareholders early on.

"We've had some deals go south because that hasn't happened," Bourgeois says. "It's always more attractive to buyers to not step into infighting among owners and other parties."

What makes family businesses so unique is that these stakeholders and shareholders are typically siblings or cousins, meaning deep-seated resentments can emerge.

Morton advises families to sit down and have a long conversation about what each person wants out of a sale and what it will take in order for their desires to be met. To guide these conversations, Bush recommends a business consultant who specializes in family governance counseling.

Because the process can drag on for so long, Bourgeois says sellers must also remember to continue running the business efficiently or else risk missing out on a deal should their revenues or production fall off target.

Businesses must also consider whether they can afford to sell.

It's common for companies to have an outsized belief in their value; after Morton audits them, his valuation usually comes at 30% to 50% of what a company thinks it's worth.

Oftentimes, buyers will also make sellers sign a non-compete clause, which typically spans several years. Therefore, Bush says business owners should ask themselves whether they're young and financially comfortable enough to wait out the terms of a non-compete clause, as well as how much of their lump sum is going to be taxed by capital gains.

"Surround yourself with a good team that's been there and done that before and that can help you identify your blind spots," Bush says, noting that 86% of a business owner's net worth is typically tied into the value of their business. "Owners have to sell for an amount that will set them up for the rest of their lives."

While sellers should certainly loop both their attorney and accountant into the process, they should nominate one point-person to court potential buyers. It's also useful for sellers to know what buyers are considering before signing a purchase agreement.

Following a 30-year career as a senior executive for several large corporations, Gene Bagot was searching for an industrial services business to buy three years ago. After hiring a broker, Bagot was able to narrow his selection down to four or five companies, then two, before getting to the altar with one. However, he couldn't reach an agreement with the owner of that company, so he moved onto the other.

Today, he owns Morgan Signs in Baton Rouge—a decision he says was largely driven by the similar values he shared with its former owner, who has stayed on with the company as its director of operations.

"I wanted to purchase something from somebody that I liked," Bagot says. "I spent a lot of time with this guy to make sure we could get along. Finding someone who I could understand, appreciate and empathize with was crucial in having a successful transaction."

Heading into a deal, financial planners encourage business owners to ask themselves honestly whether they'd be comfortable working for someone else, among other questions.

Chiefly, sellers must determine the best sale and payout structure for them. For example, if a private company sells to a large, publicly traded organization, they may receive stock in the new company, in which case they may want to research the buyer's profits and stock portfolio well in advance.

Alternatively, if it's being sold to another small business or to its employees through an Employee Stock Ownership Plan, will they expect an upfront payment with a note that's paid off over time? If so, what's the initial payment, length of the note and interest rate, and is it in the seller's best interest to ask for a larger upfront payment or for a lengthier note to rack up more interest?

"All of these processes can take unwinding and untangling, especially if the business has multiple lines," Takyi says.

But just because a business is sold doesn't necessarily mean its seller is in the clear, legally speaking. Bourgeois suggests sellers examine their purchase agreements, which will likely hold the seller liable for claims or lawsuits that were filed pre-closing or for any indemnities owed to the buyer after the sale.

"Any structure you agree to," she says, "make sure you have properly vetted with your attorney and CPA."

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