Fall 2024

OWNER TO OWNER

BROWN BROTHERS HARRIMAN

Thriving After Change:

Helping Departing Leaders Let Go

OWNER TO OWNER

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Dear clients and friends,

Earlier this year, BBH conducted our second annual Private Business Owner Survey. The respondents represented 400 U.S. private businesses with enterprise values from $10 million to $500 million and more. We asked about how the business affects their family, how they think about the future, what might happen when they step away from the business, and how business strategy might be changing due to market and economic conditions.

The results were fascinating:

- Despite citing the rise of artificial intelligence (AI) as a challenge, **99%** are currently using AI for business purposes, including marketing and content creation, data and predictive analytics, and automating processes – and **46%** state that AI must be more regulated.
- Ninety-one percent of private business owners say that it is important for their business to remain in the family for the next generation, but **29%** are still struggling to pick a successor.
- Every private business owner surveyed says they have an estate plan, and **91%** say their plan aligns with their values. But **97%** report factors that have prevented them from communicating their estate plans to family.

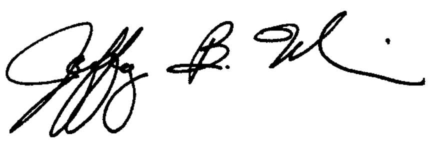
We also found that for nearly half (**45%**) of owners, the top reason they would not consider selling some or all of their business in the next 12 to 24 months is that they identify with their business too much to give it up. Indeed, one of the most overlooked yet crucial steps of succession planning is helping the departing leader learn how to transition out of their role in the business. A leader's openness to exploring a future for themselves represents a crucial turning point in beginning the transition journey. In our feature article, we lay out several steps owners can take to begin on the path of a successful business transition.

The looming year-end 2025 expiration of the current federal gift and estate tax exemptions also appears to be on business owners' minds. Nearly three-quarters (**74%**) plan to engage in additional estate planning in order to take advantage of the higher exemptions. BBH Senior Wealth Planner Stacia Kroetz explores steps business owners can take to ensure they make the most of their planning before the exemption expires.

We also include a roundup of the survey's key highlights – what the results reveal about common challenges for business owners and how they are planning for the future. And as always, Michael Conti, Jack Goryl, and Christine Hourihan provide an overview of the economy, the credit markets, and the private equity and mergers and acquisitions markets thus far in 2024.

We hope you enjoy this issue. If you have any questions about the topics covered in this edition, my colleagues and I would welcome the conversation.

Sincerely,



Michael Conti, CFA / Investment Research Group
Jack Goryl / Corporate Advisory & Banking
Christine Hourihan / BBH Capital Partners Private Equity

The Business Environment Q4 2024

In each issue of *Owner to Owner*, we review aspects of the business environment on three fronts:

- Overall economy
- Credit markets
- Private equity (PE) and mergers and acquisitions (M&A) markets

The following article examines the state of the economy in the midst of rate cuts, continued caution from banks, and the growing influence of artificial intelligence (AI).

The Economy

According to the "third" estimate by the U.S. Bureau of Economic Analysis, U.S. real gross domestic product (GDP) expanded at a quarter-over-quarter annualized rate of 3.0% in second quarter 2024, topping the 2.9% estimate. This marks an acceleration from the 1.6% (revised upward from 1.4%) real GDP growth recorded in first quarter 2024, which reflected an upturn in private inventory investment and an acceleration in consumer spending. The personal consumption expenditure (PCE) component of GDP – which drives 70% of GDP over the long run – advanced 2.8%, with increases in both services and goods. In addition, corporate profits rebounded sharply from the first quarter, which should help sustain the economic expansion.

Meanwhile, the U.S. unemployment rate remained above 4% for the fourth consecutive month. August's reading of 4.2% marks its longest streak above 4% since the beginning of 2018 (excluding the

COVID-19 pandemic period). The increase in July's unemployment rate (released on August 2, 2024) was a key driver of the August 5 market sell-off, in which the S&P 500 declined 3% and the VIX Index recorded its widest daily range ever, advancing to an intraday high of 65.7. This was its third highest level after the global financial crisis and the COVID-19 pandemic.

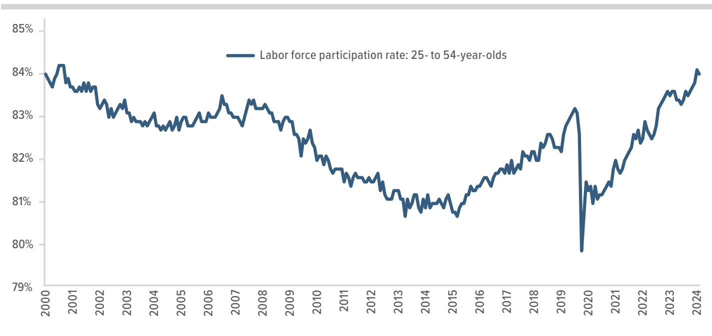
The rise in the unemployment rate over the last several months was driven by:

- A continued robust increase in the labor force, up 1.1 million since the end of 2023
- A rise in the labor force participation rate for prime-age workers (25- to 54-year-olds) to 83.9%, the highest level since 2001

The latter suggests that the labor market is in better shape than the unemployment rate indicates, as prime-age workers typically become discouraged and leave the labor force during a recession.

From 2024 to 2026, the Federal Reserve estimates real GDP growth of 2% annually, down from 2.9% (revised upward from 2.5%) real GDP growth rate in 2023. As such, the Fed does not currently forecast a recession over the next three years.

Prime-age labor force participation rate reflects labor market strength

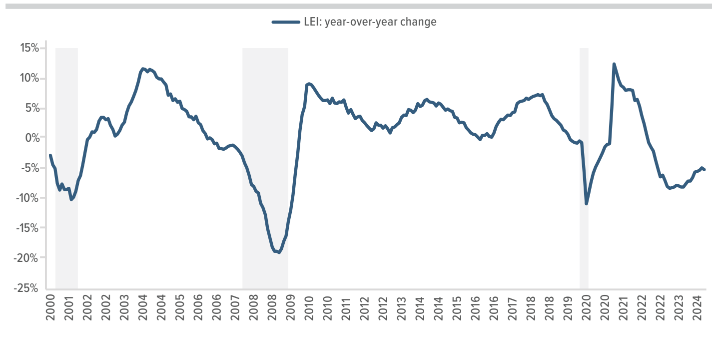


Data as of August 31, 2024.
Source: Bloomberg.

Turning to forward-looking indicators, we believe that The Conference Board's index of 10 leading economic indicators (LEI) provides the most balanced, forward-looking gauge of economic activity. While many economic indicators display more noise than signal, the LEI has proved to be a valuable forecasting tool over multiple economic cycles. In the prior three recessions (excluding the COVID-19-induced recession in 2020) that started in 1990, 2001, and 2007, the LEI began declining between 12 and 22 months prior to the start of the recession. As of July 2024, the LEI has declined for five consecutive months since recording a flat month-over-month reading in February 2024.

Despite the overall decline, four out of 10 leading indicators made positive contributions to the LEI in July. Nonetheless, a deterioration in new orders, softer building permits, and lower hours worked in manufacturing offset these improvements. As the magnitude of monthly declines has lessened, the LEI's 12-month growth rate has continued to trend upward after bottoming in October 2023 but remains negative, suggesting downward pressure on economic activity ahead is probable.

