BUSINESS SUCCESSION PLANNING

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From the perspective of a business owner, planning for business succession can present a daunting array of challenges. Perhaps that is one reason a significant number of owners fail to plan or do not plan adequately. Reputable survey information conducted over the years suggests that one-third to one-half of U.S. small businesses (defined as 500 employees or less) do not have a succession plan in place.

What should a proper succession plan do for a business, and just as importantly, for its owner or ownership team?

Establish Priorities

The place to start with any planning is at the beginning, and this means with the owner and his or her vision for the future of the business. What is the goal for the business – is it continuation with family members or an existing management team in place, sale to a third party buyer, liquidation or some other outcome? The desires of the owner or ownership team for the business are key to determining future steps. It is this goal which shapes the strategy for any business succession plan. It is important that the owner spend time with key professional advisers – attorney, accountant, financial and insurance advisors – so that owner desires and the pros and cons of various courses of action for the business can be carefully mapped out.

Maximize Business Value

Assuming that the business has value as a going concern and is likely to be sold or transferred, a major element of the succession planning process is ensuring the maximum value of the business. This includes a due diligence investigation of the business entity records, contracts, financial and operations information to ensure that all is in order and no unknown liability or other concerns lurk.

It also concerns the identification and safeguarding of valuable business assets, including intellectual property (patents, trademarks, trade secrets), business licenses and permits, key employee know-how and valuable business equipment.

Maintaining a broad perspective on the business, seeing it as others would see it, is necessary for objectivity. How would a third party buyer view it, based on its revenue and potential for growth, its existing customer base, the industry and economic conditions in which it must operate and the quality of its competition?

Engaging a business valuation specialist to assess the business is a further step in the process. Among the various methods of valuation, including market comparison and income method, one method may be most suitable to the business concern at issue and yield the best valuation for use in discussions with any prospective buyer. This assessment by a specialist may also yield insights into business operations which create further increase in value.

Identify the Successors

Candidates for successor to ownership may be grouped into four major categories: current business associates, employees, family members and outside third parties. Whether one or more of these categories would yield a suitable successor depends on a variety of factors which include the nature of the business and its value as a going concern, the current ownership and management structure and the desires of the owner for the future of the business.

Each group of potential successors would present its own unique challenges and opportunities for the owner. For example, transferring the business to other family members offers opportunities for wealth planning not available with the other candidates on this list, but may present some of the knottiest problems for a retiring owner. Are there family members with the proper skills to run the business? How will bringing in family affect other key employees in the business? How will internal family dynamics be affected if one family member is passed over for another in succession? These and other questions must be asked and answered by an owner who contemplates keeping the business in the family.

An arms-length, negotiated sale to a third party may be structured in a variety of ways and may offer the greatest financial

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return to a retiring owner. Negotiating the sale may take time and patience on an owner's part and require significant investigation of and by the prospective buyer. Such a transaction also raises questions for existing employees about what the future will bring, and for a customer base with loyalties to the retiring owner.

Integrate with Estate Planning

A going concern is typically an owner's most valuable asset, and this in turn can have major influence shaping the owner's estate plan. The business is likely to impact estate planning in one or more ways: the need for the efficient transfer of the business (avoiding probate); preservation of the value created by the business (including tax considerations) and maintenance of some form of asset control by the owner (avoiding dissipation of the value created through spendthrift and other protections).

Integrating these objectives with the owner's existing family dynamics can present major challenges in business succession and estate planning. These challenges include the blended families resulting from second marriages which are typical today, the marriage and divorce of children and the birth of grandchildren. In many situations, estate planning is part of and basic to business succession planning if the objectives of the business owner are to be realized.

Ensure Retirement Security

A common characteristic of many owners is that they have focused so intently on making a success of the business that they have failed to maximize the possibilities that ownership of a business offers for their own retirement planning. When it comes to such planning, business owners generally can be divided into two groups: those who have made the most basic retirement savings contributions (traditional IRA, Roth IRA) and those who have gone beyond and established defined benefit plans or non-qualified salary deferral plans which leverage compensation from the business.

A business succession plan may offer the opportunity to compensate for any shortcomings in retirement savings. Some owners may find it desirable (or even necessary) to negotiate an employment or consulting agreement with the new ownership team to continue working for a period of time after the transition.

If succession planning takes place sufficiently far in advance of the actual transfer of the business, it may be wise for the owner to consider establishing such plans as a SEP-IRA, 401(k) or defined benefit plan while there is the possibility for additional savings.

Other considerations for the retirement years are any continuing need for life insurance protection and the updating of estate planning documents such as the will and power of attorney to reflect the owner's post-transfer financial circumstances.