Who's going to take the reins of your business when you retire?
It's never too early to think about succession planning.

By BRAD SLANEY, CPA

Whether you have been a business owner for one year, five, or even twenty, there is no escaping the reality that you will not own it forever.

If you care about how your business will continue to operate after you exit the company, it is essential that you develop a well-designed succession plan.

Chances are that your business – like 80 to 90 percent of those in the United States – is family-owned, and you probably know that less than 40 percent of those family-owned businesses survive a transition to a second generation.

How, then, can you increase the odds that your business will be part of that 40 percent, and not one of the majority that falls by the wayside?

Step one is to plan early. We recommend a 10-year head start from when the transition would occur. If you are planning to step aside in less than 10 years, do not delay any longer. Start planning now. Identify the key advisors who will assist you in the process: an attorney to handle the legal issues, a certified public accountant to handle the financial aspects and a business valuation expert to ensure that, whenever the transition occurs, the pricing is accurate and equitable.

Step two is to consider your options. Broadly speaking, you have three: transferring ownership within the family; selling to one or more of your employees; or selling to a third party.

Before digging deeply into those options, it is critical that you have "The Talk." Bring together the family members who have an interest in the business – either because they work there or they are your heirs – and begin to share your thoughts. Face it, there is no point in spending months developing a plan to turn the business over to your first-born if that child has little interest in taking over the operation or, even worse, does not have the skills to guide it to continued success.

The first option is transferring ownership within the family. If one or more of your children has the interest and talent to carry the business forward, it is crucial that they become familiar with all aspects of its operation: production, purchasing, sales, marketing, finance and human resources. The knowledge needed to run a business isn't acquired by serving a two-week internship in each department. That's one of the reasons we recommend a ten-year plan.

If you have several children, and some of them are not interested in the business, the scenarios become more complex. Do they maintain an ownership share, perhaps as a silent partner, or do you cut them out altogether and find a different way to assure them future financial security? As these details are worked out, you will want to consider many other factors including maximizing funds available to you for retirement and minimizing the tax impact of the transaction on your heirs. Questions like these demonstrate the importance of having an attorney and a certified public accountant to advise you.

The second succession option, selling the business to one or more employees, is often accomplished through a stock bonus plan in which additional shares are created and, over time, employees secure an increased percentage of ownership in the business. Such plans are often structured so that the company has the option to buy back the bonus shares if the employee decides to liquidate. To ensure a smooth transition, it is beneficial that the business be in a growth mode – some experts recommend 20 percent above normal growth – in order to generate the additional revenue needed to cover transition costs for taxes, insurance and professional advisors.

The third option – selling to a third party – is, in some respects, the cleanest way to make the transition to retirement. It is not always easy, however. A buyer might not appear when you are ready to sell, and economic conditions – either big picture or in your industry – might prevent you from securing the price you desire. The ultimate consideration here is making sure the terms enable the owner to enjoy a financially secure retirement. After all, once the deal is done, there's no turning back.

The options discussed here merely scratch the surface, and demonstrate the need for careful thought required in succession planning.

As you started reading, you might have considered 10 years to be far too long to execute a transition. With these examples in mind, you can see why the extended time frame makes sense.

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