THE NORTHERN TRUST INSTITUTE

ENTREPRENEUR'S GUIDE TO BUILDING WEALTH

While intently focused on building your business, you may have less time to spend on building, sustaining and distributing your wealth. Early wealth planning, in our experience, provides entrepreneurs with the financial flexibility to do and create what is important to them throughout their lives, whether that may be starting another business, setting up a venture fund or establishing a charitable foundation.

In our new guidebook, we provide insights, gathered from the entrepreneurs we have worked with, for building wealth at each stage of your journey — whether you are growing your business or exiting your business and pursuing new opportunities.

GROW

As you reinvest your time and money to grow your business, it is equally important at this stage to set the foundation for building and sustaining your long-term wealth.

CHOOSE YOUR ENTITY STRUCTURE WISELY

Items at the top of your priority list should include setting up the optimal entity structure for your company, putting in place an estate plan for your assets, and identifying sources of liquidity to fund your personal expenses and financial goals.

The entity structure of your business will have significant implications for how you grow your business and your wealth over the long run. Successful entrepreneurs periodically reevaluate their choice of corporate entity (e.g., limited liability company vs. S corporation) and how those entities relate (e.g., holding companies and management companies). They also remain flexible to modify these structures as their business becomes more complex and as tax laws change.

Consider the following factors when building the optimal entity structure for your business:

- Individual and corporate tax implications, including the ability to qualify as “qualified small business stock”
- Ability to raise capital and accumulate cash on balance sheet
- Placing hard assets (e.g., real estate) and soft assets (e.g., operating business) in separate corporate entities to limit liability and facilitate transfers of assets out of your estate
- How business decisions will be made (e.g., a corporate board versus a general partner)
- Ease of converting to a different corporate entity (e.g., from a C corporation to an S corporation) in response to anticipated tax law changes

SET UP YOUR ESTATE PLAN EARLY

For most entrepreneurs knee-deep in building their business, estate planning may not be top of mind. Implementing the right estate plan early on, however, can result in significant tax savings down the road when you exit your business. To the extent you can transfer some of the value of your business out of your estate now (e.g., into trusts for charity or your family), any increase in value from the time you transfer shares out of your estate up to the time of sale may pass to your beneficiaries free of estate and gift taxes.

Questions to ask when building your estate plan include:

- What assets will you transfer out of your estate? Generally, you will want to transfer growth-oriented assets that you will not need to "consume" during your lifetime (e.g., private equity investments, business interests).
- How much will you transfer?
- How will you transfer the assets, by gifting or "selling" them to a trust?
- What structure will you use? Forming a family limited partnership to own certain assets and transferring shares of the partnership out of your estate may achieve additional tax savings through "discounting" the value of those shares.
- Who will make decisions about the assets — your heirs directly, or a trustee or advisory board?

Keep in mind, transferring shares outside of your estate does not necessarily mean giving up control of your business. Many entrepreneurs, for example, will convert a portion of their business' shares into "non-voting" shares and transfer those shares out of their estate, while retaining voting shares. In the example on the following page, we show the value of one such instance.

THE VALUE OF EARLY ESTATE PLANNING TO AN ENTREPRENEUR

BALANCE SHEET		PLANNING STRATEGIES	
Liquid Assets	$7,000,000	Pre-sale gift of shares of business to charity	$2,000,000
Business (assumes $0 tax basis)	$40,000,000		
Real Estate	$3,000,000	Pre-sale gift of 35% of business in trust for children	$14,000,000
NET WORTH	**$50,000,000**		
NO PLANNING		**WELL PLANNED**	
Net to Children	$33,936,000	Net to Children	$34,981,600
Net to Charity	$0	Net to Charity	$2,000,000
TOTAL WEALTH TO CHILDREN AND CHARITY	**$33,936,000**	**TOTAL WEALTH TO CHILDREN AND CHARITY**	**$36,981,600**
		$ VALUE OF PLANNING	**$3,045,600**
		% INCREASE IN WEALTH VS. NO PLANNING	**9.0%**

Example assumes entrepreneur sells their business for $40 million and applies a 35% valuation discount on the value of the shares transferred to trusts for their children. Assumes a 40% estate tax rate and federal estate tax exemption of $12.06 million per individual (assumes entrepreneur is married).

LINE UP CAPITAL SOURCES FOR PERSONAL EXPENSES

Entrepreneurs are typically hyper-focused on finding capital to help grow their business. However, it is equally important to have access to near-term liquidity for personal expenses (e.g., funding education, buying a second home) as your business grows so you can reinvest profits back into your company.

