Business Succession Planning: A Short Course
by John Latta, guest writer for Bell Investment Advisors
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Introduction by Jim Bell, President/Founder Bell Investment Advisors

In 2000, I entered into a contract with Business Consultant John Latta to help me plan for an important transition at Bell Investment Advisors. My business partner from the very beginning in 1991, Dr. Hy Resnick, was getting ready to retire. I hired John to help me plan for the future of the business and search for the right person to help get us there. We hit the bull's eye with Matt King, CFA. Matt has been with us ever since. He is now our Chief Investment Officer and Managing Director.

It was never in my mind to prepare Bell Investment Advisors for sale. I always wanted to develop my team and culture internally so that the character and values that have been so important to my wife, Bonnie, and me would carry on after we are gone. Once John helped me with this initial transition, Matt and I continued to work with him on a broader, long-term succession plan. He introduced me to the concept of "institutional independence" first thing, and we began working on institutionalizing the business away from me as an individual to our highly competent team of 14, including our son, Forrest, who is a Senior Investment Advisor and lead Financial Planner.

For the past 11 years, John has worked with the Bell management team to develop annual budgets, review monthly financial statements, determine the true cost of our services in alignment with fee income, and other special projects. I am proud to report that we have been working on our succession plan for over 11 years now, and that John Latta continues to be my trusted guide and counselor. John is highly qualified to teach, speak, and write on business succession planning.

Succession planning in a business context ordinarily involves passing that business on to a succeeding generation. It has two important components: ownership succession and management succession, each of which needs to be carefully planned. More on this below. The founder's children usually represent that next generation of ownership (and possibly management), but others, such as charities and employees, can also qualify. However, business succession is usually about the children.

The Difference Between *Estate Planning* and *Succession Planning*

The term *estate planning* is sometimes confused with *succession planning* but the two speak to different but related processes. *Estate planning* contemplates the death of a person, and provides for passing that person's entire inventory of wealth (possibly including a business) to his or her beneficiaries. The term *succession planning* relates more directly to the business itself and to the steps that will be required to keep it intact, functioning, and profitable under the next generation of ownership and management. The former is a legal process completed at death, while the latter relates more to an ongoing series of decisions and actions which occur well within the owner's lifetime. It is, in a very real sense, a unique type of business plan. The final step of the succession plan might be completed through the owner's estate, but usually some ownership transfers will have occurred beforehand if for no other reason than it may be more tax-efficient to do so. Thus, the two terms are quite related and are sometimes overlapping.

Growing the Identity of the Business Beyond the Founder

An important challenge in structuring a successful succession plan is that the business has probably been closely associated with its founder up to this point. As a result, everything has been aligned. The business served the founder's wants and needs, and chances are his full working attention was devoted to its success. When the founder calls it quits and passes on both ownership and management to others, new wants and needs will enter the picture from a variety of sources and will almost certainly not be so well-aligned. Previously stable and uncomplicated, the business and the wealth it represents now face a number of unique demands as new people (perhaps several of them) enter the scene.

A successful succession plan anticipates these potentially conflicting and competing demands and attempts to realign the business structure to serve them in an environment where the old rules don't apply any more. Ordinarily, the objective of first import is preserving the business unit for the continuing source of well-being that it represents. It is the legacy of the founder for the benefit of its future owners, which are usually his children.

Common Considerations for Business Succession Planning

The purpose of this paper is to lay out some of the more common considerations for business succession planning and thereby open up an avenue of thinking for you if you are beginning to struggle with the subject.

The founder's children can have at least three ways of seeing the business created by their parents: as a source of personal wealth, as a potential career, and as a source of family and individual identity. The manner in which their parents pass on their wealth often touches the core of their perception of themselves and their siblings in new ways. And those ways are usually not as predictable as one might imagine. Sorting this out and creating a succession plan that offers a bright future for all of the successors can be incredibly challenging. One size definitely does not fit all – not all families, not all businesses, and perhaps not even all the children within the same family.

An early question that must be addressed is whether the business is capable of surviving the retirement of its founder and thriving under new ownership and management. Many businesses are so identified with their founders that they lose their identity in the minds of customers and perhaps even employees once that founder is no longer involved. Thus, task one in succession planning is to assess the separate identity of the business and to work to create its "institutional independence" from its founder. This can be a challenge, but is particularly tricky for a professional services business that in many respects has been one and the same as its founder.

