

A Better Way

Some Tools for Business Succession Planning

By G. Timothy Leighton, JD, CFP® *

The previous “Better Way” column explored succession planning as an investment in the future for the enterprise, its owners, employees and even your customers or clients. In order to preserve the value the business owner has created, it’s important to plan for the orderly transition of ownership. This article covers some of the tools for that planning.

There are financial tools, legal tools, and others that blend these two areas. Careful communication, sometimes with a facilitator or specialist, can also make the difference between success and failure.

Financial tools. In operating a business, it’s essential to have report cards from time to time, helping compare where the business is to where you want it to be. Owners rely on three specific ***financial statements*** for this on-going assessment: the balance sheet (reporting assets, liabilities, and equity), the income statement or P&L (showing income, expenses, and net profit/loss), and a cash flow statement (to help manage that scarce resource in business operations and investment). Quality professional advice helps interpret and understand how these various numbers relate to the enterprise so the owner can lead and adjust, rather than react.

For succession planning purposes, you use these same tools but compare where the enterprise is to what it is going to take for the owner to depart in a planned fashion, or what it is going to take for the next owner to buy if the change happens ahead of plan (for example, because of premature death or disability). The ultimate value of the financial statements depends on how accurately they reflect actual performance in order to rely on them for making future decisions.

As you consider the future, you must generate ***projections regarding*** both internal challenges as well as what is going on in the market place, including competitors, suppliers and customers. Take care to incorporate historical trends, infusions of debt and/or equity, and other factors particularly relevant to your enterprise.

The last key financial piece is ***business valuation***. Valuation experts should be engaged from time to time for formal analysis. Owners should also check with trade associations and industry journals for comparison data. Both the present owner and the likely future owners need to determine their respective objectives in order to negotiate mutually acceptable exit/entrance strategies.

Legal tools. Entrepreneurs decide how to structure the enterprise to accomplish such objectives as tax treatment, continuity of the business, liability management, and levels of complexity or simplicity. It’s wise to rethink those decisions from time to time

and consider whether the *choice of entity* still helps advance the goals. Should you continue in your present form, whether sole proprietor, partnership, corporation, or limited liability entity (to name the major ones)? Or would a change make sense?

Also consider how the owners have structured the relationship between their personal and business checkbooks. Have you reviewed your personal *estate plan* lately? What about employee ownership issues and gifting to relatives, friends, and key colleagues? Think through how the owner's personal life, business operations, and state & federal laws have changed. Work with your lawyer and accountant to figure out various options and the tax and control consequences of each choice regarding wealth transfer.

Related to these transfer issues is how the enterprise treats *compensation* of both owners and key employees. There are many techniques available for transferring income year to year. Again, assess these from the dual perspectives of control and tax impact.

Financial and legal together. The wildcard that allows for maximum control of the desired outcome is an effective *buy-sell agreement*. We all know we won't live forever. We can anticipate exit strategies either on schedule or out of sequence. By planning for the options and negotiating mutually agreeable results before the pressure of a crisis, the entrepreneur can maximize wealth preservation and transfer success. Like the proverbial umbrella, it's best to have it before the storm clouds gather.

To make the buy-sell effective, you must *fund it*. Pull together the pieces regarding financial and legal planning to determine costs involved for major alternatives. Then line up the appropriate financial instruments to achieve the desired control, tax and transfer results. Typical funding tools include life insurance, annuities, and sinking funds, unless existing cash flow is sufficient both to carry the ongoing enterprise as well as compensate the exiting owners or their heirs.

Starting with the end in mind. Business owners who ask themselves how they will preserve the value of the business for when they are no longer in business will keep their financial statements current, analyze them regularly both independently and with professional advisors, and arrange legal structures for their present and future positions. By anticipating their requirements, generating choices, making decisions, and implementing them, they eliminate anxiety and enhance their chances for success.

*** Tim Leighton is a lawyer and Certified Financial Planner™ who helps business clients plan for building their enterprise and providing for its continuation after they stop being in business.**