

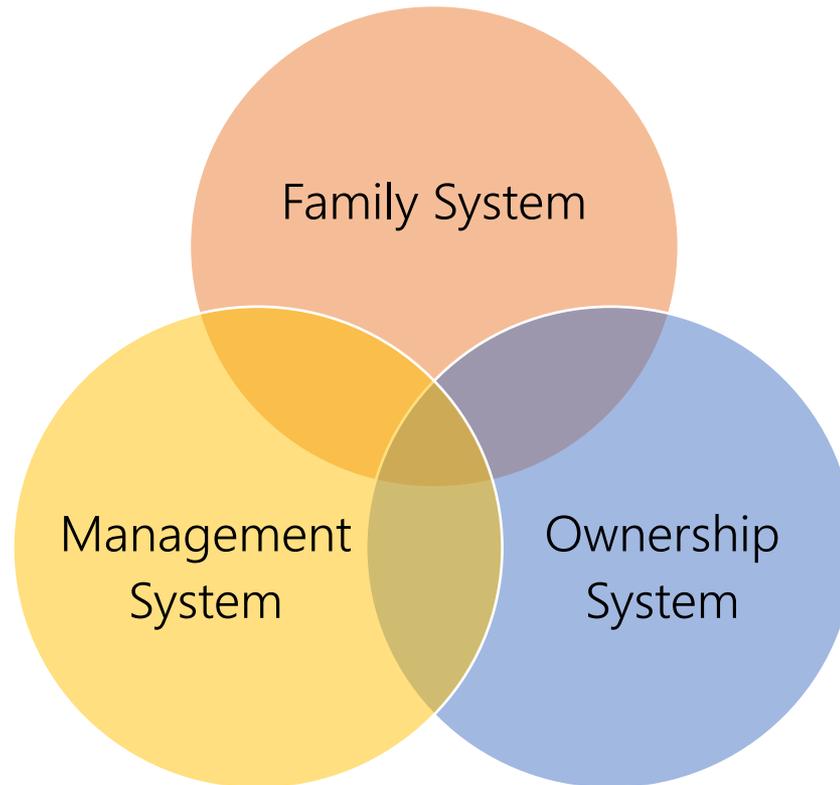
Succession Planning Fundamentals

Kathleen Hoyer, MUPP, CEXP, ACFBA, CWFA

Consulting Principal Team Leader,
Family Business Advisory Services

Tuesday, November 9, 2021

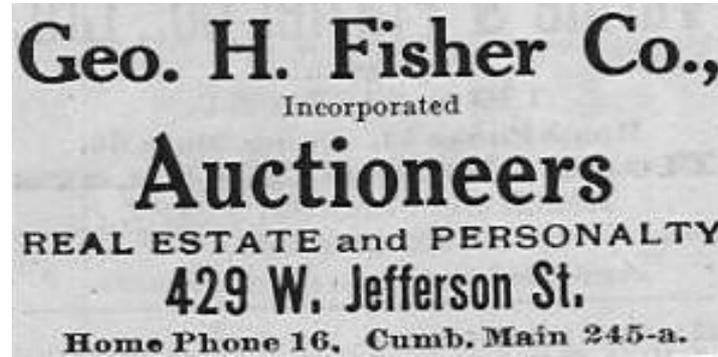
Three Circle Model



An interrelated system of subsystems



Multi-Dimensional



The owner(s) must deal with business, family, tax, and estate issues when planning for the succession of both management and ownership.



Succession Planning is a Process, not an Event



It is one of the greatest challenges of leadership!

It Starts With You

Critical questions:

1. **When** do I want to leave the business?
2. **To whom** do I want to transfer the business?
3. **How much** money do I need to retire after I leave the business?





