

Business succession planning

Strategies for increasing the value of your business and positioning it for the future

June 2026

Sixty percent of older generation owners plan to transition their business over the next 10 years. However, more than half do not have a formal succession plan in place.¹ As a business owner, you know the importance of planning ahead. Spending time now to develop a succession plan can help you:

- Increase current value of the business. A solid succession plan may make a business more attractive to potential buyers and may result in more favorable terms from banks on financing arrangements.
- Establish financial security in retirement. Research suggests that only a quarter of small-business owners participate in 401(k) plans (ShareBuilder 401(k) 2022), and many sacrifice personal savings in order to continually invest in their businesses.
- Help provide financial security for family members. In the event of disability or premature death, a succession plan can help ensure that family members have access to cash or liquid assets.
- Minimize taxes and efficiently transfer wealth. Estate taxes and other costs can take their toll—and often cause businesses to fail—without a proper plan in place.

Benefits of early planning

Successfully transitioning a business is directly correlated to how early you begin planning. Research shows that business owners who began planning for their succession 10 years ahead of time had an 85% success rate while planning two years or less resulted in only a 25% success rate.²

Planning now can help you beat the odds³

Small businesses that survive to the next generation:

30%

Small businesses that survive to the third generation:

12%

1. Kreischer Miller's 2016 Family Business Survey. Most recent data available.

2. BluePrint for Business, Family Business Succession Planning, 2009. Most recent data available.

3. US Small Business Association, March 2010. Most recent data available.

Key steps for business succession

1. Get organized and define goals.

Make sure records related to operating the business are in place and updated, including operations and systems manuals and processes, training documents, financial records, competitive analysis, partnership or shareholder agreements, and contractual arrangements such as leases.

2. Conduct financial analysis, including business valuation.

Are balance sheets and income statements up to date and accurate, for example? How much is the business currently worth? As an owner, what is the cost basis in the entity?

3. Outline options for succession.

These options may include an outside sale, transition to other family members or key employees, buyout from partners, or liquidation.

4. Examine options to structure the sale.

Will the assets of the business be sold, or can the sale be structured as a stock sale? Will there be an installment or earn-out agreement as part of the arrangement?

5. Utilize tax-advantaged strategies for effective wealth transfer.

For example, these may include such strategies as a family limited partnership (FLP), a buy-sell arrangement, or a sale to an intentionally defective grantor trust (IDGT).

6. Develop a communication plan.

This includes key parties such as customers, suppliers, management, employees, and other professional relationships and partners, such as banking, legal and accounting advisors.

Determine your successor

Business partner

Selling the business to your partners can provide continuity with customers and other key associates, but a sale in the open market may be more lucrative.

Family

Transitioning within the family has advantages as well as challenges. Consider whether family members have the proper skills to operate the business, whether you will need to facilitate wealth transfer to family members or children who won't be affiliated with the business, and how the transition may affect non-family key employees.

Third party

An outright sale of your business could be the most valuable transaction, but it may negatively affect relationships with key customers and business contacts.

Employee stock ownership plan (ESOP)

Transferring ownership of a small business over time to an ESOP can be an effective method for creating liquidity for business owners while rewarding employees. If structured properly, it may provide significant tax benefits as well.

Assess the value of business

Take a broad overview

Before looking at cash flow, revenue, or other financial data, consider how a potential buyer may perceive your business based on other variables. Does your current customer base offer potential for future growth? How would an ownership transition affect the client retention rate? Is your revenue stream consistent and dependable? How stable and appealing is the overall structure of your business, including location, employee base and operations?

Business valuation methods

Asset valuation

Estimate the value based on various assets (minus liabilities) the company owns.

Market comparison

This method measures earnings or revenue valuation based on recent transactions. While this method is easy to understand and communicate, most businesses are not identical, and a unique business or service model could make market comparisons difficult.

Multiple of earnings

With this approach, you multiply earnings or another financial figure by a specific factor based on variables for the industry and company. For example, the valuation might be calculated as three times EBITDA (earnings before interest, taxes, depreciation, and amortization).

Income method

The income method applies a discount rate to determine the valuation of the business. A discount rate is used to calculate the present value of future cash flows. This may be a better representation of the business's value for buyers, who typically invest based on expected future cash flows.

However, it can be difficult to objectively determine the appropriate discount rate—which is critical to the calculation.

Valuing a business using income method

The valuation can vary dramatically based on the discount rate used. The higher the discount rate, the lower the valuation.

	Cash Flows	10% Discount	20% Discount
Year 1	\$450,000	\$409,090	\$375,000
Year 2	600,000	495,867	416,666
Year 3	800,000	601,051	462,962
Residual value	8,000,000	6,010,518	4,629,630
Firm valuation		\$7,516,526	\$5,884,258

The calculation assumes hypothetical cash flows for three years and a residual value of future cash flows based on the Year 3 cash flow of \$800,000.

How to determine a discount rate for a small business

Start with a risk-free investment rate. What type of return could you generate if you invested in a Treasury bond, for example, rather than in the business itself?

Add an equity risk premium. What could you earn by investing in a broad equity market?

Consider adding a small-cap premium. What could you earn by investing in a broad range of small-cap companies?

