Formulating the Best Succession Plan

By Mike Ferraro

The time to think about a succession plan for the business and its owners is three to five years before the event takes place. Formulating a succession plan right before a business owner is ready to exit typically results in lower realization of value for the business in a sale. If the succession plan includes transfer to the next generation, greater family disruption will likely occur. Not having adequate time to formulate and administer a succession plan can result in higher estate and income taxes and disproportionate distribution of family wealth among siblings. When not all of a business owners siblings participate in the family business, one of the many challenges the owner must face is sibling financial equalization and financial fairness.

Often, closely held businesses are owned by multiple generations or more than one sibling. Agreeing on a succession plan is often a long process that requires understanding multiple owners' personal financial goals along with balancing family relationships. Selection of a new family leader, personal differences in lifestyle needs, the ability of siblings to work closely once the patriarch is retired, and differences of opinion regarding the speed and financial impact of a succession plan implementation are some of the challenges that need to be considered as part of a succession plan.

The significance of starting the planning process early is to allow time to determine the best succession strategy for the business and owners and to ensure there is adequate time to implement the plan in a way that results in the best possible outcome. My experience is that no two succession plans are the same. There is not a clear right way to do it, but there is always a best way to do it. The best way is usually not perfect, but it provides the business, the owners, and, in many cases, the owner's families with the best possible outcome.

Formulation of the best succession plan usually includes answering the following questions:

- Is the form of business ownership likely to result in a tax-efficient transfer?
- Should the business and the assets included in the business be restructured to allow for the greatest post transaction cash flow? For example, if the business owns real estate, should the real estate be removed pre transaction?

- What is the business worth?
- Is there anything that needs to be done now to increase value in the future?
- Does the owner need to monetize the value of the business to live comfortably post transfer?
- Are there steps that need to be taken pre transaction to prepare the business for sale to a strategic buyer?
- Should the owner consider sale of the business to an employee stock ownership plan (ESOP)?
- If the business is going to remain in the family, what options exist to transfer the business? For example, gifting, selling to a grantor trust, part gift/part sale, complete vs. partial transfer.
- Should the business be recapitalized with voting and nonvoting common stock to allow for retention of control while transferring value?
- How should the plan be structured to minimize income and estate tax?
- In cases where not all of the owner's siblings work in the business what is the plan to equalize the non-working siblings in the event the working siblings retain the business?

As you can see there are many questions that need to be addressed as part of a well-thought-out succession plan. The above list is not all inclusive. In most cases, the answer to one question raises several other questions that need answering.

Getting an early start on succession planning will allow you to understand your options while providing time to create the plan that best accomplishes your objectives. Once the plan is determined, time will be needed to communicate and implement it. The best time to formulate a succession plan is long before it is required due to reasons either within your control or forced upon you as a result of unforeseen circumstances. LC

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