About 60% of private businesses are owned by baby boomers. As these boomers draw closer to retirement, succession planning and intergenerational business transfers become increasingly critical. Plan now to maximize value and ensure a lasting legacy.

Passing the Torch and Keeping it Lit

A Succession Planning Overview for Owner-Managed Companies

Wayne Gatien began attending retirement seminars when he was only 28. His father owned PowerTel, a high voltage electrical contracting business in Whitefish, Ontario. Today, Gatien is president and chief executive of the firm and is following in his father’s footsteps, making proactive plans to transition ownership to a new leader.

A key factor in Gatien’s exit strategy: delegation. “By the time I’m 60, I should have delegated 100 percent of my job and be able to continue to work if I want to … or not,” Gatien said. “If I haven’t delegated my responsibilities by then, I’d have to say I wasn’t successful.”

Such foresight is rare. Among the estimated 15 million to 18 million closely held businesses in the United States, about 60 percent are owned by baby boomers. Of those that plan to retire in the next 10 years, only one in 10 has a succession plan.

Those are the findings of Atlanta-based financial firm White Horse Advisors. The company conducted a survey to see how business owners planned to leave their companies.

“This has profound implications for our labor market over the next 15 years and also for the owners and their companies,” said Patrick Ungashick, a White Horse partner in an interview with The Atlanta Journal-Constitution.

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1 Denise Deveau (2008, October 29). It helps to have a plan when it’s time to move on; Creative options exist to ease the transition of passing on the reins. The Vancouver Sun, p. D.5.
Private, closely held companies account for about half of private sector payroll and non-farm GDP. They also generated about 80 percent of new private sector jobs in the last 10 years.³

Poor transition planning can lead to all sorts of problems for new owners, employees and family. With the vast number of boomer-owned businesses turning over in the next decade, this general lack of planning could have widespread effects.

Changes in top level personnel have a significant impact on employee retention, leadership and business plans. Unplanned interruptions could result in diminished customer service, employee turnover, missed business opportunities and even a devaluation of the business.

Plus, when a new leader’s performance is in question, vendors and lenders may take notice. Anticipating losses, banks sometimes cancel the company’s line of credit and vendors tighten payment terms—further hampering success.

**Impact of poor planning**

Tightening credit—that’s exactly what happened to Teresa Spinelli from Edmonton, Alberta, Canada. Spinelli worked in her family’s European foods store, but never expected to take over the business. When her brother died at age 32 and her father followed four years later, Spinelli was left in charge.⁴

Staff, who had known Spinelli since she was a little girl had, a hard time taking her seriously. When she announced her intentions to keep the company and run it herself, a few employees quit. Even vendors balked, sometimes holding shipments until they had received a check.⁵

Spinelli soldiered on and eventually got the business back on track, but she is one of the fortunate ones. According to a 2005 survey from the Association of Chartered Certified Accountants in the U.K., 30 percent of small-business closures take place because of the lack of an effective succession plan.⁶

It’s not only the businesses left behind that suffer. Poor planning can wreak havoc on retirement plans as well. When new leaders fail, original owners often lose out on seller financing or revenue sharing agreements. In worst case scenarios, buyers default and the original owner is forced to return to work in an attempt to revive a damaged operation.

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³ Laura Raines. Ibid.
⁵ Camilla Cornell. Ibid.
⁶ No author. Succession planning. [http://www.hie.co.uk/article-0139.html](http://www.hie.co.uk/article-0139.html)
Even selling or finding someone to take over the business could be a challenge in the near future. Depending on which study you read, analysts project that in the United States about 35-55% of privately held companies will change hands between 2006 and 2016. Canada is facing similar projections.\(^7\)

Inevitably that means that at some point there will be a glut of businesses on the market. The laws of supply and demand apply. For some, business values will be driven down too far to support retirement goals. For others, a lack of buyers will make a sale impossible.

“Many businesses don’t have a second in command or executive committee who can run the company, so the business goes unsold,” said William Custer, founder and CEO of Custer Capital an investment management firm and 4imprint customer. He advises business owners to think ahead about how they will leave the company.

“If we can help our clients build value in their businesses and focus on retirement and exit strategies, they will have a better chance selling their businesses for what they are worth,” he said.

Overall there are five key reasons to have a succession plan:

1. Unexpected death
2. Shrinking buyer pool
3. Ease of transition
4. Long term profitability
5. Tax mitigation

**An issue of values**

Of the 444 respondents in the White Horse survey, about 58 percent expected to sell to a third party, 19 percent planned to sell to employees and 15 percent planned to pass the business down to family members.\(^8\)

When the buyer pool tightens, those business owners who have already identified new leadership will have an advantage. Be aware, however, that selling to internal stakeholders could mean a lower sale price and/or greater responsibility for seller financing.

Price issues, however, may be secondary to the company’s ongoing legacy and employee welfare. Many business owners would gladly sacrifice a portion of the business value to know that their children will always have a role in the company, that employees will be kept on, or that the company will be run by someone who shares their same values.

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\(^8\) Laura Raines. Ibid.
If you haven’t decided between selling or an internal transition, talk with an advisor who specializes in your market. He or she should help you gauge the buyer pool for your industry and determine an initial value.

If the business isn’t at the value you need to meet your retirement objectives, your advisor can help identify strategies to increase value. William Custer recommends that you plan at least three to five years in advance before putting your business up for sale. Those planning to transition internally should start much earlier.

If you have identified a successor and/or plan to pass the business on to family, you’ll still need a transition team that can include a CPA, a financial planner, a lawyer and a banker. Each of these advisors should have extensive experience in business transitions. Ask your current advisors for recommendations.