Grim Statistics

70% of all family firms are either sold or liquidated after the death or retirement of their founders –*Lansberg*

The Odds

- +30% transfer successfully to 2nd
- +12% to the 3rd
- +3% to the 4th
- +1% to the 5th



"BOTH, AND" Thinking

Succession Planning means making the preparations necessary to ensure **BOTH** the harmony of the **family** **AND** the continuity of the **business** through the next generation



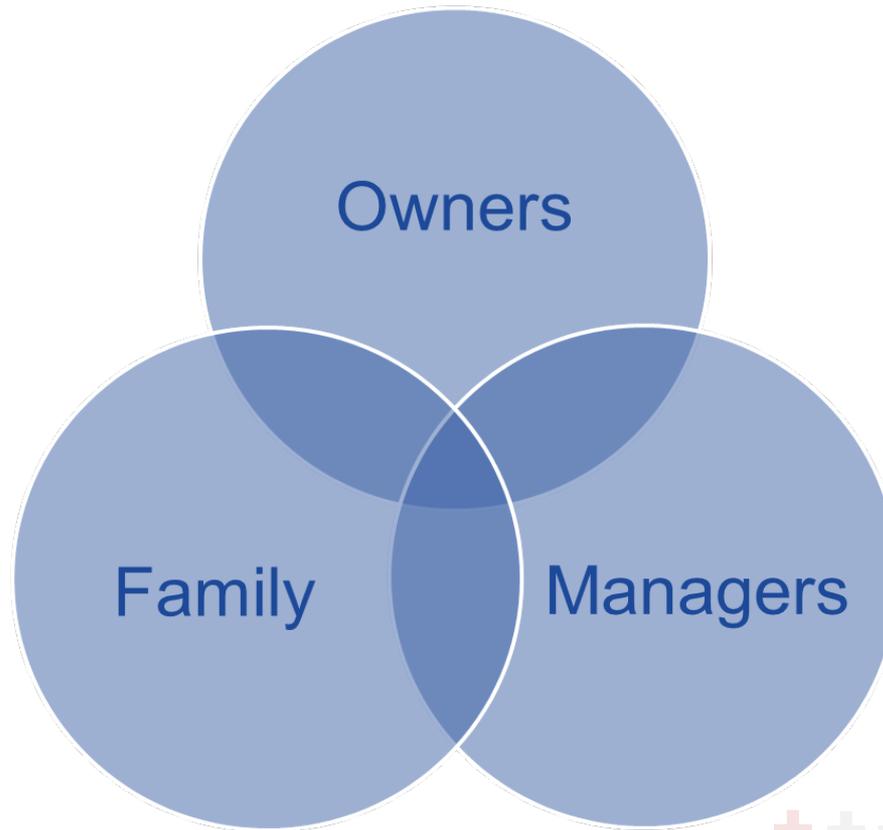
Art and Science

A typical succession plan has two elements, which should be considered separately:

- + Transfer of power: control over the business's operation is transferred to those best suited to exercising it (*art*)
- + The transfer of assets: wealth concentrated in the business is transferred to designated family members, who may be a different or larger group than the person or persons who will be assuming power (*science*)