Leadership, Infrastructure and Competitive Advantage

Three other fundamental qualities of the business will demand assessment as well: *leadership*, *infrastructure*, and *competitive advantage*. *Leadership* relates, of course, to having a next generation of management that can keep the business moving forward and profitable for the benefit of its future owners. In addition, the business's *infrastructure* (sales force, back office, systems and procedures, etc.) needs to be stable, productive and durable. *Competitive advantage*, in this context, simply refers to having a secure product line or service that will survive the founder's retirement and keep customers coming back for more. It is closely related to the *institutional independence* referred to above. It is not unusual for a succession plan to begin with a serious effort to strengthen one or more of these critical business elements, even before the succession piece begins to come into focus. If the fundamental qualities of the business are not strong and durable, the business will be at risk as the influence and involvement of its founder begin to ebb.

The Family

And that brings us to the family. The way in which one child's perception of how he or she has been favored (or not) after the parents are out of the picture has been known to cause unpredictable friction. In fact, without the parental influences to stabilize these intra-family relationships, what have previously been close ties can become quite strained and evolve in unpredictable ways. The career viewpoint of one sibling provides a ready example.

Picture two siblings, each falling heir to 50% of the family business upon the passing of their parents. One expects to run the business, and may have actually been preparing for this role for years, while the other has no interest in the business at all except as a source of wealth. Naturally, the new CEO expects to be compensated for his or her services, but the second heir has the opportunity to view 50% that compensation as coming out of his or her pocket. At the very least, this can open up the issue of what is fair and reasonable compensation, but to a certain mindset, particularly one not of a business orientation, it can easily come to resemble a favoritism that seems totally unintended by the parents, i.e., an unequal blessing upon the employee-owner. In the absence of the parental influence, this can open up a conflict between two siblings who formerly seemed as close as family can be. This is, in fact, a classic example which I've seen repeated several times.

On the other hand, the business has its own needs which may or may not line up with those of the children. These include a need for stable, properly independent ownership, which, in turn, relates directly to the business's need for capital. It also has a need for skillful, energetic management. Until now, these two needs have likely been met by one person (or perhaps by a husband/wife team). This sole-source arrangement may not be possible following the passing of the principals. What has been one portfolio of value serving one family unit must now become two or more, depending on the number of siblings involved. And the wants and needs of each don't automatically align with those of the business. This, of course, has the potential to set up the compensation conflict suggested above, but it can go in other directions as well. One child may have a pressing need to cash out, while the other is optimistic about the business and content to leave his or her chips in the game. Satisfying the needs of the first can pose a direct threat to the business's stable ownership and capital requirements if the only source of value to liquidate lies in the assets of the business. Previously, with ownership and management being represented by one unit, this conflict would likely never have arisen. At least, it would have been easily resolved.

The Needs of the Business

The other need of the business, however – that of skillful and effective management going forward – can also be an issue. It can take many forms. The sibling tapped to run the business may not be the right or even the best available choice. It's very easy for proud parents to fool themselves here. The desire to pass the torch on to the next family member in line can be a very powerful one. This can lead to seeing capabilities in the next generation that just aren't there in sufficient measure to carry the ball.

But there can also be another, also unrecognized, issue imbedded in this situation. Chances are the passing generation has been doing the job for a long time and probably does it rather easily by now. It is quite common for that person to grow blind to important skills and instincts that he has been using to run the business for so long and that are critical to doing the job well. It's like taking for granted your ability to ride a bike while completely forgetting the bumps and bruises you suffered as you learned to do so. This can lead to seeing the job requirements as simpler than they really are, thereby creating a serious blind spot that can lead to flawed assumptions about the suitability of the kid for the job.

There is still another hazard. The founder may be seeing the business as it always has been and not as it will have to be in the future. And for some unknown cosmic reason, the passing of the torch often seems to happen around the time when significant course corrections need to be identified and implemented. So the founder may be looking at his chosen successor and accurately seeing the presence of his own skills in the child, but these may not be the skills that the business will need in order to thrive in the future.