Making a plan
Succession planning isn’t just about having someone to take over the business. Comprehensive plans address tax implications, unexpected death of the owner, leadership development and family considerations.

- **Tax implications**
  Tax management strategies can save millions in a succession. Decisions you make early on about how to structure the business and allocate ownership will have a lasting impact on you and your successor’s tax obligations. Gifting or selling stock early, while the business is still growing, limits liabilities later on. Such gifts, however, can have implications on financial control and your future retirement resources. (See “Financing” below and seek the advice of a professional tax advisor.)

- **Unexpected death**
  Likewise, tax liabilities can cripple your business in the event of an unexpected death. If you have a business partner, your partnership agreements should already address taxes, buyouts and other financial concerns. Keeping those agreements up to date should be part of your ongoing succession plan. If your business will go to heirs, evaluate your life insurance policy to be sure it is adequate to cover taxes and support the business through a transition.
• **Identifying leadership**

Recruiting good people is a key strategy in any succession plan. Even if you plan to leave the business to family members, a strong management team is an asset to any operation and will provide critical support during a transition. If a family succession isn’t an option or becomes unfeasible, the management staff will be well positioned to take over.

Recognize that a son or daughter may not be the best fit to lead the business. One common reason small business owners sell is because the company grows beyond their management skills. If your children don’t have the necessary experience and/or education to drive continued growth, consider looking elsewhere for new leadership.

If you do intend to pass the business on to one or more of your children, begin planning early. In many households, that means college education followed by several years of experience in an outside corporation before rejoining the family business.

• **Relationships**

Succession plans should also give attention to transferring relationships, shifting the trust and respect that’s been earned over the years to new leadership. If business relationships are over-reliant on any one owner, clients often leave when that owner is no longer around.

Teresa Spinelli, from our earlier example, would have been in a better position to take over had her father actively groomed her for leadership, introducing her to vendors and putting her in decision-making roles.

Get staff, clients and vendors comfortable with interacting with the next generation owners. As they see that service and follow-through will remain the same, they’ll have confidence in the new leadership and be more likely to stick around after a formal transition.

• **Responsibility**

Turning over control can be the hardest part of succession planning. Ease your way into retirement, gradually delegating responsibility and turning over decision making to others.

It’s important to let others have an opportunity to lead. Yes, they will make some mistakes, but that’s how people learn. Better those mistakes...
are made while you can provide support, than after you’re gone and the livelihood of your employees and the future of your company are at stake.

Succession planning is best begun early. Include a candid evaluation of your retirement goals and the financial resources you’ll need to support those goals. Consider the legacy you want to leave not only in terms of financial inheritance but of company name, continuity or employee support.

Once you identify your likely successor(s), ask him or her to share their long-term goals. If you’ve found a good fit, look for opportunities to ease the transition and set up the business for long-term success.

**Financing**

A major obstacle in any business transition is financing. If you are planning to sell to a family member or someone inside the company, this person will either need sufficient financial resources or you will have to assist in financing the transaction.

As in any sale to outside buyers, lenders look favorably upon experienced managers with industry insight. Demonstrate that your successor is a proven company leader, and he or she will have an easier time securing a loan.

Still, exchanging owner equity for debt service can drastically change a company’s financial position. Secure a professional valuation and meet with transition advisors to determine an appropriate price and structure that can support debt service without crippling operations.

Your advisors can help you evaluate the following options:

- **Conventional financing**
  In addition to standard bank loans, other fairly conventional financing options could include seller financing, earn-out agreements, mortgages, leaseback arrangements, long-term buy-out agreements or SBA loans.

- **ESOPs**
  Another approach to financing a succession is a long-term employee share ownership plan or ESOP. In an ESOP, employees who participate in the plan (all or some) arrange with the owner to purchase shares in the company on a
regular basis over a period of time. These employees can acquire significant equity in the company before succession occurs, meaning they would only have to finance a portion of the purchase price. ESOPs can be combined with traditional bank or vendor financing to further facilitate the transaction.

- **Gifting shares**
  Whether to family or existing management, gifting shares will impact tax ramifications and operational issues. Some advisors recommend owners ‘give early and give often’ to eliminate a large tax liability later on, when the business has presumably grown and is worth more. This of course begs the question of financial control—a problem you may be able to overcome by giving class B (non-voting stock) instead of class A (voting stock).

Again, consult with professional advisors who have ample experience in business transitions and successions.

### Family issues

Financial matters are a critical part of any succession plan, but you also need to address personal issues, particularly the implications for your family.

Don’t assume anything. Talk with your children early on about their potential involvement in the business. Convene active members on a regular basis to work through succession and ownership issues. Put agreements in writing and stipulate criteria for employment and compensation.

Recognize that money issues can drive a wedge between the closest of family. Eliminate uncertainty by sharing your succession plans with all family members. Consider whether you will gift shares only to active business members, weighing the implications of gifting shares to all children.

Family-run businesses have unique challenges. If multiple heirs will operate the business, seek ongoing support and guidance. Find out if your state operates any family business programs such as the Family Business Center at UW-Madison in Wisconsin. Other family business resources include the Family Business Network, Family Business Magazine and the Family Firm Institute.

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10 No author. Succession planning for book publishers: Insider succession. Ibid.
Begin early to build assets outside the business. If you have sufficient wealth built outside the company, you’ll be more comfortable transferring stock and you’ll have greater flexibility when it comes to providing equitable gifts to multiple heirs.

No matter who will take over your business, succession plans should be living, breathing documents that flex with changes in your family and your company. For the smoothest transition, begin planning your succession 10 to 15 years in advance. Professional advisors can evaluate your unique situation and make recommendations that will maximize your business value, build a comfortable retirement, and help ensure a lasting legacy that will endure under new leadership.