The Importance of Business Succession Planning

Arthur F. Rothberg, Managing Director, CFO Edge, LLC

Succession planning is one of those things that business owners sometimes put on their back burner, but never get around to really focusing on until succession is literally staring them in the face. However, failing to plan early and adequately for business succession can have serious implications—for both the business entity and the owner.

For starters, it can harm a company's prospects for long-term survival after the owner leaves the business. It can also make it more difficult for the owner to exit the business on his or her terms and with the financial resources needed for the next stage of life—whether this is retirement, a new business venture or perhaps a charitable or philanthropic endeavor.

Ownership vs. Management Succession

There are two broad categories when it comes to succession planning—ownership succession and management succession:

> **Ownership succession** — This refers to the transfer of formal business ownership to the new owner(s) and the monetization of the owner's wealth, as well as the transition of the owner's key relationships to the successor owners.
>
> **Management succession** — This refers to the successor management team that will be responsible for keeping the business running after the owner has departed.

There are a number of different factors involved in ownership and management succession that CEOs and CFOs should be planning for, including:

- Locating the right buyer for the business
- Obtaining a current and accurate business valuation
- Building a deep and talented management team "bench"
- Tax and estate planning implications of monetizing the business
- Personal financial planning, including retirement and lifestyle planning

These issues can be especially tricky for family businesses, which often must determine whether heirs are prepared (or even want) to own and run the company. Statistics reveal that only 30 percent of family businesses are passed from the founders to the second generation, and only 12 percent make it from the second to the third generation.

© 2012 CFO Edge, LLC

Questions to Consider

As you begin the succession planning process, start by asking yourself a few important questions:

1. What are your primary succession goals? The answer to this question will drive many of your upcoming decisions. For example, if your main goal is to sell your business at the highest possible price and assume the lowest possible risk, it might be difficult to sell to insiders (via an ESOP, for instance) who may need more flexibility in price and terms. But if you mainly want to make sure your business continues as a legacy and your employees are well taken care of, you might be willing to accept a lower price and owner-finance the purchase yourself.

2. What are your liquidity needs? If the proceeds from the business' sale will be used to finance your retirement, you'll want to try to ensure a consistent income stream for life. This can be accomplished by investing the money conservatively and withdrawing a set amount or percentage each month or using it to buy an annuity, which would pay a fixed amount of income each month for the rest of your life. If you plan to use the proceeds to start a new business venture, you'll likely want to collect the full purchase price at closing, instead of owner-financing the deal.

3. How strong is your management team? Do you have a deep management bench? This will be an important consideration of any potential buyer. Start training your successor management team years in advance of your planned exit and be prepared to offer them incentives (perhaps including equity in the business) to stay onboard for the long term.

4. Who are your potential buyers? Depending on your goals, these may be inside buyers (existing managers and employees) or outside buyers. Outside buyers may include strategic buyers (such as competitors), complementary buyers (businesses in a complementary industry to yours) or private equity investors (including venture capitalists and angel investors).

5. What will be your post-sale role in the business—if any? Sometimes, buyers want the owner to stay with the company for a set period of time after the sale to help smooth out the transition, especially of key customer relationship to the new owners. This may be done as a paid consultant or employee or as a board member—either way, it should be negotiated as part of the terms of sale.

Concluding Thoughts

Los Angeles and Southern California CEOs and CFOs should begin succession planning well in advance of the date when the owner plans to exit the business. Failing to do so may severely limit the options available to the owner when it's time to move on. An outsourced CFO services provider can offer valuable assistance to help ensure that owners' financial goals are realized in the implementation and execution of the succession plan.

About CFO Edge

CFO Edge, LLC is a leading Southern California provider of outsourced CFO services. Based in Los Angeles, we are a group of experienced chief financial officers who engage with CEOs and CFOs on demand to address strategic planning, business management, and day-to-day financial operations challenges. Our seasoned professionals deliver services as interim CFOs, part-time CFOs, project-based CFOs, recruitment-to-permanent CFOs and interim-to-permanent CFOs. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 626.683.8840.

This publication has been prepared for general information on matters of interest only, and does not constitute professional advice on facts and circumstances specific to any person or entity. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication. The information contained in this material was not intended or written to be used, and cannot be used, for purposes of avoiding penalties or sanctions imposed by any government or other regulatory body. CFO Edge, LLC, its members, employees and agents shall not be responsible for any loss sustained by any person or entity who relies on this publication.