Succession Planning to Maximize Your Small Business

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Succession Planning: What Is It?

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Identifying Your Successor

- Potential buyers or next CEO

Training Your Successor

- Formal plans to teach the new company leader

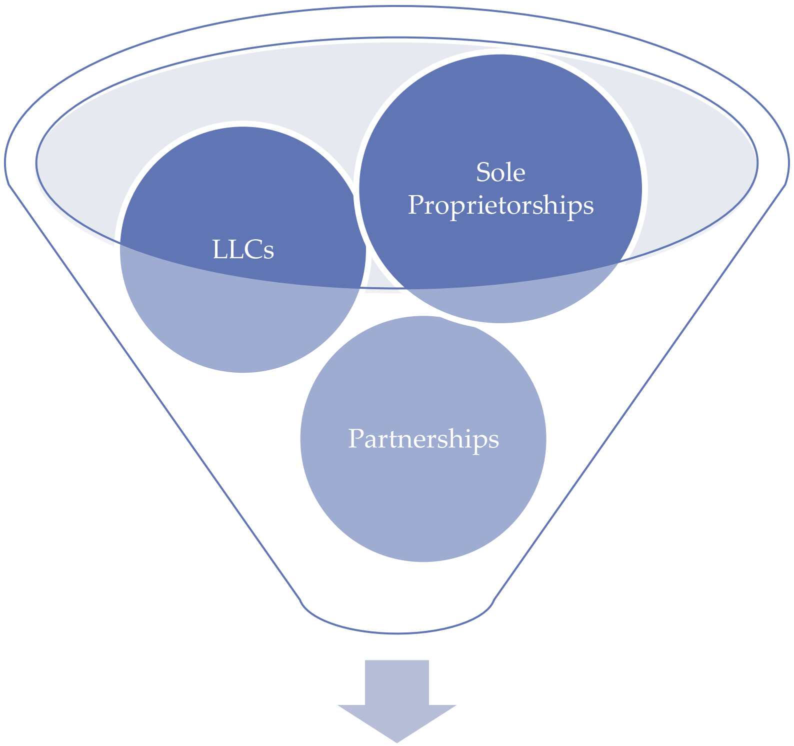
Valuation

- The financial side to succession planning

Transitioning

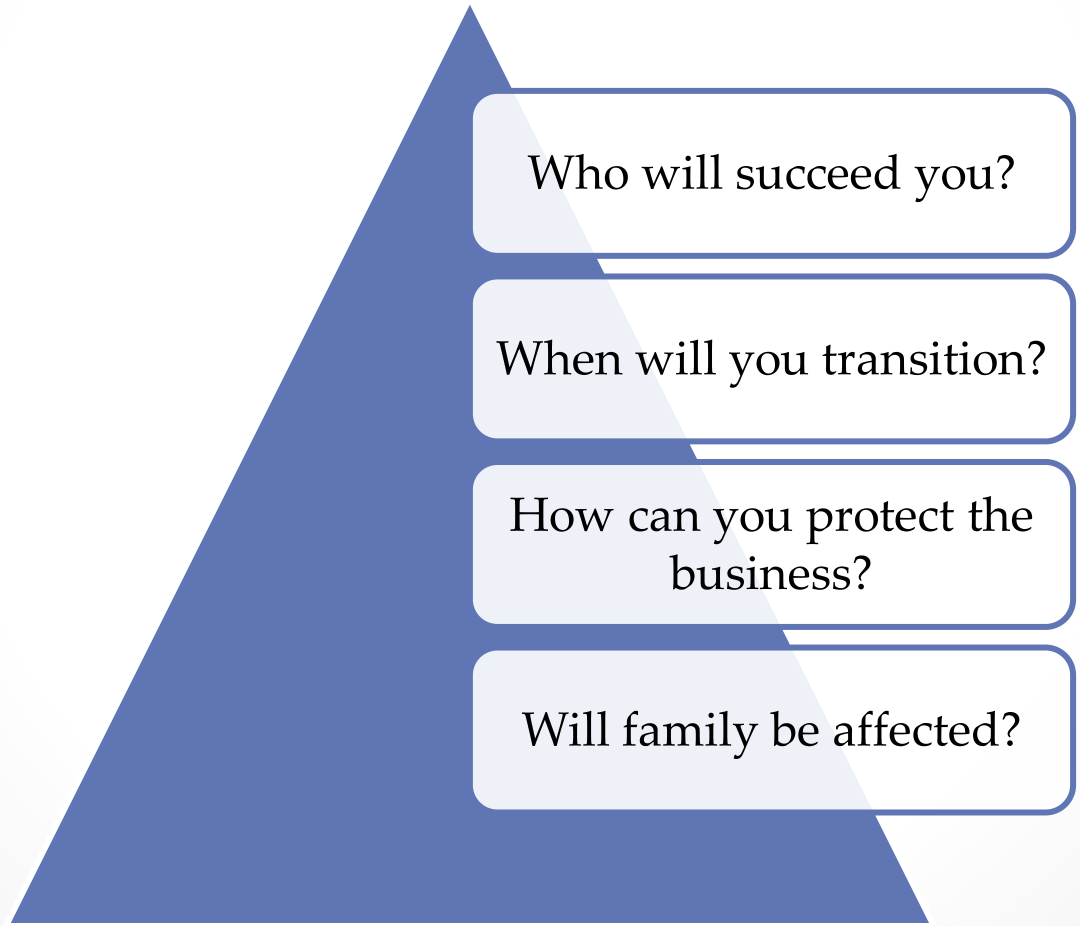
- Maintaining a productive company

Succession Planning: Who Should Use It and Why?