LEI's annual growth has stabilized but remains negative



Shaded lines represent recession.
Data as of July 31, 2024.
Source: Bloomberg

At the Fed's annual policy conference in Jackson Hole, Wyoming, in August 2024, Chairman Jerome Powell stated that "the time has come for policy to adjust," as inflation continues to trend toward the Fed's 2% target and as the Fed does not seek further cooling in labor conditions. Indeed, in August, the U.S. Personal Consumption Expenditures (PCE) Price Index increased 2.5% year over year, its lowest level since early 2021. This increase gave the Fed confidence that inflation is declining in a sustainable way toward its 2% target. As a result, the early August drawdown in the S&P 500 proved to be short-lived, with the S&P 500 advancing 2.4% in August and VIX Index falling sharply to end the month lower than July levels.

As it relates to monetary policy, in September the Federal Open Market Committee (FOMC) joined global central bank peers by beginning its interest rate-cutting cycle. The FOMC reduced the fed funds rate by 50 basis points (bps) to a target range of 4.75% to 5.0%. This marks the FOMC's first rate cut since July 2019.

As of September 26, the fed funds futures curve is pricing in that the fed funds rate ends 2024 at 4.1%. This implies a target range of 4.0% to 4.25%, which is more ambitious than the Fed's terminal rate guidance of 4.4% (implying a target range of 4.25% to 4.50%) estimated in its September 2024 economic projections release.

The difference between the Fed's and investors' estimates on the number of potential rate cuts in 2024 may result in elevated volatility in the near term and may impact equity prices, as real interest rates are likely to stay higher for longer than what is currently priced (equity multiples share an inverse relationship with real interest rates).

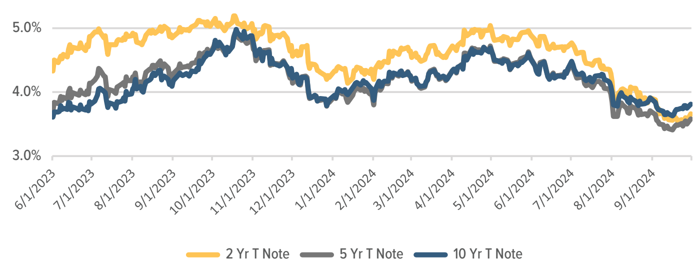
There is much underway as we progress through the remainder of 2024 – rising tensions in the Middle East, ongoing economic uncertainty in China, and the fast-approaching U.S. presidential election, to name just a few – and we will be watching inflation and global growth developments closely.

The Credit Market

Since the beginning of 2024, market participants have been uncertain about when and how quickly policymakers will adjust the federal funds rate. The widely referenced CME FedWatch tool showed significant fluctuations leading to the September 2024 FOMC meeting. In the FOMC's Survey of Primary Dealers and Survey of Market Participants, most respondents expected a 25-basis-point (bps) cut at September's meeting, while futures prices implied a greater probability of a 50-bps cut.[1] Though banking analysts, Fed presidents, and other experts suggested different opinions about the magnitude of the adjustments, investors could have turned to Rod Stewart because, as the saying goes, "The first cut is the deepest."

All FOMC governors, save one, ultimately voted to implement a more considerable 50-bps rate cut at the September meeting. Chairman Jerome Powell described this decision as a "recalibration" of monetary policy, recognizing that the policy rate, currently at 4.75% to 5.00%, is still higher than the neutral rate. Importantly, Powell stated that the 50-bps cut was intended to support the economy's current strength rather than respond to significant economic weakness.

U.S. Treasury yields



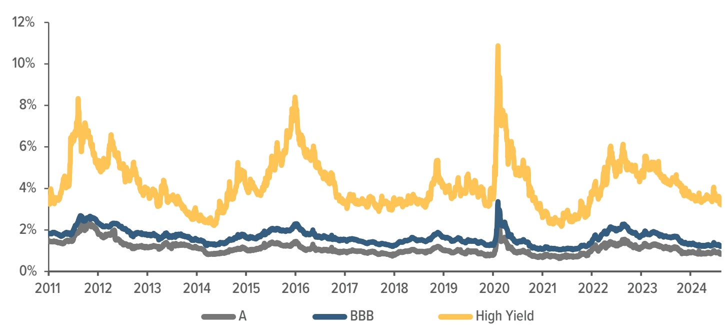
Data as of September 30, 2024.
Source: Bloomberg.

While the FOMC will continue to use incoming economic data to assess the timing and pace of future monetary policy adjustments, which influence short-term rates, outlooks for future growth and inflation are more impactful on longer-dated Treasury yields. The long tail of high but short-term, pandemic-induced inflation and the Fed's policy rates in response, combined with more modest, longer-term inflation and economic growth expectations from market participants, drove the two-year Treasury yield above the 10-year yield for the last two years – a scenario known as an inverted yield curve.

The overall impact of elevated but slowing inflation through the end of 2023 and into 2024 is shown in the nearby chart, where U.S. two, five-, and 10-year Treasury yields on average shifted downward by approximately 132 bps from their recent October 2023 peak. Notably, in September 2024, the yield curves normalized, or un-inverted, as two-year Treasury yields continued to decline with falling inflation and the 50-bps Fed rate cut. Like the FOMC, the market will reflect expectations of the economy. However, the normalization suggests a more positive outlook or potential for a soft landing, as investors are willing to lock in higher rates for extended periods. Further, the 12-month Consumer Price Index (CPI) measured 2.4% in September, which may enable further rate cuts during the remainder of 2024 .

Corporate spreads reflect how the market assesses risk and credit quality by measuring the additional return demanded for investing in riskier securities. Spreads for corporate bonds across various rating classes narrowed through September, reaching a three-year low. All were below their respective 2023 averages and narrower than at the start of 2024. The nearby chart indicates that the bond market is gaining confidence in corporate creditworthiness and stable or improving economic conditions.

Corporate spreads by quality

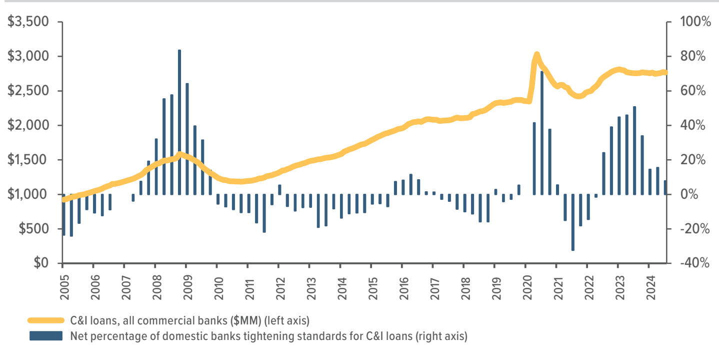


Data as of September 30, 2024.
Source: Bloomberg.

The following chart shows the historical trend of commercial and industrial (C&I) loans outstanding, as well as the net percentage of U.S. banks adjusting their credit standards for loans to large and middle-market firms according to the Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS). Note that the SLOOS data corresponds to activity in the prior quarter (that is, a report released in July represents the activity from April through June). As illustrated, during economic uncertainty or decline, banks usually tighten their lending standards and increase the cost of borrowing, leading to reduced loan demand in the following months.

