

PRACTICAL MATTERS

Succession Planning Necessary for Survival

Closely held or closely controlled businesses — those with a limited number of owners or principals in control — account for approximately one-half of all business activity in this country. Surveys suggest that these businesses also generate more than three of every four new jobs. Yet despite their critical role in our economy, only about 30 percent of these businesses survive to a second generation of ownership, and fewer than half of those make it to a third generation.

These businesses fail for a myriad of reasons, the most common of which is the absence of a business succession plan. Many owners become so immersed in day-to-day business pressures that succession planning — with its series of difficult questions and challenges — is viewed as sufficiently frustrating and burdensome to be considered a waste of time.

That thinking is both shortsighted and self-defeating. Business succession planning is absolutely necessary to ensure that a business' success is preserved and further developed. While the methods and tools vary, and their application necessarily depends upon the circumstances unique to each case, there are a number of considerations that apply in nearly all situations.

When to start the process? Ideally, the process of business succession planning should be addressed when the business is first organized. Though plans may be tentative at startup, that's when organizational and structural decisions should be made, when tax and valuation considerations are most easily handled. Most businesses today are set up



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as limited liability companies, the proper structuring of which is to establish two or more classes of interest so that voting or control can be separated from participation in the distributions or proceeds as the business prospers.

Who participates in the process? Initially, the process involves the business founder(s) and advisers — the attorney, the accountant and other professionals. Over time, as the business develops, key employees, other consultants, business brokers and even respected outsiders may play a role.

What are the initial issues to be addressed? The two threshold issues for a business succession plan are A) defining the business itself; and B) determining the owner's expectations for its growth. Inherent in defining the business are determining its place in its market and attaching a value to it.

While business succession planning often contemplates future generations of "inside" ownership, the determination of a business's value and an analysis of opportunities available once that value is established sometimes dictate that the best succession plan is to sell or merge the business. Transitions of this nature often result in more immediate value to the owners, and also provide the opportunity for the business to grow to the next level — an option usually not available without the infusion of capital and resources. The "regionalization" or "rolling up" of many local businesses are good examples of these opportunities.

Tax and liquidity considerations

Both income and estate taxes will have an important and sometimes critical impact upon any business succession plan; you need a lawyer and/or accountant experienced in such matters to be involved. Similarly, both the business's and its owner's liquidity needs must be carefully projected to ensure the success of any plan. While statistics vary, the failure to anticipate liquidity needs accounts for a substantial number of the failures of otherwise successful businesses.

When family considerations apply

Many, but certainly not all, closely held businesses are owned solely or predominantly by members of a single family. Even where family ownership does not exist, there are often "family-type" considerations involved in the planning process, especially when the owner wishes to make provisions for her/his spouse. It is important to identify the family members currently — or in the future likely to be — employed by the business, and to define their current and potential future roles in — and expectations from — the business.

Commit the plan to writing

Without an effective plan, nearly 90 percent of all closely held businesses will not survive to benefit the first and second generations following the founders. Committing the succession plan to writing is the best method of defining goals most accurately and memorializing planning so that it can be reviewed and modified over time. Addressing these matters in writing also helps achieve a level of communication that assists in resolving issues otherwise left to chance, which is an invitation to future failure.