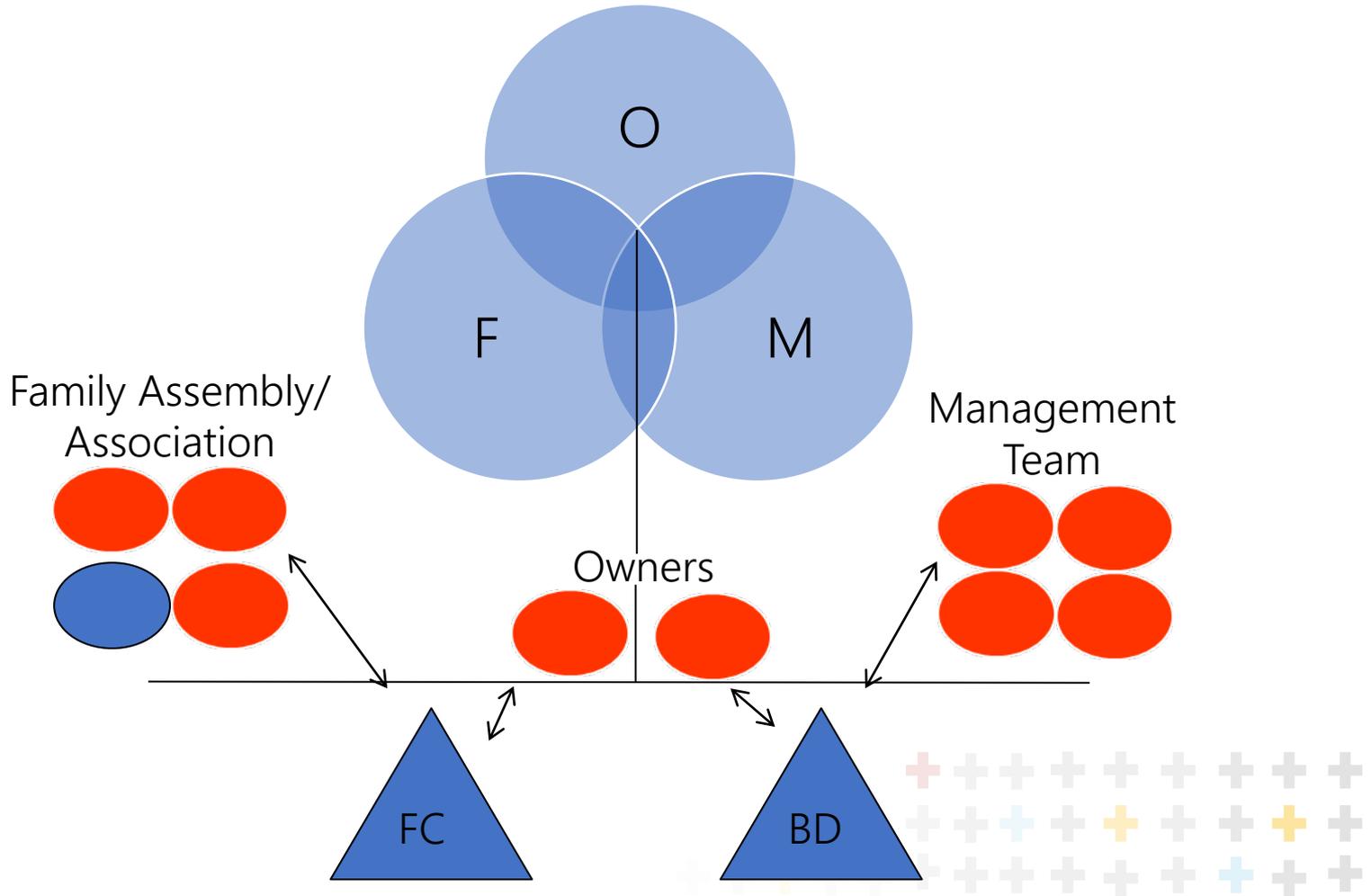
Many Hats, Many Roles, Many Stakeholders, Many Perspectives



