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Common (*Preventable*) Succession Planning Mistakes

By Howard Simmons

Your eventual exit from your business will be the culmination of structured planning, days of discussion, many option variations, and probably a good deal of heated argument. Succession planning is a serious, ongoing, sometimes difficult and time-consuming project that has to be considered.

No “if’s”, “and’s” or “but’s”.

Through the years, I have observed just about all the possible mistakes that business owners could make in planning their exit from their companies. Let me cover a few, and hope that this will save you some heartache by avoiding these common mistakes as you start succession planning, or ensure they are completely addressed in the plan itself. Yes, there will be heartache, it comes with the program, but when it is done, just think of the fun you can have at the annual Toronto Boat Show! If I haven’t covered your particular “pain” today, please talk to me about it.

mistake #1:

Not making any succession plan at all.

Do not believe for one second that fate will intervene and that Santa’s corporate commercial elves will magically cause your exit to occur speedily, effortlessly and painlessly. Procrastination is your worst enemy. If you leave it too late, your options will be limited and your preferred result may be impossible to achieve, or may not be achievable with the economic return you hoped for. Forget the boat show. There may be cat food in your future.

mistake #2:

Thinking of succession planning as an activity, not a process.

You should not build succession planning around a single retreat or meeting, but you should view it as a process, with numerous twists and turns. It may not be apparent right now, but there are numerous exit options, some of which may appear unworkable at first glance. Setting all the right strategies in play to give you the outcome you want with the best possible return takes time, discussion and commitment.

mistake #3:

Not using objective, outside advisors.

You have to be able to see the big picture in order to surface the most viable options and develop the most advantageous strategies. Embarking on succession planning on your own and arriving at conclusions could be a classic illustration of not being able to see the forest from the trees. You should take advantage of insight from people who have done it before. The right combination of advisors, including an experienced business lawyer and an experienced business accountant, will increase your chances of developing a creative, realistic and successful plan which fully incorporates your financial and emotional needs and goals.

A Bunch of Common (*Preventable*) Succession Planning Mistakes

mistake #4:

"I am my business."

Owners who have spent years building their businesses tend to identify strongly with their companies. Too often I see individuals trying to retain too much control for too long. Big mistake. As part of the planning process begin the mental process of letting go at the appropriate time. A critical upfront exercise in the planning process is for you to create a vision of your future life without the business. Many entrepreneurs have trouble letting go when the time comes. Recognize that you have accomplished as much as you wanted to with the business when you hand over the reins. But before you put pen to paper and begin writing your plan, give a good deal of thought to what outcome you really want – money, control, cash flow income, or a place to hang your hat everyday (with a promise not to interfere!).

mistake #5:

Not preparing your successor.

Although the prevailing thinking by most owner managers is that no-one can run the business as well as they can, it is very likely that whoever runs the business after you leave will have their own way of doing things, which may be different from yours. Unless you are selling out to a third party, you should have a good idea who your successor will be and you should make it a priority to prepare them to take over control. This could include:

- Ensuring that he or she will be a capable CEO
- Ensuring that the management team will be a capable of running the business, and are not merely a good managers
- Ensuring he or she have a good understanding of the business and the industry
- Training and educating new team long enough in advance to deal with running the company
- Ensuring that the new management team has sufficient time to properly integrate
- Ensuring he or she has a good understanding of the business and the industry
- Training and educating the new team long enough in advance to run the company

mistake #6:

Not preparing your business.

The business must be able to prosper without you. If you are a very hands-on operator, and the business is dependent on you to make all the important decisions and for critical certain functions like supplier and customer relations, product development, vision etc., you need to anticipate stepping back slowly, and integrating key managers into the ongoing process. This will take time. But if you are thinking of an exit sometime, you had better do it. You should also prepare the business operation for the transfer. All corporate records etc. should be updated, and any aspect of the day-to-day running that you have personalized to suit your style or lifestyle should be examined. The business will enter a new stage when you leave and may require an updated long-term vision. The new management will benefit from your perspective. There is a role for insurance in your plan. Not only life insurance, but critical illness insurance as well. The usefulness of insurance for risk management, funding and tax planning should not be overlooked.

mistake #7:

Not really giving up control.

A succession plan guaranteed to fail is one where the owner never really gives up control. Such an action can only end up demoralizing your successors and expose your business to risk in the event of your illness or death, while escalating the danger of conflict between yourself and your successors.

mistake #8:

Hanging on too long.

