

Succession Planning in Small Businesses

By Robert A. Normand

SUMMARY: Succession planning is a requirement for good company management. Without it, disaster could cause the demise of the company and a bitter disruption in family life. Transfer by inheritance without planning for new management is the worse scenario. Key questions should and must be answered well in advance of the transfer. Starting the process early, relying on outside guidance and advice from experienced professionals is highly recommended.

For many people, succession planning consists of placing personal property in joint tenancy, executing a will, and buying some life insurance. These measures alone may not be very effective for the owner of a closely held business.

Many business owners are so focused on the daily operational concerns of running a business that they do not take the time to plan for the transition of their business assets. Consequently, succession planning is not done. It is put off until retirement is imminent or is rushed into amidst a crisis.

Waiting too long can be a serious problem for the company and/or intended heirs. Options could be reduced or no longer available because of bad timing. Failing to provide for an orderly transition is one of the top reasons for bankruptcy in small businesses that were, before an unplanned ownership change forced the issue, operationally successful.

There is no specific time in the history of a closely held company when succession planning should begin, but the earlier the question is faced, the better the result. In a family operation, the Succession Plan can provide a firm foundation for orderly transition, provide confidence in management and relieve owners of a potential burden.

The worse strategy for succession planning is *doing nothing at all*. This is the best way to create havoc and often has been the demise of an otherwise healthy company. In the event of the death of the owner(s) without a funded and protected succession plan, chaos ensues, the government is often the heir of reality and family life is bitterly interrupted. Insurance helps but is certainly not the whole answer; planning for *managerial* succession is still a great question that must be addressed and answered.

The Stages of Company Growth

The process of building a company proceeds as follows:

- 1) Initial start-up period (also called "Survival")
- 2) Building Value Period
- 3) Developing a Self-Sustaining Organization
- 4) Providing for an Orderly Transition to New Owners

Certainly a Succession Plan needs to be in place by Stage 4 and would be logical to have by Stage 3 (otherwise it can't be "self-sustaining") but is definitely preferable to be in place during Stage 2.

Key Succession Planning Questions

The major questions that must be faced in a succession plan include (and here we assume, like most small and emerging businesses that we have a situation of family involved):

What are the retirement goals of the current owners (timing and required financial compensation)?

Which option makes sense: Sell to family, sell to an outsider or liquidate?

What is a fair market value of the enterprise?

What do I do about heirs that do not or will not participate in the business?

Does it make sense to designate heirs a number of years ahead of the transfer?

If family members are buyers of preference, to what degree do they get a "break" on buying the company?

Have family members received appropriate and adequate training in management to take over either as managers or owners?

How can a sale be structured for minimum tax consequences?

How do I protect the Succession Plan in the event of the untimely death of a key owner or a preferential heir?

Engaging Your Professional Resources

What is apparent from this list is that succession planning is not a casual exercise that is engaged in one year before retirement. It requires the formation of a business "team" consisting of current owner(s), plus key family (particularly the likely heirs, if any), your tax accountant and your corporate attorney, among others. If you have a Board of Directors or Board of Advisors they should read on your succession plan also. They can provide valuable independent experience on key questions that you may have in this area.

"Failing to Plan is Planning to Fail."

Effie Jones

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