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Business Succession Planning 101

Article By
Mark Ludolph
Heyl, Royster, Voelker & Allen, P.C.
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A well structured succession plan is critical for businesses that want to survive from generation-to-generation, while seeking to maximize value for the business. Creating an effective succession plan presents a series of specific challenges for closely-held and family owned businesses. Strategic planning, corporate and business organization structure, valuation, tax implications, estate planning, identifying talent, client relations, financing and transactional work all intersect during the succession process.

When should businesses begin succession planning?

There is an old Chinese proverb which states, “The best time to plant a tree was 20 years ago. The second best time is now.” While there is no single correct answer for every business, it is important to provide the business with sufficient time to address all necessary considerations as well as sufficient time to overcome any unforeseen complications which may arise.

What are the necessary first steps in developing a succession plan?

Businesses need to identify their future objectives and incorporate the succession plan into the business's overall business plan. The first generation (Generation One) needs to determine how the business plan impacts his/her retirement or other financial goals. Obviously, Generation One wants to maximize their return on the value of the business. The second generation (Generation Two) needs to identify the long-term goals of the business and pursue a succession plan which allows the business to achieve those goals. It is vital that the acquisition of the business does not place insurmountable financial restrictions on the business which would prevent it from achieving its long-term goals. The business will want to coordinate these efforts with its accountants, attorneys, lenders and other consultants in order to assure that all necessary stakeholders' interests are protected.

What are potential elements of the plan?

While there is no "one-size-fits-all" approach to succession planning, there are a number of elements which are typically addressed. The Generation Two successors, either from inside or outside the organization, and their roles in the organization need to be identified. The role, if any, that Generation One will play in the ongoing operations needs to be clarified. A determination of the appropriate corporate structure for both the transfer and the ongoing business will need to be made. Ultimately, the necessary elements will need to be included in a buy/sell agreement which sets the price. The timeline for this agreement needs to provide sufficient flexibility for change due to unforeseen circumstances, but also provides sufficient structure to move the succession plan forward.

How should the business be transferred?

There are a number of options available to effectuate the transfer. A sale of the stock may be the simplest. A sale of assets may be more advantageous under certain circumstances. A gift or bequest may be an option, but can be complicated by probate issues. Any sale would involve financing. Third-party financing will necessitate the involvement of a lender early in the process. The lender will likely have a role not only in financing the sale, but also in providing financing to the business for its ongoing operations. Self-financing may also be an option, but will require informed buy-in from both Generation One and Generation Two on the structure of the financing agreement. The tax implications for the transfer will vary depending on the form of the transfer and may make certain options more favorable than others.

Ultimately, succession plans are as varied as the businesses who require them. It is vital that any business pursuing a succession plan consult with its professionals (accountants, attorneys, consultants, etc.) in order to develop a plan which achieves its goals while successfully balancing the sometimes disparate interests of Generation One and Generation Two.

This article was adapted from a roundtable discussion presented to the Peoria Chamber of Commerce by Mark Ludolph, Tim Kirk and Ken Davies from Heyl Royster and Mark Dalbey from CliftonLarsonAllen.