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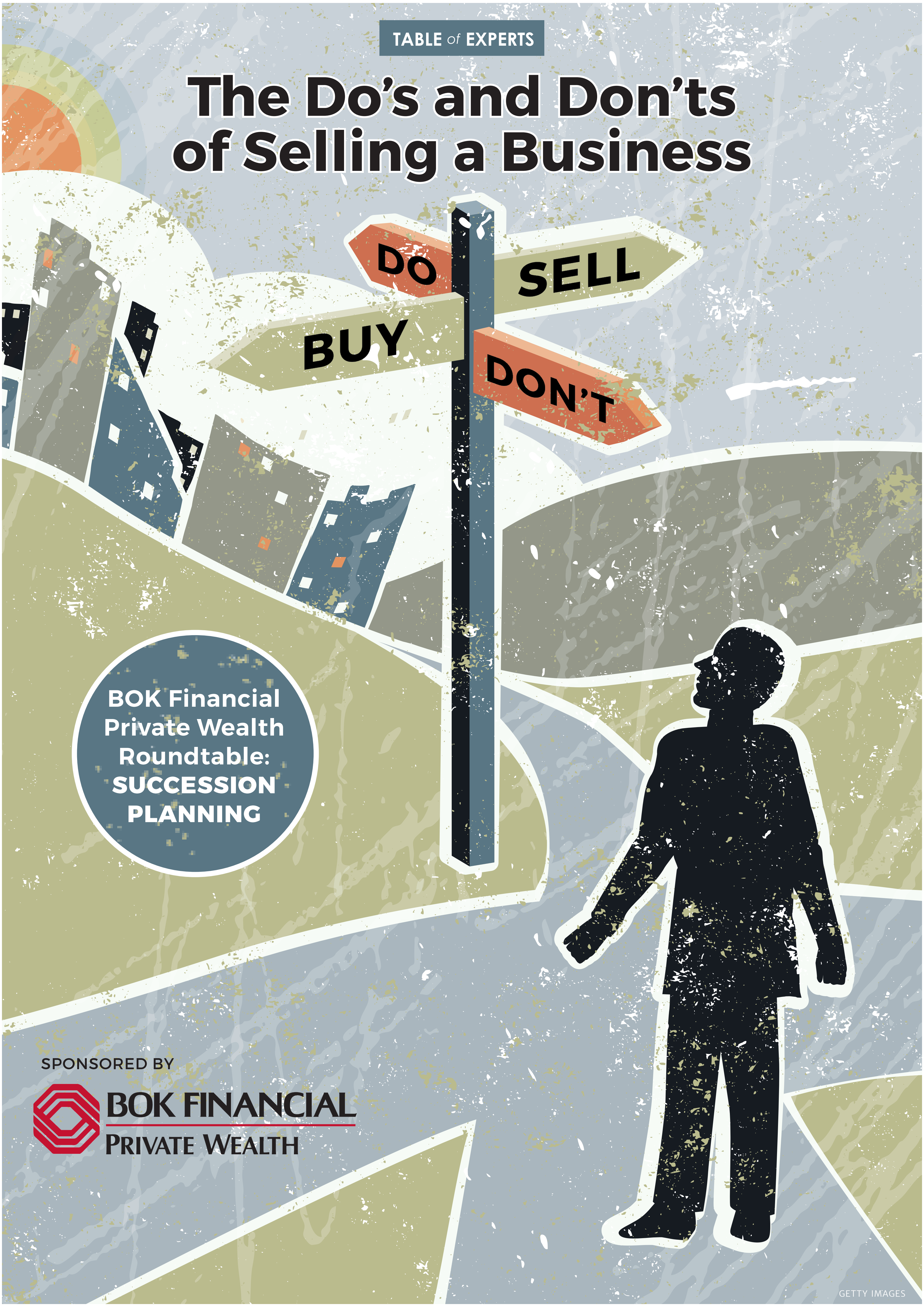
The Do's and Don'ts of Selling a Business



BOK Financial Private Wealth Roundtable: SUCCESSION PLANNING

GETTY IMAGES

The Do's and Don'ts of Selling a Business

ADAM VOGLER

Estate and succession plannning experts at BOK Financial Private Wealth in Kansas City disuss strategies to help business owners prepare for the future.