The Employees

There is still one other group of people that might have important things to say about this transition from founder to future – the employees. The loyalty factor has often been a key reason for the success of the business and therefore should be an important consideration in the plans for its succession. Radical changes in the direction of the business can have a very negative impact on this group, but so can new management if it is not up to the task. These influences can threaten the stability of the business and in turn the jobs of the employees. In addition, some founders feel a genuine desire to share some of the wealth with this group. Channeling minority ownership shares to key, non-family employees, or the implementation of an ESOP, frequently become a part of the planning conversation. At a minimum, this aspect of succession should be given a nod in the planning process.

Guidelines for a Successful Transition

By now, you are probably thinking, *OK, it's complicated – I get that now. So what do I do?*

First of all, recognize that a successful succession plan must address, indeed be founded upon, the unique circumstances and personalities of the people involved – the founder or founders, their children who will succeed to the ownership of the business, potential managers (whether family members or not), and others such as employees and even, perhaps, significant customers. While there are many tools in the succession planning toolbox, they must be applied creatively to your own set of wants, needs and influences. Nevertheless, here are a few suggestions:

1. ***Start early.***
   Successfully planning for business succession is a challenging and difficult process, and the thing is, you can't know what the task will require until you get into it. To be effective, it should begin years before it will be implemented by assessing what the business will need to operate without you and sizing up and nurturing the potential future players. And the chances are that your ideas on the outcome you seek will go through an evolution as you proceed. Doing it right takes time.

2. ***Recognize that it's not easy.***
   You will have to shape the outcome you want. A future leader will need to be identified, trained and carefully watched through his development. The intra-family dynamics that will result from ownership being divided will need to be anticipated and set up in ways that have the best probability of insuring stability. Key employees will need to be counseled on your expectations of them after you are no longer in the picture. Ideally, it's usually best to move these individuals into their continuing roles before you phase out so that they can learn under your tutelage and you can judge the likelihood that they will perform as expected. Customers may have a need to know that their source of supply for your product or service will be secure.

3. ***Treat different needs differently.***
   Ownership succession is not management succession. These two challenges need to be considered somewhat independently of each other. The assumption by the founder that a son or daughter who has worked in the business is qualified to run it, or that her or she is the only CEO possibility is a common reason for heartache as the plan is implemented. Your son or daughter may indeed be an excellent choice, but if so, make that decision for the right reasons after careful consideration of what is best for the business, and therefore ultimately your children, in the long run.

4. ***Remember your employees.***
   Your influence on this important group will be different from that of your successor. You founded the company and know what you're doing. The new leader (whether

family or not) didn't, and won't have the degree of respect that you enjoy. So what skills will be required by that person to maintain the respect of employees and customers and still be effective?

5. ***Talk it up.***
   All of the parties mentioned above, along with several others (your banker, for example) will benefit from an understanding of the careful thought that went into your plan and the reasons for the decisions that grew from it. Knowing your intentions gives them an opportunity to help you pull it off. Your employees need to understand the game plan. Because they are in contact with still another really important resource – your customers – employees will need to know how to talk about the transition. Including them in the process and conversation will also help hold down the time they will spend speculating among themselves.

6. ***Get help.***
   As your ideas begin to take shape on a conceptual level, you will need the involvement of your team of professional advisors to help you structure the plan so as to secure it and make it happen in the most efficient way. This will require legal and tax advice, but there may be others whom you trust who can help as well.

Summary

In summary, a plan that will succeed requires a great deal of careful thought. Then, the plan implementation will likely require many small steps over a considerable period of time. The more time you allow yourself for thoughtful and intentional progress, the greater the probability of achieving the outcomes you are seeking for the business and for your family. Remember, it may be many years after the plan's implementation before it will be possible to call it a success.

About John Latta
John Latta*, MBA, CPA is the President/Owner of Orion Advisory Group LLC, a business consulting firm located in So. San Francisco. Orion's clients include owners and key executives of law, engineering, architectural, and money management firms. John has also served on the boards of and consulted with several non-profit organizations.*

Prior to starting Orion almost 12 years ago, John was with Grant Thornton LLP, for 30 years, initially as a corporate tax consultant, and later holding two key management positions. He first headed the tax-related services function for the entire firm, which included over fifty offices in the United States, and later served as the managing partner for the firm's offices in San Francisco and San Jose, California.