PAST=family
PRESENT=family/manager
FUTURE=family/manager/owner



Governance Can Help



Leading with the Head (Hands) and Heart

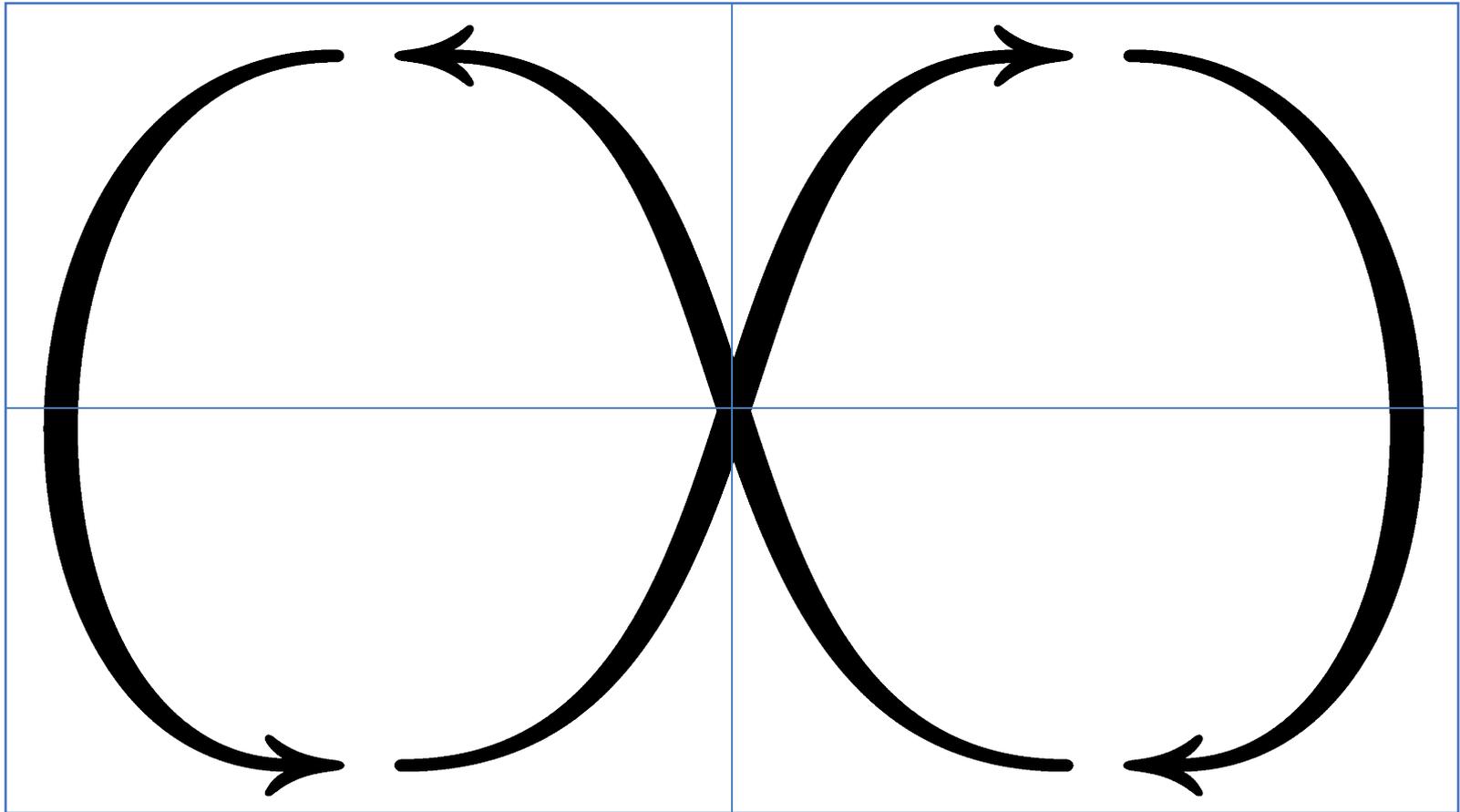


THE "3H" FORMULA

