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Giving Them the Business: Ensuring a Smooth Transition When It's Time

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Unfortunately, most business owners fail to plan for the continued operation of their business should they become incapacitated or die. Only 30% of family-run companies today succeed into the second generation, and only 15% percent survive into the third generation. More often than not, the failure to plan is psychological.

Contemplating one's mortality is generally not considered to be a favored activity. Moreover, some business owners identify so closely with their business that they simply cannot comprehend the idea of their business being operated by anyone other than themselves. Others believe they have plenty of time to plan. When a business owner becomes incapacitated or passes away without a plan in place, the business always falters and often fails.

A successful business succession plan includes a number of events that are carried out over time, as opposed to an emergency fix based on an unexpected crisis. The generally recommended time to plan for business succession is between the ages of 55 and 65.

Some succession consultants recommend a 3-5 year plan, while others advocate a 5-10 year plan. The success of the plan is almost always directly related to the amount of time allotted for planning. Adequate planning time allows a business owner to test potential successors in different roles and to evaluate their maturity, commitment, business acumen and leadership abilities. Further, once a successor is chosen, adequate planning time allows the successor to build up expertise so that the business does not falter when the former business owner leaves the business.

When formulating a succession plan, the business owner should begin by organizing their thoughts about when they want to step away from the daily operations of the business. The business owner will want to decide how long he wants to remain active in the company and in what capacity. Then, the business owner should discuss his ideas about the future with his family, senior management team and key employees.

Once these parameters are established, the business owner should begin revising his business plan, or establishing one if need be. Here, it should be noted that business owners prepare the most effective plans when they prepare the plan in conjunction with the successor, thereby allowing them to include any future new products, plans for expansion, growth or new investment, and a candid assessment of the company's current environment and competitive positioning.

More often than not, the head of a family-owned operation chooses

a child as successor. Commonly, more than one child is competent to step into the parent's shoes, which makes the selection process even more difficult. When a family member is not available, a key employee from middle or upper management often fits the bill. Typically, these employees have already displayed the abilities necessary for operating the business.

Once a successor is selected, the business owner should develop a financial strategy for turning over the business. Perhaps the most significant activity associated with succession planning, a financial strategy protects the company, the family and the employees against a monetary burden that could doom the entire process to failure.

For example, if a business owner intends to leave the business to his children, he must be sure to consider any estate taxes his children may face upon his passing that may require the liquidation of the business, despite his best intentions.

Regardless of who “inherits” the business, it is critical to obtain an accurate valuation of the business. Such a valuation encompasses tangible assets, such as real estate, buildings, machinery and equipment, as well as intangible assets, such as employee loyalty, manufacturing processes, customer base and business reputation, patents on products and new technologies. As there are many different factors that affect the value of a business, employing a professional valuation company to obtain a supported figure is recommended.

Once the business has been valued, it is necessary to determine the method of transferring the business. Some of the options for transferring a business include: (1) gifting; (2) the use of a trust; (3) buy-sell agreements; and (4) life insurance funded plans.

There are many different methods, and one factor that will strongly influence this decision is the successor. Surely, there would be a difference in the plan that gives the business to children or family members and the plan that requires a third party to buy out the business owner’s interest. When transferring to a child or related party, the business owner may gift some of the business’s value whereas when transferring to an independent third party, the business owner would most likely want to be paid the full fair market value of the business.

As various plans may be established and the specific situation of the business is always a factor, each different type of plan must be reviewed on its own merits given the particular situation. The process of choosing a succession plan involves numerous factors and there are many pitfalls along the way; therefore, it is best to allow as much time as possible to plan and make the transition. By doing so, the business owner can ensure the vitality of the business for many years to come.

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