

Family Succession Planning: A Guide With NTA Member Case Studies

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"Succession isn't an event, it's an endeavor that takes years. The toughest management challenge an owner will ever face is orchestrating his or her own departure from the company. The finest testimony to an owner's career is how well the business succeeds once he or she is gone."

-Mark Fischetti, Editor, The Family Business Succession Handbook

Many successful business owners, caught up in the here-and-now demands of running a company, have given little attention to what will happen to the business once they retire. Some owners postpone succession planning because the task seems too difficult, while others assume they can wait until retirement is imminent. For many business owners, succession planning is avoided because of the emotional issues involved – it's simply too painful to imagine relinquishing control of what has been one's greatest accomplishment, or to acknowledge that one will not live forever.

While succession planning is important for all types of businesses, it is of special importance for the family business, in which business affairs tend to be closely linked to family relationships, values and aspirations. A 1997 study by Arthur Andersen and Massachusetts Mutual revealed that fewer than 30 percent of American family businesses survive into the second generation, and fewer than 17 percent survive to the third generation – sobering statistics that further suggest succession planning's importance.¹

A majority of NTA tour companies – 72 percent – are family-owned businesses, as are 42 percent of NTA tour supplier companies, according to NTA's 2000 Second Quarter Survey results. Yet among these family-owned businesses, fewer than half of tour operators (42 percent) and just over half of tour suppliers (53 percent) report having a succession plan in place.

This report examines the benefits of succession planning, succession options and challenges, and key steps in creating an effective succession plan. While the focus is on family-owned businesses, many of the ideas presented here apply to any closely held business. To help the reader put succession planning ideas into actual practice, NTA member case studies, a succession planning checklist and a succession planning resource list are included at the end of the report.

¹ Phil Davies, "Sibling Rivalry Takes on New Meaning in Succession Planning," In Depth: Family Business, December 25, 1998, <http://www.bizjournals.com/twincities/stories/1998/12/28/focus1.html>.

Succession Planning Basics: What, Why and When

Business owners may assume that if they have an estate plan, they don't need a succession plan. This is not the case. Estate planning, with its primary focus on the transfer of property, is an essential component of succession planning, but succession planning is much more comprehensive. A good succession plan, in addition to outlining the business's future ownership form, organizational structure and management, identifies how the transition from one generation of leaders/owners to the next will be managed. Furthermore, it provides a means of transferring a company's accumulated store of trust, respect and goodwill to new company leaders.²

It is important to emphasize that a succession plan is a *written document*. Because failing to plan for business succession can mean significant monetary losses and even loss of the business itself, an owner's intentions about what will happen to the business upon his or her departure from it are a poor substitute for a formal plan. In order to be effective, a succession plan must also be regularly reviewed and updated to reflect company changes, industry or market developments, changes in tax laws, etc. Even in the absence of such changes, an annual review is in order.

A number of crises can befall businesses that operate without a succession plan. For example, company leadership can fall to successors who have not been properly prepared for leadership, thus threatening the company's profitability and endangering relationships with key clients. Potential tax disasters are also important to consider. In the United States, estate taxes alone can take 18 to 55 percent of a taxable estate, forcing successors to take on immense debt just to keep the business running after the owner's death. Although estate taxes are not levied in Canada, family-owned businesses in that country are still vulnerable, according to John R. Daly, an attorney specializing in taxation, business succession and estate planning. Estates of deceased persons may be required to pay Canadian tax in the form of an income tax payment on the transfer of property to a non-spouse family member.³

In addition to preventing a crisis down the road, succession planning offers many immediate benefits. Having envisioned a specific future, companies often emerge from the succession-planning process with a clearer sense of their mission and core values. The necessary discussions of company organization, management and operations may lead owners to the discovery that existing structures or practices are no longer effective, while a formal business valuation may reveal that the company's product has stagnated. Implementing a long-term

² Gregory Amundson, "Form a Business Succession Plan in Seven Steps," Small Business Insights, May 16, 1997, www.bizjournals.com/louisville/stories/1997/05/19/smallb6.html.

