INSIGHTful DISCUSSIONS

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SUCCESSION PLANNING FOR A SUCCESSFUL FUTURE

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When small business owners open up shop, they don't always start with the end goal in mind. Yet, planning ahead for retirement, death or disability can mean the difference between a smooth transition of ownership and leadership – to a trusted family member, employee or third party – and a major hit to the hard-earned value of a business. Since succession planning is key to a business's overall success, we asked four local experts for their advice on how to get started and what to consider as part of an overall exit strategy.

What are the benefits of a succession plan?

ADAM BEAUDOIN: Succession planning is basically a smaller component of exit planning strategies for a business owner. Succession planning is simply an existing business plan to transfer management, ownership and control of that company from one generation to the next within the business itself.

Such transfer doesn't necessarily have to be to family members; it just could be to a different management team. The benefit of succession planning is that it allows the owner to hand-pick the new management team members and establish timing of the transition of the business, as well as create certainty surrounding cost. In a nutshell, the succession plan establishes who, when and how the transition of the business will take place.

HANK ESTEP: It continues the life arc for the business. The owner can exit on his or her terms with cash that funds retirement, while also seeing to the future of the business with the new owners.

Griffin Estep is, at its heart, a family business. We always wanted to make sure we had a plan that would ensure a seamless transition for our clients.

LISA LEATH: Exits of any kind leave gaping holes in

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your workforce and business leaders wondering who will pick up the pieces. Whether they are planned (retirement) or not (resignation, leave of absence, death), the work still needs to get done and by someone who has the knowledge, hard skills, people skills, behavior and culture needed for superior performance.

Having an appropriate succession plan in place allows for a smoother transition when any exit occurs. But a succession plan is part of a bigger workforce planning picture that includes honest and regular assessment of talent across the organization. The benefits of discussing succession – and talent, in general – is to have an understanding of future talent gaps and/or exits, top talent, high-potential development, and personalized transition plans for internal successors.

JASON WILKINSON: Succession planning is essential to keep a business vital into the future, as ownership or management transitions from one generation to the next.

As the market continues to reshape and evolve, family-owned businesses will experience the need to significantly modify or establish substantial succession plans to cultivate future leaders.

Unique to each company, a succession plan effectively addresses its vision for the future; there is no one-size-fits-all. The plan reduces the impact of ownership and/or management transition to a business's employees.

What possible issues or problems can result from failing to plan?

ESTEP: In general, any business is an asset, one that you want to maintain and grow in value. This requires time and attention, both to the present needs of the business, while also looking to the future.

If there is no succession plan in place, there may not be anyone capable of taking over the business when the time comes, or enough money left in that business for the owner to retire and turn over management to new owners.

WILKINSON: Succession planning is the blueprint for the future management plan for the business. In many cases, owners have started their companies from the ground up or have made extreme impacts that have elevated their companies.

Often, these individuals drive the key customer and vendor relationships of the companies. Thus, the owners believe they will operate in their current capacity forever for the company to succeed.

If there is no clear and transparent succession plan, not only are family and non-family employees wondering what the future holds for the company, but so are the other key stakeholders.

LEATH: There are a few problems that can result from failing to effectively run a succession planning process.

First, the volume of unanticipated exits may cause a business to flail or fail. If multiple individuals leave with the same skill set or within the same department, chances are the back-ups will be spread too thin and/or work will be de-prioritized or staff will face burnout. You need a plan because we all know "winging it" is stressful and generally ineffective.

Second, without a succession planning process, the business has no objective evidence of the potential pipeline that will provide the pool for vacated positions.

Ask yourself: *Do we have a strategy for evaluating talent at all levels that could feed critical positions or leadership positions within our organization? Do we have a strategy and action plan for developing talent within the organization for new assignments that dually support career wishes and the business needs? What cross-training initiatives should we invest in as a business to ensure the business is not floundering when someone with great skill and institutional knowledge leaves?*

These are questions that can and should be answered with a thorough succession planning process.

BEAUDOIN: This reminds me of a basketball coach I had in high school who would say, "Failing to plan is planning to fail." I thought that was hokey and corny at the time, but the problem that develops from failing to plan is basically, worst-case scenario, you don't get any value for your business and there is nothing to pass on to your family.

So many small businesses – especially professional businesses, doctors, dentists and orthodontists – are so dependent upon the relationship the business owner has with his or her customer or patient base that it's like a perishable commodity if you don't plan.

