

Succession Planning - How to Effectively Pass the Torch

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For owners of family owned businesses, one thing is certain, the withdrawal of the owner of the family business is inevitable. This creates a need to develop a mechanism for the successful transition of the family business.

There are many issues surrounding succession planning and how to pass the torch to the next generation. Most successful succession plans will have at least three components:

1. a process for providing continuity of competent business management;
2. a vehicle for transferring the ownership in the business; and
3. tax planning consistent with the other two objectives.

The major reasons that owners of family businesses sell out have been identified as burnout or boredom, lack of capital for operations and growth, and children having no interest in running the business. We have all heard that approximately 65 percent of family businesses fail in the second generation and that by the third generation 80 percent of those businesses close their doors.

There are many reasons that family businesses fail in the second or third generation. Some fail because no family member wants to become active in the business. Others fail because those who are interested are not capable of managing the business. Other reasons include improper tax planning, competition, inadequate capitalization, or failure to meet technological, production or marketing advances. However, perhaps the single most devastating factor that contributes to the failure of a family business is unresolved conflict in the family. Therefore, any succession planning process must address, head-on, the issue of existing and potential family conflicts. This can be a difficult task. It is also not always possible to identify all existing conflicts or to anticipate future ones. Notwithstanding this bar, the succession plan should endeavor to identify and resolve existing conflicts within the family and establish a process for resolving future conflicts as the ownership and management of the family business passes from generation to generation.

There are basically six groups of people that should be addressed in a succession plan. Those include the owner, his or her spouse, his or her children or relatives that are involved in the business, his or her children or relatives that are not involved in the business, the spouses of his or her children or relatives that are not involved in the business, and other key employees.

The first element of a succession plan is a comprehensive analysis of the family. The second requirement is to assess the company's key employees and other persons that are critical to the development of the company. Criteria should be developed for the transition of management and in the design of a plan that makes use of that criteria. Another ingredient of the succession plan is a business plan. The business plan usually serves as a mission statement for the company and should explain why the business exists, who it

serves, and how it operates. Another critical component of a business plan is to have a clearly defined family plan. The goal of the family plan should be to preserve family unity and harmony that will focus on several different issues. The last element of a succession plan is the actual preparation of a formal estate plan of the owner.

To have a successful succession plan, it is generally advisable to implement the succession plan when things are going well. Based on my experience, most succession plans originate in the estate planning arena. Most families do not disclose their estate plans (and/or succession plans) to their children. Unfortunately, a great deal of estate planning and hence succession planning is done on the owner's death bed.

Comprehensive and thoughtful succession planning is a time-consuming and challenging proposition. A plan which merely transfers stock ownership at a minimum tax cost, by itself, does not address the most critical elements necessary to provide for successful continuation of the family business. Succession planning for the family business should consist of a thorough plan containing the input and elements discussed herein. It should be developed well in advance of the event which gives rise to the owner's withdrawal. Anything less risks, or even encourages, family and employee discord, emotional trauma, litigation, and significant economic loss in both the short and long term.