



WHY SUCCESSION PLANNING MATTERS FOR BUSINESS OWNERS

DWORSKY
WEALTH MANAGEMENT

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Why Succession Planning Matters For Business Owners



Whether you intend to work for the rest of your life, or you would like to retire someday with the money you need, succession planning is critical for your business.

Retiring, Selling or Continuing to Work

Succession planning, sometimes called exit planning, paves the way for a smooth transition of business leadership by choice, creating the structure and necessary resources that will allow you to sell your business and/or transfer it to your chosen family members, business partners, or leadership team. An effective succession plan can help you retire if that is your goal.

But thorough succession planning also looks at potential future adverse events and includes contingencies for those, especially if you are one of the people who plans to work for the rest of your life. Although no one likes to think about the worst-case scenario, such as the possibility of themselves or a partner becoming disabled or dying unexpectedly, it's better for you and your company to have provisions in place just in case.

There's an old saying that explains it best: **If you fail to plan, you plan to fail.**

What Does Succession Planning Do?

Succession planning is used by businesses to streamline the process of a change of leadership or ownership, helping it run smoothly and without interruption whether key people leave the company due to retirement, or in the event of unexpected circumstances, such as the death or displacement of a team member. Effective planning helps make succession a managed event rather than an unexpected crisis, so that a business can continue seamlessly.

With all of the effort you have put into growing your company through the years, a succession plan can help ensure that your business lasts rather than fails, and that your business legacy continues into the future.

Key Constituents and Components

All the people in a company as well as those who would be impacted by a future change should be considered in a succession plan. A thorough succession plan done for a business takes into account the entire business, and it considers the impacts on all the key stakeholders. Included are the business owner's goals, business partners' if applicable, the owners' family members (whether or not they work at the business), employees, key people and executives, and the company's customers and clients.

The Company's Brand

A rarely-discussed aspect to effective succession planning is the maintenance of your brand identity that you've taken so long to build. The successor that takes over the reins should be well-versed in your brand and understand your company's customers and their needs so that your firm's reputation and continuity are maintained—and so that the business doesn't lose its clients or customers. This is particularly important if you are passing the reins on to a partner or family member, but it's also important if you are selling the business and relying on a payment plan that extends into the future.

If you do plan to sell, it's important to get an accurate business valuation, which often considers the likelihood of a business retaining its customers.

Strategies Used In Succession Planning

Here are some of the strategies that may be considered when designing your succession plan. It is recommended that you work with a team including your financial advisor, tax professional and legal expert when designing and implementing a succession plan and assessing any tax or legal ramifications.

In some cases, specialized life insurance policies may be included as part of your succession plan. A life insurance policy can sometimes provide tax advantaged funds that can ensure the continuity of business through a crisis or major change.

- **Buy-Sell Agreements**

Often used by sole proprietors or closely-held partnerships, buy-sell agreements stipulate how a partner's share of a business may be transferred in the event of a partner's death or departure. They may also establish the method that will be used for determining the value of a business. The most common buy-sell agreements are cross-purchase or entity-purchase; some agreements will combine the two.

- **Cross-Purchase Agreements**

Cross-purchase agreements allow surviving partners or owners to buy out the interests of a deceased or selling owner. Each partner purchases a life insurance policy that names the other partners as the beneficiaries. This type of succession plan allows the surviving partner/s to continue operating the business by providing the financial resources and cash necessary for them to purchase the deceased partner's ownership share from family members.

- **Entity-Purchase (or Redemption) Agreements**

Redemption agreements often require the business entity itself to buy the interests of a selling owner. A redemption agreement is a legally binding agreement between company shareholders spelling out the terms by which they can purchase, sell, or transfer shares of the company.

- **Key Man or Key Person Policies**

With key person policies, the business itself is generally the owner as well as the beneficiary of the policy. A key person policy is taken out by a business to protect against financial loss due to the passing of an owner, partner, top executive, or essential employee. It can also protect heirs, because key employee life insurance can be used by surviving owners or partners to buy out the ownership shares from family members in the event of an owner or partner's untimely death. Sometimes these types of policies also have a disability insurance provision or rider, in which case they also function as key person disability insurance.

Formal Succession Plan Adoption and Training

It's important that companies communicate their future succession vision with all employees, and provide training and oversight to help ensure that the new management team has the skills, talent, and institutional knowledge to advance and succeed during a transition and beyond. Knowing there's a solid succession plan in place can boost employee morale and retention as they consider their long-term prospects with your organization.

You should also update and reevaluate your plan on a regular basis. Succession planning is a living plan; it is not a one-time event. It should be reevaluated and updated each year or as needed as your personnel, the economy, local business conditions, and other factors change through time.

The Importance of Succession Planning

Even if a business owner is young, having a succession plan should be a priority. No one can anticipate when they might develop a serious illness, meet with an accident, or lose a key person in their business. Unexpected events can strike and things go downhill quickly without a plan. Just like you buy a security system to protect your property, and purchase property insurance to protect your company from theft, fire, or weather, creating a succession plan is part of shoring up and disaster-proofing your company for the long haul no matter what the eventuality.



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