MODERATOR

Molly Kerr

SENIOR VICE PRESIDENT, MARKET EXECUTIVE

BOK Financial Private Wealth

With more than 30 years of relationship banking experience, Molly Kerr oversees BOK's investments, trust and private banking functions in the Kansas City area. She earned a bachelor's degree in finance from The University of Oklahoma in Norman and a master's degree in finance from the University of Missouri in Kansas City, Missouri. Kerr is also a chartered financial analyst and current member of the CFA Society Kansas City.

PANELISTS

Mike Benedict

SENIOR WEALTH ADVISOR

BOK Financial Private Wealth, Inc.

For over 24 years, Mike Benedict has been a professional financial advisor specializing in providing financial planning and investment advisory services for high-net-worth families. He became a Certified Exit Planning Advisor in 2017. With its requirements of over 90 hours of training in the nuances of succession planning this certification has helped Benedict better prepare and plan his business-owner clients for their ultimate business exit.

Chris Graber

MANAGING DIRECTOR

BOK Financial Capital Corporation

Chris Graber and his team identify and execute direct equity and mezzanine investments in private, middle-market companies within the institution's Midwest/Southwest geographic footprint. The group has made 18 platform investments and closed more than 20 follow-on investments to fund acquisition and organic growth opportunities since its inception in 2007. For 20+ years, Graber has worked with companies in a variety of industries to evaluate and execute strategic initiatives.

Charles Hunter

SENIOR VICE PRESIDENT AND COMMERCIAL BANKING MANAGER

BOK Financial

Charles Hunter is a senior vice president and commercial banking manager for BOK Financial in Kansas City, where he manages a team of commercial relationship managers and support staff. Hunter has spent over 35 years in the financial services industry. He earned a bachelor's degree in economics, a master's degree in business administration and juris doctorate all from the University of Kansas.

Mindy Ward

PARTNER

Van Osdol

Melinda "Mindy" Ward chairs the law firm's estate planning department with expertise in complex taxation, estate and gift and business planning issues. She specializes in generational wealth transfers and is known for making the complicated seem a little simpler. Ward, licensed in Missouri, Kansas and Colorado, has been regularly recognized as one of the Top 100 Lawyers in Missouri and Kansas and Top 50 Women Lawyers in Kansas City.

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BOK FINANCIAL PRIVATE WEALTH ROUNDTABLE: **SUCCESSION PLANNING**

Regardless of who starts a business, eventually that person will become unwilling or unable to run that venture. But the success or failure of an ownership transfer often depends on the strategies created long before the founder runs out of steam.

The *Kansas City Business Journal* recently gathered several estate and succession planning experts to share insights and tips to help business owners develop and implement strategies to ensure the future they envision for their families and businesses. Molly Kerr, Senior Vice President and Market Executive of BOK Financial Private Wealth, moderated the discussion.

Molly Kerr of BOK Financial Private Wealth: Mike, what do people need to know before they sell their business?

Mike Benedict of BOK Financial Private Wealth, Inc.: One question that needs to be answered early on is how much they need out of the transaction. For most of my clients, this is a retirement event. So, they need to work with a financial planner to develop a comprehensive personal financial plan to identify that number.

At the same time, they need to identify the tax implications of the transaction. Even though they won't know all of the details, they really need to have a conversation with their CPA about what the taxes will look like on the transaction. Many owners assume that every piece of the transaction will have a capital gains rate applied to it, and that's just not the case. A lot of owners are surprised by how much comes in as ordinary income. They need to understand that up front.

Then, while they're doing that, they need to have a solid understanding of the value of the business. Often, owners overestimate the value of their business. Early on, it makes sense to hire a certified appraisal firm to establish the fair market value.

Those are some starting points, and then once those questions are answered then they can go into timing — when will this transaction happen. We understand that day typically changes, but to do proper planning, we need to make some assumption about the date early on.

Hopefully, that date is about five years away. We can do some really cool planning within five years. Then, they also need to identify to whom they're going to sell the business. That's where we can get into some options.

Chris Graber of BOK Financial Capital Corporation: I agree. Owners should first focus on the when, the why and the how:

• When: They will want to make sure that they've developed a road map to accomplish some of the more advantageous structural and succession planning components.

• Why: Why do they want to sell? What are their motivations? Is it all about liquidity, is it about finding a partner to help grow the business, or is it about finding a partner to help them supplement their resources?

• How: The "how" question is more tactical in nature. What steps do they need to put in place to execute the transaction? They need to make sure that they're thinking through the types of advisors they need to help them effectuate that change. Those can include tax and accounting advisors, a corporate lawyer, a transaction attorney, a financial advisor and an investment banker.

