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Are You Planning For Succession?

By Deborah Lockridge, Editor in Chief

Last year, Midwest Wheel celebrated its 100th anniversary under a fourth-generation owner. Betts Spring is in its sixth generation and just promoted a sixth-generation Betts family member to vice president.

But many more small businesses perish with the death or retirement of their founder. What are these companies doing wrong when it comes to succession planning?

"The first thing they're doing wrong is they're not doing it," says Bill Wade of Wade & Partners, who's also executive director of the Service Specialists Association.

According to Wade, 88% of current family business owners think they will maintain control in the next five years. But only 30% of all family businesses survive into the second generation, 12% by the third generation, and 3% by the fourth generation.

If you don't plan, the unexpected death of a family business owner could mean the business is treated as part of the estate and subject to stiff estate taxes. Often, no one has the cash to pay the taxes, and the heirs have to sell the business.

Where to start

The first step is to realize the need to plan. What's going to happen to your business if you're hit by the proverbial Mack truck?

Bob O'Hara, owner of O'Hara and Company and creator of the website *www.exitplanning-edu.com*, suggests asking yourself questions such as:

- What are your goals for you and your business?

- What is the value of your business today, and why is it worth what it is?

- What do you need to put in place to make your business independent of you?

- How long do you want to be involved in the business, and in what capacity?

- What key employees can run the business in your absence?

Have the talk

Next it's time for a family council. Wade says 30% of junior family business members have no knowledge of their senior generation's transfer plans. "You really have to figure out who all the potential stakeholders are and get their ideas," he says.

Find out your family's expectations. Are any of your children interested in taking over? Does the family want to operate together? If so, is the business financially capable of supporting multiple families? What about children who don't want to be a part of it?

You also need to think about whether your kids are qualified to run the business. "You have to make an honest assessment of your children," says O'Hara. "Don't assume the next generation has the same skills."

Ownership vs. management

This is about more than who will own shares, Wade says. It's about "who's going to do the thankless and countless tasks which make the family business an asset worth preserving in the first place."

He says there are really three different areas of succession to consider:

1. Management succession

2. Ownership succession

3. Leadership succession

In many cases, all three are one person -- the founder of the business. As the company grows, you may find different people can fulfill these different areas. The owners don't necessarily have to be involved in the day-to-day management.

"In a non-family business, decisions regarding leadership and management of the enterprise are generally determined by considerations of competence, commitment and character," Steve Swartz, a family business consultant based in Minneapolis, notes on his website. "In a family-owned business, these objective criteria are often overshadowed by issues of blood relationship, birth order and gender."

It may be that a non-family member is the best choice for succession when it comes to management.

Do your homework

Research the options available for the ownership and control of land and buildings, machinery and equipment, and inventory.

You'll need to think about whether your business structure is the right one to facilitate a succession, whether it's a sole proprietorship, joint venture, partnership, C-corp, S-corp, etc.

Examine management roles for all individuals, discuss labor allocation and skill development, and research the options for financing the transfer of assets.

If you don't already have a business plan, now is a good time to create one, as well as a board of directors containing an outsider or two.

All in the family?

Succession planning isn't always about family.

For instance, Total Truck Parts, West Palm Beach, Fla., has a succession plan focused on developing key employees who will continue the business. It recently promoted two of its key managers to its Senior Executive Management Team, including a general manager, as part of plans both for growth and succession.

In addition, many businesses are looking at Employee Stock Ownership Programs, where ownership of the company is gradually transferred to the employees.

Bring in the experts

Once you've hashed out the outlines of what you want to accomplish, it's time to bring in professionals to handle the details. You'll want legal advice as well as tax advice. Talk to insurance specialists, trusted suppliers and lenders.

Yes, it's going to cost some money. But this is one area it's vital to get right, Wade says. "You only get one shot at doing this."

If you don't develop a succession plan, and you don't get it right the first time, it'll cost the future owners of the business -- and maybe even cost them the business.

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