In a perfect world, business owners would begin planning for the succession and continuation of their business from the beginning. Though business succession forethought inevitably makes later decisions easier to follow, in reality, this happens very seldom. This article examines five key areas of business succession and continuation planning to help ensure a smooth, efficient transition.

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In a perfect world, business owners would begin planning for the succession and continuation of their business from the beginning. Such pre-launch advance planning would be beneficial since the decisions made at the start of a business will inherently impact the business owner’s ultimate succession and business continuation options. Succession forethought inevitably makes later decisions easier to follow and helps focus the business plan from inception.

However, the reality for most business owners is that they tend to be consumed with developing and implementing the business plan. Choice of entity and jurisdiction, organizational documentation, hiring personnel, creating distribution and marketing channels are time consuming and can dominate one’s focus. Business succession planning is rarely given its due until a business owner begins contemplating a personal exit strategy. This rushed approach can cause unnecessary challenges for an otherwise smooth continuation of the business operation, transition to new ownership, and even the value of the business in the eyes of any successor.

In this article, we will examine five key areas of business succession and continuation planning: stakeholder goals, business needs, strategy, the personal side of retirement and estate planning, and plan execution. The objective is to ensure a smooth, efficient and value-maximized transition for all stakeholders in the business through important “early stage” discussions with one’s business and financial advisors, as well as with family.

**Stakeholder Goals**

Assessment of a business owner’s goals typically starts with questions of how to maximize the exit value of the business to the owner. This assessment should include an in-depth look at the goals of other stakeholders. Family members, for example, may rely on the earnings of the business either indirectly or as workers or partners in the business. Also, for many business owners, retaining key employees may be critical. Without these stakeholders, there would be no business.

During this stakeholder assessment phase, it is imperative to determine the business’ core value. What do I want my business life to stand for? What will be my legacy? After my exit, do I want the business to continue to reflect these values? Is it important that my family stays involved in the business? Additionally, the assessment should consider current versus future business needs.

**Family Considerations**

Often a business owner may assume the business is a family asset to be willed down to future generations. However, the business may not meet the needs of the existing family or future generations. To the extent the goals of the owner and the family differ, the owner may need to reconsider end goals. If the family is not interested in taking over the business, but would rather sell it, the owner must recognize this reality. Without engagement of family members in the business, a re-evaluation of the succession plan may be required.

This exposes the greatest challenge faced by many business owners. They may demonstrate great competence and expertise in regard to the business, but may overlook communicating their succession plan with their family members. Making presumptions about family desires rather than actually conducting a family needs assessment can severely damage family relationships and have a negative impact on the future of the business.

Too often, a business owner will think “I built this business so that my children can run it when I am done.” But it is critical to ask family members what they want. They may not share the same desire to run or build the business. Family communication must happen early to avoid misinterpretation, bad planning, or worse. Also, business owners need to ensure the family members have the right abilities to run the business. If the family members’ skill sets aren’t compatible with the long-term success of the business, a contingency plan should be considered.
The Goals & Abilities of Management and Employees

Another critical conversation that often gets neglected involves managers and key employees. If management and key employees are important to the ongoing success of the business, they need to understand that the business succession will keep them in mind. This is a prudent strategy to avoid losing these essential staff members. It is not easy for a business to continue operating on solid and stable footing when key employees become leery about the future. By being open and direct with these employees about the succession plan, they will feel more valued and secure about their ongoing role with the company.

In addition, employee ownership is an alternative succession strategy if family succession is not an option. In order to consider this path, the owner needs to know three things: the employees’ desire to take on ownership of the business, their abilities to take on greater leadership, and the financial capacity of the employees seeking leadership or ownership roles.

Objective Business Analysis is a Key Part of Succession Planning

While stakeholder goals are being assessed, the business must also be studied objectively. Many business owners overvalue their businesses, while others undervalue their true worth. The bottom line is that no business owner should attempt to move through the succession and continuation planning process without an objective and detailed business analysis.

Business Needs Analysis – SWOT

A SWOT (strengths, weaknesses, opportunities and threats) analysis is a highly effective method of objectively examining a business' attributes. This analysis can help identify business growth opportunities while also helping a business owner plan for succession. A well-executed SWOT analysis will include actionable recommendations for increasing the value of the business.

The following chart provides a framework:

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<th>INTERNAL ENVIRONMENT</th>
<th>EXTERNAL ENVIRONMENT</th>
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<td><strong>STRENGTHS</strong></td>
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<tr>
<td>Financial</td>
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<td>· Cash flow</td>
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<td>· Collectability</td>
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<td>· Robust sales pipeline?</td>
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<td>· Niche leader?</td>
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<td>· Ability to charge a premium?</td>
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<td><strong>WEAKNESSES</strong></td>
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<tr>
<td>· Inventory obsolete (perhaps sell at a discount to generate cash flow)</td>
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<tr>
<td>· Management team young and inexperienced (consider mentoring or outside training)</td>
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<td><strong>OPPORTUNITIES</strong></td>
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<td>A line of business similar to current core business offerings, but reticent to act on. After studying existing...</td>
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<td>· Capacity</td>
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<td>· Team skill sets</td>
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<td>· Market penetration capability</td>
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<td>...determination made there is no time like the present to move forward. This additional business segment could be horizontal or vertical to current business and may add value in the eyes of anyone interested in acquiring or continuing the operation.</td>
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<tr>
<td><strong>THREATS</strong></td>
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<tr>
<td>· Competition lowering price to gain short-term market share</td>
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Strategy

After assessing the goals and needs of the stakeholders and studying the business and its environment, business owners and their professional advisors are now well-positioned to plot a strategy and set a course that will meet business succession and continuation planning objectives. We’ll address the personal side of a business exit as it relates to retirement and estate planning in the next section, but generally speaking, a business owners’ exit and the continued operation of the business can fall only into the hands of one of three groups.