[1] *Basis point (bps) is a unit that is equal to 1/100th of 1% and is used to denote the change in price or yield of a financial instrument.*

Amount of C&I loans vs. bank standards

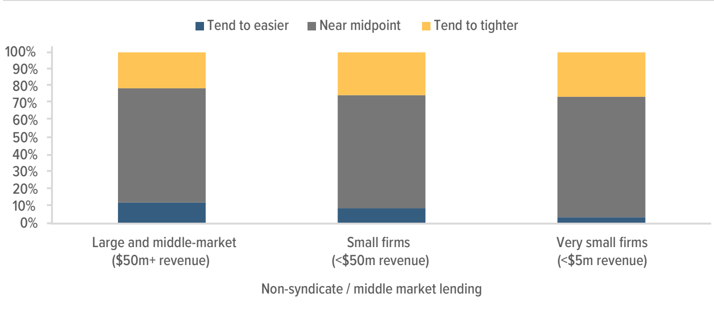


Data as of August 5, 2024.
Source: Federal Reserve Bank of St. Louis.

With a cautious economic outlook aligned with the Fed's view and increasing policy rates, the banks' tightening cycle began in first quarter 2022. U.S. regional banking disruption in March 2023 exacerbated this. As banks restricted access to credit and costs to borrow increased, C&I loans outstanding moderately declined throughout 2023 and into the first half of 2024, helping to cool down the economy and contributing to moderating inflation.

In the July 2024 SLOOS, the net share of banks reporting tighter standards for C&I loans fell to the lowest level in two years (8%). However, the current state of bank lending remains relatively stringent compared with historical norms. The following chart displays responses from the banks surveyed in July regarding their current lending standards compared with historical levels since 2005. The evaluation shows that, on average, lending standards were near the historical midpoint. Still, about a quarter of the banks reported that their standards across various categories were tighter than the historical average.

U.S. bank lending standards (2005 vs. present)



Data as of August 5, 2024.
Source: Federal Reserve Bank of St. Louis.

While most lenders reported about the same C&I loan demand as in the previous quarter, banks reporting weaker C&I loan demand equaled banks reporting greater demand for the first time since October 2022.

While banks' caution prevails, driven by economic outlook and risk tolerance, the results indicate a steady and gradually improving borrower optimism. In addition, with the recent decrease in the federal funds rate in September and the anticipation of further cuts before year-end, we anticipate the October 2024 SLOOS will show an increase in demand for C&I loans among U.S. banks in the upcoming months. Similarly, at BBH, we are actively expanding our corporate loan portfolio while focusing on sound credit opportunities.

The Private Equity and Mergers and Acquisitions Markets

A number of the macroeconomic and market trends from 2023 carried over through the first half of 2024. Fund managers continued to work through the shifting economic landscape by:

- Being adaptable
- Embracing technology and AI
- Focusing on value creation and optimization

U.S. PE dealmaking in the first half of 2024 increased approximately 12.0% year over year both in deal count and dollar amount. Second quarter 2024 PE activity saw its strongest quarter in two years with 122 deals valued at $196 billion – nearly double the $100 billion announced in the first quarter. While dollar volumes are down 46.2% from the peak quarters of 2021, deal value and count in 2024 are significantly above the "old normal" quarterly levels of 2017 to 2019 by approximately 25% to 45%, respectively. Add-on acquisitions accounted for 75% of all buyouts in the first half of 2024, a trend that has continued in recent years.[2]

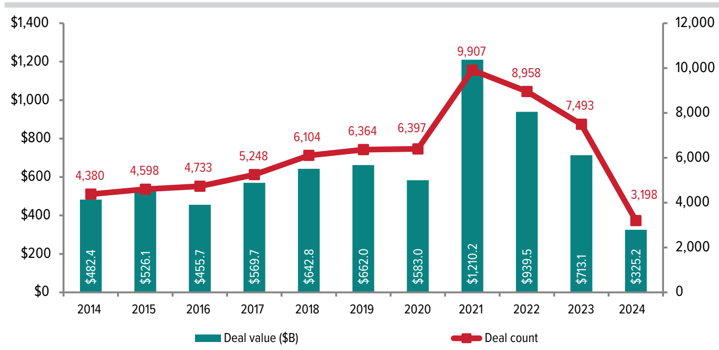
Generative AI is showing potential to transform and accelerate deal activity by summarizing a large amount of data so analysts can sift through opportunities more quickly. In addition, AI tools can rapidly develop outreach strategies and expand or narrow lists based on a PE manager's investment criteria. As deal sourcing and analysis will happen at a greater scale in the coming years, PE firms must keep up with these technological advances in order to stay competitive.[3] According to Deloitte, by the end of 2023, around 10% of private investment firms had begun implementing AI in core functions such as deal sourcing and due diligence.[4]

The slowing pace of inflation and the potential for the end of rate hikes could clear the path for more dealmaking in the second half of the year. According to a KPMG Survey, 70% of dealmakers expect more deal activity in 2024 than the prior year.

[2] *Pitchbook.*
[3] *AlphaSense: Private Equity Trends and Outlook for 2024.*
[4] *Deloitte Center for Financial Services.*

“[A]t BBH, we are actively expanding our corporate loan portfolio while focusing on sound credit opportunities.

U.S. private equity activity deal flow by year



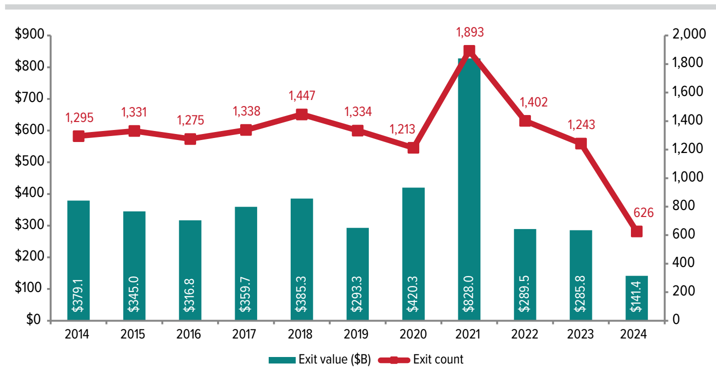
As of June 30, 2024.
Source: PitchBook.

U.S. PE exit value increased by approximately 15% year over year in the first half of 2024 while exit count remained relatively flat. The lingering valuation gap between buyers and sellers is a core driver of lackluster exit activity. The exit-to-investment ratio of 0.36x in the second quarter is a new record.[5] In an EY survey of general partners (GPs), just 30% cited a lack of interested buyers as the main exit impediment. Rather, GPs are focused on:

- Ensuring that their portfolio companies' performance is optimal
- Making sure their portfolio companies present a compelling equity story
- Waiting for valuations to improve to maximize value[6]

The market has been clear that, in order to produce exits in this environment, GPs need to boost EBITDA efficiently and demonstrate to potential buyers that there is money "left on the table." Fund managers need to be able to turn on value creation "levers" that can generate organic growth.[7] EY's latest "CEO Outlook Pulse Survey" reported that 74% of PE-backed companies are already using or piloting AI solutions, and this number is expected to grow.[8]

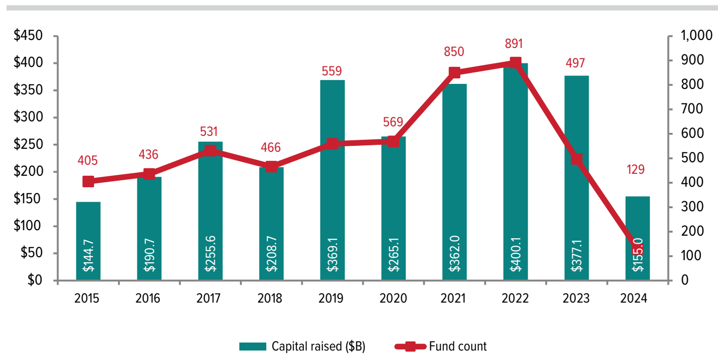
U.S. private equity exits by year



As of June 30, 2024.
Source: PitchBook.

