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Succession Planning | What You Need to Know to Successfully Transition Your Business

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July 2023

George Sparks:

Succession planning for business owners is really just the transition from one ownership group to another ownership group. It can be a private equity sale, it can be generational between family members, from one generation of the family down to the next generation of the family, or like I said, an external from one buyer to another buyer. Whether that be an individual, private equity group, or just another person, another company that's in your market that wants to expand into this market, or sees a vertical integration, maybe, into their business line as well.

Kellie Woodruff:

So, what things should you consider when you're doing a succession plan?

George Sparks:

Well, I think there’re all kinds of things to consider. The first and most important thing is, as the business owner, has it run its course for you? Are you ready to step away from what you're doing? Are you ready to move the business on to the next generation of leadership? Are you willing to exit? Do you have in your plan, your overall individual plan? Are you ready to step away from something that you've probably put your heart and soul in for a number of years? There's usually a very emotional connection with the company that you've been building and putting so much effort into. You're going to look at it in the context of your overall retirement plan. Has it now generated enough worth that you have to monetize it to execute the plan that you've come up with for your retirement plan?

If those questions are all, yes, you want to start having those conversations with your advisors. And you want to do that years in advance. The last thing you want to do is come to decide that you need a succession plan and you've got 12 months to execute it. Because that's just going to put everything into such a short timeframe that you're not going to be able to wrestle with all the different things that come about from it. This should be something 5, 6, 7 years prior to when you think you're going to execute, you start doing that.

There’re just numerous steps. You've got to make sure you've got the right team in place, if it's an internal succession plan. You've got to have the right people in the right seats on the bus to make all this happen because each of those key seats, roles that are played inside of a company have to have the right person for the succession plan to be set up for the best results. Because if you don't have the right players, it hampers the value. People that are acquiring external, they're looking to see what talent you have as well as what are they buying. The talent is also there, because they want to know that... They want to do it in the least way that interrupts the business. They want the transition to be as smooth as possible.

So, having key management in place is important to them. They know that they're going to bring other expertise to the field, but it's hard to replace homegrown expertise and knowledge that is institutional knowledge. Even though they might be familiar with what you do, might be in the same line of business, it's not their business yet. So it's important to have that DNA of the business that you're buying to be there and in the right places. Missing a piece of it can affect the overall value of what somebody's willing to pay for it.

Kellie Woodruff:

So tell me, how do you know whether you should, in your succession plan, should you pass your business on to a family member or whether that business should be moved outside of the family?

George Sparks:

That is probably the hardest question, because not only you emotionally tied to your business, but emotionally tied to your family is a different story. And sometimes the real answer is not the preferred answer, meaning, yes, I want to take this and give this to the next generation. That may not be the right answer for everything completed. Because as you are in your own plan, you've developed your retirement plan and you're now monetizing this asset, it's generally because you're also wanting it to go to the next generation.

So the answer might be... And this really is where you have to separate. And you usually have to surround yourself with other advisors that can probably give you honest answers because you're going to be skewed. I know how I am. Love my children, but I want them to succeed. But wanting and being able to do it in the same manner to provide growth, financial stability, not just for myself, but when you think about the business owner but the generations below them, the answer could be that your children or the next family members are not the right answer.

And that's where you really have to get involved with your advisors to say, "Be honest with me. Tell me what you see." And they should be able to point out strengths and weaknesses of your team, your succession team, if it's children, if it's other family members, to give you an honest assessment. And that's a struggle that many of our clients have, when it comes to that. Sometimes the answer is exactly that, and that works great. But sometimes, it's not that. And if you don't have the right plan in place, the overall plan, it doesn't turn out to be exactly how you would envision when you went down this road.

Kellie Woodruff:

I know occasionally the family member, if it's going to be passed through the family, the family member that the owner might like to pass it to might not be just the right one. There might be somebody else in that family that could possibly run and take that company to the next level.

George Sparks:

Yeah, I think the answer shows up well before you come to the decision. We're using family members here, but it might just be key management as the people you're looking to succeed too. I would say that what you have to see well before and not something that you have to say to make happen, they should have a passion, they should be committed. They should already be thinking that way. And that shows up before you ever bring it up to them.

So if you're looking at an internal succession plan, that should already kind of be evident to you, just by what you're seeing in the performance of those people that are in those key management places. Whether it's a family member or whether it's internal succession, just people that you've brought on inside the company that you have. They're going to exhibit those characteristics that are going to show you that they have the same drive, or the drive to make the business go like you've made it go.

Kellie Woodruff:

When is the right time to transition your business to that next generation or next owner?

