8 Steps for Successful Succession Planning

from Robin S. Weingast & Associates

Your business is your pride and joy, but it can't last forever if you don't make a plan for when you're no longer at the helm. Succession planning is an essential process that will help you understand how to make sure your legacy and business lasts for generations.

Step #1: Be Prepared

To successfully plan, critical information needs to be assembled and organized, including financial statements; an examination of profit centers; cash flow analysis; a review of the top customers and vendors, and the susceptibility to loss if those relationships are terminated; geographic coverage; evolving ways business is conducted; and an examination of the company's business model, organization chart and suitable backup.

Step #2: Get Personal

Most sales to successors are not necessarily at arm's length. One of the parties is usually not in an equal position to negotiate price and terms. Furthermore, terms play a strong role since many times payments are made from the business' cash flow and not independent investment sources.

Step #3: Value the Business

Before any plan can be presented, a sense has to be obtained of the business' value. Entrepreneurs who want to pass the baton need to come up with a price suitable to them, their family, and the people paying it. In many instances, the value of the business is based upon what the buyer can pay, either to the seller or to the lenders who provide buyout financing because — in a transition to current management — it will most likely be from someone who doesn't have the money to pay for it. Consider the allocation of the purchase price, taking into account the tax treatment to the seller and buyer. This, too, would have an effect on the price.

Step #4: Remember the IRS' Interests

Valuations for transactions between related parties may attract the interest of the Internal Revenue Service. To the extent the trans- action is not arm's length, the IRS might deem the difference between the transaction price and an arm's length price as a taxable gift, inclusive of prohibitive penalties and interest. The IRS recognizes fair market value as the appropriate standard for determining the sale price between related parties. It's advisable to engage the services of a credentialed valuation expert to assist in determining the sale price.

Step #5: Determine a Timeline

Time is an important element in structuring the transaction. A lot more can be done in five to ten years than only one or two, even less if a death or disability is causing the transfer. An orderly transfer can accomplish much more for everyone involved. The longer the time, the easier it will be to train and ease the successor into a leadership role. The sooner you start, the better.

Step #6: Structure the Transfer

A succession plan involves the sale or transfer of the business to the next generation of owners, be it relatives or long-term employees. The needs of the seller have to be balanced against the ability of the business to make the payments. The payments are not just the direct payments to the owner. They could be to a bank, another lender or to a venture capital group that is a co-owner with the designated successors who provided the funding so the retiring owner could get an upfront payment.

Step #7: Train the Successor

The successor needs to have the essential skills to carry on and successfully grow the business. The current owner has to decide if the chosen person or people will be able to maintain and grow the business. If the qualities are there, then there should be grooming, training, team building, and the passing on of knowledge and insights over a period of time. This is another reason for advance planning.

Step #8: Assemble a Team

Don't undergo this process alone. A team of advisors should be assembled, including a CPA, attorney, financial planner, business appraiser and possibly a business broker, investment banker, business coach, or psychologist.

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