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Exit Planning

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Succession Planning

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Why Do Succession Planning?

According to TEC speaker [Mike Kiley](#), succession planning -- the process of deciding how to transfer your business when you exit and who will run it after you're gone -- accomplishes three critical goals. When done properly, it enables you to:

- Plan for an orderly transition of the business (as opposed to a panic event)
- Identify and prepare a capable successor
- Build, protect and transfer your net worth

Unfortunately, many CEOs neglect succession planning. They don't get it done (or they don't keep it current) for many different reasons, the main one being that the highest and best use of their time involves running a company and making a profit, not moving the succession planning process along. Without this critical piece in place, however, the whole tower of blocks can come crumbling down when the time comes to move on.

"First identify what succession means to you," Kiley says. "Do you intend to keep the business (either for yourself or your family) or do you plan to sell it? Your answer sets the tone for everything that follows. From here, the decision tree branches out in many directions. The 'selling' branch leads to a whole different conversation about whom to sell it to, for how much and when (see the article "Selling the Business" below). If you decide to keep the business, however, the branch leads straight to the classic succession planning issues."

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Basic Steps

Succession planning answers the question, "If I die, become disabled or otherwise leave the business, who will run the company and what will happen to it?" According to Kiley, answering this question requires three basic steps.

1. Identify the successors.

When deciding who should run the business after you're gone (assuming you decide to retain ownership or transfer the business rather than sell outright), you only have so many options:

- Family member(s)
- Partners and/or shareholders
- Professional managers or key employees
- Some combination of the above

From these options, select a successor based on two critical criteria -- whom you want the business to go to and who is best qualified to run it after you leave. Often, these two people are not one and the same. As a result, says Kiley, identifying a successor can prove to be the most difficult step in the entire process.

"Choosing a successor is a very personal and often gut-wrenching decision, especially in single-owner family businesses," he says. "Having partners or other shareholders simplifies the decision because they usually represent the most likely candidates. Or, you may want to reward a few key employees who have helped you grow the business over the years. Many times, however, it comes down to whether or not the kids have what it takes to run the business and whether they want to. Mix in all the family dynamics and you have a recipe for a lot of sleepless nights."

2. Plan for every contingency.

The next step involves planning for any and all events -- such as retirement, death or disability -- that can trigger the succession plan. Be sure to identify the appropriate successor in each case, because they may not be the same. For example, suppose you plan to turn the business over to your daughter upon retirement in five years. But what happens if you get hit by a bus tomorrow and become permanently disabled? Your daughter might not have enough experience yet to take over the firm, in which case you would want to leave the business in more capable hands until she could grow into the position.

3. Memorialize the plan.

The third step formalizes and memorializes your succession plan by putting everything in writing and creating the necessary legal documents, such as buy-sell agreements, partner agreements and living wills. These documents also specify where the money will come from to facilitate the transition of the business. Because of the complexity of the issues involved, memorializing the plan requires expert help from attorneys, CPAs and tax and estate planners at every step of the way.

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Planning for Catastrophe

In the vast majority of cases, succession planning leads to a smooth, orderly transition of the business upon retirement or the decision to sell. However, even CEOs can have heart attacks or die in automobile accidents. In those situations, succession planning can provide direction for your management team, save the company from disaster and spare your spouse and family members untold additional grief.

In the event of your untimely death or disability, says Kiley, your succession plan should:

- Include an up-to-date financial statement.
- Clearly state what happens with key employees, who is in charge, and what roles they play.
- Identify a board of advisors to help your surviving spouse through the crisis.

In addition, Kiley strongly recommends writing a "love letter" to your spouse that details what will happen to the business should you die unexpectedly and whom he/she can turn to for advice.

"The one element of succession planning that all too often gets ignored or overlooked is communicating your intentions to your spouse," he says. "Unfortunately, most husbands and wives don't communicate very well on this subject, and some don't talk about it at all. So I recommend writing a 'love letter' that spells out in detail everything that will take place in the event of your untimely demise. It should also identify whom your spouse can turn to for unbiased advice and counsel."

Several years ago, Kiley worked with the family of a long-time TEC member who died in a small plane crash. Fortunately, the member had done enough succession planning to put in writing who should step in and run the company. He clearly spelled out the line of succession and had good people in place. As a result, his successors have continued to grow the company.

However, he hadn't prepared nearly as well on the family side. He had no independent board of advisors to provide his wife with objective advice. Surrounded by people and money -- many with conflicting ideas on what to do with the business and the money -- she didn't know which way to turn. Finally, believing they were the only ones she could trust, she reached out to her husband's TEC group. Rallying to her side, the members helped see her through the crisis, but not before a great deal of mental and emotional distress on her part.