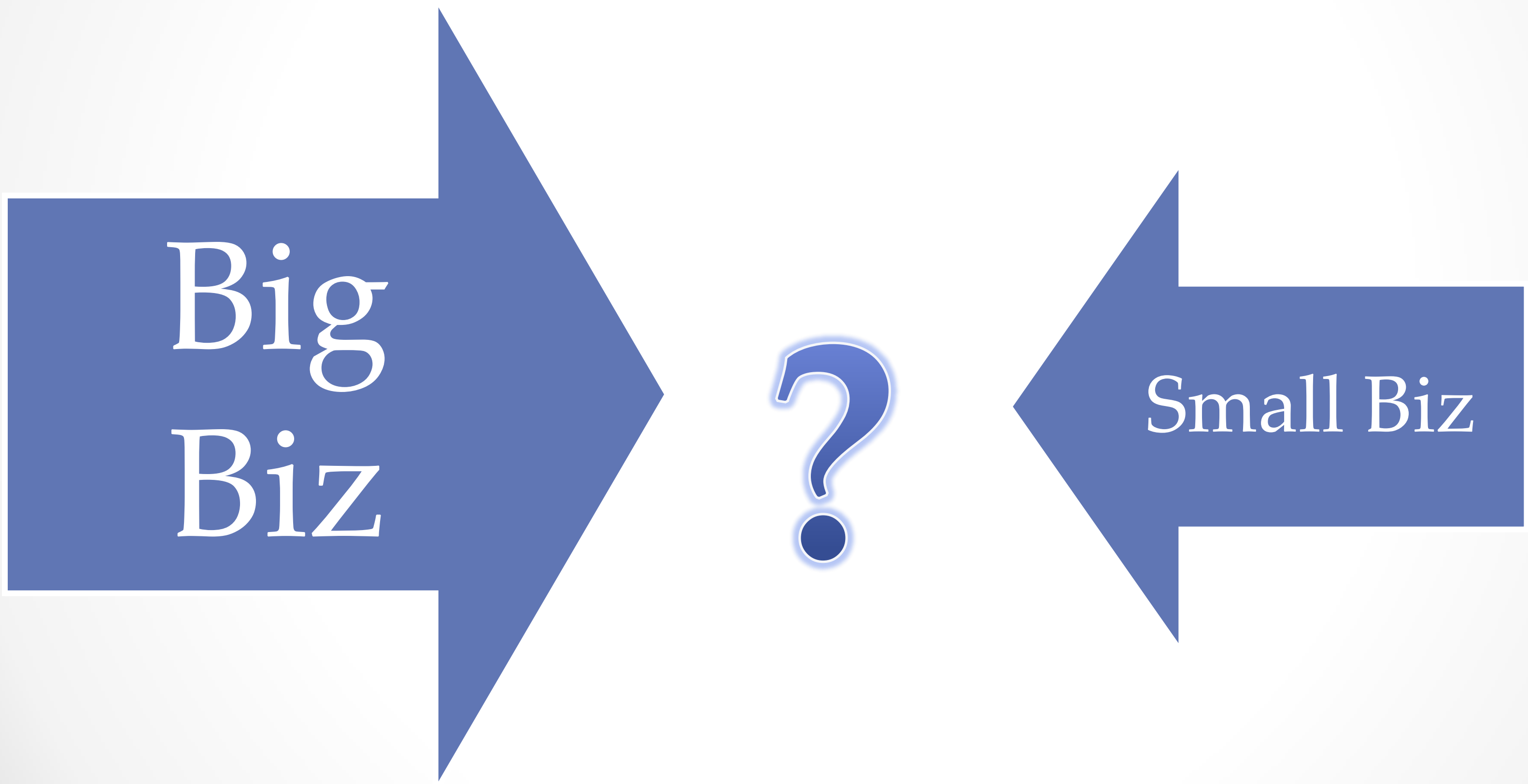


EVERYONE!