The decline in exit activity has had a significant effect on fundraising. Slower distributions have left limited partners (LPs) cash flow negative, stifling their ability to put more capital back into PE funds. PE fundraising remained resilient in the first half of 2024 as U.S. PE funds closed 129 funds at a value of $155.0 billion, which is slightly ahead of the first half of 2023 (2023 was PE's second-best fundraising year on record).[9] However, LPs remain highly selective. While capital flowed to a subset of large and established buyout funds, fundraising for most GPs remains quite difficult.[10]

U.S. private equity fundraising by year



As of June 30, 2024.
Source: PitchBook.

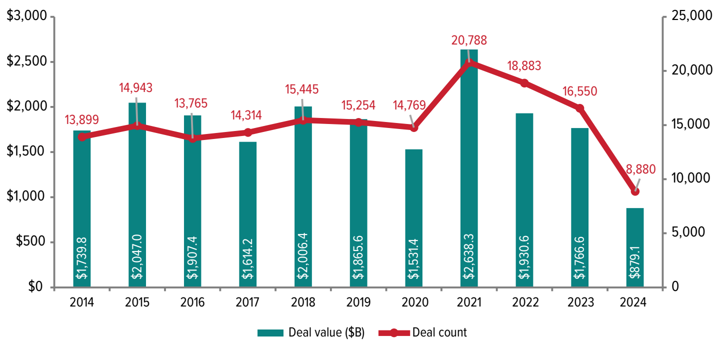
[5] *Pitchbook.*
[6] *EY Private Equity Pulse: key takeaways from 2Q4.*
[7] *Private Equity Outlook 2024: The Liquidity Imperative.*
[8] *EY.*
[9] *Pitchbook.*
[10] *Bain: Private Equity Outlook 2024: The Liquidity Imperative*

Cautious optimism is returning to the M&A market in 2024. After a tepid 2023, an M&A recovery has arrived, driven by:

- Strong corporate profits
- Rising executive confidence
- Stabilizing inflation[11]

In the first half of the year, North American M&A increased by approximately 13.0% year over year in terms of deal count (9,000) and deal value ($975 billion) and led all regions during this time period.[12] According to a June KPMG M&A survey, the majority of executives anticipate a surge in M&A activity this year, and three-quarters plan to complete at least one deal.[13]

North American M&A activity



As of June 30, 2024.
Source: PitchBook.

Conclusion

As we near the end of 2024, we are keeping an eye on a variety of converging factors, including the Fed's recent rate cut of 50 bps, the rise in the unemployment rate over the last several months, continued geopolitical tensions, and the upcoming U.S. presidential election – to name a few.

Meanwhile, in the credit markets, banks' caution prevails, driven by economic outlook and risk tolerance. However, results indicate a steady and gradually improving business environment. Generative AI is also at the front of everyone's minds – including in the PE and M&A markets, where it has the potential to transform and accelerate deal activity. We continue to monitor this quickly developing technology and the risks and opportunities it presents. Finally, third quarter 2024 saw an increase in U.S. PE exit value, while cautious optimism returned to the M&A market after a tepid 2023.

> "After a tepid 2023, an M&A recovery has arrived, driven by strong corporate profits, rising executive confidence, and stabilizing inflation."

[11] *PWC US Deals 2024 midyear outlook.*
[12] *Pitchbook.*
[13] *KPMG 2024 M&A outlook for corporate deal makers.*

Thriving After Change:

Helping Departing Leaders Let Go

Benjamin Persofsky / Head of the BBH Center for Family Business

Our second annual Private Business Owner Survey revealed that one of the most pressing concerns on the minds of many leaders, especially owner-operators of private businesses, is the eventuality that one day their role as leaders will end. That shift could come as a result of a deliberate transition of leadership to the next generation, a sale of their business(es), illness, or death.

For leaders who gain meaning from what they do or view it as a core element of their identity, confronting and planning for their inevitable separation from some or all aspects of their current leadership role can be difficult and emotional. In fact, 45% of business owners in our survey say they identify with their business too much to give it up. However, the long-term cost – both financial and personal – of not facing this challenge, and not devoting meaningful attention to it in advance of a transition, could be significant.

45% of business owners say they identify with their business too much to give it up

The good news is that leaders who recognize gaps in their preparation for a transition and decide to then invest deeply in facilitating an orderly and thoughtful transition have better outcomes. This applies regardless of whether it is to the next generation of owners and managers or a sale to a new ownership group. To be clear, this is not easy. One of the hardest challenges to overcome for the leader is gaining comfort with the idea that life will be different moving forward.

ACCEPT THE CHALLENGE OF TRANSITION

The process of transitioning away from ownership starts with both an acknowledgment and a commitment. Regardless of whether a leader decides to keep a private business in the family or sell the company to a third party, they must come to terms with the fact that there will be a transition, which means that their role will change. For that reason, the fear of coping with rapid change or an acute loss of identity can be conflated with the fear of the unknown. However, when planned for correctly, the change is typically gradual and informed by the leader.

Leaders should commit to taking the long journey – to prepare for the future of the business and themselves – early. A rapid transition can be stressful, so encouraging owners and key stakeholders in the transition process to begin the work early is essential. While that requires patience and due diligence, it also ensures that the fear of change can be extinguished over a period of time, decreasing the likelihood of trauma from “ripping off a bandage.”

To that point, it can be beneficial for the leader in transition to also engage with others who have direct prior experience in undertaking these transitions. While professional outside facilitation of the process is often very helpful, having someone to talk to who also understands the intensity of the emotions can be reassuring.

Challenges that prevent successful transitions

- Fear of being unable to replace the enjoyment and fulfillment felt in current role
- Fear of loss of identity
- Fear of the unknown; there is not necessarily anything apparent that will improve current livelihood
- Association between a shift in role/responsibilities and death (similar to why some leaders have difficulty with estate planning)
- Overwhelmed by the magnitude of effort required to facilitate a transition relative to other present priorities
- Concern that there is not a “good solution” – meaning a leader feels no one is ready – in the case that an owner seeks to hand the reins to a successor generation

WHAT DOES THE FUTURE LOOK LIKE?

The next step is for the leader to ask themselves, “What do I want the future to look like?” If the answer is an eventual sale of the business to a strategic or financial buyer, the leader should start to evaluate and plan for the endgame of the transition and separation.

The exit planning process includes appointing people to leadership roles who will sustain the business, providing stability for both new owners and key employees, and creating structure surrounding processes, systems, and financial reporting. These efforts go a long way toward what a leader can control (which does not include macroeconomic or industry dynamics and trends) in seeking to maximize the value of the business in a sale.

54% of private business owners are considering hiring a qualified outsider to take over leadership of their company

OPENING A DIALOGUE WITH THE NEXT GENERATION NOT ONLY ALLOWS OWNERS TO GAUGE THE NEXT GENERATION'S INTEREST, BUT ALSO SHOWS POTENTIAL SUCCESSORS THE DIFFERENT ROLES THEY MAY BE ABLE TO ASSUME WITHIN THE ENTERPRISE."

