Take Time to Protect Your Business with Succession and Exit Planning

Entrepreneurs often risk everything in pursuit of a dream and those who succeed are an inspiration for future generations. As business grows and owners deal with the daily aspects of running a business, personal financial planning (including the most important aspects of succession and exit planning) may take a backseat due to "hotter fires burning." Not only does it consume their hearts and souls, but typically a significant amount of their personal net worth may be wrapped up in the business. For this reason, proper exit and succession planning should be viewed as one of the most important tasks a business owner will ever undertake.

Exit planning is the overall process that explores all strategic options available to a business owner and includes succession planning and sales strategies. If done successfully, it is an orderly process by which the ownership and management of a business are transferred to the next generation in a tax effective manner.

A well designed exit plan enables business owners to:

- Control the process and timing of their exit
- Achieve their personal financial goals
- Maximize their company's value
- Facilitate their retirement
- Explore all available options for exit
- Promote long term growth and survival of their business
- Minimize taxes on the transfer or sale of their business

Failure to have an exit plan typically results in:

- Not achieving the highest value for their business
- Not being in control of timing or strategy of the exit plan
- Creating family fairness issues
- Paying additional income and estate taxes
- Not providing an atmosphere for longevity of key employees
- Creating uncertainly for all stakeholders

How do you begin the process and make it a priority? The first step should be to schedule an offsite meeting with a facilitator to discuss exit and succession planning in depth.

- Are family members or key employees capable of running the business?
- Are you relying on the value and cash flow from the business in your retirement planning?
- Is selling to an unrelated third party the right long term solution?
- Who are the company's likely buyers?
- What valuation models are used in the industry for past sales transactions?
- Should a sales process start with advise from professional sell-side advisors such as an investment banking firm, business broker, or an experienced M&A attorney? (Yes, it almost always should.)

For instance, consider this all too common example.

Mr. Jones, the founder of a highly successful business, is approximately 60 years old. For more than 30 years, he worked tirelessly in his business, but has not developed a succession or exit plan. His dream is to turn the reins over to his son who would take the business to the next level. Mr. Jones is looking forward to spending more time at the beach and on the golf course.

A substantial amount of his personal net worth is in the business; therefore, he could not just gift it to his son and continue to live his current lifestyle. His son does not have the financial ability to outright buy the business from him, and the bank would require his personal guarantee on an acquisition loan to his son. With a guarantee, even after an outright sale of the business to his son, he would rely on the future success of the business for his personal financial security. His high net worth causes concerns about future estate taxes and he worries his business may have to be sold to pay estate taxes at a time that would not maximize the businesses value.

If the family business ends up with his one son, how can he be fair to his other children's inheritance? There are key long term employees who are expressing concern over whether the business has a succession plan.

If this sounds familiar, consider the succession planning process.

Top Ten Steps of Succession Planning

Succession and exit planning is a highly personal process. There are no one-size-fits-all plans. Every plan must consider the unique individual circumstances of its situation. For that reason, a successful exit and succession plan should be easily updated based on the current state of affairs.

Force yourself to start the process or, at the very least, take a fresh look at your company. At best, you will have a long term plan in place that protects you and your business.

1. Personal Financial Plan. This critical first step guides the remainder of the process. Does the owner need additional retirement income from the business? Is the owner in a financial position to gift ownership to family members without any consideration? A personal financial plan for the business owner will project the business owner's retirement income needs and compare that to income available from other sources allowing the business owner to assess how much income is still needed or desired from the business.

2. Family Plan. A family plan will access the future roles of family members for those both active and not actively involved in the business. The plan includes fairness of compensation issues and fairness of inheritance issues.

3. Business Strategic Plan. What is the strategic plan for the business beyond the owner's retirement? This will assess the economic outlook of the industry and look at financial trends. Is the business still anticipated to be in growth mode?

4. Corporate Governance. Establishing a more formal corporate governance structure of the entity is important and includes a "real" board of directors, establishing corporate officer accountability, and a compensation structure that rewards achievement.

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5. Tax and Legal Entity. Is the business operating out of the right entity such as a C Corporation, an S corporation, or LLC? Is the real estate ownership separated from the operating entity? The right entity can be critical to the options available for the ownership transfer and the future tax burdens.

6. Operating Agreement. Make sure a corporate attorney is involved in the drafting of the operating agreement and the shareholder's buy sell agreement of the business before any ownership transfers are made. This is important to restrict the future transfer of ownership and assure how an owner's equity is handled due to an owner's death, disability, retirement, or other separation of service.

7. Transfer of Ownership Tools. Consider all the tools for the tax efficient transfer of ownership including stock gifts, stock sales, self cancelling installment notes, grantor retained annuity trusts, redemptions, employee stock ownership plans, charitable remainder unitrusts, family limited partnerships and intentionally defective grantor trusts.

8. Owner's Estate Plan. Work with an estate attorney and update the estate plan of the business owner. Make sure estate documents are current and updated properly for the new succession plan.

9. Soft Side Issues. Often times, additional help is needed on the soft side issues such as leadership training and transition, communication, conflict management, and selecting the right people for the next generation of management. HR professionals, executive coaches, and leadership trainers can be important members of this team.

10. Start The Process. The sooner you start the process, the more options are available. There's nothing worse than watching a business go up in a "fire sale" because a strategic buyer thinks the owner doesn't have any options other than to sell.

As a business owner, take the necessary steps to protect the investment that has consumed your heart, soul, passion…and has most of your net worth! What could be more important?

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