If something happens – the owner becomes disabled, meets his or her life expectancy unexpectedly through tragedy or otherwise – the business owner's family is often times left with something that may not be as marketable or as valuable as it could have been with proper exit planning strategies in place.

For most business owners, their business is their number-one asset. They're planning to take care of their spouse, their children, their grandchildren with that business. If they fail to plan, it's likely not going to happen that way.

Also, if a business owner waits too long, he or she is likely not going to receive as much for the business, and not going to have enough time to put a plan in place to really groom and bring in the next generation of leaders. It also may mean that, as a business owner, you end up working longer than you desire. Unfortunately, you may end up working to a point where you become disabled.

Another thing about succession planning, along the lines of exit planning – if a business doesn't have its books in order, it's very difficult to make sure it's moving in the right direction. Third-party buyers want to see a clean bill of health, and you're not going to get top dollar for your business or the buyer may walk away because things aren't as in order.

An example of a very basic thing we see all the time is failure to have a top management team under a non-compete. Buyers are probably going to walk in that situation, unless the business is able to get them under non-competes and, in order to do that, additional consideration must be offered.

So, those are a couple of issues or problems that can result from failing to have a succession or exit plan in place.

When should a business owner or leader begin planning for succession?

BEAUDOIN: At the beginning. I actually have these conversations with my clients even before we form or start the business. It's never too early.

The business community always talks about how going into business with other people is like a marriage. Everyone is happy at the altar and everybody is on the same page but over time, things can change. So, it's good to have a talk with the owner, even if it's a sole shareholder versus multiple, as to what each of the owner's individual goals.

The very purpose of owning a business is to grow it, make a profit, sell it, and move on to something else.

I believe reverse engineering an exit plan can be beneficial to my clients. I tell them, "Okay, I understand what you want to do right now, but let's talk about where you want to be five or 10 years out, then let's reverse engineer this plan, working backwards to actually help you achieve it."

And I think a lot of times, too, when someone is starting a business, it can be difficult to pay for professionals, and there is a desire to put it towards the actual vessel of the business. But the reality is that if the business owner doesn't get it right out of the starting blocks, it's going to be much more expensive to correct later, not only from a cost perspective but also from an emotional- and time-investment standpoint.

WILKINSON: None of us knows when our number will be called, so there is no magic age at which an owner should begin considering succession. As such, each owner should set a succession plan to handle the question, *What if I am not here tomorrow?* For an owner's wishes to be addressed and handled in a manner pleasing to him or her, proper discussion and planning is the only way to achieve the goal.

In order to yield the intended results and receive buy-in from the aforementioned stakeholders, time is of the essence in setting the plan, as it often takes multiple years to ensure successful outcomes. The owner and/or leader needs to create a team to help craft, implement and monitor the succession plan. The team will likely include family members, the current leadership team, advisors, and/or peers and professionals.

ESTEP: Parks Griffin and I formed the agency in 1998, and we actually began creating a succession plan at the time of inception.

Ideally, you want to start as soon as you can and actually have built something of value, because you never know what can happen, but at least 10 years before the owner's retirement date.

In your experience, what is the biggest reason business owners or leaders put off succession planning?

WILKINSON: Often, succession planning is a discussion that owners and/or leaders do not want to have with themselves or others. This discussion often brings to mind that each person will face certain stages in life, and many of the latter stages just are not as fun as their current state.

Death is often the state that many consider, but many do not consider issues, such as disability. The physical and even mental states carry an emotional burden that is often uncomfortable to consider for one's own self but is often much more difficult to discuss and convey with a spouse, children, employees and key business relationships.

Another key element to putting off planning is the very real possibility that a child that works in the company has the expectation to elevate as next in command but does not have the leadership and business intelligence to continue the company on its current course. Often, this discussion is more difficult than dealing with life planning.

"It takes time to make sure any employee or family member has a similar or complementary drive, set of values and interest."

HANK ESTEP
Principal,
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ESTEP: A couple of reasons. First, you are busy building the business and don't spend enough time thinking about the fact that you will exit one day and will no longer be doing what you do on a day-to-day basis. Second, it isn't always easy to identify successors willing and able to take over the business. In our case we have been fortunate and have found both family and non-family successors who are learning the business together and complement each other very well.

BEAUDOIN: I think the biggest reason is many of them think they are going to live forever. They're not thinking about meeting their life expectancy. It's the same reason business owners don't like to do their estate planning because it brings the harsh reality that, at some point, you're not going to be here anymore.

