The Simple Truth About Business Succession Planning

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While the majority of family business owners would like to see their business transferred to the next generation, it is estimated that 70% will not survive into the 2nd generation and 90% will not make it to the 3rd generation.

--Family Firm Institute www.ffi.org

<u>What is Succession Planning?</u>

Succession Planning involves two components: **Management Succession** and **Ownership Succession.**

Management Succession Planning is the thoughtful consideration and development of a plan to **continue the day to day management** of an enterprise in the event of several life occurrences, such as: death or disability of a venture's key leader(s); unexpected termination of a leader's services due to employment opportunities outside the venture; or the natural and eventual retirement of a leader.

Ownership Succession Planning is the thoughtful consideration and development of a plan to transfer **ownership** of an enterprise in the event of several life occurrences, such as: death, disability or retirement of an owner(s), or the desire of an owner to simply leave the business and cash out.

Ideally, a well planned and executed succession plan or exit strategy places the business owner in the best possible position to maximize the financial return on the company, and facilitate the long term perpetuation of the business as might be desired.

In essence, Succession Planning is a process that is intended to create a desired future for the business well beyond the current owner's day to day managerial involvement.

<u>Foundational Principles</u>

The process of succession planning is grounded upon a few simple principles:

1. Defining personal hopes, goals, desires, motivations and intentions.

2. Inviting, encouraging, allowing and listening to the hopes, goals, desires, motivations and intentions of other critical stakeholders (family members, partners, key employees, etc.).

3. Identifying, discussing and evaluating the possibilities and options under a variety of scenarios.

4. Consulting with and allowing your professional advisors to offer input on financial, tax and legal aspects of the various succession alternatives.

5. Deciding upon a reasonable and realistic plan of action.

6. Putting the plan into writing.

7. Revisiting the plan annually.

Managerial Succession Options

Managerial Succession Panning involves: (i) building a leadership pipeline/talent pool of key employees and executives to ensure managerial continuity by developing potential successors in ways that best fit their strengths; (ii) identifying the best candidates for future key managerial positions, (iii) determining the core competencies (knowledge, skills, education, and traits) associated with each key managerial position; (iv) assessing possible candidates' core competencies; and (v) a developing specific and individual development plan for each candidate that outlines an educational process to prepare each candidate with knowledge and skills to do the job of the future.

Succession planning recognizes that some jobs are the lifeblood of the organization and too critical to be left vacant or filled by any but the best qualified persons. Effectively done, managerial succession planning is critical to mission success and creates an effective process for recognizing, developing, and retaining top leadership talent.

Business Ownership Succession Planning

Business Ownership Succession Planning typically involves consideration of the following eight (8) options:

1. Sale to an existing partner;
2. Sale or other transfer to family member(s);
3. Sale to key employee(s);
4. Sale to a competitor, another industry player, or individual;
5. Putting professional management into place;
6. Going public;
7. Liquidating the business; and
8. Doing nothing, waiting and seeing what happens, and then choosing among the best alternatives that appear.

Sale to Existing Partner

Most business partnerships (a business venture where two or more persons agree to carry on a business with joint rights of management and control) begin with a legal agreement outlining the process for selling a partnership stake to a remaining partner(s) upon certain occurrences such as death, disability, involuntary transfer, or retirement. When this document exists, the details of the process (often including the buyout price) are already established. Where one does not exist, it is highly desirable to create such a document, commonly referred to as a "buy-sell" agreement.

One key benefit to selling to an existing partner is that it usually results in the least disruption to the business, clients and employees.

Sale/Transfer to Family Member(s)

This option is ideal when there are family members who are interested, have been working in the business, and are knowledgeable and capable of running the business in the absence of the primary owner.

Family sales or transfers, however, rarely result in top dollar sales. However, such an exit strategy does provide flexibility in determining future involvement in the business and typically creates a smooth transition for family, customers and employees.

This option can also allow for the retiring family member to enjoy a continuing income stream after retirement if planning occurs well in advance of the anticipated retirement date.

A key success factor under this option is to have the junior family members well trained and exposed to all facets of the business, as well as, have in place: (i) a viable long term strategic plan, (ii) annual business operating plans with goals; (iii) an agreed upon set of leadership principles and values, and (iv) a healthy process of communication and conflict resolution to facilitate meaningful discussion and dialogue. Often, family businesses retain an experienced business facilitator who can lead family members through this form of business succession planning process.