ADAM VOGLER

Molly Kerr is Senior Vice President, Market Executive, at BOK Financial Private Wealth in Kansas City.

Kerr: What are some of the options available to business owners thinking about selling or transitioning a business?

Benedict: Generally, the owner can sell to one of two types of buyers: an insider or a third party. With an insider transaction, options include a management buyout with one key employee, a small group of multiple key employees or an Employee Stock Ownership Plan (ESOP) with the entire employee base.

In third-party transactions, owners are typically selling to a strategic buyer — a buyer who's in the same line of business and sees some synergistic reasons for the acquisition. It also could be a financial buyer, such as a private equity firm or a family office that's looking at this acquisition as an investment.

For smaller companies with revenues of $5 million to $10 million, the third-party buyer could be somebody who is looking to buy a career or a job. You see a lot of this with retirees who have taken early buyout packages and are not quite ready to step out of the workforce. It's easier to buy a company versus to do a startup.

Kerr: Are you seeing many ESOPs these days?

Benedict: Not as many as I think we could. As of 2016, there were about 6,600 ESOPs in the United States compared to over 8 million businesses that have over 20 employees.

I think they are underutilized, and I have a theory about why: Most wealth advisors and CPAs don't fully understand them. The misconception is that they're complex. They're really not complex; they are complicated because they have multiple moving parts.

ESOPs may be an effective option for owners in the top tax bracket who are considering an insider transaction and have:

• A payroll of at least $1 million (not including their own compensation)

• Annual revenue of more than $10 million

• A good stable business with good cash flow

Both C corporations and S corporations can implement an ESOP. A C corporation offers owners amazing potential tax advantages. An S corporation that's operating as an ESOP has an advantage over their competitors because they effectively have no tax. It's a very intriguing option for an owner to explore.

Charles Hunter of BOK Financial: We have a number of engineering companies in Kansas City that have gone 100 percent ESOP, and to your point, they pay no taxes at any level. So, it is a huge competitive advantage.

Kerr: What are other issues to consider when you start thinking about selling?

Mindy Ward of Van Osdol: The first discussion is always about the many different ways of selling a business. You can sell the stock or you can sell the assets. That's important for them to understand because there are pros and cons to both. Buying the company means you're buying the liability that comes with the company. When you buy the assets, you're starting the depreciation over. It's always somewhat negotiable, but usually the buyer has a pretty good idea of what they want to do, and it's a little hard to convince them otherwise.

Graber: Somebody can sell part or all of a company. Consideration could be in the form of cash, stock or seller note (or a combination) and could include an installment method for receipt of payments over time.

Benedict: Chris, are you seeing more owners these days hanging onto a piece of the company in a transaction? Has that changed in the past few years or has it been pretty constant?

Graber: It's been pretty consistent. There are a variety of sellers out there with a variety of objectives. It really just depends on where they are in the life cycle of the business and the life cycle of the planning phase.

Ward: On these private equity deals, there's often a carrying interest that you have to deal with, too. You want to help the seller understand what they're getting in the new business. It can make a difference.

Kerr: Any other comments concerning the steps that people need to take when they're considering a sale?

Benedict: When an owner has made the decision to sell, it's time to start thinking about the value of the business and how to increase it. A simple sales formula for a sales price of a business is Earnings Before Interest Taxes and Amortization (EBITA) times a multiplier. EBITA is effectively cash flow. Increasing the value of the business involves increasing each of the three variables: revenue, margins and the multiplier.

The owner can increase a multiplier by having an effective key management team in place. If an owner can't take a three-week vacation without the business imploding, they have a senior management issue that needs to

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be addressed.

Another key driver for the multiplier would be the diversification of their client or customer base. If 50 percent of their business is represented by one customer, they need to address that issue. They also can upgrade the financial statements to audited financial statements to increase the multiplier. It's an investment that can provide significant returns on the multiplier of the business.

To address the cash flow, I recommend just scrubbing every aspect of a business — everything from shipping rates to insurance costs to expenses. Every expense line item could be evaluated.

They also could look at upgrading their accounting system or enterprise resource planning system so they can track their performance better.

Some consultants work on a contingency basis to evaluate your processes and recommend and implement cost savings. They get a percentage of the savings so there's no upfront fee for the owner.

These are all things that any business ought to do. If an owner hasn't done these things but now they're two to four years away from the sale, they can roll up their sleeves, implement these things and increase the value of the business as well as increase the chance of success when they're ready to take it to market and actually get a deal done.