People don't like to focus on their own mortality. In my experience, it's difficult for folks, especially the older generation. Being vulnerable is not something they like to talk about. Millennials will talk about it all day long.

What are the different paths to succession planning?

BEAUDOIN: There are many different paths to succession planning. CPAS, attorneys, financial planners and consultants all can help business owners focus on which path is best for them.

These paths focus on goals: *Is my goal to turn this over to family members? Is my goal to have it not transfer to family but instead to people I handpicked? Is my goal to retire by a certain age? Is my goal to turn a certain amount of profit from a third party?* There are a whole bunch of different ways to look at it, but at the end of the day, the ultimate goal is based on how the business owner wants the business to operate when they are no longer in control. Ask yourself what that looks like, then huddle up with your professionals and figure out the best path to get there.

WILKINSON: We often see a few different paths to identifying the next leaders for a company. A few of them are noted below.

Designated replacements are appointed, qualified and trained employee(s) who will be able to immediately step in and perform the duties of the role. This type of plan is usually implemented in the case of an unexpected transition, typically due to death or illness.

Target date replacements are similar to the designated replacement but do not require the employee(s) to be fully trained. This type is used when a business can foresee the transition of ownership, usually due to retirement. As the transition approaches, the candidate field is narrowed to a single adequate candidate.

Situational replacements are set in place for uncertainty or a declining situation. Unlike the aforementioned types, situational replacement is not "role-specific." This plan typically sources from within the existing pool of employees and is the most cost-effective. Often, the successor is chosen based on performance reviews, training programs and attributable skills.

LEATH: The first and most straightforward way to approach succession planning is to simply schedule dedicated time with the leadership team to discuss key talent. Have someone who is skilled at facilitating run this meeting and ensure you're objectively evaluating critical talent gaps now and in the future for the business. Conduct this formal meeting, where presenters come prepared with their thoughts on talent they're responsible for, at least annually. Ensure an open and honest discussion in which leaders feel comfortable voicing praise or concerns, even in areas of the business for which they're not responsible.

Create action plans to address those talent gaps. Those action plans could include development initiatives that will set the business up to later absorb an exit because there are trained individuals waiting on the bench.

For more mature organizations, there may be more of a multifaceted approach that evaluates talent beyond "key employees." Templates like SWOTs [Strengths, Weaknesses, Opportunities, Threats] or 9-blocks can be generated by supervisors and managers for review with senior leaders at a set of formal meetings.

Communication is the name of the game when it comes to succession planning. You can't plan for something that's not widely understood or known. Therefore, the annual meetings are great, but real-time feedback to senior leadership may require the business to hold occasional impromptu succession huddles.

When the organization receives news that a key employee will retire or resign, a team should discuss and formulate a succession plan immediately.

Tip: Supervisors, don't let your boss be surprised by a key employee exit! There may always be a chance you can talk the employee out of leaving if timely two-way communication is initiated upon notification of resignation or retirement.

ESTEP: They are at least three paths for succession planning. The first path is to sell the business and walk away. The second way is to bring in family members, younger partners or long-term employees to take over the business. The third way is to merge with a business in your field and work with them until the business owner is ready to transfer ownership.

What special considerations should be given when creating a succession plan for a family business?

ESTEP: First, the business owner needs to make sure long-term employees and family members are fully invested and involved before the changeover takes place.

Any planning should also involve the future owners of the business, so they can begin to understand the path the business has taken over time and then allow them to help make informed decisions on its future.

Ceding some of ownership, prior to fully exiting, will gain commitment from all involved.

BEAUDOIN: Factoring in whether some, all or none of your children will have a role in the business.

This forces business owners to really think about how they want to treat their children. In my experience, those children that own stock and are running the business sometimes can have resentment creep in towards siblings that own stock but don't work in the business. This can destroy relationships among siblings and can even happen between generations with aunts, uncles, nieces and nephews.

Family dynamics can be very challenging. It should just be business, right? But when you bring family in, you're bringing in emotion, you're bringing in spouses. And that's another thing to think about – *My daughter's great, but I don't want her husband touching the business. How do I navigate that? Or of my three sons, only one of them knows how to run the business but I don't have a large enough estate to give the other two cash.* Those are the types of things that family business owners really need to pay close attention to.

The ultimate question is – *Do your kids even want to run the business?* I have several clients that are in third- and fourth-generation businesses because the kids are groomed from day one to take over. They work every job in the business. They work their way up and they're all involved, knowing they will someday take over the business.

