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FAMILY BUSINESS FORUM

Failing to Plan for Succession

By Donald Levitt

The Issue

When it comes to succession planning -- failing to plan is planning to fail. Those family business owners who do not properly plan for the succession of management and ownership, and for the disposition of their estate, increase the likelihood of the demise of their business, their family, and their estate.

Attorneys Tom Handwork and Jeff Kerscher are with Handwork and Kerscher, LLP in Perrysburg, OH. Their practice includes estate and business planning.

“We have seen many family business owners who executed a simple will 30 years ago, after their first child was born. Since then they have been so involved with their business that they have not updated their will. This has just about the same result as dying without a will,” notes Tom Handwork. Handwork and Kerscher describe some of the ways in which owners fail to plan for succession.

Failing to Plan for Future Management

If the owner dies and the business passes to their spouse – what happens if the spouse has no interest in or ability to run the business? Or what if an adult child in the business is not yet ready to run the business? “If no one is ready to run the business, or if the wrong person starts to run the business, the value of the business can decline rapidly. The business may need to be liquidated at below market value – or may be sold for the value of the hard assets,” says Jeff Kerscher. This results in a considerable loss in value for the spouse, and the loss of a career path and source of income for the adult child – all outcomes which the owner would not have intended.

Failure to Plan for Future Ownership

Let’s say a family business owner’s will calls for the business to be divided equally between the children. The children who are managing the business may expect generous salaries and reinvestment of profits into the business, while those children not in the business may expect profits to be paid out as dividends. “When the entrepreneur is gone,” says Kerscher, “differences of opinion are more likely to arise among family members – and they can destroy a family.”

Failure to Plan for Estate Taxes

An inability to pay estate taxes can lead to the sale of a family business. Almost half of all family businesses plan to use life insurance to cover the majority of the estate-tax bill. Yet for many family businesses this approach may fail because they do not conduct regular formal valuations of the business, and thus the insurance may not be adequate to pay the estate tax.

Issues in the Succession Planning Process

Some of the following challenges can hinder the succession planning process.

- Talking with your children about decisions which affect their careers and financial well-being is uncomfortable for most people – let alone the discomfort of talking about your own death.
- Parents often want to treat their children equally – or at least fairly – yet this requires careful planning to avoid disrupting the business.
- Family business owners may have accountants, attorneys, financial planners, and insurance professionals, but often these advisors are not working in coordination, and thus the family business owner feels that the estate plan is not well-thought out.
- It takes years to prepare the next generation of leaders, and to transfer assets in a tax efficient manner – yet owners often wait until shortly before they intend to retire to address these issues.
- Succession plans need to be updated as there are changes in the laws, the family, and the business. Often family business owners are “too busy” to update their succession plan.

The Tip

Failing to plan for succession can destroy a business, or a family, or an estate. The best advice? “Planning is dramatically enhanced if you can implement the plan over a number of years – so get at it early,” says Tom Handwork.

Donald Levitt, president of Levitt Consulting, helps family businesses to succeed as both a business and a family. More information about this month’s topic, and other family business issues, can be found at LevittConsulting.com.