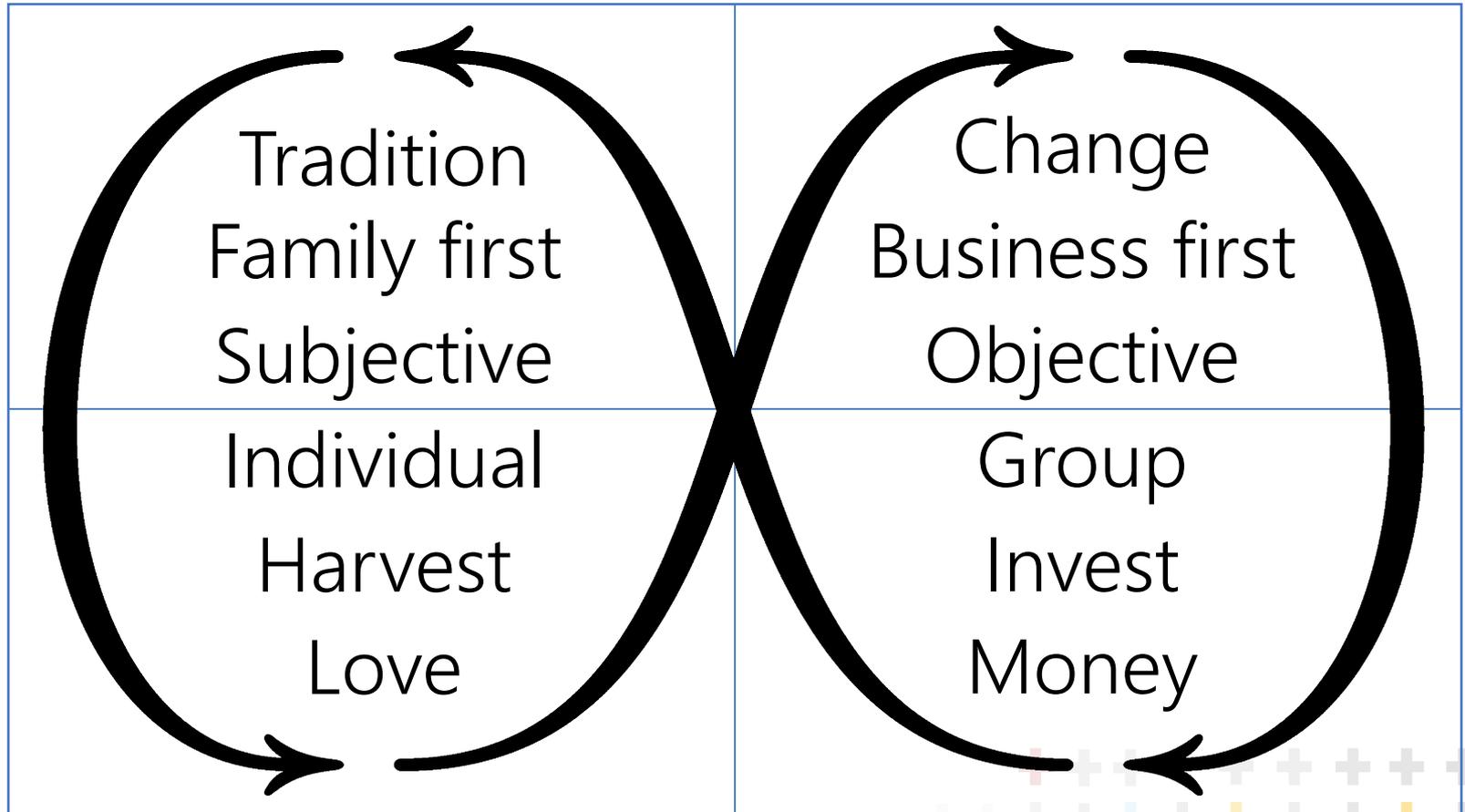


Business-First

Family-First



Finding Balance



Don't Divide

A decision to divide the power between siblings is not likely to be successful.