A deal that takes too long to extract you from the business can end up being no succession plan at all. Your successors may become so frustrated they will turn away from your business and leave, creating a further strain on family and business relationships. You could similarly cause problems by giving up too much control too quickly. Set clear exit goals, and stick to them.

mistake #9:

No contingency plan for a spouse of your child in the case of separation.

Particularly when a spouse of your son or daughter is integrated into the business, there could be extreme tension or a serious disruption in the business. Give thought to what other serious family problems could impact on the business operation.

mistake #10:

Not securing your retirement funds.

Do what you need to do to be secure in retirement. At the very least your succession plan must secure the money you will need in retirement. This where I can assist you in making one of your basic exit strategy choices – how you will be paid out. There are tax implications, business valuation and cash flow issues to be addressed.

mistake #11:

Anticipating an excessive profit on the sale of your business.

There may be a temptation to sell the business to your children at a higher price than a third party buyer would pay. This is generally not recommended. If nothing else, it could sour your relationship with your successors as they struggle to pay a value that is in excess of market value. A worst-case scenario could be that the business itself may falter under the excessive cash flow strain or debt burden, impacting the financial reward you were hoping for that the business that was supposed to provide for you.

mistake #12:

Providing overly generous financing terms.

Because the buyer will not have the funds to cover the purchase price, it will have to be sourced from operating cash flow. You should be creative in assisting the new owner/management source funding, as they cannot rely on traditional sources. However, you will risk your purchase price (which may be your retirement income) if you provide financing terms more generous than the

marketplace would provide to a third party purchaser. You put yourself, your successors and the business at risk by selling on over generous terms.

mistake #13:

Not maintaining the best interests of the business.

Here is where you may be forced to make tough decisions, particularly with regards to your children. In business succession planning there will be times when you have to maintain the best interests of the business and not treat your children equally. However, you should treat each child fairly. Do not place your personal agenda ahead of what is in the best interests of the business or you could risk everything.

mistake #14:

Not involving your successors in developing the plan.

It is not smart to assume that you can impose a succession plan and expect a smooth, exit. Ongoing communication, responding to feedback and involving successors in the planning process will lessen the chances for problems and roadblocks to arise.

mistake #15:

A verbal plan.

Believe it or not, this does happen. Please write it down. No matter how simple you think it is, working from a document will really make your life, and those around you much easier. It's very difficult for others to assist you in the process if they cannot properly share in the details of your plan. It is the only proper record of what should happen, when, and how. Should anything happen to you, if you die or are critically ill no-one will benefit.

mistake #16:

Not sharing the plan with others.

You should not try to develop your succession plan by yourself. No-one can help you prepare yourself, your successors or the business for succession without knowing the plan. As noted above, you will be in for a very bumpy exit if you do not involve your successors.

Common (*Preventable*) Succession Planning Mistakes

mistake #17:

Not integrating the plan into your other legal documents.

Your will, powers of attorney, family trusts, shareholder agreements and similar documents will need to be reviewed and amended as required to integrate into the plan.

mistake #18:

Not sticking to the timetable.

Once the plan is in writing and shared you should stick to it. If you don't, you risk unraveling the whole plan.

mistake #19:

Not thinking about the unthinkable.

Build in flexibility. The occurrence of one or more of the following can force a 'crisis' on the family succession planning

- Your death
- Your critical illness or disability
- An offer to buy your business that you 'cannot refuse'
- The loss or potential loss of a key employee
- The loss or potential loss of some key business relationship
- Actual or impending significant increase in competitive forces
- Actual or impending loss of competitive advantage
- The need for significant capital investment or funding
- External forces create financial difficulties
- Ultimatums from the next generation
- The death of a spouse or loved one
- Another family crisis
- Loss of enthusiasm for your business
- The desire to do something else with your life

The comments in this newsletter are of a general nature and are not designed to replace the need for a professional advice in specific situations. If you have questions about this bulletin, we would be pleased to assist you.
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There are probably other mistakes that are being made by family business owners who are looking down the road to their exit from their company. Give yourself time to consider options. Talk to others. Talk to your successors. Talk to experienced outside advisors. Too many wrong decisions made too late in the process could result in you doing your personal grocery shopping down the cat food aisle at PetSmart. It's time to start planning.

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Simmons da Silva & Sinton provides legal services to entrepreneurial business clients and individuals. At a personal level, we assist clients with all matters relating to family law, including mediation, collaborative law and court-contested proceedings. We also advise as to the preservation of wealth, Wills and estates. For more than thirty-three years our reputation has been built on being astute problem solvers and providing common sense solutions to the legal issues confronting our clients.