The time is now to plan for succession

You’ve worked hard, whether building your business from the ground up or leading an established institution. Maybe you have added another company or two. Life is good. You love your job, and things are going well. So why would you want to think about succession planning?

Inevitably the time will come when you are not running your organization anymore. And that is why every owner needs to create a succession plan to protect the future of his or her business.

“The appropriate time to start thinking about succession planning is the day after you open the business,” says, Mark Perry, executive vice chairman of Global Commercial Banking for Bank of America Merrill Lynch. “No one does that, but that’s the right time. Or maybe even before purchase; it could be structured in the acquisition.”

“You have been busy managing and building your business,” says Perry. “You need to step back and take the time to look at what you want your business and personal legacy to be.”

Every business owner needs to ask: What is going to happen to this company if something happens to me? And then the business needs to plan accordingly.

Creating an ownership-transition plan is critical to business success. Following are key considerations and steps to help you achieve a seamless transition, protect your business, and allow your family and staff to benefit from your hard work.
Succession planning encompasses a number of important considerations:

- Designating a person who will operate the business if you are suddenly disabled
- Creating a detailed plan to leave the business to your family, a partner or a colleague
- Investigating the best ways to help your estate pay the estate tax and other costs associated with transferring the business to a new owner
- Preparing your business to be sold if there are no obvious successors
- Naming a person who will run the business until it is either sold or officially passed on to new owners

If you don’t have an answer and a plan in writing for each of these scenarios, it’s time to begin working on a succession plan.

Ask yourself:

1. What will happen to my business when I retire?
2. What will happen to my business if I am disabled?
3. What will happen to my business when I die?

“This is a very personal decision for owners. So they don’t want to think about leaving their company — it’s so much a part of who they are.”

Karen Reynolds Sharkey
National Business Owner Strategy Executive, U.S. Trust

The goal of all of these steps is to provide for your family and your employees and to protect the business you have built. “Your view of your legacy will determine your succession path, but you have to plan for it,” says Perry. Although succession planning primarily deals with the future of the business from a managerial and ownership perspective, business owners who begin working on a succession plan find it often overlaps with estate planning, which is all about preparation to transfer assets either during life or after death. Sometimes one set of legal and financial documents can meet both needs, says Holly Swan, managing director and wealth strategist at U.S. Trust, Bank of America Private Wealth Management.

“Owners have passionate feelings about what they want to have happen with their business,” Swan says. “Some feel strongly that they want it to go to their kids — but haven’t asked if the kids feel the same way, and haven’t really assessed if they are equipped to run a business. Also, oftentimes key managers — those designated as successors — might want a piece of the business in order to stay on.” She says effective succession planning considers all of this.

“Your legacy is the core issue of succession planning,” says Perry. He suggests business owners discuss what their objectives are, what their options are and begin preparing their business for transition.

Five options for retiring business owners

As your career winds down and you think about retirement — and what will happen to your company after you leave it — you have several options to consider. You can:

1. Transfer ownership to family members
2. Transfer ownership to employees, management or partners
3. Sell to a financial or strategic buyer
4. Take the business public — an option only for a small number of carefully groomed companies that have achieved a critical size with clear growth prospects
5. Liquidate the business — a real but usually unappealing option

The ESOP option — Employee Stock Ownership Plans (ESOPs) are tax-advantaged liquidity solutions that enable business owners to sell all, or only a portion, of their businesses.

They generally enable business owners to:

- Gain liquidity with less financial burden
- Continue leadership, governance and equity participation (if desired)
- Diversify assets
- Create employee ownership
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- Reduce Federal income taxes

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Perry notes that entrepreneurs are uniquely qualified to take on philanthropic causes because they’re in the business of solving problems. That same attitude leads business owners to drive creative and diverse giving strategies.

Perry also recommends to engage in practical thinking about your industry. “You have to understand if you are in an industry that is ripe for growth, such as cybersecurity. This could help guide your succession plan. Or, are you in an industry that calls for consolidation or acquisition such as healthcare or industrials?” Typical growth industries, according to Perry, include automation, cloud services and security, healthcare and medical devices, and consumer discretionary products. He identifies consumer staples, telecom and utilities as consolidating businesses.

