Retiring from the Family Business

Last update: October 27, 2011

Summary

If you are the owner or a major partner in a small business, your retirement concerns are more complex than most peopleȇs. It is hard to generalize about small businesses, but here we do our best to lay out some of the concerns and possibilities you may face.

Work and ownership

In principle, there are two issues to consider: your retirement from work, and your ownership interest in the business.

In personal service businesses, these sometimes cannot be separated. If you work by the hour or under contract, and you are essentially a one-person company, there may be little value to your company when you stop working. There could still be some value, of course: your client list might be worth quite a bit, especially if you are able to provide transitional services on behalf of a new provider. You may also have equipment, receivables, or other assets of some value.

If you own all or part of a business that can plausibly continue with out you, your ownership interest should have value in and of itself. In theory, and perhaps in practice depending on your situation, you could sell your ownership interest without retiring, or you could retire without selling your ownership interest.

So it is worth considering each of these issues separately ï even if you do decide to do both at the same time.

Retirement – with or without a successor

As an owner, you may have more control over when and how you retire than the typical employee has ï but you probably have more constraints as well:

- You are hard to replace. You may not be able to retire until someone else can be found ï and probably specially trained ï to fill your role. This may be difficult. It may not even be possible. And it often means starting to plan for retirement and groom a successor years ahead of time.
- You canȇt just walk away. Most employees donȇt have to worry much about what happens to the company when they are gone. Chances are, you do.
- You may not be able to collect much in the way of employee benefits. Small businesses tend not to have the same level of pension and post-retirement medical benefits as larger companies. Depending on what arrangements, if any, you made during your career, retirement could mean a complete absence of income, or maybe just getting Social Security benefits.

If you have one or more partners, the transition into retirement will probably be a lot easier than if you are the sole owner. But in either case, you will probably need to consider the possibility of phasing out gradually, rather than leaving all at once. If you intend to continue to own or partly own the company during your retirement, a gradual retirement, enabling you to keep your hand in the business for a while, is probably very much in your interest.

Whatever the arrangements, unless you are shutting the business down completely or selling it lock, stock, and barrel to some outsider, having a smooth transition is in everyoneӳ interest. This means:

- You should start planning this transition years, not weeks or months, ahead of time, and
- You should discuss it with everyone who is involved, and who therefore could make it harder or easier for you: your other business partners, your employees, your clients, your vendors, your landlord (if you rent space), and your family.

Ideally, you have had a business succession plan in place all along. Anything could have happened to you at any point along the way (death, disability, desire for change) ї and, for that matter, it still could. If you do have such a plan, then you are halfway or more toward resolving your retirement concerns as they affect your business. If you do not have such a plan, you should start working on it *today*.

Selling your ownership interest

If your business still has commercial value when you are no longer working there, or if you pan to sell your ownership interest before you retire, you have several problems to solve:

- Determining the value of your business.
- Finding a buyer.
- Negotiating a buy-out arrangement.

Letӳ consider each of these in turn.

What is your business worth?

Most small business owners do not know what their business is worth. And if they think they do, then they are usually being too optimistic. You may know what your business is worth to *you*, as a going concern. But if you are planning to sell your interest, you need to know what it is worth to a buyer.

A buyer will be interested in the book value of the assets and net income of the business, but he or she will need to know about all the items that are not reflected in the books. The market value can be very different from the book value ї either more or less. A buyer will also want to estimate what the future of the business is: is this a growth business, a cash cow, a good-looking business but with a market that is drying up, a business with new potential, or one that is losing its biggest asset, namely *you*? Your business is your baby, and you cannot be expected to be objective about it. A buyer will be much more objective, even cruelly so. Furthermore, a buyer is thinking about how your business will fit into his or her own life and other business plans, which may be very different from how it fits into yours.

Various techniques are available for estimating the value of a business:

- A general rule of thumb is that an enterprise is worth 7 times its annual net revenues. But different multipliers apply to different kinds of businesses. The rule will also not hold if your business is either growing or shrinking at a significant pace, or if it is subject to large annual fluctuations. This rule may also vary geographically, and it may be invalidated by other factors. Still, itôs a good place to start.
- Other methods for making estimates exist. The web pages referenced at the end of this paper can lead you to sources of information about them
- You can also hire an expert to do an objective evaluation ï your accountant can probably refer you to a local appraiser. Business appraisals are difficult to do well, however, and it is common for errors to be made. Even in the best of cases, there are (or ought to be) subjective elements to be taken into account. If you get two separate appraisals, you might be surprised at how different the results are.

But in the end, the only value that matters is what a real buyer will pay you for it, and you wonôt know that until you find a buyer and negotiate a deal.

You also need to consider whether your business would be worth more if you waited a while. Maybe the market is changing in your favor. Maybe a competitor is closing, relocating, or changing its focus. Maybe there are ways you could spruce up your company to make it more attractive (physically or financially), if you moved more slowly. In any event, expect it to take a while to find a buyer and then negotiate and close a deal ï typically about a year for the entire process.

