Getting Started: Plan Your Business's Succession

~ E. John Wagner II

Business owners often find succession planning baffling. Clients call us, incredulous, asking why so many consultants are pushing them to address a problem they don't understand. And when they do understand, they often fear the process will cause more near-term problems than long-term benefits. They ask, "What is business succession planning, anyway?"

Business succession planning is the process by which business owners determine the manner in which new management and ownership will replace current management and ownership. It can take many forms: It can address a near-term change in control, ownership, or management. It can also consider a transition far into the future, but still include plans to keep the business alive in the event of an unexpected death or disability, which could lead to the erosion of the company's core principles. Business succession planning seeks to maximize the value of your business to you and to future generations of your family.

Successful business succession planning works differently for different people. At Williams Parker, we find the most successful business succession plans result from active thinking by business owners who set their own goals, then connect their succession plans to those goals. Let's look at a typical process we would use to develop such a plan for your business.

Set Goals

As a business owner, once you understand the concept of business succession planning, your next logical step is to decide how such planning fits your specific needs.

If you are a relatively young owner of a growing business, you may not contemplate a change in ownership or control for many decades. You may, however, undertake business succession planning to deal with the possibility that your health will deteriorate or that you will die prematurely.

But if you are a mid-career owner of a valuable or rapidly growing business, you may undertake business succession planning in anticipation that your business will create estate taxes many years in the future. Here, you may wish to reduce that estate tax burden by divesting yourself of ownership at an early age.

And if you are a late-career owner, you may undertake business succession planning to create liquidity for retirement or to minimize estate taxes. You may want to transition the business to younger family members so they can continue the business even after you retire. Alternatively, you may seek outside capital to grow your company to better position it for sale to an outside party before you reach an age when you no longer wish to manage the business.

Depending on your age and the particulars of your business, you will likely develop a succession plan distinct from owners at different stages of their lives—an appropriate strategy because individual owners have different goals. Knowing your goals is essential: it allows you to select the right planning tools to meet your needs.

Connect the Right Business Succession Tools to Your Goals

Once you decide on your goals, the next step is to gather information about the tools that will best serve those goals. Attorneys, accountants, and financial advisors can provide valuable input in the information-gathering process. Your advisors should also take the time to understand your goals so each can recommend appropriate tools.

The young business owner planning more for unexpected disaster than near-term retirement may build a plan around retaining a few key employees who could operate the business if he or she could not continue to do so. The owner might combine that personal planning with disability and life insurance to provide for the needs of his or her family if they can no longer rely on income from the business. Insurance may fund a buyout of the business by other owners or by key employees who would purchase the business in those circumstances. Agreements setting forth the terms of such purchases and sales can help smooth the transition and improve the family's negotiating position when contemplating a business sale in the face of an unanticipated event.

The business owner seeking to grow the business for a future, value-maximizing sale may have the same agreements and insurance policies in place. This owner, however, will undertake a more elaborate planning process that involves raising capital to fund the growth of the business. To make the business attractive for investment by private equity firms, venture capital firms, or private investors, this business owner may improve the business's accounting processes. He or she may engage an accounting firm to perform an annual audit to increase the credibility of the company's financial statements to potential investors. The owner also may contact industry groups to test the market for future potential buyers. This step would ensure that the owner has realistic expectations regarding pricing and the most desirable size of the company. Taking these steps will enable the owner to develop a business plan that will be more attractive to potential investors. The owner will improve his or her chance to raise capital to fund the growth for the future "exit" he or she desires.

Business owners planning to transition ownership and control to another generation of their families will undertake a very different process. To maximize financial value, these owners will likely rely on planning that involves trusts, intra-family sales, insurance, or some combination of these tools to minimize estate taxes and to ensure they have sufficient wealth to provide for their own needs for the remainder of their lives. While the financial plans may be complicated, there are well-established planning techniques that owners can understand and implement with a little patience. Often the far more daunting task is maintaining family harmony throughout the transition. Each owner must decide who will receive ownership interests in the business and who will control the business at the next level. If only some family members are involved in the company's day-to-day operations, the owner must decide how to equitably compensate those family members for their labor while still treating the inactive family members fairly. Different plans work better for different families. Business owners must understand their families' values to make the best decisions.

Be Proactive

No matter what your reason for business succession planning, be proactive. Set your own goals. Set deadlines. Create your own process that suits your needs. When meeting with your advisors, express your goals. If an advisor tells you that you need an ILIT, GRAT, IDGT, SCIN, private annuity, or anything else with a catchy name, stop the conversation and ask how the suggested tool fits your needs. Each business succession planning tool can be effective. Each, however, is useful only to solve certain problems. If you don't have those problems, then that particular tool may not serve your goals.

As you move ahead with business succession planning, don't forget the old saw, "The perfect is the enemy of the good." You cannot anticipate everything that will happen. You cannot always control your own health or the health of others. Your business could have significant, unexpected setbacks—or it could have serendipitous windfalls.

Do not use uncertainty as an excuse to procrastinate. You should update your business succession plan periodically. Taking advantage of what you know and can control, you can develop a plan that fits you and your business for the foreseeable future, knowing you can adapt it as your personal situation and your business evolve.

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