Avoiding the Pitfalls in Business Succession

By: John W. Kaiser, Jr.

Have you thought about what would happen to your business if you were to become disabled or die? Do you want your children to take over? Will they be capable of doing so? Will the business be ready for them?

Many business owners think about these questions but fail to plan the answers. Lack of planning is a prime reason why only 30 percent of family businesses survive to the next generation. Without succession planning for a closely held business, several things can happen – all bad. Among the common problems:

Nobody is ready to lead.

Too many entrepreneurs fell the business can't get along without them – and they're right. That's because they haven't planned for a successor. The person who takes over will have to go from one crisis to another.

The "vultures" will take over.

If the owner has been the key contact with customers, suppliers, the bank, and outside consultants, the competition will steal the business; suppliers will be less cooperative and more demanding; the banker will be nervous, and consultants will command rather than consult.

The business will be sold at a fire sale.

We've seen the results when the owner dies and no one is there to manage. The family must sell the business quickly to protect its goodwill and its value as a going concern. Unfortunately, the price they get maybe much less than fair market value.

The government will get more than its share.

It is common for the founder of a business to the stock to the family. Often it is for the benefit of the spouse, going to the children after the spouse's death. If the spouse is already deceased, or dies shortly after the founder, the result can be very high estate taxes.

Valued employees lose their source of livelihood.

If your business is sold, how many employees will be retained by the new management? If the new owner has been in the same business, you can be almost sure your valued employees will be replaced by his or her equally valued ones. The people who helped you build your business may have to look for other jobs.

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You can avoid these pitfalls through good business planning, as follows:

Decide on your successor.
Will it be a family member, a key employee, or an outside buyer? Debate the pros and cons, but make a choice. Even weak leadership is better than no leadership at all.

Develop a plan of action to train the next generation.
Once you choose a successor, teach him or her what he needs to know about the business, but don't expect to reproduce a carbon copy of yourself.

Have a contingency plan.
Introduce your successor to your best customers, your suppliers, your banker, and key advisors. All these contacts should be familiar and comfortable with the plan for the future of your organization. It is important that outsiders know that your loss, whether through retirement or death, will not affect the company in a negative way.

Determine the value of your business.
When you purchase fire and casualty insurance, it is based on the value of the insured property. Succession planning is insurance for your most important property, your business. Your plan is incomplete unless you know its value. Find out what similar companies have sold for and request a valuation by an outside firm.

Put your plan into writing.
If your company has more than one stockholder, you need a buy/sell agreement. Your will and/or trust should be up to date and should provide specifics on the disposal of stock. Shares should not go to family members who are not involved in the business. Draw up a business plan and communicate that plan to key family members and employees.

Good planning is the key.
With proper planning, your business can be one of the 30 percent that survive to the second generation. With your successor securely in charge, you can retire in the knowledge that you've done your best for your family or your chosen replacement. Without succession planning, you may never be able to retire at all.

So it's up to you; if you plan wisely and well now, your heirs will not have to pay for your lack of planning later on when you are no longer active.

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