Take a comprehensive "personal cost of capital" approach and evaluate all potential liquidity sources that may be available, including:

- Collateralizing liquid assets such as marketable securities with a line of credit
- Adding additional leverage to real estate holdings
- Putting debt on your business and issuing a one-time dividend
- Selling a minority stake in your business
- Raising funds through private investors or "friends and family"
- Structuring intracompany or intrafamily loans among related business entities or family trusts

Consider how each potential capital source stacks up across the following factors:

- Complexity — How complex or time-consuming will it be to raise the capital?
- Amount — The amount of funds available from each source
- Borrowing terms
- Financial impact — Impact on other assets (e.g., lower returns on your real estate investments) and your investment portfolio allocation
- Repayment — Potential sources of repayment, such as rental income or investment income
- Tax implications — Corporate, individual income and estate tax implications

EXIT

Exiting your business will be a pivotal wealth event for you and your family, and you may get only one opportunity to do it right.

As you embark upon the sale process, it is important to fully evaluate your exit alternatives, implement a robust succession plan for your management team, and create a wealth plan for how you will invest and distribute your wealth post-exit.

UNDERSTAND YOUR EXIT ALTERNATIVES

Receiving an unsolicited offer or seeing peers selling their businesses can tempt entrepreneurs into selling their business without proper planning. Before diving into a transaction, however, it is critical to evaluate the spectrum of available alternatives for generating liquidity from your business, such as a full sale, selling a minority stake, going public, selling to your management team (a management buyout) or selling to your employees through an employee stock options program (ESOP).

To best evaluate your options, we work with clients to develop a comparative grid that weighs the benefits of each alternative across a variety of factors, including:

- Timing considerations
- Ability to retain an interest in the business post-exit
- Estimated transaction proceeds
- Impact of the transaction on employees
- Level of involvement in the business post-exit
- Individual and corporate tax implications

LEAVE YOUR COMPANY IN GOOD HANDS

One of the most important value drivers for buyers of private businesses is a strong senior management team with a well-defined succession plan for key roles within the company. Additionally, building out a robust succession plan will give you peace of mind that your company will be in good hands and help support future upside potential to the extent you retain an ownership interest in the business post-exit.

Important aspects of a comprehensive succession plan that we have seen successful entrepreneurs implement include:

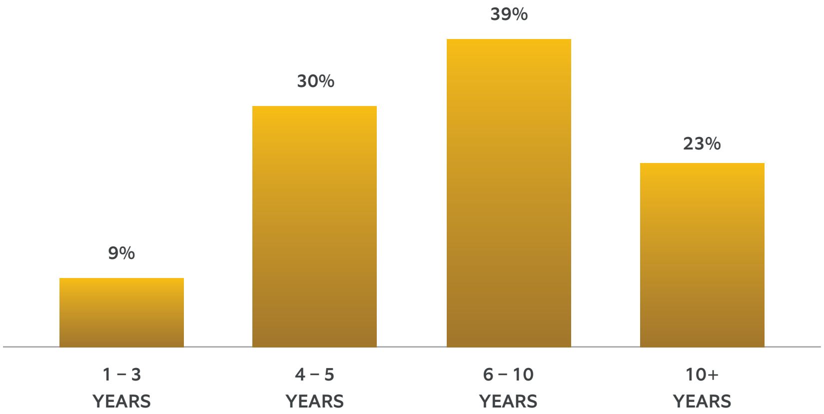
- Setting up a strong board of directors, including several independent directors
- Creating ownership incentives for key employees (e.g., stock options, phantom stock, etc.)
- Adopting formal employment policies for hiring, compensating and promoting senior roles
- Developing a leadership transition plan for senior management
- Implementing guidelines for identifying and grooming successors for leadership positions
- Hiring an executive coach to help develop senior talent
- Create a contingency plan in the event of the death or disability of key management before the succession plan is fully implemented

7 AVERAGE NUMBER OF BOARD MEMBERS

3 AVERAGE NUMBER OF INDEPENDENT MEMBERS THAT WORK IN THE SAME INDUSTRY

4 AVERAGE NUMBER OF INDEPENDENT MEMBERS THAT WORK IN A DIFFERENT INDUSTRY

AVERAGE TENURE OF PRIVATE COMPANY



Source: Northern Trust 2021 Business Owner Benchmark Survey

CREATE A 12-MONTH POST-EXIT CHECKLIST

It is all too common for entrepreneurs to get wrapped up in the chaos of getting the deal closed and overlooking important things that need to be done post-exit.