Other areas to address when preparing for a business transition include:

- **Personal pre-sale planning:** In addition to business planning, owners should engage in personal pre-sale planning with an advisor well before a transaction to ensure they have achieved optimal tax efficiency.
- **Operator to mentor mindset shift:** If the leader decides to maintain family ownership in the business, they will have to prepare to take on the role of mentor. Doing so requires gaining comfort with the satisfaction of watching the next generation rise to the challenge and effectively lead their organization as owners and, in some cases, as management.

Owners must also shift from "calling the plays" to serving in an advisory capacity to help the next generation make those calls. How that shift ultimately plays out, however, is highly dependent on the needs and circumstances of the family and the business. For leaders who prefer their enterprise to remain family-owned going forward, many start the process with the belief that their greatest personal success was how they "ran the plays." By the end, their thinking often shifts to how they set up the family and the business for future success.

Preparing the next generation for success

Ninety-one percent of family business owners say it's important to keep the business in the family for the next generation.

For those leaders who want to maintain family ownership in the business, it is essential to prepare the next generation to assume responsibilities – yet 74% of business owners say that the next generation's roles are either not well-defined or not fully communicated. To help address this roadblock, here are some strategies for communication between the current and next generations.

- **Start by building a solid foundation of stakeholders' knowledge about the business** – everyone should understand what they own and why.
- **Identify and engage the next generation of owners** – even if their level of interest in the business is unclear.
- **Embrace stakeholders having their own interests, views, and values** – acknowledging that everyone has different views and needs when it comes to the business can lead to better decisions and better relationships.

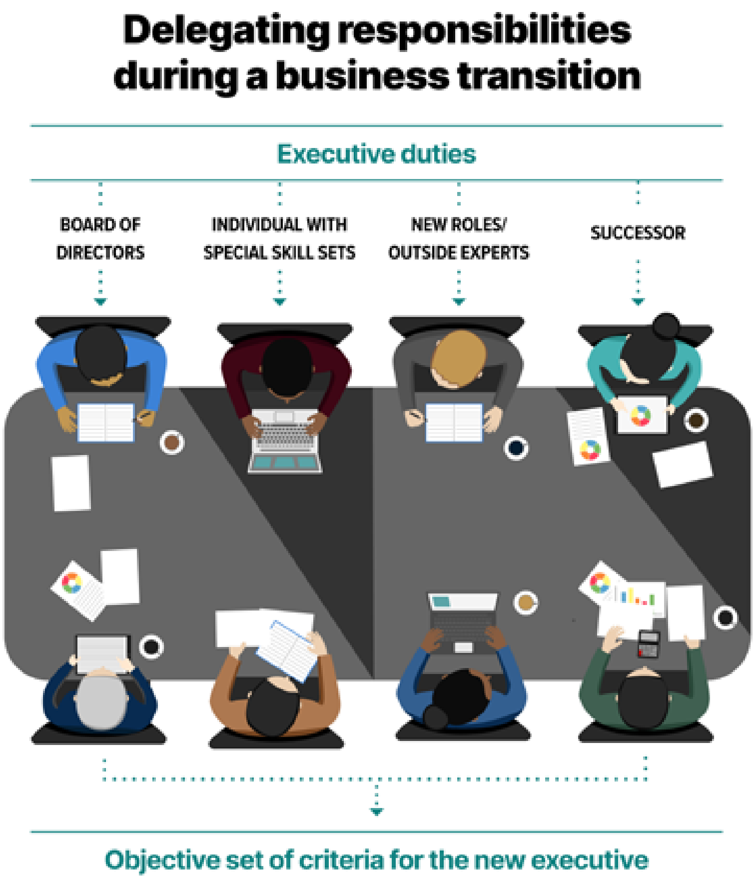
For a deeper dive into these strategies and more, read our article, "Strategies for Successful and Open Business Communication."

WHICH NEW ROLES DOES ONE NEED?

In situations where the owner is also vacating a management role, the owner must identify whether their role is fillable and whether the organization is structured to receive a successor. It's not uncommon for many family businesses to be built around the current leader, who often carries a broad set of individual responsibilities unique to that person.

In such situations, when leaders try to find someone to replicate their capabilities, it's impossible to identify a single candidate. As a result, the owner should conduct a self-reflection exercise in which they think about – and document – all the tasks they complete day to day. It is often illuminating to see everything on paper. Following this exercise, businesses can determine what responsibilities need to be shifted around or created in order to make the executive's position fillable.

For example, some responsibilities may need to be allocated to other individuals who have special skill sets or offloaded to the board or a management team. In other cases, new roles may need to be created and additional experts hired to spread out the responsibilities. What remains is what will be performed by the successor. The next step is to document a job description for the new executive that defines the new role that the business and leader are trying to fill – along with required skills and experiences. This provides an objective set of criteria that the business can point to for all candidates – both family and nonfamily – to illustrate the requirements of the role.



TAKE STEPS TO FILL THE VOID

In the case of a completed transition, there are generally three outcomes for the exiting leader who undertakes a sale or succession process:

- An ongoing advisor role in the business
- An advisor role that diminishes over time
- A clean break

In many cases, leaders can influence the outcome. If sufficient time and effort is invested in preparation, and the leader acts in a mentor capacity to the next generation of owners and/or management, then the next generation of owners (or buyers) will want to continue to leverage that experience. Conversely, there is a real risk that the next generation or a buyer does not see eye to eye with the leader, and that could abruptly end the leader's involvement. Regardless of outcome, the leader's responsibilities will shift.

So, how can those concerned with a loss of livelihood, enjoyment, or identity fill the void? While there will be many options, we recommend leaders consider a few points that we believe are important.

- **An exit from the business does not mean that the days of adding value to an organization are over.** On the contrary, there are many people who are interested in the experience of a leader who has successfully grown and transitioned a business. There are a multitude of opportunities to remain engaged through board membership or advisory roles.
- **Leaders should focus on what they want their post-transition life to look like.** Many owners determine that they are interested in building out a board presence or maintaining some other level of professional involvement where they can leverage their business experience and skills to help other companies grow. Or, they may finally decide to spend their free time pursuing nonbusiness-related activities that they never had time for in the past.
- **Meaningful "second acts" can be great.** We have assisted countless leaders with tackling this very challenge through conversations in which they identified interests, passions, and what is most important in their lives. We also leverage our network and expertise to help leaders find new opportunities such as board service, philanthropy, mentoring entrepreneurs, investing, creating family councils, and many others.

LAY OUT THE RULES OF ENGAGEMENT

Owners who are stepping down from their family business often want to continue to foster and nurture the next generation and remain involved in the business in some way. Doing so requires a different skill set than it did for ownership and retiring owners must substitute the skills needed for growth with the skills to mentor and support the next generation. Owners must think about how they will offer guidance to the next generation while also allowing them to successfully act as owners.

99% of current owners say they have taken steps to prepare the next generation to take over

No matter the level of involvement, it is critical that the previous owner's new role is clearly defined so they do not overstep any boundaries. They may have one vision of involvement, while the next generation has another, and it is critical that this is outlined and communicated.