When creating a board of advisors for your spouse, Kiley recommends the following:

- Avoid anyone directly connected with the business. Instead, identify independent, skilled business people you and your spouse both trust. You may want to consider some of your fellow TEC members.
- Don't put your attorney or other paid professionals on the board. Keep them as paid advisors who help to implement your spouse's decisions without trying to influence them.
- Don't forget the "love letter" to your spouse.

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Protecting Your Assets

The final piece of the puzzle ensures your succession plan supports your estate plan and vice versa. The secret to successful asset protection, believes Kiley, is to delegate wisely and well.

- **Create a team of specialists.** Estate planning has become so complex that the "single shingle advisor" can no longer do it all. Instead, you need a team of experts that specializes in business transfer and estate planning issues. This team should include:
 - A CPA with estate planning expertise
 - An estate tax attorney
 - A business valuation specialist
 - A life insurance specialist
 - A financial planner/money manager

On a scale of one to 10, every team member should rate no less than a nine.

- **Identify a team champion.** A team champion is someone who understands all aspects of your succession/estate plan and can communicate your goals to the other specialists on the team. To find your champion, conduct an inventory of your current advisors and select the one most qualified to serve as team leader. "Most CEOs choose their attorney or CPA," notes Kiley, "but sometimes it turns out to be their financial advisor. Whomever you choose, it must be someone you trust and who can work with other team members without stepping on their toes."
- **Clarify expectations for your team champion.** This can include having your champion review your buy/sell agreement, evaluate existing trusts, make sure you have the appropriate amount of life insurance, explore a family limited partnership and much more. The key is to make sure your champion knows *all* your goals so he or she can fit all the individual pieces of the puzzle together.

"Your champion serves like general counsel in a business," explains Kiley. "He or she identifies who you need on the team, how long things will take, how much they will cost and what you need to contribute in terms of time, dollars and attention. This can be a very demanding job, so give your champion plenty of license to badger you in order to get what he/she needs to do the job properly.

"Once you build the plan, the champion watches the horizon and ensures that you keep the plan current. In particular, he or she pays close attention to what the government does with respect to tax laws. Tax policies go back and forth all the time, and even small changes can have major impacts on your estate plan."

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Avoiding Killer Mistakes

Over the years, Kiley has seen CEOs make a lot of succession planning mistakes. He believes most of them could have been avoided with a little more forethought and attention to certain parts of the process. Here, he identifies four common errors that can sabotage even the best-laid of succession plans.

- **Failure to plan.** Sadly, this represents the biggest and most common mistake of all. CEOs typically spend a great deal of time planning for their companies. But when it comes to succession planning, many choose to bury their heads in the sand and ignore the issue altogether. "I guess it's just human nature," sighs Kiley, "but I hate to see it because even the most basic of planning can forestall major disasters for the business and the family."
- **Choosing a weak successor.** Many entrepreneurial CEOs do a poor job of hiring their eventual successor. As a result, the time comes to exit the business and they suddenly realize the heir apparent doesn't have what it takes. This throws off the succession timetable, which can have severe financial implications for the CEO and the business.

"Take your time hiring a second-in-command," advises Kiley. "Study the implications and ramifications of grooming a successor, then get real clear about what you want and don't want. Avoid the 'ready, fire, aim' approach." (For an excellent primer on selecting a #2, see the article, ["Developing a Second-in-Command"](#) from the Best Practices: Management Development module.)

- **Lack of flexibility.** Even the best-planned business transfers can get waylaid by a downswing in economic cycles. To avoid this pitfall, anticipate changes in economic cycles, build in a cushion on the downside and provide enough flexibility to meet the needs of both parties. The last thing you want, notes Kiley, is to have to go back in and take over the company in order to save your investment.
- **Taking your eye off the ball.** Don't get so caught up in worrying about tomorrow that you neglect what you do best -- running your company and making money. Put together a top-notch team of advisors, tell them *exactly* what you want them to accomplish and stand back and let them do the job.

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Additional Resources

Below are links to more best practices as defined by our expert panel:

- [Winning Beyond Business](#)
- [Exiting the Business](#)
- [Creating the Exit Plan](#)
- [Selling the Business](#)
- [How to Sell the Business](#)
- [Transferring the Business: Family, Partners or Pros?](#)
- [Finding Fulfillment After the Business](#)
- [The Search for Fulfillment](#)
- [Finding Your True Calling](#)

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