We find it helpful to create a 12-month post-exit checklist that catalogs steps that need to happen either immediately, in the first few months or within a year after closing. For example:

- Create a family communication plan to get your family on the same page about what to say and what not to say (e.g., on social media) if asked about the transaction.
- Implement a short-term cash management strategy and 24-month waterfall for deploying cash proceeds to cover anticipated liabilities and tax payments related to the transaction.
- Reassess any personal and cybersecurity needs as your wealth profile changes.
- Review insurance coverage and any corporate benefits that may no longer be available after the business is sold.
- Review estate and investment plans at key junctures.
- Close out any remaining deal items.

NEGOTIATE WITH A VIEW TOWARD YOUR "NEXT BIG THING"

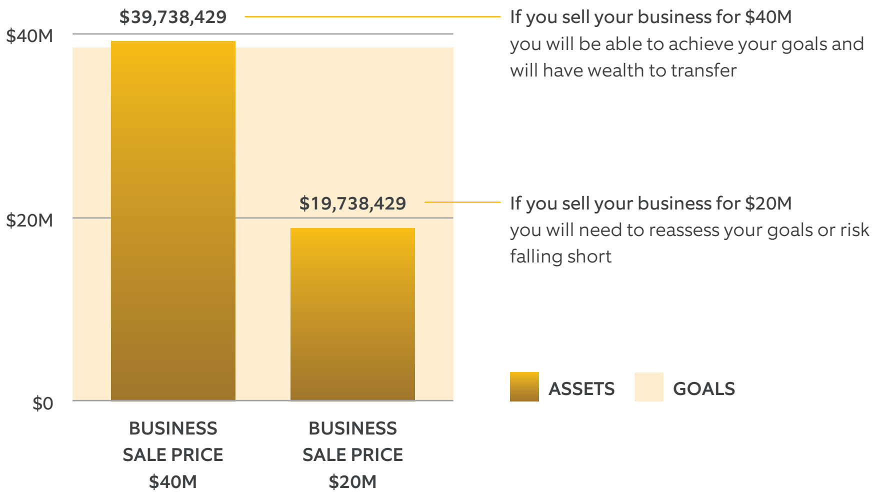
Understandably, entrepreneurs are committed to securing the highest possible sale price for the business they built. However, it can be valuable to take a step back and utilize goals-based planning to determine the minimum sale amount needed to confidently fund your lifetime goals, which may include everything from paying for college to creating a venture fund to starting a new business.

Once you have identified your minimum viable sale price, any proceeds you receive above that can be set aside as a separate pool of funds for opportunities down the road, moved out of your estate for the benefit of your heirs, or "given back" to the buyer during the deal process in exchange for other favorable deal terms.

Other deal considerations to establish pre-exit include:

- What percentage of your business you would like to own post-exit and how much of that stake, if any, should be transferred out of your estate
- Tax strategies to maximize transaction proceeds, including donating proceeds to charity or reinvesting them in "opportunity zone" real estate to defer capital gains
- Additional sources of capital that may be needed beyond the sale proceeds in order to fund certain larger goals, such as starting a new business
- Strategies for investing the sale proceeds and offsetting the risk of holding a concentrated position in a private business

ILLUSTRATIVE GOALS-BASED PLANNING ANALYSIS FOR SALE OF BUSINESS



REINVENT

In order to sustain the wealth you have worked hard to create, and give yourself resources to pursue new endeavors, it is important to build upon the foundation that you have created pre-exit.

Successfully exiting your business may provide you with the financial flexibility to chart a new path, whether, for instance, you choose to start a new business or pursue charitable interests.

At this stage of your journey, turn your focus toward creating an infrastructure and team of advisors to oversee your wealth, educating and empowering your family to become responsible stewards of your wealth, and exploring creative ways that you may use your wealth philanthropically to make an impact on the world.

BUILD OUT YOUR POST-EXIT INFRASTRUCTURE

Post-exit, you will likely be spending less (if any) time with the business you sold and more time overseeing and deploying your newfound liquidity. Many of the successful entrepreneurs we have worked with post-exit approach the task of building long-term wealth by adopting the same level of discipline and structure they relied upon when running their business.

Best practices that have worked well for founders running their “family wealth enterprise” include:

- Consider forming a family/multifamily office or outsourcing some of the services that family offices often provide (e.g., a chief investment officer’s role, administrative tasks), depending on the size and complexity of your balance sheet.
- Avoid the temptation to say yes to every investment opportunity. Instead, put together a disciplined approach and team to evaluate opportunities in the context of your overall long-term wealth plan.
- Create a formal communication structure with your family (e.g., periodic family meetings or a family council) to provide a forum for discussing the family’s wealth and resolving conflicts as your family grows and your balance sheet becomes more complex.
- Reevaluate the capabilities of your advisors to ensure your wealth has not outgrown your team.

