SUCCESSION PLANNING 101: BUILDING "SUCCESS" INTO YOUR SUCCESSION PLAN

Sooner or later you have to pass on your business or wind it up. If nothing else, illness, death or old age will eventually force your hand. But most owner managers have no succession plan in place and no plans to make one.

Triggering Events

Any one of following events can force a succession crisis upon you or your family:

- Your death.
- Your critical illness or disability.
- The death, critical illness or disability of a spouse or a loved one.
- An offer to buy the business that you "cannot refuse".
- The loss or potential loss of a key employee.
- The loss or potential loss of some other key relationship.
- Actual or impending increase in competitive forces.
- Actual or impending loss in competitive advantage.
- The need for increased capital expenditure or other funding requirements.
- Company financial difficulties.
- Demands from the next generation.
- Loss of enthusiasm for the business.
- The desire to retire or do something else with your life.

This is not an exhaustive list. There are bound to be unique things about you and your business that could trigger unique challenges or succession issues.

Most of these events are beyond your control. Many of them are not foreseeable. One of them will happen eventually, and could catch you unaware.

Having a succession plan in place can help you be prepared, and can even increase the value of your business.

Succession Planning Options

Succession planning usually requires one of the following options:

- Selling or transferring your business to a third party buyer (a competitor, supplier, customer or truly independent third party).
- Selling or transferring your investment in the business to an existing partner in the business.
- Selling or transferring your business to your management team.
- Selling or transferring your businesses to your employees, which may be a broader group than your management team.
- Selling or transferring your business to a family member.
- Dividing up parts of the business between various successors – family members, management, employees, etc.
- Taking the business public.
- Liquidating your business and distributing the surplus proceeds to your shareholders.

Making the right choice for you and your business depends on many subjective factors. However, the best way to start is to choose your first and second options and then develop a succession plan for each one.

The process of doing a plan will help you confirm your choice. The planning process can help you realize that your first choice is difficult or impossible to implement.

The main thing to keep in mind is that succession planning is a process, not an event. The process of doing the plan can be more important than the plan itself.

Proper planning forces you to assess your capabilities, set realistic and strategic objectives, enlist support from third parties, and consider the potential impact of success or failure on you, your business and your other stakeholders, including family members and others that may not be directly involved in the business.

The Most Common Mistakes In Succession Planning

As you can imagine, succession planning can be difficult and time-consuming. However, you can make it easier if you can avoid making these common mistakes:

Failing to make a succession plan at all. Procrastination is your worst enemy. If you wait too long, your options will be limited and your preferred result may be impossible to achieve. You may not even be around if you are dead, ill, disabled, or ousted by your partners, creditors or some other third party.

Thinking of succession planning as an event, not a process. Succession planning should not be built around an event or a day. Getting all the right pieces to give you the outcome you want takes time, forethought and commitment. Certainly there is an event at the end of the process, but it's more about arriving home safe and sound after an excellent journey than about getting to the airport on time.

Failing to allow enough time to develop and implement a successful plan. It can take years to develop and implement a good succession plan. No two situations are the same, so it's best to think ahead. Don't expect to be finished a few months after you decide to get moving.

Overvaluing what you have to sell. Business valuation is a subject beyond the scope of this article. Basically, most owner-managers over-estimate the value of their business. The reality of what their business is worth, or what must be done to finance the kind of price they want to get, can be disappointing. A good succession plan requires a realistic assessment of what you have to sell, and recognition that the highest prices are obtained in transactions where the owner-manager sells to a company insider, provides a, large part of the financing, and accepts payment over a lengthy period of time.

Failing to use objective, outside advisors. Succession planning is not something you should do on your own. It is also not something you should do without insight from people who have done it before. While you might do this once or twice in a career, experienced professionals develop succession plans many, many times. They will be objective about you and your best interests, and will be able to see and say things which people closer to you may not, or which you may not take seriously until you hear them from a third party.