Family

This assumes that family members indicate both interest and sufficient skills. This exit strategy ensures one’s legacy will continue and the gratification that the business will provide financial support and stability for future generations. Owners will likely not receive the highest financial value for the business, as they may not be inclined to charge full price to their family.

Inside

If family is not an option, it is possible that key employees have the desire, drive and financial means to purchase the business. Again, business owners may find reward in transferring the legacy to people who have an understanding of the business, but it is possible that they will need some assistance in securing financing to purchase the business. This may be in the form of seller financing, which doesn’t come without risk.

Both the family and inside options can occur in several different forms. Below are two options.

Buy/Sell Agreements

• It is prudent to have one in place, whether or not family is in the business. It may provide pre-determined exit pathways. This generally provides formulaic calculations by way of price and payment terms when one owner becomes disabled, wants to retire, or otherwise exits the business.

NOTE: Many businesses do not have this type of standard agreement in place, and negotiating one in mid-business lifecycle amongst relevant parties is not easy. Moreover, even fewer have actually sought out funding mechanisms for the various event-driven forms of owner exit. As a business grows and morphs organizationally, the mechanisms for funding need to be monitored and updated to ensure sufficiency.

Employee Stock Ownership Plan (ESOP) Transactions

• ESOPs have become the option of choice for many businesses. The retiring owner, other large stakeholders and the company may receive tax benefits as a result of an ESOP. Further, ESOPs can bolster employee morale and help attract and retain employee talent.

Outside

Typically, selling the business to an outside party will yield the highest price. The highest sale price is often generated when competitive bidding ensues between multiple potential purchasers. Potential buyers could include companies looking to expand their portfolio of businesses, to expand geographically or looking to acquire for vertical or horizontal integration to augment their current business. Alternatively, the business needs analysis may identify attractive opportunities for further growth that are worth pursuing to increase the value of the business before implementing any exit strategy. To that end, one may consider adding a financial partner to help support those efforts.

Once one has weighed the options, an independent valuation of the business is imperative. As referenced above, this value may be a full market valuation or a discounted pricing option being considered for “friends & family.” The business value will help determine the timing of any exit, the potential pool of buyers, and how the transaction might be structured.
The Personal Side of Retirement and Estate Planning

For business owners in particular, retirement planning can be complicated. Issues and concerns are often compounded by the transition from running the business to ownership succession and changing goals and lifestyle. Let’s look at three key considerations:

Financial Security

Financing retirement is paramount. Until now, the business was likely the largest asset on one’s balance sheet and the driver of cash flow. In order to assess whether the calculated business valuation and succession plan strategy will be sufficient – (i.e., family, ESOP, or outside buyer) – business owners should establish their lifestyle expectations post-retirement.

Usually, retirement brings some expenses not fully transparent in the years preceding retirement. These might include supporting college-age and young adult children, as well as caring for elderly parents. With individuals living longer, this can be more time consuming and financially straining than one may realize. Moreover, inflation needs to be factored into the equation as it can affect the purchasing power of one’s nest egg.

Having a budget and financial plan in retirement is even more important than during a business owners’ working years. Regular spending habits should be fully examined and any large acquisitions considered (such as purchasing a new home or a boat to enjoy in retirement). If the business valuation does not support desired retirement financial goals, they may need to continue to build the business to a higher valuation level, or scale back retirement goals. If, on the other hand, there will be an excess of capital, business owners need to define their investment structure and wealth plan prior to exiting their business. This will ensure a smooth transition from wealth accumulation to asset protection. Developing a wealth management plan with a financial advisor, much like any business plan, will be the logical next step.

Personal Goals

While it is certainly true that not everything is about money, it would be difficult to get an accurate read on financial security goals without coordinating personal goals with the anticipated costs of seeing them through. Where one wants to live in retirement is often a key decision for retirees. Many opt to retire to a sunshine state. While others decide to be snowbirds who typically maintain a home near family and also acquire a home in a warm weather destination. One thing to consider before moving is the cost-of-living in the new location, including property and income taxes.

