

FOR EXECUTIVES SEEKING TO BUY, SELL, OR RECAPITALIZE BUSINESSES

A Primer On Business Succession Planning

Business Succession Planning Fundamentals

“Dream as if you'll live forever, live as if you'll die today.” - James Dean

For every business owner the day will come when it is time for him/her to move on. The reason for the departure may be old age, health, disability, familial changes, burnout, or any number of other reasons. Business succession planning involves planning for a smooth transition of the business in the event of the owner's voluntary or involuntary departure. The impact of business planning goes well beyond the survival/transfer of the business and extends to the financial and emotional wellbeing of the owner, his/her family, and the employees of the business. To be effective, business succession planning should start preferably three years before the anticipated date of the business owner's exit.

For most mid-market business owners, their business is the largest component of their estate. In spite of this reality, most business owners do not find business succession planning to be a priority. They stay busy with mundane operation issues and neglect succession planning until it is too late. The result of the lapse can be catastrophic. Empirical data suggests that less than a third of family businesses survive the first generation of business ownership. Only a tenth of the businesses make it past the second generation. These statistics would likely be significantly better if the owners did business succession planning. By reading this article, you are already a step ahead of a typical business owner.

No business owner who cares for his estate or his employees should ignore the business planning process. To ensure financial security, and to properly transfer the wealth to the next generation, business succession planning must be a part of the estate planning process. The first step in business succession planning is to understand the end goals of the overall estate planning process.

The goals, for most owners, are financial security, transferring the wealth to the next generation, continuing the family legacy, etc. In translating these goals into business succession planning, the owner is faced with several possible scenarios:

There is a single potential successor: In this scenario the business owner needs to determine if the successor is ready, willing, and able to take over the reins of the business. Increasingly, the potential successor, typically a son or daughter, has interests that differ substantially from the business owner's.

In some cases, even a capable and able successor may not have the motivation and drive necessary to take over the business and make it flourish. The business owner needs to contemplate if a transition to this successor will result in the desired financial and other outcomes. If the business owner suspects that the estate's goals are not likely

to be met with the transition, then (s)he needs to determine if it makes sense to recapitalize the business or sell the business and transfer the proceeds to the estate.

There are multiple potential successors: It may sound logical to split the business among the successors and give them different roles in the company (some roles could be operational and others could be non-operational). Empirically, a business with multiple owners tends to wither away as each stakeholder pulls it in a different direction. It is common for multiple successors to be embroiled in power struggles that tear the company apart and negatively affects the interests of the family, the estate, and the employees.

The other common problem with multiple successors is that the successors who end up becoming active owners will very likely end up getting a dramatically larger share of the benefits of the company at the expense of the non-active owners. Unfair distribution of wealth and the violation of rights of minority shareholders is a common theme in many family business transitions.

Given these realities, multiple successors pose a particularly difficult choice for a business owner. The owner needs to seriously consider how the business may be run by multiple successors in his/her absence and see what steps can be taken to arrive at an equitable and harmonious transition that preserves the will of the estate. If the owner wants any semblance of equity and harmony in such a situation, advice from a [competent business succession planning expert](#) is mandatory early in the process. If a fair and cordial resolution is unlikely or unsustainable, the owner and the heirs' interests may be better served by selling the business and distributing the proceeds to the heirs.

There are no likely successors: If there is no potential successor that could run the business, the choice is clear and the best value for the business can be attained by a recapitalization or a planned sale either to a capable employee or a third party.

Regardless of which scenario the business owner finds himself/herself in, the planning process should begin early so that proper arrangements and precautions can be taken to maximize the value of the business. The outcome of the business succession planning should include a clear understanding of the goals, the process to achieve the goals, and contingencies in case of unexpected developments.

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