How do you find a buyer?

Your best bet may be among people you already know:

- An existing business partner
- A family member
- A key employee (or a group of employees)
- A competitor

Donôt be too quick to dismiss these possibilities. A family member or employee might be interested in the business, but unable to pay. But if a deal is structured that enables the business to continue in operation, and the new buyer can pay you over time from the proceeds of the business, it could be a winning arrangement for all concerned.

If these options are not available or do not pan out, however, you will need to go looking for a currently unknown third party. If your business is local, just putting the word out among people you know may scare up a buyer, or you could advertise in the local newspaper (or, better yet, maybe get a local reporter to do a story on your business). If your business is regional or national in scope, you need to cast a wider net, and may need to be more creative.

Or you may wish to use a business broker or investment banker. Businesses are bought and sold every day, and since you probably have not done this before, or at least not recently, you might want to enlist the services of someone who does it for a living. Yes, you will have to pay fees, but finding the right buyer will usually more than make up for it. Another advantage is that a broker can tell prospective buyers about the general nature of your business without identifying yours as the specific business at issue ï this can be very important if rumors of such a transaction would adversely affect the business itself.

Whether you are selling to people who already know the business, or whether you are approaching a business broker, a good first step is to produce a ñselling memorandum.ò This is a document that explains why the business would be an attractive opportunity for the right buyer: its financial potential, its existing assets, and its special strengths (e.g., experienced management, unique inventory, established client base, strong reputation, etc.). At the very least, *you* need to be clear on all these selling points, but buyers and brokers need to grasp them as well. You also need to have a firm grasp on any problems in the business, and be prepared to address those honestly ï better yet, clean up as many of them as you can before your business goes on the selling block.

You may also want to consider alternatives to selling, such as giving your business in trust to a charity, which will then sell it to someone else. You may be able to avoid capital gains taxes that way, plus get a tax deduction. Typically, in such an arrangement, the charity will then pay you an income for life. Other kinds of trusts and special legal arrangements can also be used, including family limited partnerships (if you want to keep the business in the family). You will need expert legal help to deal with such situations, though.

All of this assumes, of course, that you are selling your business interest intact. If not, you may be able to sell your assets off piecemeal to different parties ï for example, your customer list to a competitor, your furniture and equipment to a dealer, your real estate on the open market.

When you do find one or more prospective buyers, be prepared to open your shop/office and your financial books. But before you do so, make sure that the buyer(s) are legitimate, and have both the financing and the intent to go through with a deal if they like what they see. You donôt want to waste your time with an unqualified buyer, and you certainly donôt want to share the details of your business operation with, say, a competitor who really just wants to see how you run things and has no intention of buying you out.

Negotiating a deal

Your business is unique, and so are you, and so is your buyer. The deal you strike can be just as unique. There is no single right way to do this, so be prepared to be flexible, even creative. The main issues will be:

- What, exactly, is being sold ï a 100% interest, a partial interest? Are there any assets (including patents or copyrights) that you intend to keep for yourself?
- What is the official purchase price?
- How will it be paid (in cash, in stock, in retirement benefits)?
- What is the timing? When does it happen? Is the sale all at once, or spread over time?
- What involvement, if any, do you have in the company, either permanently or temporarily, under the new ownership?

- What obligations, if any, does the new owner have to you, after the transfer? Will the new owner commit to retaining your long-term employees? Are there certain business traditions that you want to assure get continued?
- If you do have a pension plan or other post-retirement benefits through your business, what safeguards assure that those benefits will in fact be paid?
- Who is responsible for accounts payable at the time of sale, and who gets credit for accounts receivable?
- If your name is on the business, does the new owner have the right to keep using that name even if you are no longer involved?

You do not necessarily have to wait until you are ready to retire to strike a deal. On the contrary, if you plan to sell to a family member, a current business partner, or an employee, it may be in everyoneõs interest to nail down the arrangement years ahead of time. Perhaps ï especially if the buyer is someone involved in the business ï the transfer can begin long before you retire.

If your business is incorporated, stock may perhaps be sold to a variety of different parties. If you are starting your plan well ahead of your own retirement, you might consider an Employee Stock Ownership Plan (ESOP), through which some or all of your employees can gradually buy some or all of your ownership interest, paying you cash along the way.

When making plans, take into account the tax implications ï especially the effect of a lump sum purchase vs. an installment purchase.

Expect to need a lawyer and an accountant to help you nail down the details. Even if the buyer is a family member or close friend, everything should be in writing, just as if this were not the case. Business arrangements can strain personal relationships; furthermore, one of the parties might die or otherwise become incapable of carrying through the plan as originally conceived, and someone else might end up with the responsibility ï so everything should be in black and white.

For More Information

Consult the RetirementWorks® ñRetirement Readinessò page on ñWork,ò particularly the following two sections, which will refer you to a variety of free and not-for-free resources.

- Business Succession
- Business Liquidation
- Family Farms (if your business is agricultural)