Other times, when mom or dad is about to retire, they'll reach out to the kids and say, "Hey, look, I know you're not involved in the business now, but would you like to be?" And if the kids say yes, then hopefully the parents can stay in place for three to five years to try to get the kids up to speed to make sure the succession plan is smooth.

"Unique to each company, a succession plan effectively addresses its vision for the future: there is no one-size-fits-all."

JASON WILKINSON
CPA & Partner,
Dixon Hughes Goodman LLP

WILKINSON: An established plan must: consider immediate or impending openings in leadership; provide a timeline to train and cultivate future leaders well in advance; and establish a leader to regularly check to ensure outlined goals are achieved.

Succession planning encapsulates a plan for the proper quantity and quality of successors in the event of retirement, death, serious illness or promotion. For effective implementation, owners and/or managers appoint successors who encompass a deep understanding of the vision of the company – both current and future – and have pronounced dedication to the company, its mission and its core values.

What are the benefits and/or challenges of gifting a business?

WILKINSON: The Tax Cuts and Jobs Act, Public Law No. 115-97, significantly increased estate, gift and generation-skipping tax exemptions to $11.18 million for an individual and $22.36 million for a married couple. The exemptions are effective for tax years beginning Jan. 1, 2018 and provide annual increases for inflation through the sunset date of Dec. 31, 2025.

This, among many other modifications in the act, will create an opportunity of flexibility for family-owned businesses planning for the transfer to the next generation.

Under the new law, many family-owned businesses are focused on utilizing these new opportunities to prepare for the next generation's success. Business owners are now able to make considerable gifts to family members of business interests in an attempt to transfer more of the business to the next generation – free of any gift or estate tax.

This tactic transfers twice as much business value, compared to 2017, to children or trusts that will not be included in the estate (or the estate tax) of the business when passed down. This change may ease the frustration built around succession planning for family-owned businesses, eliminating the estate tax and liquidity.

ESTEP: Whether you gift a business or leave it as part of an estate, there will be tax consequences at some point, depending on the value of the business.

One option would be to gift the business to a trust and have the trust manage the business and make cash payment to family members. This would help continue the business and ensure the family money is spent wisely, but it does complicate the decision-making process for business planning.

BEAUDOIN: Under the current tax structure, most businesses are not really going to have to navigate gift tax issues, unless the business is worth over $11.8 million.

Outside of the tax considerations, a business cannot really gift to employees. Owners can gift the children who work in the business but not unrelated employees.

How can business owners or executives identify future leadership within an organization?

LEATH: Business leaders can identify future leaders through an objective process that evaluates performance with growth potential. There should first be an agreed-upon definition for what a future leader looks like and that definition should be applied consistently by all levels of management, so a calibration should be conducted before the evaluation process begins.

After succession planning ends, loop back with the identified future leaders. Many high-potential employees don't know they are high-potential, simply because no one ever told them. And let's say they do know - they probably do not really know what it means for them.

Questions that should be answered through a thorough succession/talent planning process are as follows: *What actions do they own? What succession plans are they on? Are they actually interested in the roles for which they are expected to succeed the incumbent? What can they expect from the organization that is different than a "regular" employee who is not on a succession plan?*

BEAUDOIN: I generally recommend to my clients that they hire an outside consultant that specializes in this area. Consultants can help quantify the teamwork and mental attributes of the people you currently have in place and then, start a search to bring somebody in from the outside – but with enough time to have them kind of drink the Kool-Aid of your business's culture. This way, by the time a business is ready for succession planning, the new manager is viewed as part of the team.

Sometimes, business owners don't have a choice. They get boxed in because they haven't done a good job of hiring at all the different generational levels. And so, they're stuck with a bunch of people that are all ready to retire and they don't have anybody young. So now, you've got a bunch of 30-year-olds and a bunch of 60-year-olds. That's a wide chasm of generational values, which can be a big challenge to a successful succession plan.

ESTEP: It takes time to make sure any employee or family member has a similar or complementary drive, set of values and interest. Having patience with the process is the main thing.

As I mentioned before, we always need to be sure we remain focused on the needs of the clients and future ownership needs to keep that at the center, as well.

Once high-potential talent is identified, what steps should business owners or executives take to develop those future leaders?

LEATH: Invest in budding talent by simply talking to them with some regularity. Simple face-to-face gestures, like a coffee with the CEO, can mean the high-potential talent is out looking for a new job… or not. Human, uninterrupted contact with senior leaders is recommended!