Failing to integrate your succession plan into your personal financial plan. Many clients who see me about succession planning are unable to answer my first questions: *How much money do you need to be secure in retirement? Do you have that money set aside already? What do you need out of the business to be able to be secure in retirement? How does the business fit into your personal financial plan?* Most owner-managers have an invisible wall between their personal investment advisors and their professional business advisors. Succession planning often requires us to break that wall down.

Failing to prepare yourself for succession. Owner managers strongly identify with their businesses. Some have trouble letting go. Preparing yourself is an important part of succession planning, and includes:

- Being ready to give up control of the business.
- Being satisfied you have accomplished as much as you want to accomplish with the business.
- Being satisfied that the business could do well with someone else at the helm.
- Having a vision of your life without the business.

Without properly preparing yourself, making and implementing your succession plan will be a difficult task.

Failing to prepare your successor. Owner managers often believe that no one can run their business as well as they can. Whoever runs the business after you do will have their own way of doing things, which may be different from yours. Unless you are selling to a third party, you should have a good idea who your successor will be and you should have prepared them to take over, including:

- Ensuring they have a good understanding of the business.
- Ensuring they are as capable as the people heading your major competitors.
- Ensuring they have sufficient authority and credibility within your company to be accepted and respected as your successor.

- Ensuring they have the respect and support of all stakeholders, including investors, lenders, suppliers, customers, employees and others.
- Ensuring that they want to succeed you, and are emotionally, financially and practically prepared to do so.

Failing to prepare your business. Your business may be dependant on you to make all the important decisions. It may be dependant on you for vision and strategy. It may even be dependent on you for mission critical functions like customer relations, product development, or quoting. The business must be able to prosper without you. Your plan has to include people who will fill your shoes. You also need to have a vision of what the business can accomplish after you are gone. This vision must fit your succession plan, and should be shared by all key stakeholders.

Failing to really give up control. Many owner managers never really give up control, which is not a true strategy for succession, and can only end up demoralizing your successors. It also leaves your business exposed in the case of your illness or death, and increases the risk of conflict with your successors. You want to keep your finger in the pie until you are paid out financially, but a plan that never allows your successors to succeed you may be a bigger problem than no succession plan at all.

Hanging on too long. Similar to above a deal that takes too long to get you out can is no succession plan at all. Your successors may run into their own succession issues while you're still there, or they may get demoralized, or you could hit a bad business cycle. Plan to get out in a reasonable period of time – six months to two years is best. Anything more than five years does not even qualify as a succession plan.

Failing to secure what you need financially for the next stage in your life. You should not be dependant on the risks associated with owner-managed businesses if you are not in control. This applies whether you are retiring or not. Few owner managers want to step back in after they have exited a business, even if they are capable of doing so. If this means that you cannot do your first choice for succession planning, and then do what you need to do to be secure in retirement.

Selling for more than fair value to children or management. Some owner managers like the idea of "selling" the business to their children or to management because those buyers will have reasons for paying more for the business than a third party. If nothing else, this could sour your relationship with your successors. In a worst case scenario the business itself may stumble under the burden, costing you the money you were hoping to get.

Providing too much financing to your successors. Similar issues arise when you provide overly-favourable financing to your successor. You will risk your purchase price (which may be your retirement money) if you provide financing terms more generous than the marketplace would provide to a third party buyer. If your successors cannot afford to buy the business, then maybe you should not be selling it to them. You put yourself, your successors and the business at risk by selling on overly generous terms. There are good reasons why the market does not support generous terms. Do not discount them.

Failing to do what is in the best interests of the business. The business has a separate existence from you. Your employees, customers and suppliers depend upon it. Do not put your personal agenda over the best interests of the business, or you will risk everything built. If you truly love your business, then give it the opportunity to succeed in the long run, even if it results in a plan that is not ideal for you.

