

SUCCESSION PLANNING – SEVEN STEPS TO CONTINUING SUCCESS

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◆ The Need For A Succession Plan

In addition to the issues of family succession, devising a succession plan is crucial in case of disability, retirement, death, or in the event that growth in your company changes your role away from “hands on” to a more managerial focus. Your successor can then assume your duties as a “doer” and free up your time so you can direct your attention to larger issues.

Business continuity planning not only benefits the withdrawing owners and their families, but also the remaining owners and their families, the employees, and the business entity itself.

The owner’s primary goals in a succession plan are:

- To stabilize the business
- To facilitate the transfer of the business in accordance with the owner’s wishes
- Minimize eventual estate taxes
- Maximize the wealth passed on to the next generation within the family

◆ Procrastination and Facing Reality

Many business owners may resist facing succession issues or feel they can delay thinking about it. Most family businesses have unique characteristics. Envisioning the future under new leadership is daunting. Owners who are accustomed to controlling and managing all aspects of the business sometimes have difficulty “letting go”. After all, the success of the business has been achieved largely through the total commitment of the owner-it’s the owner’s baby.”

STEP ONE: Developing the Plan – an Overview

The first question should be: Will ownership and/or management remain in the family and, if so, in what capacity? If your intent is to keep your business within the family, you’ll need to determine your family’s needs and interests

as well as the needs of the business. A family conference should be called to explore the relationship between the business and the family.

Ask yourself these questions:

- Who will ultimately own your company?
- When is the plan activated or how is it triggered?
- How will the price be determined?
- How will the purchase price be financed?
- What will be the effects of a change in ownership and management on the operation and value of the business?
- How will management retain key employees?
- Will your company have enough cash reserves to carry it through the transition phase?
- How can income and transfer tax be minimized?

STEP TWO: Gathering and Analyzing Relevant Data

Before a plan can be developed, goals and objectives must be identified, various Business and personal issues must be addressed, and a large amount of information must be gathered.

Compiling Business Data

You will need to analyze your company's financial position within the context of financial forecasts for your industry and the larger economy.

Training Potential Successors

While someone can instantly become the owner of a business, becoming an effective manager of that business is not an overnight process.

Compiling Personal Needs

Among the personal issues that need to be addressed are your financial needs and desires. How much money do you want or need to take out of the business? Will your withdrawal from the business be partial or complete? When will the withdrawal take place?

STEP THREE: Refining the Plan – Strategies and Techniques

Assuming the business will be sold, the strategies and techniques available will depend on the *form* of the business entity, and on determining *what* is being sold and *who* is the potential buyer. For example, is the sale an asset sale or a stock

sale? Is the potential purchaser another current owner, a family member, a group of key employees, or an unrelated third party?

Planning for the sale of a sole proprietorship does not offer the same flexibility as that available to partnerships and incorporated businesses.

In contrast to sole proprietorships are closely held businesses, in the form of partnerships and corporations owned by a small number of individuals.

Whether your business is a corporation, partnership, or sole proprietorship, tax issues are complex and can have a dramatic effect on the ultimate proceeds received from the sale or the accepted valuation. It is imperative, therefore, that you consult with your financial advisor and especially your attorney.

STEP FOUR: Valuation Methods

The following are some of the valuation methods you can use when selling your business:

1. Fix the price. Many owners simply “fix” the price of their business. although it is more common, and better, to obtain a formal business appraisal.
2. Establish the value of the company based on book value.
3. Fix the price by capitalizing the earnings of the business.

STEP FIVE: Buy – Sell Agreements

In its simplest form, a buy-sell agreement is an agreement between two or more parties, whereupon a triggering event, one party has an obligation to buy and the other has an obligation to sell his or her interest in the company. Do not consider drafting a buy-sell agreement without consulting your attorney.

In addition to fixing the price, one of the more important purposes of a buy-sell agreement is to restrict ownership. While business owners usually don't intend for the ownership interests to fall into the hands of someone who is not part of the succession plan, this may indeed happen despite good intentions. With closely held corporate stock, it is generally advisable to try to prevent passing of such stock to a third party by placing a restrictive legend on the face of the stock.

Three general methods for structuring buy-sell agreements within a company:

1. The first technique is called a redemption or entity purchase agreement because the entity (the company) is the purchaser.

2. The second technique is a cross-purchase agreement, which is a buy-sell agreement solely among shareholders.
3. The third technique is a hybrid or combination agreement in which both the business entity and the remaining shareholders agree to buy the withdrawing shareholder's stock.

Wait-and-See Buy-Sell Agreement

A variation on the traditional buy-sell theme is what has been called a "wait-and-see" buy-sell agreement. In this arrangement, the business owners mutually agree to buy and sell their respective business interests under specified conditions.

STEP SIX: Funding The Agreement

An agreement would not be complete without addressing how the purchase price will be paid. Two of the most common funding vehicles are life insurance and ESOPs (employee stock ownership plans).

Life Insurance can be a simple funding vehicle that is relatively easy to administer.

The availability of death benefit from life insurance ensures that adequate liquidity will be available when an owner dies, thus avoiding a potentially adverse impact on working capital.

Another source of funding is an ESOP (Employee Stock Ownership Plan).

This is an employee benefit plan designed to invest primarily in the stock of the sponsoring business.

STEP SEVEN: Estate Planning Issues

Early in our discussion, we stated that an important goal in a succession plan was minimizing eventual estate taxes. However, estate planning for business owners involves a consideration of non-tax objectives along with the goal of limiting the size of the taxable estate. Some of the non-tax objectives, such as to whom property will be transferred, and whether such transfers will take place during the lifetime or at death, will have been addressed in the early phases of developing the succession plan. Divorce and second marriages can complicate succession planning and present special estate planning challenges. For example, a business owner who remarries may want to leave her business to her children, while her new spouse may be more interested in how the succession plan provides for him and his children.

Your Business is an Asset

Since an owner's interest in the business is an asset included in his estate for estate tax purposes, the value assigned to his ownership interests will drastically impact the tax eventually paid by the estate.

Family Limited Partnership

Among the vast array of estate planning techniques available, the use of a **family limited partnership (FLP)** merits special consideration because it is an attractive vehicle for both managing a family business and for protecting an owner's wealth.

As a wealth transfer tool for managing the family's enterprises, the FLP maintains control through the general partner. The business owner can give away partnership interests, thereby reducing the size of his estate for estate tax purposes while retaining control of the operations of the business.

SUMMARY

We have taken you on a long journey, starting with some general considerations and progressing through specific strategies. Some of the topics covered may seem like "common sense" issues, but good sense is anything but "common" when it comes to family business planning.

The major point in all of this is that it is absolutely essential that you use a cohesive "team" of experienced problem solving professionals to help guide you in crafting your unique succession plan, remembering the main theme of this discussion is far more important than any of the details. The two most common reasons for the low rate of successful transitions in closely held businesses are failing to plan, and attempting to implement a plan in the face of unresolved family conflicts. Although you may be years away from a planned withdrawal from your business, sudden illness, disability, or death can force your "untimely" withdrawal. So get professional advice and start your business succession planning now!