This is particularly important for owners of family businesses, who need to think of how they want to offer themselves in support of the next generation of owners while allowing them to rise to the occasion and run the business. As uncomfortable as the thought may be, retiring family business owners should be prepared to hear about the level of involvement – or noninvolvement – the next generation desires. And it seems like these conversations are occurring: Despite the communication barriers discussed earlier, 99% of current owners say they've taken at least some steps to prepare the next generation to take over.

Overall, the adjustment can take some time. Ultimately, it comes down to respecting boundaries while being intentional about empowering the next generation and giving them the space to be successful.

PLAN FOR LIQUIDITY (DEPENDING ON YOUR STRATEGY)

There is one significant area where succession to family ownership and a sale of the business diverge: generating liquid wealth. Family businesses that seek to remain as such typically appreciate "patient capital" – meaning that they want family members to hold the majority of shares and continue passing them to future generations – though share redemptions and dividends are often present and important.

Owners who are transitioning ownership to the next generation should assess how much money they will need when they are no longer working. In the partial or full sale of a business, owners of substantial private businesses realize large inflows of liquid wealth in exchange for their shares in the business. In many cases, these sums of money can be life-altering. As such, it is critical that owners selling a business prepare for an influx of wealth in addition to planning for a shift in their role in a business.

CONSIDER WHAT ADVICE YOU WILL NEED

During a transition, it is important for owners to think about the areas of their post-transition life in which they will need assistance. It may be helpful for owners to have an objective advisor throughout the process of transition to go to for guidance, whether it's about collaborating with the next generation on a transition plan, navigating conversations with potential buyers, or developing their post-transition personal and financial goals.

Another consideration is tax strategy, especially possible tax benefits. In some cases, those selling a business already have advisors who can be very beneficial for maximizing tax efficiency pre-sale. For those who do not, interviewing and hiring one can help you manage your liquid wealth or help with any tax implications that may emerge when transferring the business to the next generation.

More sophisticated advisors can also partner with owners on:

- Wealth planning
- Next generation education
- Trust services
- Philanthropy
- Direct investing
- Creating a family office

Owners can assess all of the areas of need and determine where they are comfortable managing the process themselves vs. relying on others. Underlying this decision should be the core values of the owner, family, and business. Owners should think about what role they would like their wealth to play in their life, including that of their family, and make sure they make decisions around who to hire and how to manage their liquidity and future in alignment with their vision and values.

BRACE YOURSELF FOR CHANGE

Today, most information, including estimates of a person's net worth and the sale price of a private business, is one click away. The specifics around the cash proceeds of a business sale, from what was previously illiquid ownership value, can become public.

We find with many business owners who have a liquidity event, the requests for capital post-sale come rolling in quickly – whether they be to support a less fortunate family member, invest in a local business, or donate to a friend's favorite charity. Sellers may not be able to fully avoid this challenge, but they can certainly prepare themselves and, perhaps more critically, their children, for how to handle these situations when they arise.

77% of owners are concerned about the impact of their wealth on their children

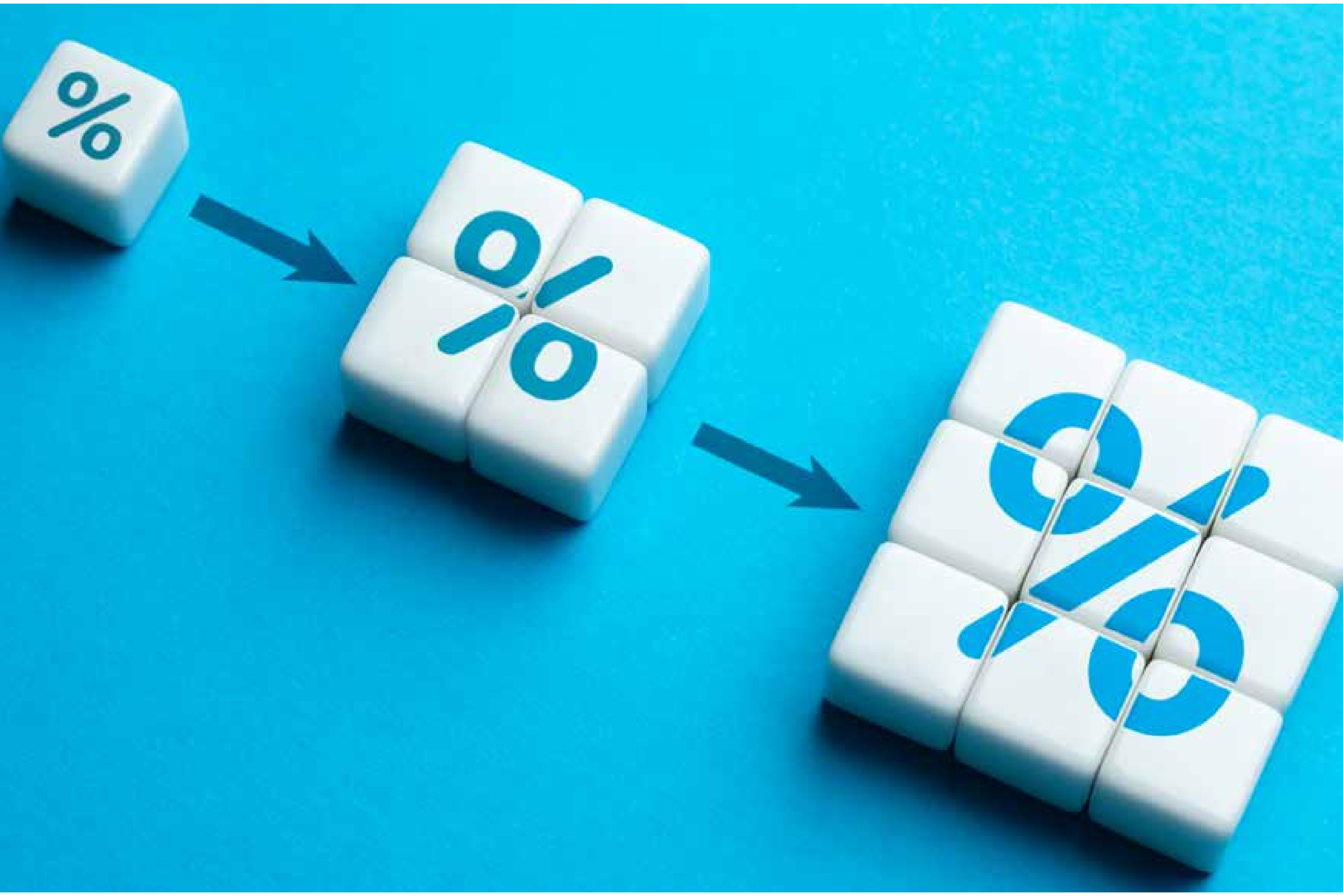
MAKE YOUR BUSINESS TRANSITION A SUCCESS

The axioms around failed wealth and business transitions are legion. At the highest level, success involves:

- Proactively beginning the preparation process
- Openly communicating with stakeholders
- Determining where to start
- Filling voids left from a change in one's livelihood

And remember to have patience – both with a lengthy process to ready oneself and the business for change and with answering the question, "what's next?" Investing the time in advance to develop an exit strategy and ensure a successful transition can lead to a renewed sense of purpose and personal joy for the leader as well as a bright future for the business and the next generation of owners and managers.

