WHITEPAPER

BUSINESS SUCCESSION **PLANNING**

SUCCESSION PLANNING DURING ECONOMIC UNCERTAINTY:

WHY THE TIME IS NOW

IT HAS BEEN A TUMULTUOUS COUPLE OF YEARS FOR MIDDLE MARKET BUSINESSES. Prior to 2020, the U.S. experienced multiple years of strong economic growth. The sweeping tax law changes initiated in 2018 further fueled that growth for many. Upending the strong economy was the pandemic, which was followed by unprecedented government economic stimulus. Due to the excess liquidity in the market from government stimulus, inflation emerged. Among major economies, international tensions rose in addition to turmoil within the U.S. and global banking systems. As a result of these significant economic factors, business owners must be more proactive than ever. Here are the major considerations impacting succession planning today.

CURRENT BUSINESS CHALLENGES

Timing has always been a primary concern for business owners when considering transitioning their business. When is the right time? When will they garner the highest value for the business or avoid major disruption to its value? If the past few years have been any indication of what's ahead, an unexpected event can happen at any time and disrupt even the best laid plans.

In 2023, Baby Boomers range in age between 59 to 77. For those who have not yet exited their business, age is a topic that is becoming more relevant when considering succession planning, as many businesses are owned or controlled by this generation. Over the years, this veteran generation has enjoyed economic booms and has weathered through downturns. Through this experience, they have learned what to do to prepare for what lies ahead.

As the economy slows, interest rates rise and credit tightens, the value of businesses may very well be lower than previous years. For business owners thinking about succession, some may delay the timing until the economy recovers. Others see this as the right time to exit their business regardless of valuation concerns and less-than-ideal market conditions.

In addition to general economic concerns, political factors have significant impacts on middle market businesses. At the macro level, inconsistent supply chains and government trading bans and actions have caused major disruption to normal business patterns. Within the U.S., political polarization between parties has also created uncertainty, especially pertaining to tax, regulatory policy and an increased focus on sustainability.

continued...

These are just a few examples of the complex realities business owners currently navigate when considering their succession plan. Regardless of the state of the economy or political environment, one consistent challenge is investing the proper time and resources into the planning process. For many business owners, succession planning is not a priority until they are close to retirement. As business leaders, it is imperative to dedicate time to plan for the future. If not, owners run the risk of limiting their options and diminishing the terms of their exit. In short, time will not be on the business owner's side. The best way to plan for an exit is to plan so that timing is not a significant factor. In starting the assessment, people, technology, governance and structure are critical areas to investigate so that timing of the exit does not matter. Let's dig into why that is.

PEOPLE

Savvy business owners understand that profit = people x process. That's why it's critical for business owners to protect their people assets in any transition.

With human capital topics such as the Great Resignation, quiet quitting, and pay transparency, competition for talent has become fierce. As a business owner, you must take extraordinary steps to protect your key employees from the temptations offered by your competition. At the top of the list is providing employees attractive, competitive compensation packages (for example, incentive compensation packages with vesting schedules). The labor market also demands increased flexibility and equity. Incorporating policies that ensure transparent pay practices, work life balance and hybrid work arrangements are areas that the next generation of leaders find appealing when deciding their next move.

Lastly, in an effort to keep an eye on cost, business owners should find a way to measure employee contribution when evaluating the value of the business. Be sure to work with human resources experts to review and plan around the protection of your most important asset: *your people*.

TECHNOLOGY

Investment in technology is no longer a nice-to-have but, rather, is the cost of doing business. Your digital footprint is what brings in customers and builds credibility. Engaging bots to perform tasks more efficiently has also become the norm. By incorporating Artificial Intelligence (AI), businesses have discovered new opportunities to focus time and resources elsewhere, as technology is now able to manage tasks more quickly and efficiently, creating competitive advantages and increased value.

When implemented incorrectly, some technological disruption can spell disaster. Continued investment in data security and processes to safeguard data and intellectual property are important steps to protecting your business. If technology is lacking or requires significant future investment to remain competitive, business value can be impaired. To increase the value of your business at the time of an exit, engage a technology partner now, that can review your technology strategies and offer solutions that will enhance business value.

GOVERNANCE

One area that is often overlooked is updating key stakeholder agreements. Many times, risk is unmitigated. As part of the succession planning process, look to mitigate that risk either contractually or with a financial instrument, such as insurance. Invest the time and resources now to update all key stakeholder agreements as well as implement legal protections over intangible assets to avoid significant headache at the time of an exit.

STRUCTURE AND TAXATION

When you engage a firm that specializes in succession planning, one of the initial phases of the process is to assess the business and identify areas to improve that will ultimately increase the value. After a valuation has been performed, net proceeds from the sale of the business will be modeled under multiple scenarios. The next step is to present business owners with the opportunity to make structural changes or to implement strategies to reduce the tax impact of an exit.

continued...

Tools that allow business owners to preserve discretionary earnings from tax by evaluating the qualified retirement plans and nonqualified plans will also be assessed at this stage.

Lastly, depending on the preferred choice of exit, the capital needs of the business before, during and after the exit will be evaluated. For a sale to family members or key employees, the strain on capital of the business can be significant, so planning early to reduce this strain on capital is essential.

PERSONAL PLAN

Most importantly when considering succession are the needs and wants of the business owner from *both* financial and non-financial perspectives.

From a financial perspective, business owners must ensure that the proceeds from the transition of their business and other assets will support the retirement lifestyle they envision. In a word, is it enough or more than enough?

From a non-financial perspective, oftentimes business owners have dedicated their entire lives to the business, and it has become a key part of their identity. The transition of the business can be an unimaginable loss and obstacle in moving forward with the process. It is a topic of discussion that should come up early in the process to achieve certainty and success in the end.

MAIN TAKEAWAYS

Despite economic challenges, industry and market trends, there are elements of the succession planning process that should be addressed regardless of the timing of a planned exit. When planning is done well and in advance, there are more options available to business owners. Such important plans can take years to formulate and require maintenance as the landscape changes. Now is the time to make your business future-ready. With expertise in succession planning, ranging from tax and structuring to technology and HR consulting, speak with one of our advisors today for your planning needs.

TOM BAYER

Tom Bayer, CPA, CExP, is the market lead for the Indianapolis, Indiana region and a partner of tax and consulting services. He has 30 years of experience providing a broad range of accounting, tax and business advisory services to commercial clients across various industries.

tom.bayer@sikich.com

SIKICH®