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# The Exit Strategy: Succession Planning

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It's never too soon to develop a succession plan.

If you own a business and are considering retirement or changing careers, succession planning should be a top priority. It's never too soon for owners of any age to choose one or more successors to the businesses they've built – because succession isn't a crisis until it becomes one.

When is the optimal time to form an exit strategy? "At least three years before a transfer may occur, but as soon as the business starts having value to a third party," states Allen Silk, shareholder and chair of the business succession planning group at Stark & Stark, a Lawrenceville-based law firm. "Succession should be a key part of the business strategy and an owner's financial and estate planning. However, people put it off because it's time-consuming and sometimes emotional. Not only is valuation an extensive part of the succession process, but psychological issues often surface when younger family members are involved, because what's good for the family isn't always good for the business."

Deal with succession early on, Silk notes, "because you may lose all your leverage later." Once established, the plan should be reviewed annually, since industries and valuations change, and people come and go. "Succession is a serious issue, because once it becomes a crisis, it's too late to do any planning."

James Duffy, a partner with Wiss & Company, a financial services firm based in Livingston, specializes in advising family-owned businesses. He says that no two families are alike, and neither are any two succession plans.

The biggest factor in guiding an owner through its exit strategy is personally knowing the family and each member's strengths, weaknesses and view of the business: "CPAs know all about companies, their financials and what makes the businesses work," Duffy states, "but some advisors fall short of knowing the family members individually, such as their management capabilities and career desires."

Family Gift? Or Ball and Chain?

For example, some parents consider the business as a gift, while one or more descendants may see it as a ball and chain. "Often, an owner is surprised to learn that the child earmarked for the business has no interest at all in the company," Duffy reports. "Unsure of whom to designate, owners often place the entire succession issue on hold. We serve as a liaison that keeps the ball moving and helps sidestep potential conflicts, while keeping family relationships intact," he says.

Once every family member understands each other's goals and objectives, "we align those dynamics into a comprehensive win-win plan," Duffy continues. "We put the big issues in writing, such as which child will get voting or nonvoting shares, which will run sales, own the real estate or be given other compensation. We let the plan simmer as questions arise and the plan evolves – then help draft the succession plan with the attorneys that will put the plan into effect."

Duffy cautions of the potential complexities that arise when multiple family members each are given an ownership share. For example, "succession may start with each of four siblings owning the business, but once they start their own families, numerous children and cousins are feeding off the same business, all with varying skills and capabilities," Duffy states. "In my experience, it's better to have fewer successors, but then balance the non-successors with operating assets, life insurance, the shore house, investment portfolio, etc."

Maximizing Value for a Third-Party Sale

When no family members will succeed the business, owners should begin maximizing business value to make the company more attractive to potential outside buyers.

The most important factors in determining business value are projected cash flow and risk, says Gerald Shanker, partner at Kreinces, Rollins & Shanker (KRS), an accounting firm based in Paramus. He states that to improve cash flow, owners should reduce accounts receivable and shed excess inventory. Controllable risks include customer and supplier concentration or diversification, depth of company management, and the quality of the company's accounting records.

Shanker explains, “In the eyes of a prospective buyer, a company with excellent accounting records and financial reports is less risky than one requiring extensive explanation, because the buyer relies on the accounting records to project future cash flow, and the projections are only as reliable as the historical records on which they are based.”

Although buyers generally won’t pay a premium for good accounting records, Shanker says, “they always demand a discount from a company with poor records.”

Multiple Non-Family Owners

A business owned by multiple non-family members faces a different level of succession complexity, claims David Broderick, partner in the law practice of McCarter & English of Newark.

For example, though one owner may foresee exiting the business sooner or later than the others, generally it is much easier to sell an entire business rather than one owner’s stake. Therefore, owners should agree, in advance, on an exit methodology that preserves their ability to eventually sell the entire business – not pieces of it.

“The price received for the whole business may be higher than the sum price of individual owners’ interests sold separately,” Broderick states. “As such, owners should negotiate the process by which an orderly repurchase of another owner’s interest by the company – not third party – for fair market value can be arranged.”

Five Guidelines for Multiple Family Member Succession

• Decisions should be based on talent and skills.

One of the biggest challenges in managing a family business is keeping family concerns apart from business issues, asserts David Ludgin, partner in the law practice of McCarter & English of Newark. As such, Ludgin offers these five guidelines for more successful succession to multiple family members:

1) Closely evaluate the capabilities of each family member who works or may work in the business. The assessment should be done according to the same standards applied to any non-family employee.

2) In most instances, a business can have only one chief. It is critical that each family member has clearly-delineated authorities and responsibilities. Ongoing communication helps ensure that each family member has a clear understanding of what the others are doing.

3) Employment and ownership are not the same. In some cases, it may be more appropriate for a family member to be an employee, not an owner, and vice versa.

4) Consider a training program for younger family members entering the business. Some families insist that prospective family employees work at one or more “outside” businesses – sometimes for several years – before joining the family business.

5) Dispel any sense of “entitlement” in any family member working in the business. Such an attitude can poison relationships with other employees, family members or not.

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