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A good succession plan requires work, insight

It is often said that one of the most important considerations in any investment is the exit strategy. An exit strategy is important for a family business, too, but it is more complicated. Day-to-day operating pressures, lack of formal decision-making processes, concentration of family wealth in the business, and reticence to confront family and ownership issues all may get in the way.



GUEST
COLUMN

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Nonetheless, succession planning is one of the keys to making sure a family business can continue successfully. Statistics show that only one in three family-owned businesses will succeed in the second generation. It is important to create a succession plan and set benchmarks to monitor its implementation.

Here are some basic steps:

1. Assemble a team. A successful succession plan requires contributions from many professionals, and it should be viewed as an investment, no different than advertising, purchasing new equipment or training employees. Owners should involve their attorneys, accountants, insurance advisers, bankers and other consultants, including family counselors. The expertise of the team is essential to developing a workable plan.

2. Assemble information. Pull together all relevant information about the business, its history, owners, operations, finances, employees and family relationships. The compilation and analysis of this information may highlight issues such as:

- **Legal framework:** It is important to know what limitations exist on the right of an owner to transfer an interest in the business. These include rights of first refusal, restrictions on transfer and purchase options.

- **Prior history:** Dormant family or owner disputes may be uncovered that could

profoundly change the substance of the plan or lead to the conclusion that no plan involving a next generation can be effectively achieved. Identifying these issues early on is important so time and resources are not wasted.

- **Expectations:** Owners must have honest and realistic discussions with each other about the strengths and weaknesses of their potential successors. Pushing a successor on another owner might work in the short term, but it will not contribute to the long-term success of the enterprise.

- **Affordability:** The profitability of the business may affect planning and limit options. Owner compensation needs, insurance costs, compensation needs of designated successors, and lifestyle considerations can all drain cash from the business. In some cases, the desired succession plan may be unaffordable, or it may leave the business with inadequate cash to fund growth and the change necessary to meet market needs.

3. Develop goals. In conjunction with assembling information, owners working with their team need to develop the succession plan in light of their personal goals, such as:

- Providing for the business to be owned by one or more owners.

- Providing for the business to pass to certain members of the owners' families.

- Protecting each owner's business interest from falling into the hands of the owner's creditors.

- Providing for effective management of the business, including resolution of disputes among owners and the orderly buyout of an owner who wants to leave the business.

- Providing for the buyout of an owner's interest upon disability or death, to assure that funds are available to pay for a disabled owner's needs or for the needs of a deceased owner's spouse and children, and to keep ownership within the original owner group.

- Requiring potential successors to achieve certain benchmarks outside the business to be considered as successors, thus lessening any sense of entitlement in potential successors and bringing in fresh ideas.

- Maintaining beneficial tax attributes of the business, such as maintaining "S corporation" status.

- And, the underlying goal, preserving the business.

4. Whose business is it, anyway? It is important to take into account all the constituencies interested in the succession plan: other owners, spouses, successors, uninvolved children and key employees.

Have definite goals for the succession plan, test all decisions against those goals, and communicate with each of the constituencies. All must align with the ultimate goal – the long-term success of the business.

Going through the exercise of developing a succession plan has multiple benefits. It can align the owners and clarify their expectations for the business. It can help the owners determine whether succession from among their families is realistic and affordable and help them embark on the training and development of support-

ing management necessary to implement the desired succession plan.

Or, if family succession is unrealistic, it can help identify the appropriate time when the business should be sold, thus enabling the owners to manage the business to maximize its value for sale. Either way, proper succession planning positions you for success. ■

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