Kerr: So, if an owner is thinking about selling next year, you would recommend they wait longer and implement these steps?

Benedict: It goes back to where they are. Sometimes, they're just ready to sell. That's why the financial planning is so important. Even without maximizing what they could potentially receive out of the business, they can sell it for an amount that can satisfy their retirement goals.

Realistically, one year is not enough time to implement many strategies to increase the value of the business. I would say two years at a minimum, and often it really takes about five years to implement these things.

Graber: Part of it is thinking like a buyer, taking a step back to better understand how somebody else might perceive their business. They should consider bringing in a consultant or advisor to provide a fresh perspective.

Also, owners should keep in mind that when identifying their objectives, money is just one of many components they need to think through. There's the structure; there's how much you retain. Maybe having a good partner would lead to a significantly better outcome if the partner invests in the business going forward.

ADAM VOGLER

Mike Benedict is senior wealth advisor at BOK Financial Private Wealth, Inc.

There are ways to minimize tax, too, which is another important consideration.

There's a lot to consider. That's why the time element is so important.

Hunter: One of the first things I suggest clients do is make sure all the shareholders are on the same page. If you have minority shareholders who don't agree with the person wanting to sell the company, it can get very, very unpleasant.

Benedict: An important step when preparing for a third-party sale is understanding that the buyer most likely is going to have a very sophisticated team. The sales process also will involve a letter of intent, which then will involve presale due diligence. It makes sense for the owner to invest some money to bring in a firm to do presale due diligence.

Owners can bring in a team of advisers who have buy-side experience to look at the company from the eyes of the buyer and identify those things they need to address before they take it to market. Then, when they take it to market and do have a letter of intent, they can go through the due diligence process with confidence.

Kerr: Mindy, what are the psychological impacts to consider when selling a business?

Ward: This is actually a fascinating question, and most people don't even think about it from a professional standpoint. I've been through quite a few of these, and watching a sale happen is an amazing study in human nature.

Creating a business is sort of like raising children. Business owners put a lot of time and energy into nurturing and growing their business. The ultimate goal is to make it self-sustaining just like a goal of raising kids is getting them through high school and later out on their own. When you have kids, your identity is tied up with being a parent. The same is true when you're a business owner — it's a big part of who you are.

Then, I equate the period during the process of the sale to dating. Everything looks rosy during the courtship phase. As you get to know the person better, he or she may not be as wonderful as you first thought.

Selling a business is very similar psychologically to these major life events. You're trying to get to that point where you can turn the business over to somebody else. Often after a sale, business owners maintain relationships or positions within the company for a period of years, and that can be good or bad.

After you walk away from the business, you have to find something to do with your life. That can be psychologically challenging as well. Some people deal with it better than others. Some people have very realistic expectations about what they're going to do when the company is sold.

As advisors, we have to understand the psychological component of selling a business. Many people turn to us for advice. The most important thing to remember is that you're not their counselor; you're not there to give them marriage advice. You're there to give them business advice. You really do have to separate yourself from the emotional side of it, but it is important to recognize that clients are going through a very emotional time.

I always tell clients who are starting this process: "There will be a 3 a.m. phone call or text. You'll send me a text saying the deal is off. And I'm going to ignore that, and I'm going to give you 48 hours, and then you're going to come around." Inevitably it happens, because it's very overwhelming. It's a huge change in their life.

Graber: I agree. Sellers also have to understand potential consequences and perceptions post-close, such as how it will affect employees, customers and suppliers. How will they react?

How does that change the owner's view of the outlook for the business and their role within the organization?

Do you run into that?

Ward: Yes, it is important, especially if you're selling internally. Ideally, you can have that discussion with key employees far enough in advance that the transition can happen over a longer period of time.

When it's a really fast transaction, lots of employees get nervous. It is very important for the owners to communicate some (but not all) of what's going on. You don't want key employees, or half of your employees, saying, "I don't know what's going on so I'm bailing." A mass exodus can have a big impact on the sale of the business.

Not all new owners want to retain the current leadership either. Sometimes, they're bringing in their own people, and that concerns key management and employees. It's important to address how the new owners are going to let employees go and build that into the transition.

