

[FAMILY BUSINESS WATCH]

BY GARY PITTSFORD, CFP

Looking beyond the family circle

When family members can't take over your business, consider selling it to a key employee



IT CAN BE REWARDING to watch a son or daughter take over your business when you retire, but that's not always possible. If you have a senior manager with a successful track record, creating a succession plan around that employee may seem appropriate. I've helped design succession plans for business owners who identified key employees with the talent to manage and grow the company long after the current owner retires.

Identifying that senior manager is only the first hurdle to clear. Financing a buyout is the next step. Typically, financial institutions won't lend a senior manager 100 percent of the needed funds to buy out his owner. So it takes financial finesse to help a senior manager swing such a deal. For example, if he can contribute 5 percent to 10 percent of the purchase price, that leaves between 90 percent and 95 percent to be financed.

For companies with excellent cash flow, there are banks willing to loan between 60 percent and 70 percent based on the health of the business assets. That leaves 20 percent to 30 percent of the total purchase price outstanding.

The remaining amount could be covered in an installment loan by the original owner to the new one. The original owner also could gift stock equivalent to that 20 percent or 30 percent outstanding to show his appreciation of the senior manager's years of dedicated service. Some business owners like gifting stock to senior managers who have earned it.

Banks are often more open to financing the remaining purchase when some stock has been gifted to the manager. However, it's important for the manager to show his commitment to the

business. That's done by investing a high percentage of his net worth into the company.

There's a third way to transfer ownership of a company. Owners can sell the operating business but retain possession of the real estate and equipment. The original owner then leases that land and equipment to the operating company. From this lease, the new owner of the business would sign a contract to purchase the real estate and equipment from the original owner.

Also, the senior manager could start a new company to rent the real estate and equipment from the company he plans to acquire. Over time—at least five to 10 years—he or she could buy out the operating company, eventually purchasing its equipment and leaving the real estate in the hands of the original owner. At that point, the original owner has the option to sell the real estate.

Of course, the original owner should be thinking about his retirement income options during the selling process. After your senior manager has secured a bank loan for the balance of the buyout, receiving cash from him is the best option. Other alternatives include deferred compensation, earning directors fees by sitting on the company's board, signing a non-compete agreement or collecting consulting fees.

Transferring your business to a key manager is a good option when no family members are interested in taking control. Financing packages for buyer and seller can be tricky, but each should feel comfortable with the negotiated terms.

There are many ways to design the sale to fit everyone's needs.



Gary Pittsford, CFP is president/CEO of Castle Financial Group Inc., which helps closely held businesses with tax issues, retirement planning, and succession and estate planning. Contact Gary at gary@castle3.com or (888) 849-9559.