20 views | Sep 24, 2019, 07:00am

Succession Planning 101: The Keys To Successfully Handing Over Your Business.

YEC COUNCIL POST | Paid Program
Entrepreneurs

POST WRITTEN BY

Jennifer A Barnes

Founder & CEO of **Optima Office, LLC**. Jennifer is a tenacious entrepreneur who enjoys jogging on the beach and snowboarding.

GETTY

More U.S. business owners than ever before are considering retirement right now. Assuming your exit plan doesn't simply involve locking the door and never looking back, there are a number of reasons why you need to start thinking about how best to hand over your business at least two years prior to your planned departure (better still, make that five years).

The stark reality is that many business owners are surprised to discover that they're not going to end up with as much money as they've been expecting. Taxes are the biggest culprit. In California, plan on handing the taxman about 40% of your net proceeds. Factor in transaction costs and you're easily at 50%. Moreover, the real value of your business versus a "back of the envelope" valuation can be a shock.

Leading a team of tax and accounting specialists, I know that succession planning is about more than just finding someone to fill your shoes. So, what are the key factors in beginning your succession planning process?

The Who

Who is going to own or run your business once you leave? One big advantage to choosing your successor early on is that you have time to pass along the skills they need to do the job justice. You have three main options: family members, employees, or an independent purchaser.

• Family: Of course, it may be that you've successfully raised children who now enjoy careers outside of your industry, so for many reasons family might not be the right answer.

• Employees: Employees, who can buy through employee stock ownership plans (ESOP) or other structures, can present a good route to easing your transition in a way that minimizes risk.

• Purchasers: Perhaps you favor an external purchaser — a competitor or strategic or financial buyer — as the best deal for you and the future of your business.

The What

Quite simply, what are you going to sell? Assets? Stock? All? Part?

The When

Once you've decided what to sell, when will you sell it? Should you sell everything at once or sell a little now and more later?

Armed with your who, what and when, let's take a look at the five most common issues facing business owners when succession planning, in order of magnitude:

Insufficient Time Frame

More time means more options, so commit to two to five years as a minimum to plan and implement succession and handover. There are serious consequences to leaving insufficient time to plan, including:

• Being unprepared when a personal crisis forces you away from the business temporarily, or permanently, prompting an early sale without a plan.

• Passing along most of your sales proceeds to the taxman, not being able to maintain your existing lifestyle while paying your successor enough to succeed.

• Crippling the business by handing it over to an ineffective successor. This has the knock-on effect of reducing the business's value at sale and diminishing your retirement income.

Remember, succession planning also comes into play when you're taken away from the business unexpectedly. A plan provides the peace of mind of knowing your business is in good hands while you're elsewhere.

The best time to start succession planning is before you even open your doors, but since that's not always realistic, make sure you begin the process as soon as possible.

Poor Tax Planning

For one thing, good succession planning can significantly reduce the taxman's bite (although it does need a few tax years to fully iron out the details).

Many privately held business owners have little or no basis in their stock and therefore pay full state and federal taxes on the net proceeds upon sale. Most of these companies manage their taxes aggressively and take excess cash in the form of dividends, salary and distribution so there's very little basis upon sale in the taxman's eyes. For example, if your basis is $200,000 and your net sales proceeds are $500,000, you pay state and federal taxes on your gain of $300,000. In California, that might be as much as 35-40%, which could add up to $120,000.

While it's complicated, there are ways to increase the basis in your company and reduce the amount you will owe upon sale. Good tax advice and strategies are a sound investment.

Lack of Preparation Specific To Your Target Buyer

Most sellers aren't prepared for thorough due diligence from buyers. Without a plan, the process takes longer, which, along with any arising issues, can drive drown the selling price or kill the deal.

Failure to Understand What Buyers Value About Your Business

Knowledge is power, as they say, so one important part of your succession strategy is truly understanding what buyers need when considering a purchase and then doubling down in those areas. That might include:

• Evidence of accurate and consistent financial performance such as financial statements and tax returns.

• A strong team with the ability to support the new owner or leader.

One top tip is to meet with a valuation expert well in advance so that you have a realistic idea of the value of your company.

Wrong Time, Wrong Buyer

You want to sell to the right buyer at the right time for maximum profit. A bad choice would be, for example, when you sell to employees through a poorly structured employee stock ownership program (ESOP) when the company is growing rapidly and consuming cash; the stock value will rise, employees may sell at the appreciated value and your company could face a further cash squeeze. Being ready to capitalize on the right opportunity when it arises is everything.

Many business owners think of succession planning purely in relation to retirement or moving on to pastures new. However, a good, well-thought-out succession plan also comes into play during emergencies. It’s a critical but often overlooked area for many businesses that can mean the difference between a well-managed transition and a full-blown crisis. It’s the key to a successful retirement and a chance to breathe new life into your much-loved business.

YEC

Young Entrepreneur Council (YEC) is an invitation-only, fee-based organization comprised of the world's most successful entrepreneurs 45 and younger. YEC members repre... **Read More**