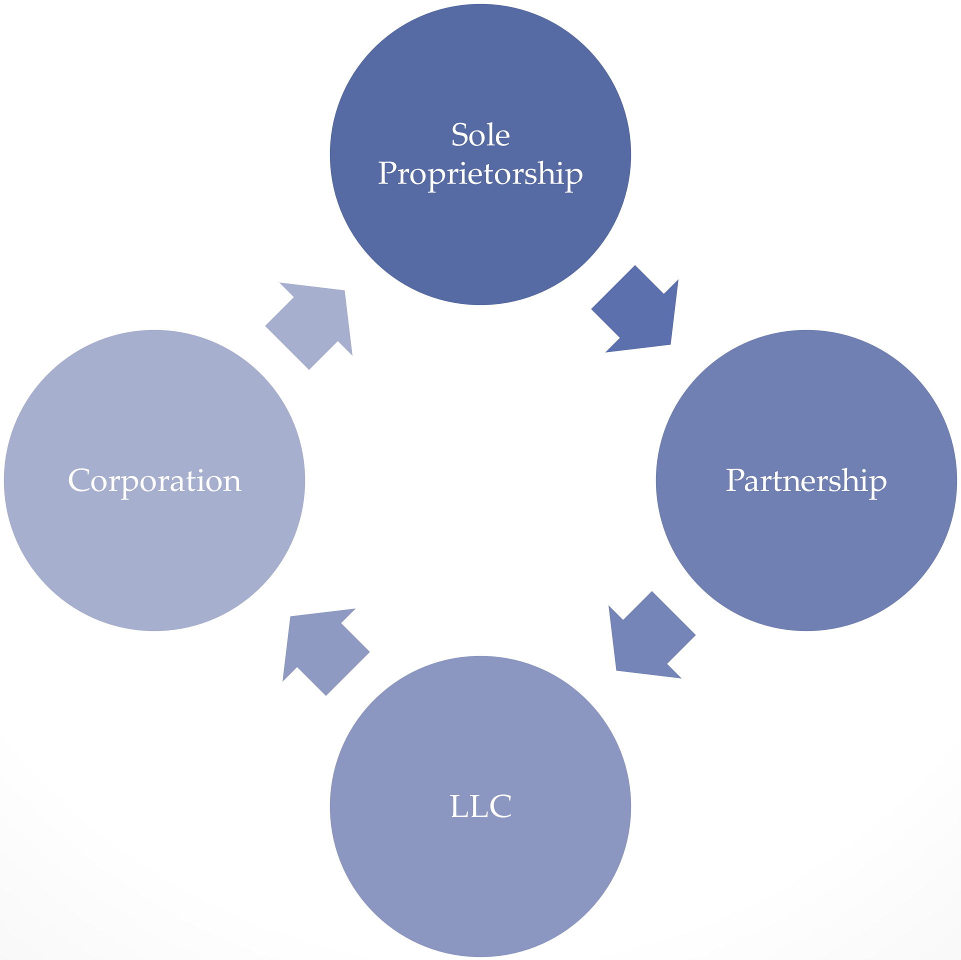
Succession Planning: Questions to Ask Yourself