*Fair is
not
always
equal!*

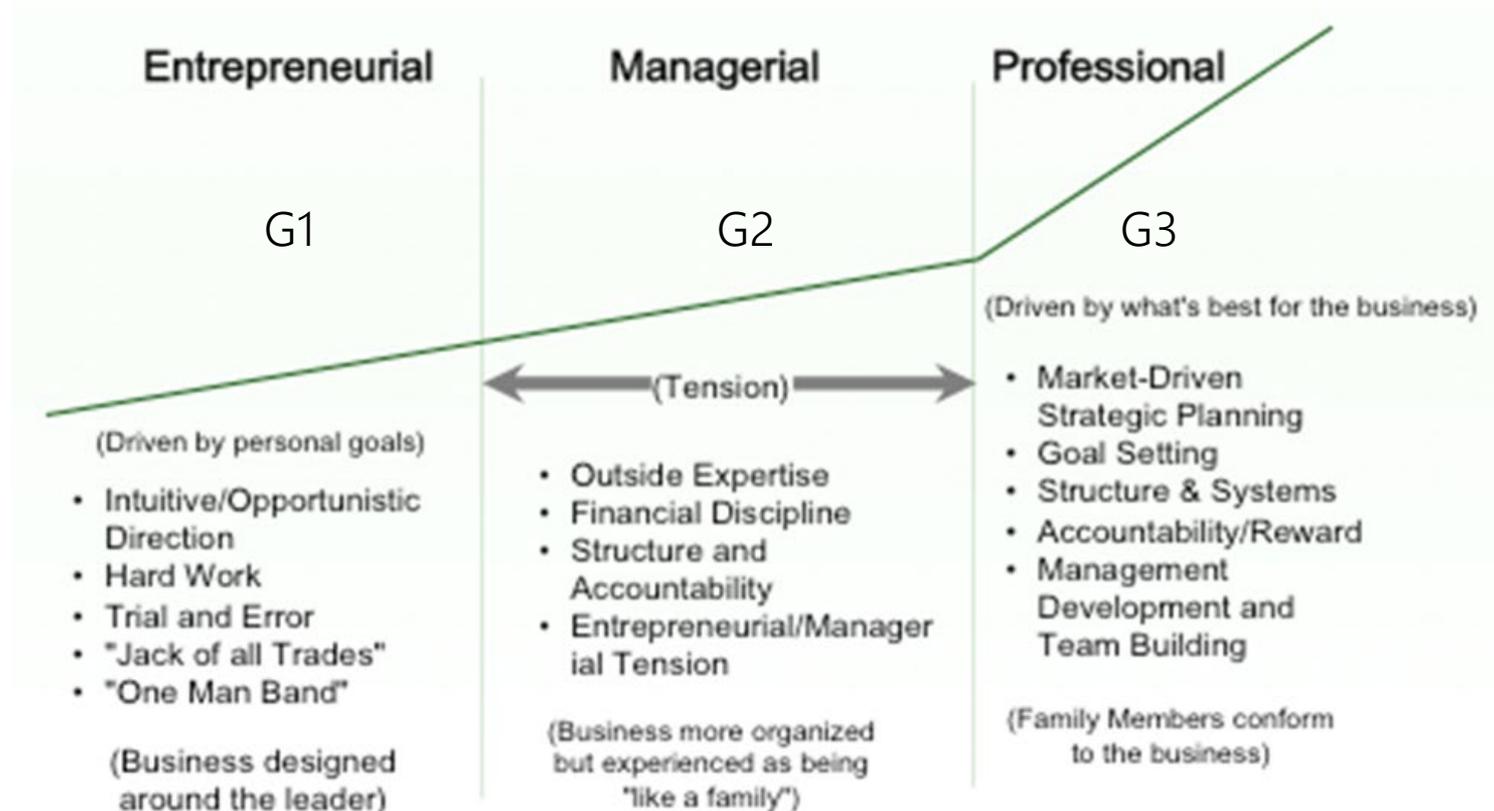


Ownership may be divided equally but **management** should be clearly delineated.

Hint: those who work in the business should own the business



Stages of a Successful Multigenerational Family Enterprise



Three Ownership Structures

- + "Family Partnership"
- + "Brother's Keeper"
- + "Business Partnership"



Ownership Structure #1

Family Partnership



+ Ownership and voting power are divided (about) equally among most or all the next generation, most of whom also work in the business. For example, in a family with four adult children, three or four will work in the business. All will have 25 percent ownership and 25 percent voting power.

+ Issues:

- + Can the group agree?
- + Requires governance/group decision making/conflict resolution policies
- + Must agree that the whole is better than the sum of its parts
- + Decisions can be difficult or slow
- + Independent directors or outside mediators can help
- + Participants must work hard continuously to nurture their relationships, reinforce values, improve communication



Ownership Structure #2

Brother's Keeper



+ One (or perhaps two) of the next generation leads the business. Most of the other siblings are passive investors, but all share equally in ownership. The offspring in the business are expected to take care of the others and control the voting power.