Benedict: In my practice, I'm dealing with owners for whom selling the business is a retirement event. This is the opportunity to extract value out of the business and fund their retirement. These are typically owners who have been large and in charge for 20 to 30 years. In nearly every sale to a third party, they're going to be required to hang around two to three years after the transaction. Going from being large and in charge to being an employee is a huge emotional transition. That's one of the things we want to point out early on so they can start thinking about that.

Being too emotionally attached to the value of the business is another pitfall. It's their baby; they created it, like you said Mindy. It's stressful to go through a third-party transaction. Their baby is going to be beat up at some point.

In those situations, I have found it's best to encourage owners to take a step back and let the advisors handle the heavy lifting in the negotiations. If they don't, that emotion is going to come into play and could hurt the deal.

Graber: It goes back to being clear about the objectives up front. What is the rationale for the sale? That could go hand in hand with dealing with a lot of the psychological challenges that they're going to face along the way. Is it for liquidity? Is it so they can focus on getting back to what made them happy to begin with, inside or outside of the business, whether that's product development or playing golf? Is it to have better defined roles for their successors, such as their senior leadership on the management team or family members?

Ward: That is a really key point because you're basically picking on their kid. Part of the process is due diligence, which means the other side is going to come to you with a list of things that they don't like. When the owner sees that, inevitably there's some emotional fallout. That's when you may have to do a little counseling and explain that this is part of the process.

Benedict: That's when you get, "The deal is off."

Ward: That's right. You hear, "If they don't like my kid, they can't have it."

Kerr: Mike, what are some of the biggest mistakes that business owners make in a third-party sale or management buyout?

Benedict: We could spend two to three hours on mistakes. I'll throw out a couple. One of the obvious ones we already touched on is simply procrastination. In an insider transaction, if an owner decides that they want to sell their business to a key employee, and they don't do two to five years' worth of planning, then it's likely that deal's going to have a significant amount of debt. Often, a significant amount of that debt will be the seller toting the note. In that case, they effectively haven't really sold the business.

That carries too much post-transaction risk. The owner is going to retire, but they're going to worry every day because their monthly check is going to be dependent on the continued success of that business.

Another mistake in the third-party sale is losing focus and letting the business deteriorate after going through the due diligence process with a potential buyer. Even if the deal gets done, it's problematic. It's not as good as it could have been, or the deal can fall through. Now you've got a business that has lost momentum and deteriorated, and the owner has to expend energy to rebuild it.

ADAM VOGLER

Chris Graber is managing director at BOK Financial Capital Corporation.

Kerr: What are some other common mistakes on the estate planning side?

Ward: The biggest mistake is not considering estate planning before you sell it. If you come to me with a business that you control or you own a percentage of, we have several options to get it out of your estate at a discounted value before the transaction. But if you come to me after you sold your business for $100 million, my options are a little more limited on how we can reduce your estate tax liability.

Often, estate tax liability is not even a blip on their radar until the deal is done. They overestimate the value of the business when they're selling it, but they underestimate it from a personal liability position.

The sooner we can get in front of the letter of intent, the more creative we can be to transition that business outside of the owner's estate and leverage their estate tax exemption. After the letter of intent is signed, we're limited in what we can do.

Kerr: Is it tough for people to give up control?

Ward: Many useful estate planning strategies require effectively making the client poor. That's a really big hurdle for people to get over, because they are used to being in control.

It's tough when you're telling them, "Oh, by the way, we're going to recommend that you transfer everything over to this irrevocable trust that you can't be a trustee of." Often, I get calls saying: "I'm going to take the money and run. I'll just pay the tax and call it good because I need that control."

It's not all or nothing. Getting some of the business out of your estate, leveraging a portion, is better than nothing. We don't want to leave you broke, so obviously we have to have a conversation about how much you want to retain complete control of. You still can have a significant amount of control even after you've given that away. Not looking at the estate planning component of selling your business can be a big issue.

Kerr: Any other mistakes we should mention?

Hunter: We talked about how a business often is like the business owner's kid and they're very emotionally attached to its health and well-being. If you pick the wrong buyer and you don't like the way the buyer treats your employees or your customers, you've made a big mistake.

Unfortunately, a lot of buyers, primarily private equity firms, are not focused entirely on the health of the employees or customers. They're focused on maximizing their return, which means they're going to squeeze every dollar out of the transaction that they can, and that could be painful for the seller.

Graber: If that's tied into the objectives, the owner is forced to think through some of those considerations on the front end. If it's all about the money, that is one consideration and that's fine. If it's about the brand and the name on the door, or if it's about key roles for key employees, maybe they would choose a different path. They would have to weigh different options in conjunction with how they define their objectives.

