

Business Succession

By Anthony V. Rizzutto, CPA, CVA, CDFIA

“Many consider family-owned businesses to be the fabric of the United States’ economy. In fact, it is a widely reported fact that of approximately 18 million businesses in the United States, more than 80% are family owned”.¹

Unfortunately this vital area of our economy has a poor survival rate. There are several reasons why family business experience difficulty making a transfer from one generation to another: Lack of viability of the business, lack of planning, little desire on the owner’s part to transfer the firm and reluctance of the children to take an interest in the business.

The main cause of transfer failure is the lack of planning.

A successful transfer from one generation to the next requires planning in at least the follow four areas: a business strategic plan, a family strategic plan, a succession plan and an estate plan.

The involvement of the family in setting business goals gives everyone a clear picture of the future. A family plan identifies each member’s role in the business. The succession plan spells out how the generational transfer will occur and the estate plan ensures that the business goes primarily to the heirs rather than paid out in excessive estate taxes.

Business succession planning is not a complicated subject; the building blocks for a plan are quite straight forward. But the process is very complex, involving many technical and psychological issues which sometimes overlap.

There are many technical issues involved with succession planning. A business valuation must be performed, property and estate law issues need to be addressed, and consideration must be given to federal and state transfer tax law just to mention a few.

Psychological issues can range from sibling rivalries to the owners subconscious need to retain control.

“The key to the successful transfer of a family-owned business is not only to structure the transfer in the most tax-efficient manner, but also to structure the transfer in such a manner as to simultaneously promote family harmony, continuity, and leadership. The implementation of a successful plan assures the safe passing of the torch”.²

¹ Estate & Business Succession Planning Russell J. Fishkind, Robert C. Kautz, 2001 John Wiley & Sons, Inc.

² Estate & Business Succession Planning Russell J. Fishkind, Robert C. Kautz, 2001 John Wiley & Sons, Inc.

Issues in the Family Business

The U.S. Small Business Administration list the following issues most family businesses face:

- Participation – who can participate in the family business and under what circumstances.
- Leadership and ownership – how to prepare the next generation to assume responsibility for the business.
- Letting go – how to help the entrepreneur let go of the family business.
- Liquidity and estate taxes.
- Attracting and retaining non-family executives.
- Compensation of family members – equity versus merit.
- Successors – who chooses and how to choose among multiple successors.
- Strengthening family harmony.

Succession Planning

A well developed succession plan is the best vehicle to address many of the issues identified above. The plan should consider estate and gift tax ramifications, the business owner's willingness to let go, and family members' willingness to commit to the business. A formal business valuation should be commissioned to incorporate the business succession plan into the estate plan of senior family members. The effect of the business succession plan on retirement planning and maintaining current lifestyle should also be considered.

Obstacles to Succession Planning

There are two main obstacles to succession planning. First, the senior members of the family are so immersed in the day-to-day operations of the business that they fail to realize the importance of implementing an effective business succession plan.

Second, many owners have strong personalities and feel more comfortable remaining in control. The idea of passing the torch may be perceived as a threat to that control.

If the owner fails to realize the importance of succession planning soon enough a life's work could be in jeopardy.

The Process

In his book “Passing the Torch” Mike Cohn identifies seven (7) “hurdles” one must clear to produce and implement a viable succession plan:

1. Goal Setting
2. Solving Family Conflicts
3. Recognizing Stages of Life (And Their Impact on Business Decisions)
4. Commitment
5. How to Let Go
6. How Much Does the Owner Need to Retire?
7. Keeping Key Employees During a Transition

It is well beyond the scope on this article to delve into the nature and complexity of these tasks. They are listed here as a guide post for the reader.

The Mission

All owners must distinguish between their business needs and their needs as owners. Doing so will help them focus on the big picture.

“There are three key questions the business owner must ask”:³

1. How to make the business enterprise valuable?
2. How to find a way of converting that value into cash for their eventual use?
3. How to integrate their personal needs, income, financial planning, and estate planning with the workings of their business?

Stephen R. Covey, in his bestseller “Seven Habits of Highly Effective People”, identified two important elements that apply to succession planning: (1) be proactive and (2) begin with the end in mind.

There are basically four ways a business owner can leave. The choices are retirement, death, disability, and bankruptcy.

Retirement under terms and conditions favorable to the business owner is the most desirable choice. To accomplish this goal the business owner must “begin with the end in mind” and be “proactive” in the planning and implementation of the steps necessary to reach achieve his goal.

³ How to Run Your Business So You Can Leave It In Style, John H. Brown, with Irv Sternberg, 1990, American Management Association

Beginning with the end in mind the business owner has several options. The business can be transferred to children or other family members; it can be sold to key employees, sold to a third party or liquidated.

If the desired option is a transfer to children a viable succession plan is an absolute necessity.

Conclusion

Again, succession planning is not complicated. One “begins with the end in mind” and then takes a “proactive” approach to reach that end.

But the process is complex. There are technical and psychological issues to deal with such as transfer taxes, financing and sibling rivalries. What are the retirement needs of the senior members of the family? Would it be better to sell to a third party? Are family members capable of stepping into a leadership role in the family owned business?

What an interesting and fascinating area to practice in?

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