Succession Planning: Large v. Small Business



Succession Planning: Entity Structures



Succession Planning: Ownership v. Management

v.

Succession Planning: Examples

The Good	An LLC President is suddenly forced to leave her business due to a family emergency, but her second-in-command had already been identified and groomed. CEO leaves Friday, and business is like usual come Monday morning.
The Bad	The entire board of a small corporation and its CEO are involved in a plane crash en route to a conference. Although the VP of Marketing would be the logical successor, no succession plan was ever agreed to, and the decision will come down to the CEO's wife. Until the successor is named, the company remains in limbo, and the fate of the employees is in doubt.
The Ugly	A family sole proprietorship failed to create a succession plan. The father is suddenly made incapacitated, and his four children are left to fight over who is to take over the family business. If there had been a succession plan, only the successor would have a claim to the business.

Identifying Your Successors

Identifying Your Successors: Buyer or Successor Owner/Operator

Timing

- ~ 15 years

Clone?

- What traits do you need?

Hard Choices

- Future success must trump favorites

Identifying Your Successors: Buyer or Successor Owner/Operator

What are this individual's technical and managerial skills?

What are this person's strengths and weaknesses?

What needs to be done to prepare this candidate to step in?

And, when do I see this potential successor being ready to take over?

Identifying Your Successors: Family Matters

- Family businesses add an extra wrinkle to the successor search
- More than 70 percent of family-owned businesses do not survive the transition from founder to second generation
  - Taxes or family discord, both issues that a good family business succession plan will cover.
- Deciding between children
- "You have to make an honest assessment of your children," said Robert W. O'Hara, owner of O'Hara & Company, a financial planning firm in Chelmsford, Mass., that specializes in exit planning for entrepreneurs. "Don't assume the next generation has the same skills.

Identifying Your Successors: Family Matters

- Opening a dialogue among family members is the best way to begin the process of a successful succession plan.
- Examine the strengths of all possible successors as objectively as possible and think about what's best for the business.
- Get over the idea that everyone has to have an equal share.

Identifying Your Successors: Consultant Services

- Succession specialists advise business owners to put their possible successors through rigorous outside analysis
- Career and management questionnaires
- Psychological interviews

What Can You Do to Protect Your Company?

- Plan Early
- Check All Options
- Continue Evaluations and Valuations
- Joint Business Plans

Training Your Successor: Formal Training Plans

Training Your Successor: Family Training Examples

"Send your kids to work somewhere else for some time until they get a raise and promotion," said Bernard H. Tenenbaum, the founder of China Cat Capital, a consulting firm in Princeton, N.J., focused on family-owned consumer products companies.

"It gives them self-respect and brings fresh blood and ideas into the family business."

Training Your Successor: Family Training Examples

Before Jos Zamzow and Callie Zamzow Novak, a brother and sister in the fourth generation of family ownership, came to work at their family's specialty products company, Dynamite Marketing of Meridian, Idaho, their father told them to work outside the business.

The two spent about five years working in stock brokering, insurance sales and retail before they put in résumés at the family firm. "We took regular jobs at the company, jobs that we had to apply for," said Jos Zamzow, who is 36 and now the vice president for manufacturing.