+ Issues:

+ Only works if the sibling in power can accept it with a "stewardship spirit," a joyful privilege to serve current and future responsibilities

+ Must be willing to adjust ownership and control to the circumstances facing the third generation when its time comes



Ownership Structure #3

Business Partnership



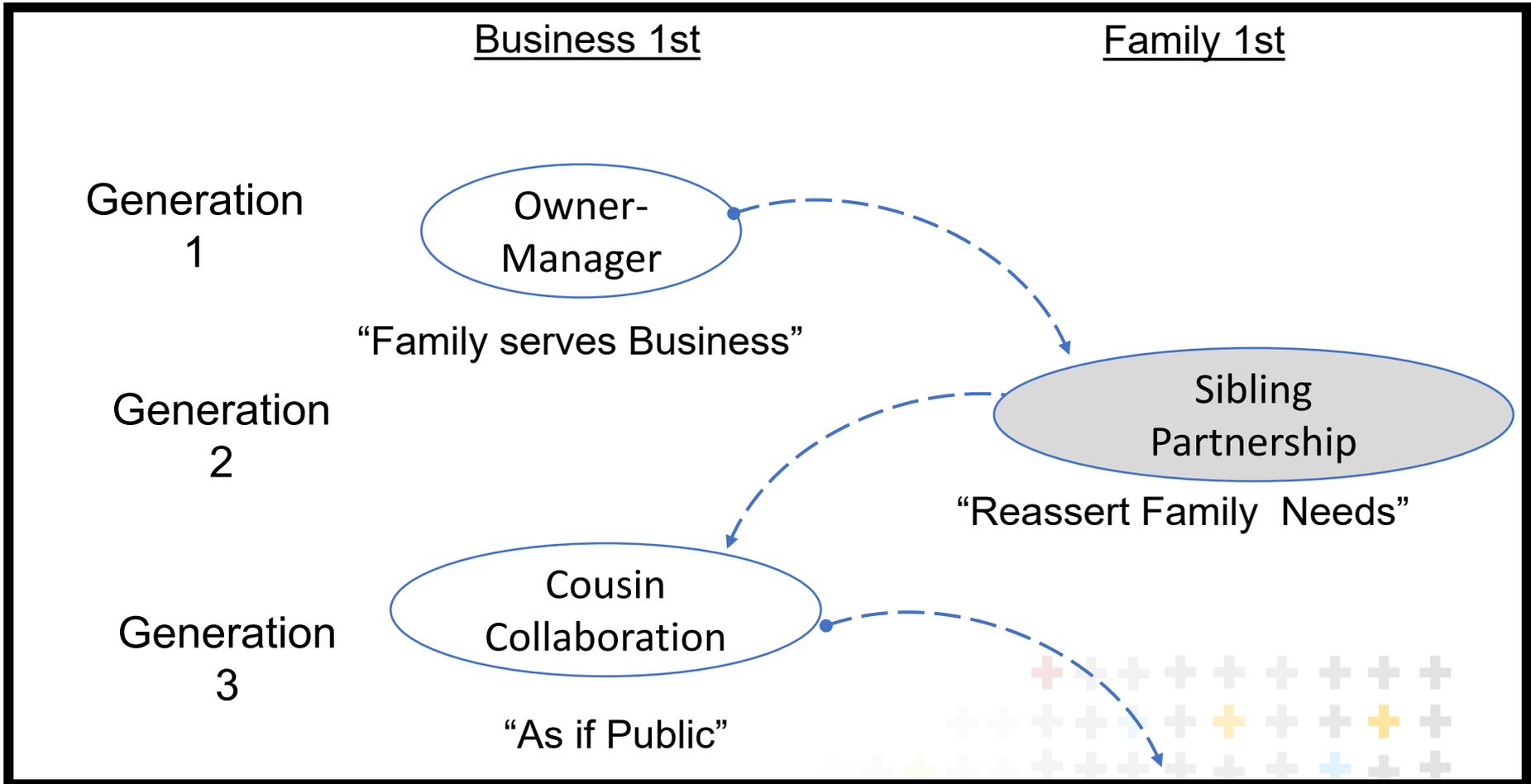
+ Ownership is limited to those in the next generation who commit their careers to the business. For example, in a family of four, one or two go into the business and receive all the shares and voting power. The other siblings are provided for with other assets from the parents.

