



June 2011

## Internal Versus External Transfers

In this Transition Strategies Newsletter we will compare the internal transfer methods for businesses to the external transfers and examine why it's important for business owners to consider both options in designing their transition strategy plans.

To begin, many business owners believe that an external sale of their business is their only (or at least best) path to a transition. Typically this is because business owners know that their employees and/or fellow family members don't have the type of money required to secure a successful transition strategy plan for them. So often times, business owners approach the topic of transitioning their business as meaning that they need to sell their business to an outside buyer with enough money to pay them what they need to retire (or, alternatively, what the owner *thinks* the business is worth).

In the case of external transfers, there are two (2) types of buyers, strategic and financial.

In the first case of a sale to an outside, strategic buyer, the transitioning owner is looking to maximize their sales price and is indifferent to the loss of their job, income and legacy within the business.

Here, the owner is willing to sell the three component parts of their business – strategic control, financial control, and operational control. The strategic buyer can theoretically pay the highest price because of the synergies involved in the acquisition.

The next case of selling to an outsider includes the sale to a financial buyer. In this case, the financial buyer is interested in making an *investment* in your business and possibly (likely) keeping you working in the company to help continue to grow it. When a financial buyer keeps the transitioning owner in the business, they often will provide an employment contract as well as continued (minority) ownership in the company. This way, your interests as an 'employee' will continue to be aligned with your new owner. You still sell strategic and financial control of the business, but likely can retain operational control. This is a powerful strategy for an owner who is not yet ready to retire but would like some personal diversification.

Now, while an 'external' sale is often-times intuitively appealing, an understanding of 'internal' transfers will also help a business owner understand all of their options for a transition and make a well informed decision.

Internal transfer strategies are not merely for owners with family in the business. They can also apply to the transitioning owner who does not want to sell strategic and/or financial control right away, but would still prefer to begin the process of drawing equity out of their business.

Internal transfers of ownership in a business are oftentimes overlooked because they are not intuitively understood by the business owner. Let's examine some of the internal transfer methods that are available to a

business owner to illustrate the benefits of a well-conceived transition strategy plan.

Internal transfer methods include Employee Stock Ownership Plans (ESOP), Management Buyouts (sales to family and management), and Gifting Strategies including Family Limited Partnerships and Charitable Transfer Strategies.

The three (3) primary differences between these internal transfers and external transfers are:

1. The corporate assets, including future cash flows, are leveraged to achieve internal transfer strategies,
2. The driving force behind these internal strategies is a business owner’s motive of passing the business to someone other than an outside buyer, and
3. The business owner will frequently be considering tax planning and estate planning along with their transition strategy planning.

As a general rule, internal transfers also allow for more flexibility in structuring the transaction than external transfers.

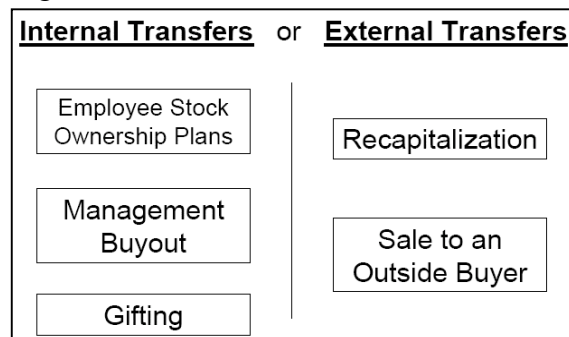
For example, a transitioning owner who is considering an Employee Stock Ownership Plan should know that they can sell any amount of shares of the business to the ESOP and get liquidity without [necessarily] giving up control of the business. In addition, the ESOP allows for a *phased* and *customized* transition for the owner, further emphasizing the flexible nature of that strategy.

Also, a management buyout can allow for some very creative deal and tax structuring for the transitioning owner. If you feel as though your management team is capable of one day running the business in your absence, you can begin your grooming

process and incentivize your managers over a multi-year time period to accommodate your own timeline for your transition. Here, you are not really shifting the risk in the business away to your ‘buyer’ because the business needs to continue running in order to make future payments to you. However, with the proper structuring you may wind up with more money in the end and a much happier group of employees who now will begin thinking as owners.

Finally, after a lifetime of business success, you may feel compelled to transfer your illiquid business wealth to both your children and charities, through a gifting strategy. If this is the case, then you need to know that certain tax provisions dictate much of the efficiency within these transfers. Also, for charitable transfers, you may be eligible for a current-year tax deduction if you structure the transfer properly.

Again, with external transfers the



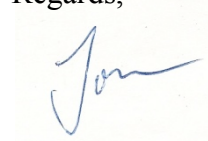
transitioning business owner can expect to lose quite a bit of *control* over the process and, ultimately, the business. And because many business owners possess a unique psychological mix of independence, intelligence and control orientation, losing control to an outside buyer often leads to choppiness in a deal.

