Decoding Succession and Exit Planning

MANY OWNERS BELIEVE SUCCESSION AND EXIT PLANNING ARE THE SAME THING WITH TWO DIFFERENT NAMES. IN REALITY, THE TERMS HAVE DIFFERENT MEANINGS.

BY VICTORIA FILLET

Retirement for a business owner can be relatively complicated compared to retirement for an employee. As an employee, retirement is about exiting the workplace. For the entrepreneur who has been busy building and re-investing in the business, retirement is exiting the workplace *and* the business.

Planning for an individual's retirement focuses on the adequacy of retirement savings for his or her goals and objectives. For the business owner, planning decisions must be made about the future of that business as well as that of the owner.

When it comes to planning, many business owners believe succession planning and exit planning are the same thing with two different names. In reality, the terms have different meanings. Succession planning is transferring the ownership or leadership of a business to the next generation or to new owners. With exit planning, the owner is focused on his or her exit from the business, financial planning and his or her emotional needs to create a satisfying retirement.

In the January 2019 issue of *The Director*, our colleague, Steve Wasserman, outlined some business succession issues and discussed why so many business owners avoid assessing the topic. Confronting our own mortality and envisioning a life for ourselves outside the business is difficult to contemplate. Successful business succession cannot and should not be conducted in a vacuum. It must be about the journey, not the destination; about the process, not the plan.

The Business Enterprise Institute defines exit planning as "the creation and execution of a strategy that allows owners to exit their businesses on their terms and conditions. It is an established process that creates a written road map or exit plan involving the efforts of several professionals and facilitated and led by an exit planning advisor who ensures not only the plan creation but its timely execution." As you can see, the distinction between succession planning and exit planning becomes vague.

A successful succession is contingent on improving the value of the business by making it attractive to potential buyers or other potential successors. This includes enhancing the predictability and profitability of the business by protecting relationships with customers, employees and suppliers.

Think of how the business looks to a buyer who will be conducting due diligence. A significant part of the value of a business is linked to human capital. Have key employees had the opportunity to develop skills and experience in order to replace the outgoing business owner at a future date? Does the business have the ability to evolve, to retain and attract employees, and to maintain and enhance its position in the community? Is leadership responsibility shared by the management team or does it reside solely with the founder and owner who is about to leave?

Exit planning should be linked to the strategic planning of the business. It should be ongoing and not just launched within a few years of contemplated retirement. Whether the business is ultimately going to be sold to an outside third party or an employee or remain part of a family legacy, systematizing leadership enhances the worth and reputation of the business and reduces the need for "repairing" when the time comes for succession.

Keep in mind that the timing of an exit cannot always be planned. Many of us have heard of stressful circumstances created from unexpected exits due to untimely illness, marital breakdown or death of the principal in the business. The common avoidance of exit planning only kicks issues down the road, which implies that they will possibly land at a time when the family is least capable of addressing them. If the exit is unplanned, crisis could ensue and finding solutions becomes more difficult.

Simply being part of a family that owns a business can lead to a mental quagmire in which everything gets mixed together: money, reinvestment and growth versus dividends, the parent/child relationship, sibling rivalry, parental expectations, individual fulfillment, ambitions, dependency, work, salary and whatever one's spouse thinks about a nephew's work ethic and contribution. All these things are tied up in one another.

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Anyone running a family business is most likely unnerved by the notion that "first generation builds, second generation maintains, third generation destroys." Entrepreneurs are often independent thinkers who do not like systems, rules and boundaries and who flourish on flexibility. The second generation may be less comfortable with that nonconformity, and if it fails to establish policies and structures that shape the business, coming generations may face chaos. Though this concept may run counter to the unfettered latitude that entrepreneurship affords, successful exits require the establishment of a rational framework to define the business and its operating and decision structure.

In their *Journal of Financial Planning* article, "Immigrants and Natives to Wealth: Understanding Clients Based on Their Wealth Origins," clinical psychologists Dr. James Grubman and Dr. Dennis Jaffe observe, "Whether clients come to wealth during their lifetime or are raised with wealth from childhood broadly determines aspects of character, adjustment to wealth, identity and family dynamics." Even if they are wealthy, founders of businesses generally view themselves and their circumstances as poor. Because many started their businesses from scratch, there is a gap between the wealth they picture in their minds and their actual net worth.

The second generation, on the other hand, is "native" to the land of wealth and holds very different attitudes about it. There are a lot of fears around intergenerational management – increased responsibilities, expectations that the wealth should be used "properly"– and it is easy to be intimidated by the sudden onslaught of decisions and obligations.

Sometimes, successors decide not to remain in the family business. In many of these cases, they stay on as owners or future owners and decide not to actively work in the business. But stepping away can be frightening for both successors and founders. Being in the family business is not just about having a job; it's also about remaining on good terms with the rest of the family. It holds weighty duties and obligations.

Successors who choose to stay with the business but implement change face the consequences of risk associated with change. The risk of failure is beyond monetary; it potentially threatens the successor's family relationships, self-esteem and heritage.

Integration of a younger generation into a family business can be a catalyst for healthy change and innovation. Creativity cannot be bound to strict rules or authority, or to an obsession with maintaining the status quo. The younger generation must be free to build and revise regardless of whether a rule, approach or process has worked for decades.

After exiting, the previous owner should recognize that "the torch has passed" and a new leadership regime is in place, whether it's a third party or, even more challenging in many ways, family. Though many business owners can offer sound advice and act as a sounding board for issues the new leadership team faces, retirement implies exit, not Monday morning quarterbacking; it implies disinvolvement and, importantly, disentanglement.

Exit planning for business owners also requires focus on readiness for retirement. Has the owner maintained a pattern of savings to provide the wealth needed to enjoy the freedom retirement allows? You certainly can't wake up one morning and expect to be ready for retirement if planning has not occurred. If the financial planning is in place, owners must also ask themselves whether they are emotionally ready to step away from the business. Will they have too much time on their hands? Healthy individuals can spend 25 to 30 years in retirement and must be prepared to maximize this newfound time.

Needless to say, outside consultants may be necessary to handle the legalities and valuation, income and estate tax implications of the sale or transition. The orderly transfer of ownership and management will ensure that an owner's retirement goals become reality and the business will continue to flourish.

As you can see, exit planning for a business owner unequivocally requires thorough analysis and integration of all the factors that can contribute to a successful retirement and realization of the value that a life's work has created. For many business owners, a disproportionate share of their identity is wrapped in what they do. Retirement should allow us the opportunity to redefine ourselves, seek new adventures and enjoy the journey. ☰

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