Ward: I do see owners having misconceptions about how well their children are going to be able to run the business. A very, very common misconception is, "My kids are going to be able to do it as well as I did." There aren't too many cases in which that actually works well.

If you can recognize weaknesses that your children have and surround them with the right people to compensate for those weaknesses, it can still work. But often, second-generation businesses don't do very well.

Hunter: Sometimes the kids don't even want to run the business.

Ward: Right, and that's a whole other issue. And sometimes you have kids who want the paycheck but don't necessarily want to work.

Benedict: I'd like to go back to some of the missteps concerning key management. I knew of an owner who was doing a third-party sale, and during the due diligence process, the buyer interviewed key employees. A key employee realized that they were an important part of the deal, and there was no financial incentive for that key employee. The key employee understood that they had leverage and went to the owner and said, "Look, I need a check for $2 million or I'm gone."

With our clients, we use what I call a stay bonus — incentives for key employees who are important to the company to participate in the transactions. Typically, the pool will be 5 to 10 percent of the sale price of the transaction. It's typically paid out every quarter over a two-year period. Then employees have a pretty significant financial incentive to stay. The buyer sees that and is comforted knowing that these key employees have a financial incentive to stay through the transition.

Now, stop and think about that for a second. That's probably going to affect the amount that the owner is going to receive, and it could potentially affect the price of the company. But in many cases, having that in place actually enhances the price because the company is worth more with the buyer knowing that these key employees will be employed through the transition.

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Kerr: Mindy, let's delve a little deeper into the major tax implications of a sale.

Ward: There are a million different scenarios. It depends on the type and size of the business. It's just very, very important to get your accountant involved as early as possible and figure out the best option for you from a tax standpoint. It's very important to get your financials in shape.

Earlier, we talked about the different ways to sell businesses. Tax implications differ between selling assets versus selling stock.

Kerr: What are the differences?

Ward: It depends on how you structure the deal. But sometimes, it's more advantageous for a purchaser to buy assets because then they can start the depreciation process over again. Sometimes, selling stock is more advantageous for basis reasons. You have to go through the scenarios for each particular client.

And it's all negotiable. If you get far enough ahead of it, you can pull the real estate out and lease it back. That looks good from a financial standpoint, and then they get to retain ownership in the real estate. Of course, there are tax consequences to that.

Benedict: A lot of buyers don't want to allocate capital to real estate. They only want to buy the business.

Ward: Right, and then sometimes it's good for the seller to hold onto the real estate, because they get a continuing income stream from the lease. You have to look at the financial statement, assets and the cash flow, and run some scenarios. That's why it's important to have those professionals involved who can run through those different scenarios and say, "If we did this, this is the way it's going to look, and if we do this, it's going to look a little bit different."

Kerr: Any other thoughts concerning taxes?

Benedict: Mindy laid out a really strong case for having a good CPA involved in the process early on. Hopefully, an owner has a CPA who has significant deal experience. If they don't, they need to find one. We can help identify those CPAs, but as owners are going through that process, they can ask a CPA certain questions to get an idea of how experienced they are.

One obvious question is, "How many deals have you worked?" An owner can ask technical questions without necessarily needing to understand the intricacies and see the response of the CPA. If an owner is a C corporation, ask the CPA, "Do you have any Section 1202 experience?" See what the response is. If they're an S corporation, ask the CPA if they have any 338(h) experience. See what their response is.

It's extremely important — maybe one of the most important things we'll talk about today — to have good tax advice through the process.

Ward: If they don't have good tax advice, identifying someone who can walk them through this process is the first thing we have to do because it can make or break a deal. Some horrible tax consequences in sale transactions can occur if you haven't thought through them thoroughly. If you have a really good tax advisor, you can take steps to mitigate the tax consequences of selling a business.

ADAM VOGLER

Charles Hunter is senior vice president and commercial banking manager at BOK Financial.

Kerr: Charles, why is it important for a commercial banker to be asking about a business succession plan?

Hunter: Business succession planning is important not only when somebody decides to sell their business, but also in case the owner dies unexpectedly — and that does happen. They need a plan for the continued operation of the company for both events.

If they're selling their business, in all likelihood, the proceeds from the sale of the company will pay off the commercial lender's debt, and at that point, the bank is out of the equation.