To summarize, a business owner who wants to transition their business should be aware of the various methods by which a transition can be directed. Thereafter, consideration

should be given to that business owner's motives. In other words, **what is most important to that transitioning business owner and how can it best be accomplished?**

Transition Strategies are imperative to a successful transition on your terms and timeline. We are pleased that you are continuing to pursue a proactive interest in Transition Strategies because ***a proactive approach to a Transition Strategy is the only approach to a successful Transition Strategy.***

Regards,



Tom Stocker  
Managing Director  
(401) 451-9799  
tstocker@OwnersEdgeLLC.com

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We help you, our owner/clients, articulate your vision into the strategies and operational actions necessary to make your profits sustainable and your business transferable. This creates true and meaningful value.

### ***About Owner's Edge***

Owner's Edge is a business advisory and consulting firm specializing in helping business owners work *on* their businesses by devising and implementing strategies to drive operational excellence every day. We are one of the few advisor firms that can provide a formal and comprehensive Transition Strategy Planning service for business owners. Call us for a no-obligation consultation today.

***Do you find it more convenient to use email? To receive our "The Edge Transition Planning Newsletter" by email instead of US Mail, please drop us an email at [info@OwnersEdgeLLC.com](mailto:info@OwnersEdgeLLC.com). We will be happy to convert your delivery to our electronic version.***

## Executive Briefing: *Business Transition Strategy Planning*

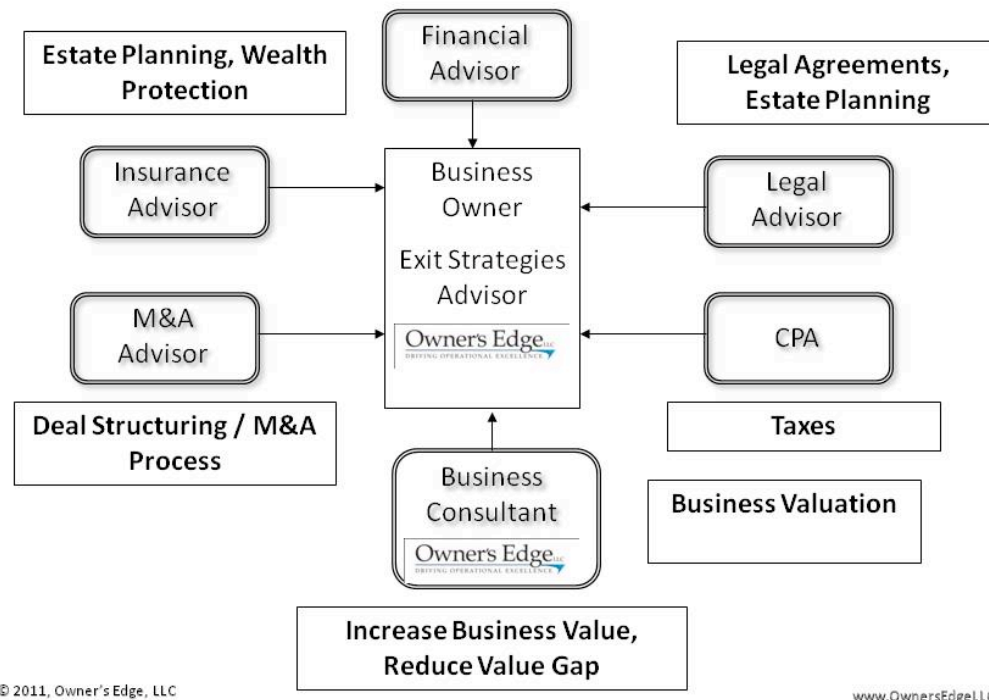
Tuesday September 12 at South Kingstown Chamber of Commerce; 8:00AM – 10:00AM

This free educational breakfast briefing is tailored especially for business owners and their key advisors. Learn why it is important to plan your transition, where you should start, what your transition options are, who is involved in the process and when they need to enter into the process. A continental breakfast will be served. Reserve your seat today and feel free to invite members of your advisory team.

Co-Host: Michael C. Paolino, Financial Advisor, Edward Jones

Kindly RSVP by September 9, 2011  
to Bette Lou Parisen at 401-783-7548  
or email to: [BetteLou.Parisen@edwardjones.com](mailto:BetteLou.Parisen@edwardjones.com).

## Your Transition Advisory Team



*A professional transition planner such as Owner's Edge can lead your trusted Transition Advisory Team you already have in place. Don't try to go it alone! Turn to the professionals at Owner's Edge to ensure your transition plan is structured and executed to leave your business on your terms.*