Top questions for a business owner

- How do I plan now to transfer my business to my family members?
- Can I transfer my business to non-family members at retirement?
- What’s the best strategy for reducing my estate taxes?
- How do I create a lasting legacy for future generations?
- Is there a way to enhance liquidity to preserve my business?
- How do I reduce my income tax exposure?
- When do I start planning for my real estate?
- What are planning-related pitfalls to avoid?
- Can I create a planning roadmap to keep me on track?

Why succession planning is important

Succession planning is really about taking a complete look at where you are in your family life and understanding what is the best thing for you as a business owner — and also asking, is that the right thing for my business and family?

Customizable solutions are available for almost any situation. If the owner would like to pass the business on to a manager or partner, a buy/sell agreement can be created. If the owner expects the business to be sold to a third-party outside buyer, steps can be taken to maximize the perceived value. Alternatively, the owner can sell only a partial interest in the business to an outside buyer to raise funds and provide liquidity.

Or an owner might have three children, only one of whom is involved in — and interested in — the business. “We’re seeing more and more private equity deals set up as part of the planning process, to reward the kid who is involved in the business yet be fair to the others,” Swan says. Those sorts of deals allow the owner to pass control to the involved offspring, while monetizing part of the business and passing that on as an inheritance to the others.

At bare minimum, Swan says, every owner’s succession plan should include an agreement to keep a key operational staff member — a general manager, for instance — in place during any transition to new ownership, even if the business will be sold.

“Many times we see individuals who have documents such as a will and a trust in place to pass on their wealth but lack the structure to serve the needs of the business,” says Bob Kitzman, senior vice president and business transition specialist at U.S. Trust, Bank of America Private Wealth Management. “There should be an overarching plan to enable a smooth transition of operations and management to go along with a change in ownership.”

And finally, consider this: The federal estate tax will take 40 percent of your assets over $11.18 million (or $22.36 million for a married couple). Estate taxes are due nine months after the owner’s death, meaning that beneficiaries have only a limited amount of time to come up with the money.

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Mitigating the effect of the estate tax on your family and beneficiaries—by gifting some of your wealth to beneficiaries during your lifetime, buying insurance or moving assets to liquid accounts—requires planning. You never want to have to sell business assets in a fire sale in order to cover the taxes.

What makes your business attractive to a potential buyer?

- Stable, healthy revenue stream and cash flow
- Good visibility into future financial performance
- Growth potential (organic and/or through acquisition)
- Strong history of profitability with the potential to expand over time
- Strong industry fundamentals
- Leading market share or unique market position
- Diversified and loyal customer base
- Proven, strong, competent and remaining management team (or belief that value can be created through management changes and/or additions)
- Tangible assets: equipment, inventory, property, computers in good shape
- Intangible assets: brand, trade secrets
- Desirable location
Steps to a successful transition

You’re ready to create a succession plan. Where do you start and what do you need to keep in mind? Here are the key steps and pitfalls:

1. **Assemble the right professional team to help**

   "You need to surround yourself with the right advisors who can provide input on all aspects of succession such as wealth management, family goals and business management succession," says Perry. He adds that advisors should include outsiders and not just family or management.

   “A lot of business owners, especially self-made businesspeople, don’t involve their advisors as often as they should,” says Laurie Krupa, managing director, Business Banking region executive. “They think, ‘I grew this business myself.’ Often they don’t have a lot of liquidity; their free dollars go back into the business. So calling an attorney and watching the clock tick and the legal fees accumulate is unappealing.”

But an effective, successful plan will require the correct set of professional advisors. That probably means more than one attorney: your corporate counsel as well as an estate planning lawyer — their expertise is different and you will need both. "We recommend looking beyond the M&A attorney who helped you acquire the business who probably is not an expert on estate planning," Swan says.

While you may not want to involve more than one attorney and the rates may be higher for specialized attorneys who handle succession planning, they may ultimately save you money because they are faster and provide up-to-date, expert knowledge, she says.

The process also will involve your accountant, as well as your financial advisors. Improve efficiency by designating one member of the team of advisors as the lead person, Kitzman says. "When everyone thinks they are in charge, nobody is in charge," he says. If you have an investment or wealth advisor, that person may be willing and able to coordinate the efforts of the team at no extra cost to you.

2. **Sit down with your advisors, family and key staff**

   It’s time for honest conversations with your family members about their interest in staying involved in the business. Some business owners have an idea about their kids’ future involvement, but have to ask if the kids really feel the same way. The same thing is true about key managers, who may be interested in becoming owners, or part owners. On the flip side, their loyalty may rest with you; they may not want to stay on permanently without you there, but may be willing to do so during a transition to new ownership.