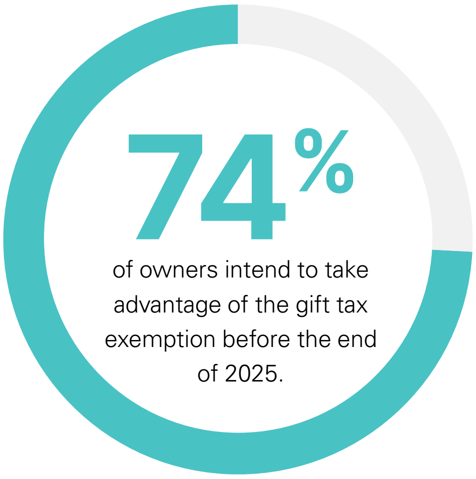
If you are thinking about embarking on a business transition, reach out to our Center for Family Business. We would be happy to help you.



How Business Owners Can Maximize the Gift Tax Exemption in 2025

Stacia Kroetz / Managing Director and Senior Wealth Planner

Thoughtful estate planning is essential for business owners who want to preserve the value of their estate, minimize transfer taxes, and ensure the smooth transition of their business to the next generation. As we approach 2025, understanding and utilizing the gift tax exemption is more important than ever. In our second annual Private Business Owner Survey, 74% of participants indicated an intention to do additional planning before the end of 2025 to take advantage of the historically high gift tax exemption amount.



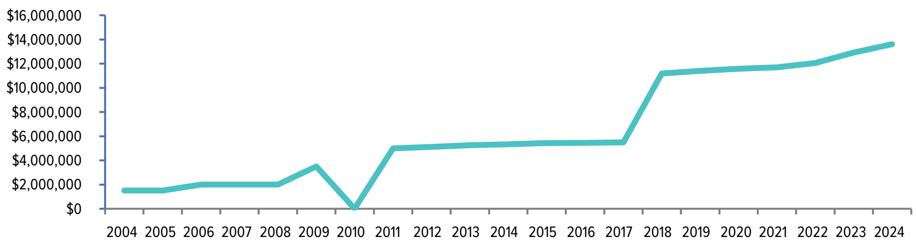
What is the lifetime gift tax exemption, and why are we focused on it now?

The lifetime gift tax exemption is an amount individuals can transfer to others without incurring a federal gift tax liability. In 2024, the exemption from gift tax is $13.61 million per person, or $27.22 million per married couple. Thomson Reuters is projecting the exemption to be $13.99 million per person in 2025, or $27.98 million per married couple. The applicable federal tax rate on transfers over the exemption amount is 40%.

Prior to 2018, the gift tax exemption was $5 million, adjusted annually for inflation. The 2017 Tax Cuts and Jobs Act (TCJA) doubled the exemption to $10 million, adjusted annually for inflation, from 2018 through 2025. Under the TCJA, the increased exemption amount will sunset (or expire) at the end of 2025. Unless there is intervening legislation (requiring some level of consensus in Congress and the White House), the outcome will be a federal gift tax exemption of approximately $7 million as of January 1, 2026 (or approximately $14 million for married couples).[1]

Note: These numbers are the same for the estate tax exemption, but this article focuses on lifetime planning.

Annual gift tax exemption amounts



See Section 2010 and Rev. Proc. 2023-34.

As a result, many individuals are considering making gifts up to the current exemption amount before that opportunity goes away in 2026.

Planning opportunities for business owners

For business owners, estate planning is not just about identifying beneficiaries for personal property or investment accounts. It often involves strategies aimed at:

- Transferring ownership of the business to the next generation
- Minimizing the tax consequences of such a transfer
- Planning for sufficient liquidity to cover estate taxes or buy-sell agreements
- Preparing for a smooth transition of operational responsibilities
- Communicating the plan to the family

The following opportunities relate specifically to business owners leveraging their remaining gift tax exemption to minimize the tax consequences of transferring ownership of the business to the next generation.

Gifting an interest in a privately held business is an effective way to use up one's exemption for a number of reasons, including:

- Reducing the size of your taxable estate
- Allowing future appreciation in the business to accrue outside of your estate
- Minimizing the family's overall tax liability

In addition, when you gift an interest in a privately held business, you must obtain a valuation for purposes of reporting the gift. When valuing the interest, appraisers take into account factors like the marketability of the asset and the control or voting rights associated with it.

Typically, appraisers will take a discount for lack of marketability when assessing the value of a privately held business interest. This is because there is not a readily accessible market for it in the way there is for liquid investments or publicly traded stocks. Appraisers will also reduce the valuation when the gifted interest is a minority stake in the company or does not have voting rights. The application of these discounts decreases the value of the gift for gift tax purposes, thereby maximizing the amount of the business you are able to transfer using your remaining gift tax exemption.

[1] *There is also a gift tax annual exclusion, which is $18,000 per recipient in 2024. Thomson Reuters projects the annual exclusion to increase to $19,000 per recipient in 2025. This article is not focused on the annual exclusion from gift tax because there is no expectation of a reduction to or loss of this exclusion.*

The most common way to transfer interests in a business is through outright gifts or gifts to irrevocable trusts.

- **Outright gifts:** The simplest option is to make an outright gift of shares of stock in a corporation or interests in a partnership or LLC. The recipient will be a new owner of the business. You will need to commission an appraisal to determine the value of the transferred interest and file a gift tax return to report the gift.

- **Gifts to a trust:** The combination of valuation discounts and gifting to a trust (rather than outright) maximizes the amount that you can transfer without the imposition of gift tax. It also minimizes not only your estate taxes, but those of future generations.

  In addition, the trust structure allows more than one person to benefit from this gift. For example, you could gift a 40% interest in your business to a trust for the benefit of your spouse and your descendants. The cash flow from that interest could be distributed to any or all of the beneficiaries of the trust, or it could be accumulated for the future. The appreciation in value of that business interest would occur outside of your estate (and therefore would not be subject to estate taxes at your death) and outside of the beneficiaries' estates (and therefore would not be subject to estate taxes at their death).

  If this transfer is made to a trust that benefits your spouse, commonly referred to as a spousal lifetime access trust (SLAT), then your spouse (and you, indirectly through your spouse, as long as your spouse is living and you are married) can benefit from distributions from the trust. This flexibility often provides comfort when making a large gift because it allows you to get assets (and future appreciation on those assets) out of your estate for estate tax purposes while still having a way to access those funds if necessary.

  You can maximize the tax efficiency of your gift by making it to a grantor trust, or one that requires you to pay income taxes, thereby allowing you to further reduce your estate and the trust principal to grow free of income tax liability.

Layered onto discount planning, some business owners have unique opportunities based on the structure of their business. For example:

Qualified small business stock (QSBS): If your shares in the business meet the requirements for QSBS, then not only can you use those shares to plan for your family, but you may also be able to reduce your eventual capital gains tax liability when the business is sold. The interest must be:

- Shares in a C corporation
- Acquired at original issuance directly from the company
- Operating a qualified, active trade or business
- With less than $50 million of assets at the time you invested
- Held for at least five years

Carried interests/profits interests: If you are a private equity (or other) fund principal with a carried interest, you can take advantage of the typically low initial valuation of your carried interest by transferring it, along with a proportionate share or "vertical slice" of all other interests you own in the fund, to an irrevocable grantor trust.

