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Five Steps to Business Succession Planning

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You already may have resolved to create and monitor your business plan and develop a succession plan for your business. The first part of the resolution is fairly easy to achieve. After all, everyone with a business needs a business plan. But few of us really consider what would happen to our business – and our families, our employees and their families – if something happens to us. They might be left without adequate resources to survive or the ability to have jobs or continue generating income. The fear of something bad happening to our families or staff should be sufficient motivation for us to begin building our business succession plans, shouldn't it? Yet, more than fear should motivate us. We should want to pass our business to our families or others in a way that leaves something for us as well! Whether that something is monetary or an excellent reputation of quality work and products or a combination of both, we should want to leave a legacy that survives us.

We need an exit plan for our business, which usually implies a sale or a merger or acquisition of the business. It may even indicate an initial public offering, although that strategy is now reserved for a very select few. Instead, our exit plan should anticipate what will occur – in an orderly and thoughtful way – when we are no longer involved in the business.

Here are five basic steps you can take to build a successful exit plan that allows your business to survive you and thrive:

1. **Plan Now for Yourself and Your Family**. If you've accepted the reality that you will leave your business at some point in the future, you will want to determine your planned exit strategy and retirement date and the amount of income and resources you and your family will need following that date. A financial planner will be able to assist you in establishing your goals and objectives and plotting the strategy to meet your needs. Your ultimate goal should be financial independence. That is, you do not want to depend on the government or other individuals (including your kids) for your survival and happiness. If the business can be sold to a third party, you may want to ensure that your valued employees will be retained after you depart and that you will generate enough cash after taxes to maintain your quality of life. If the business is not capable of being sold or if you want to pass it onto family members and/or employees, you may want them to purchase your ownership interest over time in a manner that does not jeopardize the business or your ability to be paid. And, you should plan for the possibility that you may not survive to your planned departure date. In other words, make sure you have adequate life and disability insurance in the proper structure and vehicle for the possibility of an early exit.

2. **Determine the Value of the Business and Adjust Your Goals.** You should determine the value of your business from two perspectives. First, what is the business worth if you wanted to gift shares of ownership or if you passed away? A qualified appraiser can assist you with this task, particularly if the benefit of this exercise is worth the effort and cost. The valuation approach used for gift and estate tax purposes is based upon accepted IRS rulings and case law and often differs significantly from the actual value of the business if it is sold. An investment banker or qualified business broker can assist with the task of valuing the business for current sale. Really, the business is worth what a willing buyer will pay you – no more, no less. You should surround yourself with a team of competent professionals – before, during and after the valuation process – to assist you in fine-tuning your goals and objectives, both from a

personal perspective and from the perspective of running the business after you are gone. The team – consisting of a business, tax and estate planning attorney, your tax accountant and your financial planner (and potentially an insurance agent who is experienced in business succession planning) – should meet with you at least once per year to guide you on your path to the exit ramp. Their guidance will include tax planning strategies that minimize income and estate taxes for your and your family.

3. **Don't Forget About Your Staff!** One of the greatest lessons I have learned in as a CPA and lawyer has been to hire someone to replace me, someone who could do my job as good as or better than me. I've learned that no one is irreplaceable and everyone should have someone working with them who can do the job better. That approach will ensure the long-term success of your business and will inspire growth. In taking that approach, you need to take care of your people. This starts with compensation and rewards for excellent performance and extends to benefits, such as paid time off, health insurance, life and disability insurance coverage, participation in qualified retirement and profit sharing programs, and may include the ability to earn ownership in the business or participate in other equity incentives. Involving your professional team at the early stages of this phase is extremely important. I've seen (and corrected) myriad errors made by entrepreneurs when they use "boilerplate" plans developed for other businesses to incentivize their own staff.

4. **Determine How to Exit Your Business.** If the business is being sold to an outsider, you've settled on a straightforward and hopefully uncontroversial exit plan. On the other hand, if the business is being transferred within the family, a whole host of issues arise. For example, if one child is deeply involved in the business to the exclusion of the other children, you may need to equalize your estate by making gifts or bequests of other property to the other children if the involved child is going to receive your share of the business. Further, if more than one child is involved or if you want to control the behavior of the involved children, you may want to transfer your ownership interest in the business to a trust for the benefit of the involved children or for all of them. Drafting these trusts and the succession planning relating to the trusts becomes particularly challenging if you want to retain control of the business until your death or your spouse's death. You must carefully consider estate taxes and income taxes when engaging in family business transfers, because you do not want your heirs to be forced into selling a lucrative business to pay the transfer tax liabilities generated at your death (or during your life in the case of gifts). If an intra-family sale is not for you but you are contemplating selling the business to the employees, a variety of options exist. These options may include employee stock ownership plans, buy-sell agreements funded with life and disability insurance and many other vehicles.

5. **Draw Up the Documents!** Have your business/tax/estate planning attorney draw up the business succession documents. And have them reviewed by your advisory team for consistency with your financial, tax and business goals and objectives. Then, you should work with the team annually, as noted above to refine the documents as your goals and objectives change over the years. It is not too early to begin your succession planning!

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