Valuing the Business: Public v. Private

- When business owners decide to cash out (or death makes the decision for them), the first task is establishing a set dollar value for the business, or their share of it.
- This can be done via appraisal by a certified public accountant (CPA) or by an arbitrary agreement between all partners involved.
- If the portion of the company consists solely of shares of publicly traded stock, then valuation of the owner's interest will be determined by the stock's current market value.

Valuing the Business

- Tangible Assets
  - Real Estate
  - Buildings
  - Equipment
- Intangible Assets
  - Employee Loyalty
  - Business Processes
  - Customer Base and Loyalty

Valuing the Business: Buy-Sell Agreements

Valuing the Business: Buy-Sell Agreements

Cross-Purchase Agreements

- Remaining owners buy out the departing owner

Redemption/Repurchase Agreements

- Company buys out the departing owner

Valuing the Business: Life Insurance

Why have life insurance?

- Help cover taxes
- Facilitate buy-sell agreements

Two Types:

- Cross-Purchase
- Entity-Purchase

Valuing the Business: Life Insurance

Cross-Purchase:

- Each partner buys and owns a policy on the other partners

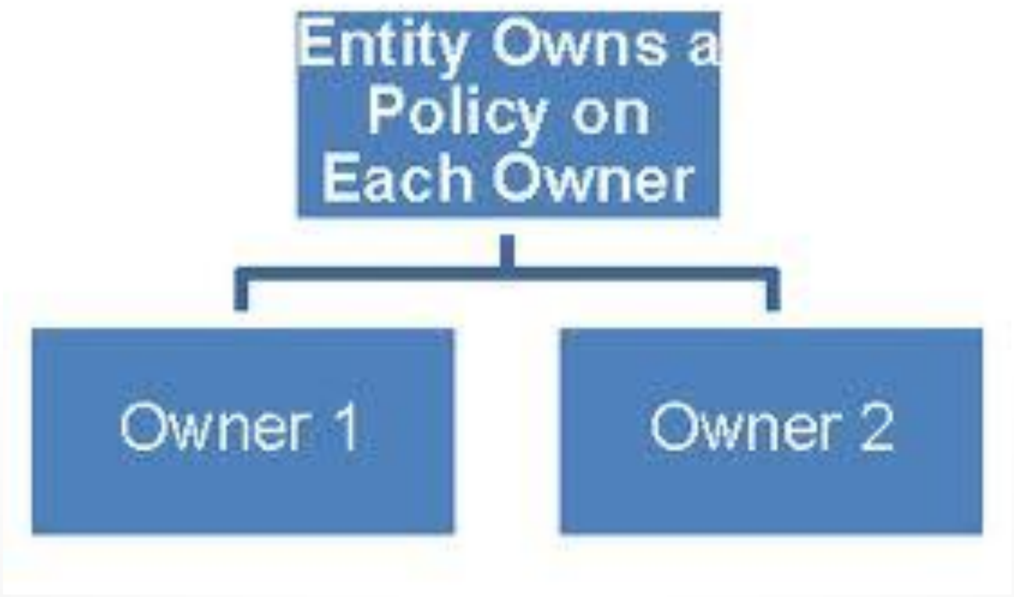
Example:

- Imagine that there are three partners who each own equal shares of a business worth $3 million, so each partner's share is valued at $1 million. The partners’ cross-purchase agreement requires that each partner take out a $500,000 policy on each of the other two partners. This way, when one of the partners dies, the other two partners will each be paid $500,000, which they must use to buy out the deceased partner's share of the business.

Valuing the Business: Life Insurance

Entity-Purchase:

- The business itself purchases a policy on each partner as the owner and beneficiary



