Business Planning

Planning for business succession is key differentiator for astute entrepreneurs.

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Many an entrepreneur has worked hard to build a successful, thriving business; however, only a rare few actively create an exit strategy or contingent planning structures for inevitable life events that will ultimately occur. As a result, the entrepreneur's family often suffers greatly if an unfortunate life event befalls him or her, and the business folds or is liquidated at a small fraction of its previous valuation. Business succession planning should be an integral part of every business that has made it past its fledgling infancy stages and has grown into a viable, going concern.

An entrepreneur who creates and runs the day-to-day operations of his or her business is the foremost expert in the world on how and what is necessary to keep the business operating and viable. These critical components need to be identified and contractual agreements should be created and implemented directing what is to occur in the event of the entrepreneur's death, incapacity, or prolonged absence. Unless the entrepreneur expends the time and effort to provide for these documents, someone less knowledgeable or completely ignorant of these critical components could make less than optimal decisions for the entity's future, resulting in a decreased or greatly diminished financial result. For entrepreneurs without partners or key personnel, these planning documents are vital to the continued operation and functionality of the entity.

For entrepreneurs with business partners or key personnel, business succession documents should identify and describe critical proxies or mechanisms for an accurate determination of fair market value for the business. Without this key variable, family members or personal representatives may be placed at a severe information disadvantage in valuation negotiations for that entrepreneur's interest in the firm. To make sure an entrepreneur's family benefits from the years of hard work he or she invested in building the business, the business succession plan should provide timelines, valuation procedures, and clearly defined acquisition processes so all parties know exactly what to expect in the event of each different type of life contingency.

In the event the business is owned or could eventually be owned by a non-person entity such as a trust, partnership, corporation, or limited liability company, the business succession plan also should address contingencies that may befall owners such as these. Non-person entities may dissolve, become insolvent, declare bankruptcy, be acquired, or have an internal management or ownership change. If a business's succession planning documents do not address such contingencies, the owners may have to endure an adversarial co-owner that otherwise could have been avoided or stopped with a well-drafted business succession plan that provided purchase options triggered by such contingencies.

If the entrepreneur is married or may be married, the business succession documents should specifically address marital discord contingencies for owners. Courts exercising jurisdiction over marital assets often have wide discretion in the division and distribution of owned business interests. Also, state law may provide statutory rights to spouses that may wreak havoc with the ownership continuity of a closely held business. If binding business succession agreements exist regarding the division and disposition of these assets prior to the contingency, the latitude provided the court and the effect of spousal statutory rights may be substantially curtailed.

Another key component of a cohesive business succession plan is a funding mechanism for the acquisition of a departing entrepreneur's interest. Some business succession plans utilize medium to long-term promissory notes to fund the acquisition of a departing owner's interest; however, if the cash flow of the business is only marginally sufficient to meet operations, an economic downturn or unfortunate turn of events may cause a default on the note with little to no recourse on the default.

After successfully running the gauntlet of adverse life events, some entrepreneurs eventually seek to retire; however, unless an exit strategy has been developed and implemented, a sale or acquisition may not be readily available or may face unfavorable tax treatment. Many times, after having a front-row seat while growing up and observing the exhausting hard work expended in creating the business, the children of a successful business owner want nothing to do with it and pursue other career paths. However, for those owners who plan ahead, suitable apprentice-type successors may be sought and integrated into the business, allowing the owner to retire and obtain optimal value for the company he or she created. Additionally, a negotiated and well-contemplated ownership transition provides for proper structuring to mitigate the effects of taxation, and contractual protections to minimize default risks to each party.

Many business owners fall into the trap of diligently focusing on the urgent short-term operational demands of the business, all the

while putting off or neglecting the important directional and protective planning critical to its ultimate longevity and long-term value extraction. Trusted advisors familiar with business succession planning are a great resource and can substantially aid in clarifying and creating plans to avoid such pitfalls. After working so hard to create, nurture, and build a successful business, such planning truly distinguishes the most astute entrepreneurs.

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