George Sparks:

Yeah, so that is a good question. There is no magic answer to that. Again, this starts years before you're willing to do it, understanding that you have a retirement goal and plan. I think that is the starting point of saying, "What does this look like? When am I going to be ready to step away?" That, to me, is the first step. And then working backwards to say, "Okay." and assessing all those around you is, "Who am I going to sell to? Is it internal? Do I have the right people?"

If it's external, that can be a little easier. Your timeframe there is probably shorter. You don't have to have as long a runway with that, because they're going to bring certain expertise to it. But if it's an internal sale, it needs to be a number of years. And you need to be discussing, again with your advisors a lot earlier than that.

And I will tell you this, it seems to be that most people, most of the times I've been involved with it, it's been a harder transition. They think they're ready here. They're not necessarily ready at that moment in time. There're certain financial goals that you're going to want to put in place. And I say that because understanding the value of the company, whether it's internal or external, you're selling to is important. And you need to put a plan in place to get yourself to the right value.

So generally, external sales are driven by multiples of income and things like that. So you want to be watching, "How do I maximize that?" And it's hard to put any new changes and policies in place to drive growth or profitability to allow for a larger buyout in just a year. So to me, it's that you've got to have that five to six year window of really concentrated effort with an end goal in mind of saying that I'm going to set certain goals and parameters about achievements that I want to reach. Because then I'm maximizing the value of my business.

You can determine the terms from there, whether it's an external sale, or you may want to discount it because it's family members or an internal sale. And these people that you're selling to have committed themselves. And that becomes the personal choice inside of it. But again, I think you've developed an overall financial plan, retirement for yourself. And you know the number that you need to receive out of it to make your plan work. And I think that really is... the timing is just kind of up to you. You've got to leave yourself a long enough runway to accomplish those things though.

Kellie Woodruff:

So, how do business goals and your personal objectives play into succession planning?

George Sparks:

Well, I think it starts with, you have to start with your own goals. What is your goal? What does your retirement look like? When should that happen? Those are the parameters you're going to set for yourself. And again, they're flexible. It's not that you're setting it in stone, but the fact that you're thinking about it, you're talking about it, you're putting benchmarks down of when all that stuff is going to happen, and working backwards is what's going to happen. It's what's going to motivate you into the timing and where we go with that.

The business piece of this is just a piece of your overall plan. So you have to have goals not only for the business, but in your overall retirement plan. How do you hit those things? This is taking a specific piece of that plan and addressing it inside the plan to say, "Okay, I need X number of dollars to monetize the value of my business in order for my financial plan to work."

Again, so it starts with your own personal goal of when you think you want to retire or when you want to do something different. You don't have to retire, but if you want to do something different. When is that point in your life? And then saying, "Okay, I've got these retirement assets already built up. I have these assets outside of my retirement that I've built up. But I have this one large piece that is not monetized that I put a lot of value into time and effort into. I now need to monetize part of that for my retirement goals or for generational goals for the next generation of your family." And that's going to help you in that decision, help you build the timeline for that piece.

You should have started on, I'll just say, your retirement plan. You started on that years ago, the moment you started putting money away in your 401K. You started that years ago when you started putting money away just to have in savings or other investments. This is the same thing, it's just that those don't necessarily have to have an exit strategy like a business does, where it's got to be three or four years out to monetize something. Those, you're choosing growth and you're choosing risk and other things like that to go into the situation. So it's again, compartmentalizing your overall retirement plan and coming up with a plan for each piece. With succession plan, it's just a little more difficult and probably a little more concentrated.

So in summary, there's not a single answer to this, but succession planning is something that all business owners face. Some of it is easier than others, depending upon where you're at and how closely you've paid attention to it along the way. It's never too late to do it. Sometimes it falls in your lap. You get an offer from an external buyer that just makes sense.

Others are, you've got a more defined goal because maybe the external sale isn't what you want. That takes a little more time because you've got to build up the right team. You have to vet the next generation, especially if it's family members. You have to somehow separate emotional decisions sometimes, from business decisions, knowing that it might hurt some feelings. But generationally, that's the right answer because that's going to provide the greatest wealth for you to pass on from one generation to the next.

And how you do that and how you manage through that with maybe family members that are going to be involved and not involved. It's a lot of communication, a lot of relationship management. It's exciting stuff, it's scary stuff, but it's necessary stuff. And then the earlier you start thinking about it, the more opportunity you have or better chance you have for success in all of it.

Kellie Woodruff:

Thank you, George. That was very informational and very helpful. And I appreciate you taking the time to explain these things. And if you'd like to hear more, visit us at barnesdenning.com. And thanks for joining us on Ask the Experts.