   These conversations can be a lengthy process, and the owner can end up in a tug-of-war looking at all the possibilities. It’s hard not to come at it from an emotional perspective. "But once the owner looks at all the numbers, and where everyone stands, they can step back and figure out what really is best for the business and the family," says Swan.

If you’re thinking about leaving your business to your children

- Communicate your goals regarding the company with family members regularly.
- Expose your children to the business at an early age.
- Encourage your children, if they’re interested in the business, to educate themselves in the appropriate skills, with formal education and job experience outside the firm.
- Determine the appropriate person in the family with the right temperament, skills and experience for leadership.
- Consider working with an outside expert, possibly a professional psychologist or a third-party expert in family business dynamics, who can help with decisions about family succession and facilitate regular family meetings.
- Create a board with a majority of nonfamily members, which can be helpful in professionalizing the plan.

If you are the child of a successful business owner

You may realize the importance of succession planning but find it difficult to start the conversation with your parent.

Swan suggests a good entry point is asking your parent to sit down and talk about the business in the context of their own personal life. “You might tell your parent that you’re doing your own financial planning now and need to understand how the family business fits into your finances and your future,” Swan says.

Or, she says, ask to compare notes as you draw up your own estate planning documents, including wills, trusts and power of attorney papers. “Tell your parent that you want to make sure that your planning documents are being drafted properly and accordingly, based on what’s in your parent’s and the company’s documents,” Swan says. “That is a good way to start talking about what exists and what needs to be done.” Be confident and know that although it may be tough to get the conversation going, it’s critical for your parent, your family and the business.
Remember to plan for three scenarios:

- Who should take over the business if you are disabled?
- What will happen to the business if and when you retire?
- What will happen to the business upon your death?

Once you have an idea of who should take over the operations if you are disabled and where the business will end up after you’re gone, there are a variety of ways to turn that plan into reality: trusts, private equity deals, changes in corporate structure or gifts. That’s where your professional planning team’s expertise will come into play.

Swan suggests planning early, with the right advisors, and then putting your assets into the structure you create. It’s important to honor the formality of legal entities. She says business owners can get in tax trouble when assets are in an entity, but the owner continues to act as if they are still personal assets.

Make sure your plan accounts for estate taxes

Your money — and your business’s assets — may be almost completely tied up in capital assets, real estate or long-term investments. The succession plan should include a way to create some liquidity — available funds that your spouse, children or partners can access quickly to pay any estate tax and other expenses of transferring the business to your chosen successor.

One of the objectives in succession planning is to understand the timing the government allows for estate taxes and to realize the family or other successors may not have the ability to pay the tax when it comes due. Rather than force the sale of assets, you can buy life insurance or create a pool of money outside the business that is accessible to pay the taxes. A portfolio of liquid assets specifically designed for liquidity down the road makes your beneficiaries lives a lot easier.

Accept that setting up a succession plan will cost money

Just creating a set of estate-planning documents, including wills, trusts and power of attorney papers, can cost $5,000 to $10,000, Swan says. The succession planning process goes beyond that and will cost more depending on what path you choose. For instance, you might want to change the way your business is structured — split your business into voting and nonvoting shares, and then gift some of those nonvoting shares to your children through a trust. That will require putting in place several new legal documents.

Swan and Kitzman suggest a ballpark figure of $10,000 to $50,000 for the cost of thorough succession planning — again depending on the complexity of the succession plan, the complexity of your business structure and what documents you already have in place. But they quickly point out that even if it sounds expensive now, it will be more difficult and more costly to wait. “Anything you do will cost less if you do it upfront,” Swan says.

Review your plan on a regular basis

Once you have a plan in place, the work is not done. You’ll need to pull everything out and look at it periodically, in case the plan no longer fits the situation. Your family situation might change. For instance, the success of the plan might be counting on one of your kids getting experience and training. That might not happen. You’ll also need to keep asking if key managers are still in place, and still comfortable with the plan, based on the current situation.

Kitzman suggests looking at the plan annually. “People’s lives change,” he says. “If you’ve named a successor, maybe a family member to assume leadership or a key employee designated to operate the business during a transition, check in and make sure the plan is still appropriate. A good advisor can help you create a flow chart that illustrates the intent of your documents. When there’s a big change in your life or business, pull out that sheet and assess which parts of the plan still work or might not work anymore.”

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