Prepare for the Future with Succession Planning

By James Sbrolla

Issues and alternatives every business owner should be considering

Americans are aging, and American entrepreneurs are aging even faster. Over the next 15 years, more than half of the country's small- and medium-sized family business owners are expected to retire.

According to research, American family business owners are generally not adequately prepared for the business succession matters they will have to address, and the numbers reflect this. Only 10% have a formal written plan; 38% have an informal, unwritten plan; 52% have no plan at all.

Do You Have a Plan?

The majority of business owners have not even started to discuss their exit plans with their family members or business partners. An estimated trillion dollars in business assets is expected to change hands over the next decade, representing the largest turnover of economic control in generations. And yet the studies indicate that 60% of respondents feel it is "too early to plan for business succession."

Many family business owners are underestimating the challenging issues they will have to address, the time it will take to do them and the emotional decisions they may have to make.

"Those statistics are unfortunate, and the apparent lack of preparation could backfire on some business owners," said Larry Klar, managing partner of The Succession Fund in Toronto, which provides private equity financing for succession transactions, partner buyouts and shareholder liquidity. "Succession planning should be a deliberate process and not a one-time event. Business owners should realize that the best time to plan is when you can afford the time to properly evaluate alternatives and seek input from professional advisors. You ideally never want to be forced to accelerate your succession planning because of illness, divorce or death, so be prudent and plan ahead."

Business succession planning is an investment in the future of your company for the owners, employees and customers. Planning is the key to future success for everyone whose efforts have helped the business to grow. The existence of a succession plan emphasizes your commitment to your company's long-term growth and creates confidence among shareholders, lenders, employees and suppliers.

For business owners who have been putting off succession planning, there is no time like the present to explore options. This process involves tough questions and exploring scenarios that may not please all family members, shareholders, managers or employees; but what does the business owner want to do?

When beginning this process, there are seven tough questions every business owner should ask:

- Do you want to sell the entire company in due course?
- Do you want to sell some now and achieve the rest of your liquidity later?
- Is it important to you that ownership remain with family members or managers?
- Do you want them to maintain control or just have minority equity participation alongside a new owner?
- Is the incumbent group of family members or managers even capable of taking over and managing the business?
- How will they finance the purchase of your shares?
- Can they gain the confidence of lenders and investors, or are you prepared to finance their acquisition?

The first step should be to have a professional business valuation firm prepare an assessment of the value of the company, and it should reflect normalization adjustments to account for unusual, nonrecurring or one-time items, such as excessive remuneration and family perks.

It is important for the business owner to be realistic with respect to valuation expectations or considerable time will be wasted. Accountants and attorneys should be involved in estate planning and any share reorganization or tax-structuring matters.

Answering these questions can be time consuming and should not be rushed. Most owners, and in fact most businesses, are not ready for the sale process to begin immediately. The valuation conclusion and business-review process often indicates that some management depth, capital structure and profitability issues should be addressed before proceeding not only to support valuation expectations but also to have a more saleable business.

"That is why many owners find a gradual exit less alarming than an immediate one," said Klar. "If you can prudently diversify the family net worth by taking some chips off the table now, you can better plan for the sale of the rest of the company and probably at an improved valuation. This also generally leads to a smoother transition and gives the owner a better chance to evaluate next-generation managers, transfer business relationships and responsibilities and identify and manage risks that a strategic buyer will consider down the road."

When buying a property, one always considers resale value. The same consideration should be entertained when building a business. This involves drafting and regularly updating a written strategic plan for the future priorities and direction of the business, creating an organization chart that allows for the evaluation of those senior managers best qualified to meet the company's challenges (whether family members or not) and striving to make the founder replaceable so that the business can grow and prosper without them.

Following these steps and starting succession planning early will ensure an effective process with due consideration given to the range of issues and emotions that family business owners face. *wqp*

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