Transitioning: Grooming Key Personnel

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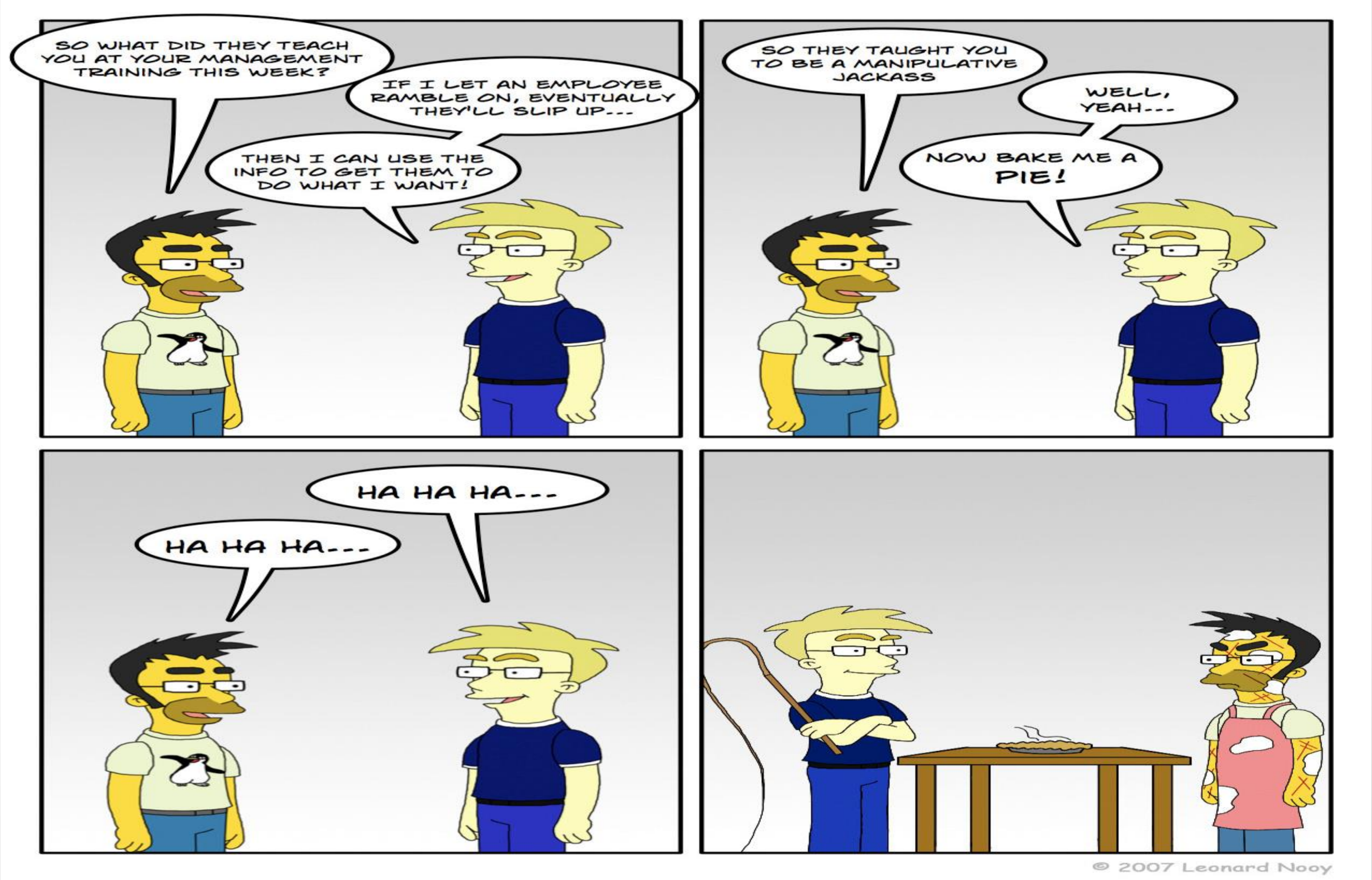


Transitioning: Grooming Key Personnel

"Leaders need to think about what they're doing within the company to develop more leaders," says Bonni DiMatteo, president of Atlantic Consultants.

"You don't want to be forced to make leaders in hindsight when there's a crisis. The moment you become CEO is when you need to start grooming your next CEO."

