Key Drivers to Successful Business Succession Planning

Four factors that will guide your decision on ownership transition

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When contemplating business succession options, there are several changes that private and family-owned businesses can make to positively impact their bottom line today, aiding in their keep-sell decision down the road.

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Most business owners do not have — but plan to develop — a formalized business succession plan. However, given the changes to competitive positioning and dynamics, capital market conditions, shareholder dynamics and the tax laws, you may not want to wait any longer. Planning ahead and anticipating changes in these areas could have favorable implications for your business strategy and shareholder harmony.

No matter how you plan to transition your business — keep, sell, employee stock ownership plan (ESOP), initial public offering (IPO) — knowing your options and building efficiency and flexibility today will provide financial peace of mind for years to come.

So what are the key determinants to guide your decision on ownership transition? We focus on the following four key drivers:

- Competitive positioning
- Capital market conditions
- Shareholder dynamics and objectives
- Changes in tax laws

Evaluating whether you have the right combination of competitive position, financial and human resources to drive production will also help determine whether to keep or sell.

In some cases, the best positioning for a company and opportunities for its employees is to sell the company to a competitor. In other situations, the better option may be to acquire a competitor or simply stay put.

Competitive positioning

As a business owner, you realize that shareholder value is ultimately a function of your company's competitive position within your industry. One way to determine the extent to which you have gained and sustained a competitive advantage is to compare your historical and current financial metrics to an industry, segment proxy or averages you deem appropriate. Now challenge yourself: what can you do to get an edge on the competition?

As if leading and managing an enterprise during turbulent times isn't challenging enough, strategic positioning for the private business owner adds much more complexity than ever before. The balancing act of coordinating your competitive business vision with the appropriate amount of financial and leadership resources is key. Given the favorable

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financial conditions, the cost and availability of capital allows most business owners the ability to finance their business opportunities.

Your key leadership team

What kind of key leadership team do you need? It is not just about the team that got you to where you are today, it's also about the team you need to take you to where you want to be in the future.

Examine your incentive plans to see if and how they align with the strategic initiatives of the organization. Too often, there is little emphasis on incentive for senior leaders to identify, train and develop their replacements. Without strong depth and breadth within the management team, the value of your business will decline as your competitive positioning erodes.

Capital market conditions

Other key questions during the decision-making process are: "What are companies paying for businesses like mine? What are the terms? And how would this change my financial snapshot and profile? It is important, regardless of whether you decide to keep or sell, to know the impact on your personal financial statement, cash flow, liquidity, risk profile and asset protection for you and your family.

For larger businesses and estates, you may need to think in terms of a multi-generational family financial snapshot and profile.

Before you make a decision, have your financial advisory team help you prepare and plan for either option. Encourage them to provide thought-provoking, strategic insights and share best practices of what other families have done and why.

In some cases, by the time you sell the business, pay taxes and reinvest in today's low-yielding capital markets, you may find the cash flow drops to 25% or less of the cash flow you had prior to selling. An all liquid, well-diversified portfolio has radically different risk factors and family harmony implications versus an illiquid private business.

Shareholder dynamics and objectives

After financial peace of mind, the most essential objective of most business owners is shareholder and family harmony. The integration of business and family goals as well as all the financial needs can develop into a transition of wealth that brings with it tremendous conflict.

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not only strengthens family bonds, but it enhances the company's ability to compete. Without a business succession plan, those who benefit might not be those you would choose.

Changes in tax laws

Competitive positioning for private and family owned businesses in the United States requires that the owners anticipate changes in areas that effect the health of the business, including areas that are less familiar, such as strategic wealth planning. Recent changes in the tax laws may create one of the largest competitive positioning opportunities of your lifetime. If ignored, however, they may pose one of the greatest threats to the survival of your business.

Under the new tax reform, estate tax exclusions, which had been approximately $5.5 million ($11 million for a married couple) has doubled to approximately $11 million ($22 million for married couples) and a federal estate tax rate of 40%.

The favorable conditions that are in place today will expire in 2025 if no changes are made by Congress. Considering increases in budget deficits and potential changes in the political climate, the "sunset" provision date may come sooner than 2025. Thus, the current window of opportunity may be short-lived. In order to strategically position your business and shareholder wealth for long term health and harmony, run the math now and compare the results against doing nothing.

The obligation to pay estate taxes is borne, personally, by the shareholders. However, from a competitive strategy standpoint, for businesses (and estates) above $22 million, the estate taxes are effectively a "hidden liability" on the corporate balance sheet equal to approximately 40% (plus state taxes) of the value of the business.

The question you as business owner, your CFO and underwriter need to ask is, "How can my company compete long-term if my estate must pay 40% or more of the value of the business in taxes simply to 'Stay in the game?'"

What is the potential cost of waiting?

Using the Rules of 72 as a handy guide, the value of an estate growing at a rate of 7.2% doubles in value every 10 years. The associated estate taxes increase as well. For deaths occurring after 2017, assuming a 60-year-old couple with a taxable estate of $22.4 million, there would be no estate taxes if both spouses died. However, assuming federal and state rates of 45%, by age 70, the estate tax liability would increase to more than $10 million and by age 80 to over $30 million.

Given the aging business owner, the ability to "fund away" the estate taxes with life insurance becomes unaffordable, and eventually unavailable (for health reasons). If the value of the business is a majority of the net worth, this growing and hidden liability (with no known due date) becomes a serious risk that jeopardizes the company's ability to compete.

By strategically positioning your family wealth (as you did your business), you may be able to properly "plan away" some or all of the estate tax liability. If you plan well, your shareholder and family wealth plan should be easier to communicate and hopefully enhance the likelihood that everyone will want to get together for holiday dinners.

The future is now

The economic reality for private business owners in the United States is that it is crucial to integrate an efficient and flexible personal wealth management strategy into your corporate strategic planning objectives. The earlier you begin the planning process, the more cost-efficient and seamless the ownership and management transition are likely to be. You may be able to strategically position for the future, but also to maximize value irrespective of the keep or sell decision.

Planning well and early will allow you to benefit the entities closest to you: your family, your community (via philanthropy) and your employees.

Ready to help

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