Failing to prepare a vision of the future of the business and building it into the plan. The business will enter a new stage when you leave, and it will need a new vision. The succession plan should be an integral part of that vision and an important first step in making the vision happen. This vision should make sense to all stakeholders, including your successors and the stakeholders they need to support them.

Failing to involve your successors in developing the plan. It is always dangerous to assume what other people want. If your successors are involved in the right way you can be assured they will be there to make it happen when the time comes.

Failing to put the plan in writing. It's hard to execute what isn't written down. It's also very difficult for third parties to help you with what you have not recorded. It's impossible for them to implement the plan locked in your head if you die or are critically ill. Plans are written down so they can be shared, so we have something to measure against, and so that people know what to do if you are not around.

Failing to share the plan with others. No one can help you if they don't know what you have in mind. No one can help you prepare yourself, your successors or the business for succession without knowing the plan. This is not something you should try to do by yourself. Sharing the plan with the right people significantly increases your chance of success.

Failing to integrate the plan into your legal documents. Your will, powers of attorney, family trusts, shareholder agreements and similar documents will need to be reviewed and amended to integrate into the plan. Conflict creates uncertainty and confusion. Since your plan has to recognize that you might not be around to solve those problems, integrating your succession plan into your other critical documents is an important part of ensuring that the plan is effective and successful.

Failing to integrate insurance into the plan. There is a role for insurance in many succession plans, including both life and critical illness insurance. You should not overlook how useful insurance can be for risk management, funding and tax planning.

Failing to build in flexibility for unforeseen events. You should try to anticipate unforeseen or unplanned events such as death, critical illness or a downturn in business fortunes. These things could happen to you or to your chosen successor. Your plan should survive a challenge to your most basic assumptions about yourself, your successor and your business. Plan B or Plan C may need to be dusted off if the bottom falls out of Plan A.

What It Really Comes Down To

In the end, most of these issues come down to two really important themes:

- Not really letting go; and
- Not making a commercially sensible deal.

If your plan avoids these two big mistakes, odds are you are a long way towards implementing a successful plan.

A Checklist for Doing It Right

With all the “do nots” in mind, as set out above, a checklist of succession planning “to dos” should include the following:

- ☑ Commit to having a written succession plan.
- ☑ Integrate your succession plan into your personal financial plan.
- ☑ Determine what you need to get to be secure in retirement, and make sure your plan gets you at least that much.
- ☑ Have a realistic assessment of the value of your business, obtained from independent objective advisors.
- ☑ Have a realistic assessment of how transactions can be financed, and how that effects what you can get for your business, how long you have to wait to get it, and the extent of financial or management support you may need to provide to your successor to get your ideal price.
- ☑ Hire experienced and objective outside advisors to help you develop the plan.
- ☑ Consider all the different opportunities and choose the one that is best for your circumstances.
- ☑ Prepare yourself.
- ☑ Prepare your successor, as appropriate.
- ☑ Prepare the business.
- ☑ Involve your successor in the planning process, if possible.
- ☑ Do a commercially sensible deal.
- ☑ Develop a realistic timetable that isn’t too long.
- ☑ Empower your successors, and disempower yourself, in a timely and realistic fashion.
- ☑ Consider how the plan will work if something unexpected happens.
- ☑ Consider how to integrate insurance into the plan.
- ☑ Put the interests of the business ahead of any personal agendas.
- ☑ Put the long-term interests of the family ahead of personal agendas.
- ☑ Put the plan in writing.
- ☑ Integrate the plan into other legal documents.
- ☑ Share the plan with others as needed, especially anyone financially or emotionally affected by the plan.

A Closing Thought

There are great effects of a good succession plan:

- You and those around you will know where you are headed.
- You and those around you will have a plan for getting there.

_ You will have a backup plan if something unexpected arises.

_ A lot of unspoken or hidden issues will be brought into the open and resolved.

_ Everyone who can help you get where you want to go will know your plan and will be committed to making it happen for you.

In fact, just completing the process and recorded the plan is usually worth the effort.