If the owner dies without a business succession plan in place, you have chaos. The company could very well be at risk because the company has no leadership. It's much, much easier to develop the business succession plan prior to something like that happening. Then if it happens, you don't have to worry about who's leading the company because you've already identified that. And it's much easier to recruit a new leader when you're not in the middle of chaos.

Ward: You have to plan for disability as well. If the guy running the show can't run the show anymore, that's a problem.

Kerr: How do you plan for disability with a business owner?

Ward: The same way you would plan for death. You just need a backup plan.

Benedict: There are disability buyout policies that are a potential resource for that. Then, what I call the business continuity instructions kick in when an owner dies or becomes incapacitated. It's like a will for the business. It's just a list of written instructions that the owner prepares, and it will addwwress things like: Who tells employees that the owner just died and everything's going to be OK? Who reaches out to the vendors? Who reaches out to the customers? Is there a plan in place to incentivize key employees to stay through a business transition?

Some of our readers are probably business owners who don't plan to sell their business. They don't plan on selling their business, but they're going to exit it at some point in some way, and it could be death or incapacitation. Even if they don't plan on selling, they still need to have business continuity instructions in place.

Graber: I'd like to reiterate your initial point about the importance of discussing the succession plan with a commercial lender. The commercial lender is going to have a good idea about how the business operates and could be a resource if there is something other than a strategic sale. If there's a partial sale to management, they could provide financing and/or identify a financial buyer who would be in a great position to provide guidance and capital to finance that event.

Hunter: Good point.

Benedict: The commercial lender is an important part of that process and team, as you said Chris, especially for the insider transaction. Planning the debt capacity to allow for that transaction is extremely important.

Kerr: Mindy, how is estate planning different from succession planning?

Ward: There is a big difference. Even saying succession planning implies something totally different from estate planning. Estate planning is planning for someone being gone. Succession planning is planning for the future.

When you're doing succession planning, you're primarily working within the confines of the business structure. You're putting key employees in place, and you are making sure that the cash flow is going to work — all of those business components. When you're the primary owner of the business, there's a whole other component that you need to address, and that's the estate planning side.

Current laws are pretty favorable from an estate planning perspective. Right now, we have a permanent tax law, but it has a sunset provision. All of the laws change in 2026 on the estate planning side. Most likely, they're going to change before then, because we'll have a new president by then one way or the other, and it's all driven by politics at this point.

Creating an LLC is a form of succession and estate planning. From the very beginning, you can set up some of those components to build that structure. Within the documents, you can build in buy/sell provisions, and you can deal with death and disability. That's the succession planning on the business side.

But on the estate planning side, as I said earlier, a lot of times we don't get people until after they've signed a letter of intent and are getting ready to close the deal. Then we have only a few things that we can do.

If you come to us in advance, we can choose from a number of different estate planning techniques to transition the financial value of the business while still allowing you to maintain control of the company. It's fun to watch. We could list a number of businesses in town that transitioned the value of the company to a younger generation early on while the older generation had control of the company. Then, when the company sold or went public, the kids benefited tenfold from the transaction, and the parents still had enough to live comfortably.

We can lay out a number of options. We can recapitalize the company into voting and nonvoting blocks in certain situations. We can give the nonvoting shares to the next generation but still allow the older generation to maintain the voting shares and the control. Those can work wonderfully. When you sell the business, it's all worth something, and you're getting value out at a much lower value and leveraging it.

We also use insurance a lot for leveraging and succession planning — purchasing insurance inside of irrevocable trusts and using the value in the trust to leverage for the next generation. Currently, if you don't do the right kind of planning and you sell your company, then what the next generation gets is going to take a 40 percent cut. The estate tax is 40 percent on everything in excess of $22 million. If you sell your business for more than $22 million, the IRS is going to want a check for 40 percent of what they think the business is worth, which is a little bit different from what you think the business is worth, nine months after you die.

If I took one piece of paper and cut it into five different pieces and handed you all one piece, your individual piece is worth much less than if we put them all together. From an IRS valuation perspective, if we can divide things up, even between husbands and wives, we can shift value and get a discount.

In effect, they are valuation discounts. We can build wealth on a leverage basis fairly easily, and it's fun to watch. That's the cool thing that we can do, especially with privately held companies.

Benedict: I suspect many of our readers are philanthropic, and so that's one of the reasons a financial plan is so important. A financial plan will help them identify how much they can give to charity. With enough time and knowing how much they can afford to give, they can go to somebody like Mindy and incorporate some really neat charitable trust planning into their exit strategy.