REDEFINE YOUR RELATIONSHIP WITH YOUR BUSINESS

Whether you part ways with your business or remain involved as an employee, board member and/or minority shareholder, it is important to recognize that your relationship with your business will fundamentally change post-exit. It is not uncommon for entrepreneurs to feel a sense of regret or loss of identity after the sale of their business.

Prior to closing the deal, mentally prepare yourself for the transition and have a clear understanding of how your authority and access to information within the business will change. Founders who have already lined up a new endeavor before exiting their business to reroute their focus, motivation and desire to make an impact in the world are often the most satisfied with how things turn out. Finally, write down any circumstances that may cause you to consider getting more involved in your business again — for instance, a significant decline in sales or erosion of the company culture.

INSPIRE (DON'T SPOIL) YOUR KIDS

Whether your children are young or grown, one day they likely will become stewards of your wealth. Many entrepreneurs struggle with how to strike the right balance between providing enough for their children — but not so much to make them complacent and dependent.

Start with the "why." Instead of hard and fast rules for what your children get and what they can and cannot do with your wealth, create a trust structure that gives the trustee flexibility and provides guidance on the purpose of the family's wealth.

Encourage your children to be entrepreneurial, cultivate their interests and provide opportunities for them to make their own decisions and learn from their own mistakes.

Communicate frequently and transparently as a family about the family's wealth and proactively address any potential friction or issues that may arise.

Specific strategies to implement strong family governance include:

- Giving children the opportunity to learn firsthand about the family's business holdings, real estate and other assets

- Creating opportunities to cultivate your children's entrepreneurial spirit, for instance by including specific language in their trusts about how certain trust funds may be used to invest in start-up ventures, or creating a family LLC whereby family members work together to invest in early-stage businesses

- Inviting outside perspectives to guide conversations and provide a sounding board for family members, or even considering creating a formal advisory board to advise the family on key decisions related to the family's assets

REIMAGINE PHILANTHROPY

In many respects, the corporate and civic profile you have built over the years may still be aligned with your personal goals and interests even after you have exited your business. However, this is a good time to reevaluate your continued engagement with certain charitable causes and explore other opportunities to make an impact.

Keep the following in mind when pursuing philanthropy post-exit:

- Understand what is out there. While many entrepreneurs choose to pursue philanthropy through traditional routes such as charitable giving and forming a foundation, there are numerous creative structures for supporting the causes that are important to you, from for-profit businesses committed to a particular charitable mission to funds that invest in businesses that support a particular set of values. Weigh the costs and benefits of each alternative before forging ahead.

- Avoid jumping in too soon. Just as you've made plans for transitioning out of your business, your philanthropic activities require a similar commitment to planning. While you may have more time on your hands, your philanthropy will be more impactful and rewarding if you take the time to create a philanthropic giving strategy to implement over time.

- Don't go it alone. As a (former) business owner, you will likely still have access to the community partners with whom you have been engaged over the years. Work toward deepening those relationships, identifying resources that will support your philanthropic goals and otherwise not "reinventing the wheel."

HOW NORTHERN TRUST WORKS WITH ENTREPRENEURS

Business Advisory Services

Evaluate your exit alternatives, put together a deal team and quarterback the transaction process from start to finish.

Goals Driven Wealth Management

Model different financial scenarios to help you determine the amount of proceeds you need to walk away with post-exit to fund your long-term goals.

Wealth Planning & Advisory Services

Develop tax and estate planning solutions that help maximize after-tax proceeds upon exit and preserve your wealth over the long run.

Family Business Services

Develop a succession plan for your management team to maximize the value of your business pre- and post-exit.

Global Family & Private Investment Office

Evaluate what post-exit infrastructure will work for your level of wealth.

Philanthropic Advisory Service

Explore creative and tax-efficient opportunities to give back and make an impact.

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ABOUT THE NORTHERN TRUST INSTITUTE

The Northern Trust Institute is a research center dedicated to advising affluent families. More than 175 experts collaborate across 34 areas of expertise to analyze behavioral patterns and identify the strategies that have been most effective for our clients — bringing the breadth and depth of our firm to each unique situation. The resulting insights position you to take action with confidence and achieve optimal outcomes with your wealth.

ABOUT NORTHERN TRUST

Northern Trust collaborates with clients and their advisors to offer holistic wealth management services for individuals and families, privately held businesses, family offices, and foundations and endowments. We are recognized for innovative technology, service excellence and depth of expertise across all aspects of financial planning, including wealth transfer, banking, insurance, investments, tax management, philanthropy, family communication and more.

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Northern Trust
50 South La Salle Street, Chicago, Illinois 60603
866-296-1526

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