If an organization is going to have a formal development program for high-potential talent, ensure that it meets their individual needs, as well as the business needs. That means the business should ask the high potentials what they are interested in learning about and what kind of development they would like to engage in versus creating a blind development program that doesn't account for previous experiences, training or education.

Create a group of high potentials that meets as a kind of support group. Beyond building rapport amongst the futures leaders of the organization, the cohort approach may build a dose of healthy competition that can propel the business with a renewed energy.

Tell high potentials that they are doing well when it is deserved and why they are considered to be high-potential. Many supervisors are uncomfortable articulating why the employee is so great because it feels like they're expressing feelings, when it's simply an objective compliment!

Think Situation, Behavior, Impact – *where was the employee, what did they do, what was the impact of their actions, and why did it impress you as a leader?* Simple!

Talk to the high potentials about your plans for them. Ask them what their plans are for themselves.

Gather 360-degree feedback on future leaders and work through development plans diligently. Talk about strengths, not just "areas for opportunity." People function best when they're working in a position that uses their natural talents.

Give and invest in their learning experiences.

Invite them to meetings at which they don't need to be, so they can absorb the dynamics and then debrief about what they picked up on.

Create a job shadowing program that allows employees to spend a day with co-workers who perform a different role to generate understanding for the broader mission and expose developing talent to other career paths.

WILKINSON: Start with a strategy. Define business goals to help identify the types of competencies required for a leader, and define those critical skills as objectives.

The right skills are essential, so find a candidate(s) that meets the objectives. Either develop an employee from within or hire externally.

Communicate clearly. Help get your employees prepared through open dialogue, as well as career development and performance reviews.

Encourage healthy competition. This helps to test their skills but it should be monitored closely – negative impacts can affect company culture.

Be prepared. Not all succession plans are done at the time they're intended to be implemented. Be prepared for a sudden leadership exit.

ESTEP: Keeping open lines of communication is key to make sure the interest on both sides is still there and the strategies are clear.

Over time, the owner needs to make sure the designated employee is included in the decision-making process and is given pieces of the ownership to ensure long-term interest.

BEAUDOIN: I think the overarching theme is to make the talent feel appreciated. Millennials, for example, are more into the work-life balance than simply the amount of salary they will take home.

The idea that a business is going to find somebody who is in their 20s or early 30s who is going to walk through hot coals for you, work every weekend and not take vacations is a fiction.

There, of course, is a monetary component to attracting talent, but I always like to say that your talent is evaluating whether the juice is worth the squeeze. *Is there enough financial compensation for the position commiserate with the responsibility they are undertaking in their role? Is there loyalty to them? Do they have enough autonomy? Do they have support from the generation ahead of them?*

This is why building up camaraderie and creating a positive work culture is so vital to attracting talented people. The financial piece is easy – bonuses, phantom stock plans, as well as earning equity in the company or a place on the board of directors.

How do succession planning and exit planning differ? Are the two strategies compatible?

ESTEP: Yes. It is all based on timing. At some point in the succession planning, the owner slowly exits the day-to-day operation of the business. So, one has to follow the other.

WILKINSON: Succession planning is the process of identifying successors and providing learning opportunities to develop their skills to replace existing leaders of the business at a future date. Succession planning is one of the components of exit planning.

Exit planning addresses a wide variety of issues that are important to business owners, including their current and future planning with respect to their business (its value, its employees, its position in the market), their family and their community.

Exit planning starts from the perspective of the business owner's goals and objectives in each of these critical areas, along with his or her current and projected resources (business value, personal and business financial resources), to identify the specific strategies and steps that are most likely to allow the business owner to reach his or her goals.

BEAUDOIN: Succession planning focuses on the transfer of management, leadership and/or ownership of the company from one generation to the next within the business itself. Exit planning is more of a comprehensive analysis of all the factors that are important to the business owner with regard to getting out of the business. I would say that succession planning is under the umbrella of exit planning.

Part of an exit planning strategy could be a succession plan, but it is possible to be a business owner who doesn't want any succession planning, who instead wants to sell to a third party.

What are three basic strategies you have for successful succession planning?

BEAUDOIN: The three basic strategies I have a for any business owner if they're going to have successful succession planning is, number one, start early.

Number two is revisit the plan regularly and, third, be flexible. Make sure that you're not so wedded to the plan that you can't make changes or accommodations as the market changes or as your life goals change.

ESTEP: Start planning early.

Identify who will take over the business. Is it an employee, family, another firm (buyout) or a combination?

Before leaving, think about how your clients and employees will be taken care of when you leave.