Succession Planning: Will Your Business Survive You?
The Why And The How To Succession Planning
Joanne M. Murray, Esquire

What is succession planning?

A business succession plan is a coherent, organized process to transfer ownership of a business over time or on the occurrence of a triggering event (e.g., death, disability or retirement) and allows for the least disruption of the business and the family while preserving value for owners and heirs and minimizing income, gift and estate taxes.

Do many business owners have a succession plan?

Unfortunately no, according to a 2010 study by Heldrick & Struggles and Rock Center for Corporate Governance at Stanford University. This study revealed that more than half of the businesses surveyed could not name a permanent successor CEO should the need arise. The same study showed that while 69% of the respondents believed that a CEO successor must be immediately ready to take over the reins, only 54% are actively grooming an executive for this position. Nearly 39% of the respondents reported that they have zero viable internal candidates, which an executive at Heldrick & Struggles shows "a lack of talent management and not paying enough attention to your 'bench'." A majority of respondents haven't asked potential successors if they are interested in the CEO position, and those who do know that they are being considered often don't receive regular communication on the issue which creates the risk that talented managers might be lured away by other companies.

A recent American Bar Association survey of law firms revealed that lawyers are even worse at planning for the continuity of their firms after their retirement, disability or death. Only 25% of law firms had developed and were implementing a succession plan.

Why don't businesses have succession plans?

According to the Heldrick & Struggles and Stanford University study, boards simply don't spend enough time on CEO succession planning. On average, respondents reported two hours per year of board time devoted to this issue.

Other reasons why small business owners don't engage in succession planning include procrastination, reluctance to face the inevitable, lack of time/failure to establish succession planning as a priority, fear of losing control of the business, and an inability to envision the business as running successfully without them.

What issues should the business owner consider?

- When do you want to leave the business?
- Is there someone in the business currently who could replace you? Do key employees have knowledge of all business areas or are you holding this back? Is the value of your business dependent on your personal knowledge and skill set?

- Would your business partners want to take over? Is there insurance available to fund a buy-out? Are they of the same generation as you? (Succession planning should involve younger successors.)

- Is your family involved in the business? Do they want to be? Are they qualified to run the business? Do they get along with each other? With current employees and management? Do they have the respect of key employees?

- Timing: on average, plans take 3 to 5 years to implement.

- Make sure the business is organized to survive you (i.e., that a separate business entity such as a corporation or an LLC has been established)

<u>What succession plan options are available?</u>

- Gift or sale of business to family
    - Via will
    - Lifetime gift of shares
        - Goal: reduce value of business owner's estate by moving appreciation outside of estate
        - with or without voting rights
        - gift tax limits

- Sale to co-owners
    - Via buy-sell agreement (typically found in a document such as an LLC operating agreement or corporation's shareholders' agreement)
    - Triggers: death, disability, retirement, expulsion
    - Insurance funding available for certain triggers
    - Valuation methodologies: formula, agreement of owners, appraisal, combination

- Sale to third parties
    - Stock vs. asset sale
    - Strategic buyer vs. private equity firm
    - IPO
    - Traps for the unwary: seller financing risks, earn-outs, non-competes, post-closing consulting agreements
    - Make the business an attractive target so purchase price is maximized:
        - Pay down debt
        - Maintain competitive position
        - Make sure plant and equipment are maintained and up-to-date
        - Keep corporate records in good order

- Sale to key members of management team
    - Benefits: rewards key employees for loyalty, ensures continuity of business by those familiar with its operations
    - ESOP
        - Company establishes an ESOP trust
        - ESOP trust purchases stock from current shareholders
        - Bank-financed (Bank loans funds to company secured by company assets; company re-loans to ESOP trust to use to acquire shares from current owners)
    - Stock options/stock sale

        - promissory note held by sellers secured by corporate assets, pledge of stock and/or personal assets of buyer
        - significant risk to seller: business failure → declining value of collateral (stock and assets), awkwardness collecting from friends/family, key remedy (i.e., taking back the business) is not in synch with personal goals
        - availability of bank financing?
    - Phantom stock – profits interest with no or limited voting rights

- Opportunity shifting: setting up another business entity to allow the next generation to ease into control by developing skills over time under owner's supervision

Joanne Murray is Partner with Antheil Maslow & MacMinn, LLP, a law firm based in Doylestown, Bucks County, Pennsylvania. As a business lawyer, Joanne provides a broad range of legal services to small and mid-sized, privately-held companies, non-profits and regional financial institutions.

Joanne can be reached at jmurray@ammlaw.com or 215-230-7500. For further information about Antheil Maslow & MacMinn, please visit www.ammlaw.com.