

Continuing success: Why every business needs a solid succession plan

How to protect one of your biggest assets

Provided by Scott Sparks, Northwestern Mutual - Denver

All owners leave their businesses eventually.

Whether you decide to slow down and let the business fund your upcoming retirement or whether an unexpected event leaves you unable to continue running the company, you need to be prepared. Your business is one of your biggest assets: You need to protect it.

A good succession plan will stabilize the business, facilitate its transfer according to your wishes, minimize eventual estate taxes and maximize the wealth passed on to the next generation. Without proper preparation, your business may face liquidation, decline in value, job losses or, at the very least, complicated relationships with family and employees.

DEVELOP A PLAN

Whether the business stays in the family or is sold, even in part, to an unrelated party, there are many things to consider:

- Who will ultimately own the company?
- Who will operate it?
- How will the change affect employees, especially those who transition to new roles?
- When and how is the plan activated?

- How will the price be determined and the purchase be financed?
- Is there enough cash to carry the business through the transition?
- How can taxes be minimized?

These questions help form the basis of your plan.

CONSIDER WHO SHOULD RUN THE BUSINESS

Think about whether or not ownership and/or management will stay in the family and to what degree. It's important to gauge family interest in owning or operating the business and to determine compensation for members who may not wish to participate in the business down the road. If a family member will not be running the business, determine who could take over, how you will train them and how you will tell the rest of the family about your plan.

GATHER AND ANALYZE DATA

To build a good succession plan, a lot of information is needed:

- Financial statements on cash flow, assets and liabilities should be prepared by an outside accountant.

- Compile a list of personal financial needs - including how much you want or need to take with you and whether or not you'll withdraw from the business fully.
- You'll also need job descriptions and responsibilities for key positions, including qualifications for your successor. When considering your successor's qualifications, establish a training plan for that person, so the transition can go as smoothly as possible. If you are promoting someone in the business already, you will also need to consider replacing that person. It is possible that multiple transitions will occur which you can prepare for with good training plans and clear expectations.

REFINE THE PLAN

Depending on the form of the business and what is being sold or transferred, strategies and techniques can vary. The sale of a sole proprietorship is a taxable event, so planning will focus on achieving the lowest possible tax costs. For partnerships or corporations, alternative valuation methods must be considered which can lead to complex tax issues. It's always important to consult your financial advisor and attorney on these matters.

DETERMINE A VALUATION METHOD

Before you sell or transfer the business, you'll need to know its value. One option is to simply fix the price and use independent appraisals. You can also use the book value, which is based on an evaluation of the balance sheet and further appraisal as needed. Your third option is to fix the price by capitalizing on net income. It is also acceptable, even advisable, to use a combination of methods to determine your company's value. Always look at multiple years and trends to get an overall picture of how the business has fared.

SET THE BUY-SELL AGREEMENT

A buy-sell agreement is an arrangement between two or more parties setting the obligation for one party to buy and the other to sell upon a triggering event. In addition

to setting a price, this agreement will define ownership within the succession plan. These arrangements can range from ones where the company buys back shares from the owner in question to ones in which other shareholders must buy stock. In the case of a sole proprietorship, the agreement may establish the outright sale of the company all at once, or over time. Making sure the buy-sell agreement meets IRS tests for arms-length transactions will reduce the chance of IRS objections to the agreement's stipulated price in determining tax liabilities.

CONSIDER ESTATE PLANNING ISSUES

It's important to consider estate planning issues throughout the process of succession planning, as well as independently from it. No one wants to be limited in options or have an unpleasant surprise await their heirs. As an asset, interest in

a business is included in the estate and will be part of estate taxes. A buy-sell agreement can help generate liquid sale proceeds to help the estate pay any estate taxes. Additionally, your business may be gifted to family members and any growth on the gifted business interest is not subject to transfer taxes. A good financial plan can help address various transfer tax issues for your heirs.

Having the right financial plans in place is essential for your business — and that includes a succession plan.

Just as you have worked hard and sought help from others to build your business, do the same when it's time to leave the business behind. A good plan ensures not only your financial success, but your company's continued success.

This article was prepared by Northwestern Mutual with the cooperation of Scott Sparks. Scott Sparks is a Wealth Management Advisor with the Northwestern Mutual Wealth Management Company, a subsidiary of The Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin.