Succession Planning for Business Owners: More Important than Ever

AUTHORS/ CONTRIBUTORS
Michael C. Zahrt

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Foster Swift attorney explains what a good succession plan should address

Michael C. Zahrt

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A robust succession plan is important for the longevity of your business; however a common and costly mistake when it comes to business succession planning is not starting the process early enough. The COVID-19 pandemic has caused many business owners to reconsider their retirement horizon. For some, retirement and succession planning is an issue they have never addressed or even thought about.

According to PwC's 2021 US Family Business Survey:

- 67% of US family businesses have next-gen family members working in the business and anticipate becoming majority shareholders within five years.
- More than half (54%) expect to be family-controlled or family-owned within five years.
- However, only one-third or about 34% of US family businesses have a robust, documented and communicated succession plan in place.

By waiting too long, an owner runs the risk of not having the right people in place to run the business and limiting tax planning options for the business and their personal estate. Either misstep can cause a business to fail when it passes from one generation to the next.

An exit that is too fast or without direction can leave a leadership vacuum and damage relationships with existing clients and customers. With clear objectives, a sense of urgency, and experienced counsel in place, you can help ensure that your business, and your future, are secure. Crafting an effective succession plan usually includes a team of your attorney, accountant, financial planner and often a business consultant.

The following is a summary of what a good succession plan should address. As you will see, good succession planning takes time and should not happen all at once.

Business succession planning is a general term that can be broken down into six separate transitions:

1. Founder Transition: How long do you plan to stay involved in the business? What are your retirement plans, if any? What financial resources will you need for retirement, and will it be independent of the day-to-day operations of the business?
2. Family Transition: If you plan to leave your business to your children, how will roles and power relationships change? How will family harmony be maintained through this transition? Should outside advisors be brought in to help with this transition (e.g., succession advisors, counselors, mediators, etc.)?
3. Business Transition: How will the business operations and customer relations be maintained through other transitions? Should a written strategic plan be implemented? If you are leaving your business to your children, how will the family balance an outward focus on the business and its customers with an inward focus on succession?
4. Management Transition: Will management be made up of family, non-family, or both? How will new leadership be evaluated? What is the schedule for transferring control of day to day decisions? How will you determine when a child is ready for more responsibilities? How will you incentivize good management? What happens if someone no longer wants to work in the family business?
5. Ownership Transition: How will ownership be transferred? A sale to management? A sale to a third party? A sale or gift to children? Will children initially have non-voting ownership? It is important to remember that ownership does not equal control.
6. Estate Transition: How will you coordinate your estate plan to ensure that the other transitions above occur as planned? How do we minimize estate tax exposure (if applicable) and provide liquidity to pay any tax liability?

Many of the transitions above will be accomplished through formal documentation (e.g., operating agreements, buy-sell agreements, trusts, etc.). Still, some companies also use informal documents to memorialize company or family values, goals, vision, and mission statement. Many successful succession plans have periodic succession meetings (often annually) to discuss succession progress and continue to groom successors to think like an owner.

“Every business succession plan is unique to the business and the goals of its owners” says business & estate planning attorney, Mike Zahrt. “While succession planning can be a huge challenge for family-owned businesses, many of the issues associated with such as lack of communication, trust issues, and different expectations for the business can be reduced or eliminated by simply early due diligence and using experienced legal and financial counsel as resources.”

If you are among the 66% of small businesses without a plan in place and have questions about developing your business’ succession plan, contact the Foster Swift business succession team.