How to retire is another personal decision that can greatly impact finances and thus retirement planning in general. One may become more frugal or may decide to travel extensively thus increasing annual expenses. One may also choose to become more philanthropic in retirement, causing charitable expenses to impact cash flows. Additional retirement considerations include: Will you continue to be involved in business opportunities? Will you support other businesses by angel investing? Will you become the grandparent who helps with family expenses such as home purchases or college tuition?
New Lifestyle

Business owners likely devoted many hours each day, week, and year to the running of the business. After so many years of hard work, it is common to have difficulty transitioning to retirement. Spare time needs to be considered pre-retirement. In some instances, by the time a business owner retires, many friends and family may have passed, or the relationships may not be strong. For this reason, it is important for business owners to have fulfilling personal as well as professional lives – hobbies, activities, and close personal relationships – so when retirement comes, there will truly be a “harvesting what you have sowed.”

Even things as simple as personal health care should be considered as current health coverage will not be available in retirement. Further, Medicare does not take effect until age 65 and supplemental and prescription drug coverages need to be considered.

No business succession plan should be considered without integrating a well-defined retirement plan and a comprehensive estate plan. Imagine a business owner working tirelessly for many years to build a successful business and accumulate wealth in the process, only to have the government take a large chunk of it because the owner did not do everything legally available to minimize transfer taxes between generations.

Judge Learned Hand wrote long ago that anyone may arrange their affairs to keep their taxes as low as possible, and “no one owes a duty to pay more tax than the law demands.” Proper succession planning needs to integrate both retirement and estate planning.

Estate planning is generally meant to accomplish two things:

Estate Maximization – ensures that the estate is as large as possible to support retirement years and to pass on a financial legacy to desired heirs.

Estate Conservation – ensures the value of the estate is not eroded by taxes, probate fees, administrative costs, market loss and inflation.

The following chart illustrates some fundamental elements of an effective estate plan that business owners and financial advisors need to consider:

| ASSETS AND INVESTMENTS | • Develop a proper investment policy statement and asset allocation strategy to maximize the estate.  
| | • Establish a family values statement or family constitution to embody the family philosophies and values and to define the roles other family members might play in managing post-retirement wealth.  
| | • Consider how assets are titled to assist in minimizing probate and estate taxes/costs.  
| BENEFICIARIES | • Consider the people who should receive assets and how the dispositions should be handled. For instance, outright versus in trust.  
| ESTATE ADMINISTRATION | • Determine who should administer the estate and any trusts after death.  
| | • Surviving spouse, family, and friends are alternatives usually initially considered, but thought should be given to professional administration – an entity with the proper experience and financial support to provide a smooth transition.  
| | • Particularly for large and/or complex estates, fiduciary liability can be a daunting responsibility and should not be thrust on inexperienced individuals.  
| NEEDS OF SURVIVING FAMILY | • If there are special needs, for example, certain types of bequests in trust with special language should be considered to protect and preserve rights to governmental assistance.  
| | • Consider asset protection for the next generation to protect against potential creditors and negative situations with spouses of your children.  

After so many years of hard work, it is common to have difficulty transitioning to retirement.
Plan Execution

Once a business owner assesses, studies, weighs options, values the business and works through integrated retirement and estate planning, it is time to implement the chosen strategy.

Things to consider along the way:

Preparation
Before selling the business, or other transitional launching pad, weaknesses found in the SWOT analysis need to be addressed to ensure the maximum value for the business. This preparatory phase might include implementing retention bonuses for key employees that any new owner would want in place for continuity in transition. Securing business value and avoiding an unwanted wave of key employee exits is paramount.

Marketing
If an outside buyer is the best option, a business owner will want to find several qualified buyers to facilitate competitive bidding. This will likely require assistance from a business broker, investment banker or other professional who knows how to showcase businesses that are for sale and what entities are in the market for an acquisition.

Due Diligence
Finding a qualified buyer assumes the business owner is prepared to perform due diligence on potential buyers. Remember, the due diligence period is not all about potential buyers digging through the business. It is very much a two-way street.

Offers
Once offers have narrowed to ones that are most consistent with the business’ goals, the transaction details need to be analyzed. Differences can be distinct; they can also be inconspicuous. An earn-out provision makes the ultimate sale price less clear, while a fixed price contract may provide what seems like fewer total dollars but is actually higher than an earn-out in net present dollars. All options need to be weighed carefully – short- and long-term and considered in net-present value in order to have an apples-to-apples comparison.

Close
Professionals, such as attorneys, accountants, business advisors and financial and estate planners (preferably those previously involved in the business), should help structure the most tax efficient process for transferring ownership. Proper structuring will help set up the buyer or successor for continued successful operation of the business. Working with a wealth management professional to properly structure a post-business wealth management and estate plan will be a critical part of enjoying retirement.

Conclusion
When it comes to business succession and continuation planning, and the interrelated nature of retirement and estate planning, one piece of wealth management advice may be most important: Have ongoing meaningful dialogue with family members. Regardless of their level of involvement with running the business, today or post-succession, taking into account all relevant short- and long-term family needs and concerns will lay the groundwork for a much more satisfying next chapter.

This communication and open dialogue imperative also holds true for key employees to reassure them of their current and future value to the business, as well as a smooth, efficient and successful continuation of the business.

And remember, it is to a business owner’s advantage to begin the succession and continuation planning journey well in advance of any such transition. When the time comes, the right strategic pieces should be in place, and it is then their chance to make the most of the next chapter.