WELLS FARGO Wealth & Investment Management

Advice and Planning Update

Which business transition option is right for you?

Tim Rahr

Business Owner Advisory Strategist

Wealth & Investment Management

Business Owner Advisory

Offered through Wells Fargo Bank, N.A.

Key Takeaways:

- Most successful business transition outcomes start with clearly defined goals and objectives by the owner.
- Each transition option has its pros and cons. Understanding each option and how it aligns with your goals is key in determining which transition option to pursue.
- Business transitions are complex, so a disciplined process can help owners confidently plan and execute a successful business transition and maximize outcomes for all stakeholders.

What this may mean for you:

- Every owner and their business is unique, and business transitions are not a one-size-fits-all solution. Invest the time to find the solution that is right for you, your family, and your business.

At some point, nearly every business owner faces a business transition. Because the business often represents the single largest asset on many business owners' personal balance sheets, its value can represent a lifetime of focus, energy, and work. Given this personal investment, the decision to transition a business can be difficult. Clearly articulated goals, both quantitative and qualitative, along with an understanding of the transition options can help lead to a successful outcome not just for the owner but for all the key stakeholders.

Identify your goals and objectives

As the largest asset for many business owners, the business is typically the primary source of funding for meeting retirement, philanthropic, and legacy goals. Understanding the financial requirements of each of these objectives is a key first step in any business transition planning process. Your financial advisor can play an important role by helping model out and give shape to these quantitative goals.

Your qualitative goals are often as, if not more, important than your financial goals. Among the many considerations in planning a transition, some of the most important are:

- Timing
- What happens to key stakeholders: the management team; rank and file employees; key customers; and suppliers
- Business/family legacy
- Owner identity and purpose post-transition

Analyze the business

As with identifying goals and objectives, analyzing the business involves both qualitative and quantitative factors. Industry dynamics, company performance, and market conditions can greatly impact what a company is worth and the available transition alternatives. Obtain a preliminary valuation for the business to confirm that it meets your objectives. If the preliminary valuation falls short of those objectives, look for ways to increase the value of the business.

The strength of a company's management team can be a critically important factor in certain transitions. Management buyouts, sales to employee stock ownership plans (ESOPs), and sales to private equity can be difficult transition paths without a strong management team in place. Special arrangements to develop and retain these key employees, such as employment, non-compete, non-solicitation, and incentive arrangements, should be considered. To learn how an empowered management team may enhance the value of your business, see "***How to build a strong management team.***"

Identify transition options

The business transition planning process typically includes a review of multiple transition options at the same time and may include:

- Keep: family transition
- Sale to strategic buyer
- Private equity recapitalization
- Internal or management buyout
- ESOP

Each option has distinct advantages and potential issues to consider. The most appropriate type of business transition will depend on an owner's near-term and long-term transition planning objectives, the company's current performance, and prevailing market conditions, as well as other factors.

The table below summarizes the most common transition alternatives considered, why each option may be desirable, and a discussion of the practical issues that can surface during the transition planning process for each alternative.

Drivers	Alternatives	Are these priorities for you?	Practical issues
What are your objectives?	Keep: family transition	❑ Continue growth and build scale ❑ Preserve your family legacy ❑ Maintain ownership and control value creation	• Postpones liquidity/future value uncertain • Ongoing business risk • Interest and capability of next generation
What are the industry dynamics and how is the company positioned?	Sale to strategic buyer	❑ Complete liquidity event for all owners ❑ Potential "spike" valuation from synergies with buyer ❑ Potential for near-term retirement	• Loss of control • Management roles and employees' future uncertain • Few motivated buyers
	Private equity recapitalization	❑ Partial sale providing significant liquidity ❑ Retained equity providing potential upside ❑ Company receiving additional financial and strategic resources	• Significant involvement from investors • Likely giving up control even though ongoing participation may be required • Leverage increases financial risk
What are the mergers & acquisitions (M&A) and capital market conditions?	Internal or management buyout	❑ Capitalize on experience of existing management team ❑ Provide key managers with the potential for a significant financial return ❑ Less risk to management and employees compared to new ownership	• Management team may not possess "owner" skills • Retained business execution risk to the extent of seller financing • Liquidity available to owner depends on management equity and debt capacity
	ESOP	❑ Tax benefits – deferral on capital gains, deductible contributions ❑ Opportunity to benefit all eligible employees ❑ Some liquidity plus managing the transfer of control	• Qualified plan subject to ERISA rules – ongoing complexity • Planning for repurchase obligation • Retained business execution risk

While business transitions can be complex, following a disciplined process can help owners confidently plan and execute a successful business transition and maximize outcomes for all stakeholders. To learn more about business transition planning, contact your advisor.

Disclosures

Wells Fargo and Company and its affiliates do not provide tax or legal advice. This communication cannot be relied upon to avoid tax penalties. Please consult your tax and legal advisors to determine how this information may apply to your own situation. Whether any planned tax result is realized by you depends on the specific facts of your own situation at the time your tax return is filed.

Wells Fargo Wealth and Investment Management (WIM) is a division within Wells Fargo & Company. WIM provides financial products and services through various bank and brokerage affiliates of Wells Fargo & Company.

The Private Bank offers products and services through Wells Fargo Bank, N.A., Member FDIC, and its various affiliates and subsidiaries. Wells Fargo Bank, N.A. is a bank affiliate of Wells Fargo & Company.

Wells Fargo Bank, N.A. offers various advisory and fiduciary products and services including discretionary portfolio management. Wells Fargo affiliates, including Financial Advisors of Wells Fargo Advisors, a separate nonbank affiliate, may be paid an ongoing or one-time referral fee in relation to clients referred to the bank. The bank is responsible for the day-to-day management of the account and for providing investment advice, investment management services, and wealth management services to clients. The role of the Financial Advisor with respect to the Bank products and services is limited to referral and relationship management services. Some of The Private Bank experiences may be available to clients of Wells Fargo Advisors without a relationship with Wells Fargo Bank, N.A.

Brokerage services are offered through Wells Fargo Advisors. Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC, and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and nonbank affiliates of Wells Fargo & Company.

 CAR-0522-00976