Sale to a Key Employee or Employee Group

This may be an option when a trusted employee or a group of employees desire to take over the business. Sales to a single key employee or to an employee group do occur from time to time, but they require advance planning and the active recruitment and incentivizing of the right kind of younger employee or executive group that possess the inner strength, knowledge, motivation and ability to be business owners. A limiting factor with this option is that the acquiring employee or employee group must have access to capital and borrowing capacity. This option affords many of the same advantages of selling to family member(s) including flexibility and smooth transition.

Sale to a Competitor, Another Industry Player or a Third Party

This option is viable and desirable if the business: (i) is in a hot or growth oriented market, and (ii) possesses unique features such as a steady income stream, a specialty product/service, or valuable intellectual property, etc.

Often the sale to a third party allows the selling business owner to take a position with the newly merged company, and is an attractive option for sellers who want to stay in the industry and are comfortable relinquishing ownership in exchange for a financial payoff and the satisfaction of being part of a larger business with additional capabilities, market reach, competitiveness and profitability.

On the other hand, the sale to a third party without future involvement in the continuing business is a highly desirable and eagerly sought after goal for many business owners.

This option requires that the business have in place business processes, systems, management plans, goals, and structures, as well as, a pool of highly talented employees that will attract potential buyers.

Put in Place Professional Management

Some business owners find it acceptable to continue the business, but to do so with professional managers or executives in place who run the day to day affairs of the business while the business owner provides periodic oversight of the business, usually, by creating a board of directors or advisors, chaired by the business owner that meets regularly to oversee the actions and performance of management.

Often this option is an intermediate step to the sale to a third party or to key employees.

Go Public

This option involves offering ownership in the company to multiple third parties, typically highly sophisticated "Wall Street" type investors.

This option is expensive and is rarely an option for small business enterprises.

Liquidate

One of the options of last resort, and a common alternative for small businesses with significant weaknesses or solvency issues, that may require an immediate exit is to simply "close the doors" and liquidate or sell the assets of the business.

Liquidation may allow for the quickest and easiest exit allowing the owner to recover some value while avoiding investing additional funds before leaving the business.

Do Nothing, Wait and See

The final business exit or succession strategy is to do nothing. This option involves simply continuing the business and allowing natural life and market forces to occur and affect the business.

This option is not the most desirable, often having catastrophic or adverse consequences for the business owner and/or the owner's surviving spouse and family members, not to mention the business customers and/or clients.

Other Considerations

Succession planning also involves finding ways to make a business profitable and marketable by focusing on the following factors:

Potential for Profitability: purchasers will want to feel confident in the ability of the business to continue to make money in the future. Evidence of reliable cash flow and revenues, and profitability through challenging economic times greatly encourages potential buyers.

Potential to Grow: evidence the business can continue to make profit and thrive in the future. Sellers who can offer buyers a focused plan for growth, which might include strategies such as acquiring competitors or expanding a product or service, will have an easier time selling the business.

Seller Financing: a seller willing to finance part of the sale price and allow the buyer to pay back with interest later may have an advantage.

Physical Assets for Debt Financing: because banks may be more cautious about business financing in challenging economic times, businesses with greater amounts of tangible assets – such as capital equipment or owned real estate – may have more success in securing purchase loans.

Strong Brand or Loyal Customers: strong brand equity or a loyal customer base can be very appealing to potential buyers, depending on the industry.

Under this succession or exit strategy, the focus is on the planning and implementation of performance improvement and growth initiatives.

<u>Things to Do Now</u>

Here are several best practices you can undertake now while you are contemplating your specific managerial or business succession/exit strategies:

1. Begin the succession planning conversation with yourself and others. Thinking and talking now about succession planning leads to the ultimate formulation of future intentions and a definitive plan which would not emerge without a starting point of reference.

2. Convene a third-party facilitated company retreat focused on succession planning. Hire a professional experienced in succession planning to help guide the conversation and create a succession or exit strategy. Note, some of the conversations and issues which you must address may be difficult to confront and hard to have in a meaningful and thoughtful manner without third party assistance. A facilitator can frame issues and set the stage or having these crucial conversations while bringing knowledge to the deliberations.

3. Do the things now that are necessary for the success of your business:

    a. Develop and implement a Strategic Plan;

    b. Create and implement annual business operating plans, goals and initiatives;

c. Create, document and follow sound business practices, systems, and processes; and

d. Identify your potential "in-house" successors and provide them with meaningful assessment and executive education opportunities.

e. Assure that you keep track of your financial performance, by creating a historical database of key performance indicators that will facilitate third party understanding of the value of your business over time.

If you want to learn more about succession planning/exit strategies, contact the author below for an initial, free, confidential assessment and exploration of other advanced principles and options that may be appropriate for your particular needs and desires.