Transitioning: Considering Company Value Retention

- In 2003, as Michael H. Bill Jr. was taking over MJ Insurance from his father, he brought in five top employees of the Indianapolis-based company as minority owners.
- He still owns 88 percent of the voting stock in the 130-employee company, which makes $23 million a year, but top employees now have a 30 percent nonvoting stake and 15 percent more is in a stock-buying program.
- “The goal,” said Mr. Bill, 42, “is to create a good platform for long-term succession beyond myself.”

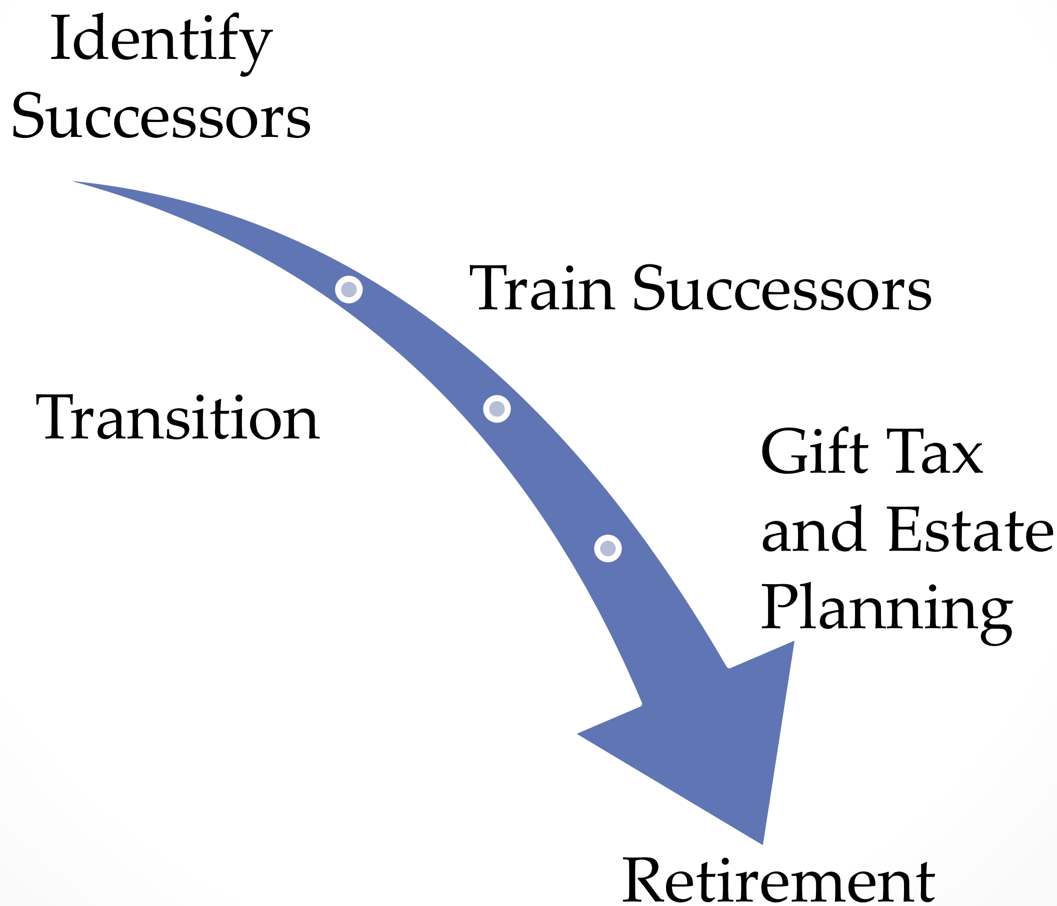
Transitioning: Establish Timelines

Develop a timeline for starting the transfer of ownership to others.	Control is shifted, i.e., your successor starts assuming some of your responsibilities.
	You successor takes on a major portion of the responsibilities.
	Responsibility for day-to-day operations shifts totally to your successor.
Decide when:	You will formally retire.

End Goals: Personal Retirement

- Your succession plan should coincide with a plan for your personal retirement
- You can't begin planning your retirement until you know what will happen with your business
- Start with the end in mind
- Form an advisory team

End Goals: Gift Tax and Estate Issues



Conclusion

Succession Planning

Questions?

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