Adjust according to subjective factors. Consider your brand, clients, recurring revenues, staff, market share, patents and intellectual capital.

Structure the deal appropriately

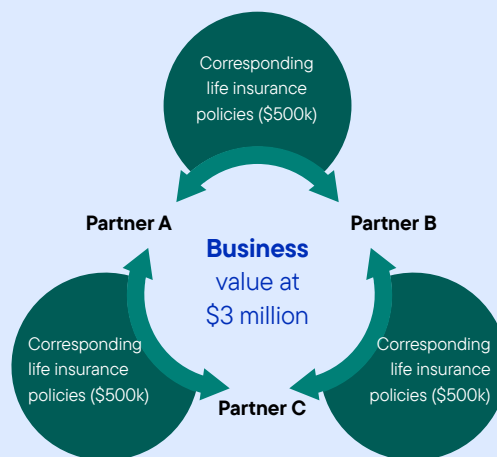
In structuring the transition, consider whether the purchase will involve cash, equity, notes or a mix of assets. You may want to initiate performance triggers based on growth and client retention. It is also essential to explore the tax implications for both buyer and seller. You may consider an installment sale to spread out the taxable gain. Also, with an asset sale, certain elements of a business may be taxed differently to the seller and buyer. For example, accounts receivable is taxed as ordinary income to the seller while the buyer receives this asset tax free as part of the transaction. For other items such as customer lists, the seller may receive more preferential tax treatment. This should be considered as part of the negotiations on structuring the deal.

Key estate planning strategies to transfer wealth efficiently include:

Buy-sell agreement

- Legally binding agreement for transfer of ownership when one owner exits
- Can prevent foreclosure and enables remaining owners to maintain control
- Typically funded with life and disability insurance
- In the event of death, provides much-needed liquidity to beneficiaries of deceased owner
- Typical models include cross-purchase and stock redemption
- A cross-purchase arrangement involves business partners purchasing life insurance on each other with proceeds used to buy out the interest of the deceased partner

A cross-purchase buy-sell agreement provides liquidity



Family limited partnership (FLP)

- Enables business owners to create two types of ownership shares—general and limited; retain control as general partners; and transfer limited partnership interests to family members
- Through a gifting strategy, senior family members can transfer the value of their assets to children and grandchildren, removing the assets from their taxable estates
- Can bring significant gift- and estate-tax savings
- Gifts of limited partnership shares are typically discounted to reflect *lack of marketability* and/or lack of control; this can help accelerate transfer in value while avoiding or mitigating federal gift taxes
- Transferring ownership of shares can result in shifting income from taxpayers in higher brackets (original owners) to family members in lower tax brackets
- Provides asset protection, since many states prevent creditors of a limited partner from attaching partnership assets

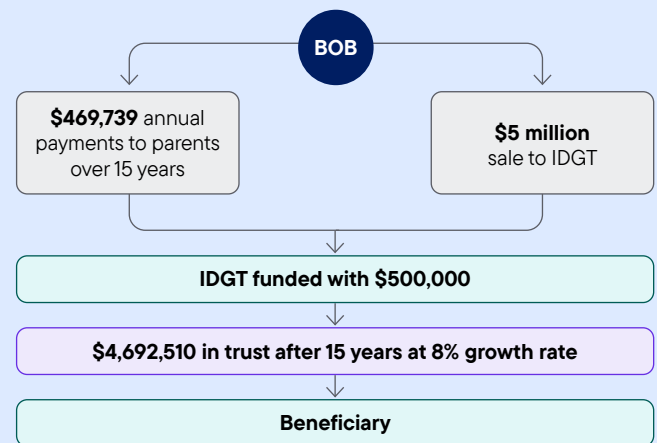
Hypothetical examples are for illustrative purposes only and do not represent any specific investment product.

Intentionally defective grantor trust (IDGT)

- Typically established by the buyer of a closely held family business
- Structured in order to be valid for estate planning, but defective for income tax purposes; i.e., the trust is not recognized by the IRS as a separate taxable entity, so there is no capital gain generated when a business interest is sold to the trust
- Depending on the IRS interest rate and appreciation of shares in the trust, assets may be transferred to beneficiaries free of gift and estate taxes
- Because the trust does not have to pay taxes, more assets remain for potential appreciation
- Taxes are paid by the business owner, thereby reducing the owner's taxable estate

Sale of family business interest to an IDGT

- Bob sells a limited partnership interest to an IDGT for \$5 million after valuation discounts. The IDGT is funded with seed capital of \$500,000 and because it is a grantor trust, no capital gain is recognized on the sale
- There is a 15-year note at 4.4% (AFR rate, January 2026⁴); the IDGT pays back to Bob roughly \$460k annually for the term of the note, and there is no completed gift (other than the initial seed gift)
- If the trust assets grow at 8%, roughly \$5 million could be transferred to beneficiaries after 15 years without estate or gift taxes



Spending the time to develop a succession plan can help you improve the value of your business, position you financially for retirement, maximize tax efficiency, transfer wealth and ensure that your business thrives into the next generation.

4. IRS Revenue Ruling 2026-02. Calculation of figures based on Franklin Templeton research.
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