Ward: That's a really good point. A new phenomenon that I am seeing is parents who don't want their children to be multimillionaires: "I earned mine; they need to earn theirs."

There are three entities that are going to inherit. It's going to be your kids, charities or the federal government. So, you need to decide which bucket you want it to go in, and then we can figure out how to get it there. I rarely hear people say, "I want a lot of it to go in the federal government bucket." Usually, we are dividing

ADAM VOGLER

Mindy Ward is a partner at the Van Osdol law firm.

it between kids and charity, and we are figuring out how much you want to leave to each.

Kerr: Do a lot of clients create family foundations?

Ward: We're seeing them fewer and fewer because the regulations have become so stringent. A lot of clients don't want to get into the complications of it. There also is a certain revenue threshold that you have to get into before a private foundation makes sense.

Donor-advised funds are a much simpler option. We are blessed to have so many options to choose from locally. We have the Greater Kansas City Community Foundation, Jewish Community Foundation of Greater Kansas City, Truman Heartland Community Foundation and National Christian Foundation Heartland. In addition, Fidelity and all of the big houses have huge donor-advised funds.

Another option is a charitable remainder trust. This is a terrific vehicle that is underused. You can put value in a charitable remainder trust and continue to get an income stream. Or if you don't need the income stream, you can give the income stream to your kids or grandkids. There are some pretty nifty things that we can do from the charitable perspective when you're selling the business if we get you far enough in advance.

Kerr: Chris, how can an owner avoid or address unwanted family dynamics when planning an exit strategy?

Graber: First, they need to make sure they are surrounded by a team of advisors to help them think through all of the considerations. We've talked about the psychological impact. We've talked about different objectives that the owners might have. This particular consideration might lead one to engage somebody with specific expertise in dealing with the family component when it comes to transactions.

Ward: Some organizations specialize in the psychological component to transitioning a family business. This can be especially important when you're dealing with a company that's not being sold to a family member but the family member is going to continue to maintain some interest.

I've seen a lot of situations in which we recognize that the next generation doesn't have the ability to run the business but they want to maintain ownership of the company. So, we set up a plan to create an outside board. We bring outsiders onto your board and take family members off of the board. You still have family control of the business, but you're selling a part of it to an outsider for capital influx or something like that.

Some organizations do a very fine job. They're not inexpensive, but they are largely worth it to guide you through a lot of those issues. Lawyers, accountants, financial planners and bankers are not trained in psychology. That's not what we went to school for. We're generally black and white people. Getting that other type of help can sometimes be very beneficial.

Benedict: In my experience, a common thread in positive family dynamics has been communication — being very open about the value of the business and being very open about what's going to happen with generational transitional wealth. Then, if we're talking about significant wealth, they can involve the second and third generations in the decisions if they have a donor-advised fund or foundation. Meeting together to talk about how they are going to transition the wealth helps teach the next generations about gifting and responsibility.

Then, on the other side, the negative common thread is lack of communication. The children and grandchildren know there's wealth. But they don't know how much, they don't know who's going to get what, and they don't know what the plan is. So many unknowns breed discontent.

Ward: Selling to one member of the family who has siblings is always very delicate and emotionally charged, too, because the value of the business is different in those siblings' perspective. They often have different perceptions about how things should be and shouldn't be, and what things are worth and what they're not. Separating the one who continues in the business from the ones who don't is often better, but it doesn't always work.

Benedict: We often have business-active children and non-business-active children, and we run into issues of fair and equal. Sometimes they're different. Sometimes what's fair is not necessarily equal.

The timing is different, too. It's possible the business-active child acquires their piece of the estate earlier because it's the business piece and they're ready to take it over. The other children will get their share, but it's typically going to be later, and it'll typically be at the death of the first generation. It's another reality of that situation, and communication is required to work through those potential land mines.

Ward: For lawyers in the estate planning and business transition area, it's extremely difficult from an ethical perspective because you have to recognize who your client is and who you owe a duty to. Often, we're representing the business, we're representing G1, and then we might even at some point be representing G2 in the family transaction. It's perfectly legal to do, but you have to be very careful ethically to make sure that the obligations that you owe to the various parties are being met.

For us, that's kind of tricky. Clients obviously want us to do it because it's more cost-effective. We don't want everybody to go get their own lawyer and hash it out, because then you have three times the lawyers' fees. It's very, very important that you find the right person to walk you through that transition and have other people around you who are supporting the conversation.