A practical example of gift tax exemption utilization

Imagine you own a family business with a fair market value of $100 million. You gift a 20% interest in the business to a trust for the benefit of your spouse and descendants. That interest would be worth $20 million if the business were sold tomorrow, but in valuing the gift, the appraisers apply a 32% combined discount for lack of marketability and lack of control. The result is a value for gift tax purposes of $13.6 million. Since the gift tax exemption is $13.61 million in 2024, you owe no gift tax.

In this example, you successfully transferred 20% of the family business out of your estate without the imposition of gift tax. If the value of the business doubles over the next five years and you decide to sell it, the trust's share will then be worth $40 million. That is $40 million that would be outside of your estate for estate tax purposes, and outside of your descendants' estates as well, if the trust was a properly created dynasty trust.

To further highlight the effectiveness of gifting interest in a family business, consider an alternative scenario: If you had instead gifted $20 million of cash to a trust for the benefit of your spouse and descendants, you would owe approximately $2.5 million in gift tax.

Conclusion

As we look ahead to 2025, we encourage business owners to consider leveraging their gift tax exemption. It is a powerful tool for those seeking to optimize tax efficiency prior to the exemption being cut in half on January 1, 2026 (absent intervening legislation). Effective estate planning minimizes taxes while helping to secure a stable future for both your family and your business.

If you have already used up your gift tax exemption, don't stress. There are some alternative strategies available – most commonly, sales to grantor trusts and grantor retained annuity trusts (GRATs).

These issues are complex and should be discussed with advisors who have deep expertise in these areas. If you have questions or wish to speak about anything covered in further detail, reach out to your BBH relationship team.

Neither Brown Brothers Harriman, its affiliates, nor its financial professionals render tax or legal advice. Please consult with an attorney, accountant, and/or tax advisor for advice concerning your particular circumstances.

A Look at BBH's Second Annual Private Business Owner Survey

Private businesses in the U.S. vary greatly in terms of size, sector, service, and product. So how do business owners plan for the future of their businesses and families based on common challenges?

- Governance structures
- Succession planning
- Long-term strategic objectives
- Capital needs
- Regulation and technology
- Strategies to handle complicated family dynamics

We set out to unearth how business owners think and feel about those challenges and opportunities and how it shapes how they run their enterprises. The respondents represented 400 U.S. private businesses with enterprise values from $10 million to $500 million and more.

The responses were fascinating. Here, we share some of the key highlights.

The state of the private business owner

In 2024, private businesses have grappled with geopolitical unrest in pockets of the word, volatility in the market, potential changes to the regulatory environment, an unprecedented presidential election season, and the evolution of how business is conducted and by who – or what. They face all this and keep their focus on the health and the future of their business.

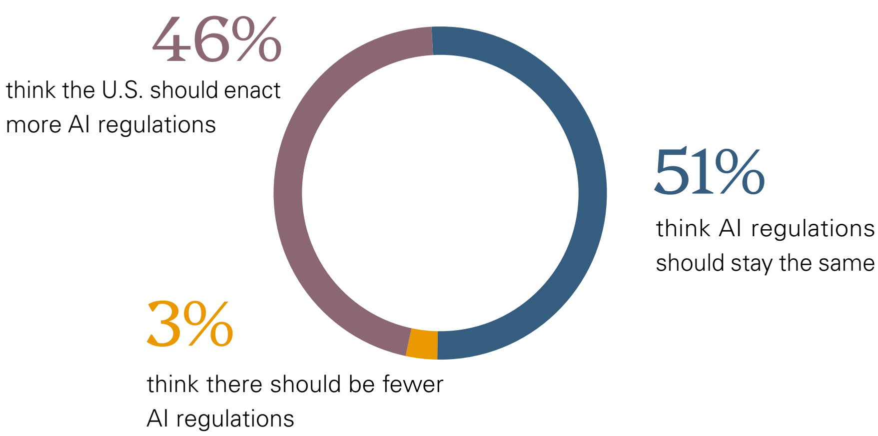
The top three challenges for private business owners are:

Economic instability and inflation

The rise of artificial intelligence

The political environment in the U.S.

Business owners are split as to whether there should be more artificial intelligence (AI) regulation.



Despite citing the rise of AI as a challenge, 99% are currently using AI for business purposes, including:

Automating processes 47%

Supply chain and inventory management 47%

Marketing/content creation 45%

Security and fraud prevention 45%

Customer service 45%

Data and predictive analytics 42%

Recruitment and retention 42%

And adoption will continue to grow, with business owners expecting to use AI in the following areas in the next 12 months:

Data and predictive analytics49%

Marketing/content creation 47%

Automating processes 46%

Customer service 45%

Security and fraud prevention 45%

Recruitment and retention 44%

Supply chain and inventory management 41%

Family businesses' unique challenges

While most business owners wish to keep the business in the family, many have yet to tackle the myriad complex issues around succession directly. For those who may believe a full or partial sale is a better option, there are still factors – a key one being the loss of identity – that prevent them from looking ahead.

Planning for the future of a business can be both challenging and emotionally charged; however, proactive preparation and open communication are the keys to setting up the business and family members for long-term success.

45%

say the top reason they would not consider selling some or all of their business in the next 12 to 24 months is that they identify with their business too much to give it up

91%

say that it is important for their business to remain in the family for the next generation

29%

are still struggling to pick a successor

For family business owners who want family members to fill critical company positions, the departing leader must identify whether their role is fillable as presently designed. Responsibilities often require division and delegation across several roles (some new) rather than handing them down to a successor.

While 99%

say they have taken steps to prepare the next generation to take over

74%

state that roles for the next generation are either not well-defined or not fully communicated

The business of running a family

The decision to establish a single family office to manage your wealth and investments is multifaceted. Often, it comes down to the services needed and the desire to devote time and money to building and running a sustainable family office – essentially a business – that will last for generations.

Single family offices are popular, but are not meeting the expectations and needs of private business owners.

34%

of private business owners rely on a single family office to manage their investable assets

But single family offices are falling short of private business owners' expectations, with the two biggest areas of concern being:

44%

Investment and manager selection

30%

Estate planning

How are private business owners responding to the year-end 2025 expiration of the current federal gift and estate tax exemptions?

74%

plan to engage in additional estate planning in order to take advantage of the higher exemptions

16%

plan to do nothing, citing their belief that the higher exemptions will not be reduced

Communicating about your wealth and your business

Articulating what is most important to you, your family, and your business provides a north star for decisions about wealth and planning.

While all private business owners have an estate plan, most haven't shared the plan with family. Their hesitancy results from concerns around timing, difficult conversations, or the plan's – and their own – readiness. Yet avoiding these hard conversations in the short term will only hurt family harmony and success in the long term.

100%

of private business owners say they have an estate plan, and

91%

say their plan is aligned with their values, but

97%

report there are factors that have prevented them from communicating their estate plan to family

The top two reasons are concerns if their plan is right and discomfort with emotions surrounding communicating their wishes

Most business owners have estate plans aligned with their values but may face challenges of their family having differing values as it relates to the company's mission.

36%

of private business owners say they have faced the challenge of family members having differing values as it relates to the company's mission

Families who run successful businesses often worry about next generation members being taken advantage of due to their wealth.

38%

of business owners are concerned that their family members could be taken advantage of because of their wealth

If you are interested in the full survey results, please visit the Second Annual Private Business Owner Survey page on BBH.com. In addition, we are happy to discuss the survey outcomes and what they might mean for you, your business, and your family, so please feel free to reach out to your BBH relationship manager.

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OWNER TO OWNER

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