+ Issues:

- + Works best when business requires very specialized talents
- + Future leaders purchase shares then sell them back at the end of their tenure
- + Prices for shares are modest
- + Requires rigorous entry standards into the business/strict selection process



Common Generational "Oscillations"



Successor Challenges

- + Solidify the **administrative** structures required for the continued development of the enterprise
- + Develop the **ambidextrous** quality of maintaining core competencies while also focusing on innovation
- + Gain **respect** and authority



Training is Essential



- + Experience/training in **all aspects** of the family business operation, from sweeping the floor to driving the truck or counting the inventory, is necessary
- + Work experience **outside** the firm is also helpful, sometimes required
- + A customized **development plan** for the any successor is recommended

Form a Team

- + If succession has not already been determined by interest, proximity, or birth order, a **group effort** in choosing and grooming an individual is advised.
- + **Key employees** who are not family members can often be recruited for a transition team.
- + Involving key employees is a good way to retain them and retaining them is essential for continuity and credibility in dealing with outside sources such as banks and suppliers. They should also be strongly **incentivized** to stay and grow the company.
- + **Independent outsiders** may also be recruited for the effort, such as trusted advisors.
- + Be sure to **objectively assess** all successor candidates!



Set a Deadline

When do I want to leave?

A transition plan or timetable should be roughed out initially to assure continuity of management and should be reevaluated periodically to see if goals are being achieved.



5-10 years ideal



What's it Worth?

Periodic **valuation** of the business is a must. Get a third-party valuation expert (CPA) to determine baseline value.

Identify and build value drivers.

You should also know how much **free cash flow** is available for transition planning purposes, because the successor likely has no money to purchase your ownership!



Transfer Options

- + To your **employees** (via an ESOP)
- + To your **competitors** or other third party (outright)
- + To your **partners** (via a buy/sell agreement)
- + Or to the **public** (via a stock offering)



Six Succession Tasks (1-3)

- + Formulate and share a viable **vision** of the future in which the founder is no longer in charge of the family firm
- + **Select** and **train** the founder's successor
incentivize future top management team
- + Design a **process** through which power will transfer from current generation of management to the next



Six Succession Tasks (3-6)

- + Develop an **estate plan** that specifies how family assets and biz ownership will be allocated among the founder's heirs
- + Design and **governance** structures appropriate for managing the change; including a family council, management task force, and BOD
- + Educate the family to understand the rights and responsibilities that they may assume in the future (**stewardship**)



Succession Planning Checklist

- ✓ **Estate Plan** Optimized and Current
- ✓ Exiting Owners have sufficient liquidity and income for **retirement** without taxing the business
- ✓ **Business system** in good condition
- ✓ **Family system** in good condition
- ✓ **Ownership system** in good condition—particularly with multiple branches
- ✓ Key business **relationships intact** and all **comfortable with successor**
- ✓ **Emergency** death and disability plans for all key employees, especially CEO
- ✓ Sufficient **liquidity** within business
- ✓ **Developmental plan** for successors in place
- ✓ Sufficient **time frame** for executing succession plan (5-15 years)
- ✓ **Buy-sell agreements** ready for new owners-outgoing owner agreements ready to be transferred, adjusted or dissolved.
- ✓ Exiting owners have **"tried out"** retirement
- ✓ **Plan B** for everything that matters

Courtesy of Vaughan Scott, Axiom Financial Strategies Group of Wells Fargo



If you do nothing else...



Thank you!



Kathleen Hoye

Consulting Principal
Team Leader, Family Business
Advisory Services

502-882-4411

Kathleen.hoye@mcmcpa.com



PEOPLE
MATTER



LEADERS
INSPIRE



EXCELLENCE
RULES