³ John R. Daly, attorney with Feirich/Mager/Green/Ryan, Carbondale, Illinois, e-mail correspondence, April 12, 2001.

training program for successors is likely to yield shorter-term results as successors acquire new skills on the path to leadership.

Because the steps required to prepare a business for succession can take several years – and because succession can be the result of unexpected death as well as planned retirement – developing a succession plan is not a task to put off. Many succession-planning experts recommend that owners develop a plan as soon as the business has weathered the start-up stage.

Developing a succession plan is especially critical for the business owner who plans to retire within 10 years, even if he or she plans on selling the business. If the business is family owned and the owner wishes to keep it in the family, several years may be needed to prepare the next generation for leadership. If the intent is to sell, considerable planning will be needed to ensure that the business will be sellable on terms acceptable to the owner.

Keeping the Business in the Family

James Lea, who has written widely on succession planning, recommends that before pursuing a plan to keep a business in the family, all family members and stockholders agree on the statement, “The business is stable and profitable enough and its future in the marketplace is bright enough to justify keeping family ownership into the next generation.”⁴ Once consensus is reached on this point, several succession options can be considered.

Options for Transferring Ownership

The best method for keeping a business in the family will depend on the availability of able successors, the size of the company and the amount of time remaining until the owner’s planned retirement.

For many family business owners in the United States, gifting shares of stock to successors over a period of years may be the best way to reduce the tax burden of succession. An annual maximum of \$10,000 in stock may be passed down tax free to each child or other family member, so if the business has a sizeable worth, gifting should be spread over as many years as possible. The lifetime family business exemption is currently \$675,000.

Canadian family business owners face a different set of laws when it comes to gifting. While Canada does not have a gift tax, the donor of a gift of property is generally deemed to have sold the donated property at its fair market value. Any appreciation in value (the difference between the donor’s cost and fair market

⁴ James Lea, “Whose Job Is It to Take the Lead in Family Business Succession Planning?” Family Business, Feb. 7, 2000, www.bizjournals.com/extraedge/consultants/family_business/2000/02/07/column87.html.

value) is treated as a capital gain for income tax purposes. The donee then receives the property at its fair market value.⁵

Generally, voting stock in the business should be reserved for children or other family members who will be actively involved in its affairs. Those who will not be active participants, but to whom owners want to leave part of the business, can be given a minority interest and non-voting stock. Other assets, such as homes, IRAs, stocks and life insurance, can be used to share wealth with children or family members who will not have a future with the company.

Those who elect a gifting program should include a “completion clause” in their estate plan to ensure that the gifting plan is carried out in the event of death or disability. Without this plan, shares that have not yet been gifted are in danger of being divided equally among all family members.⁶

While gifting may be an effective succession technique for many family businesses, it does have its drawbacks. As Andrew J. Sherman notes in his book *Parting Company*, “Gifts can’t be taken back; nor will they provide you with retirement income.”⁷ If retirement income is a concern, another option is to sell the company outright to children or other family members. It is also possible to combine gifting and selling by first gifting part of the business, then transferring the rest through a series of promissory notes.

Family limited partnerships have become increasingly popular ownership forms for family businesses in the United States and allow owners to transfer ownership while still retaining control. Such partnerships have two classes of partners: the general partner (owner) and the limited partners (successors). Under such a partnership, the proceeds of life insurance policies taken out against the owner – if they are payable to the partnership – are not considered part of the owner’s estate, and thus are not subject to the estate tax.⁸

However, the IRS challenges family limited partnerships that appear to have been formed primarily for tax avoidance or in contemplation of pending death. Succession-planning experts generally agree that family limited partnerships should be established only when there is a definite business (i.e., non-tax avoidance) purpose for doing so, with that purpose incorporated into the partnership agreement. Limited-liability company (LLC) ownership structures need to withstand the same IRS scrutiny.⁹

⁵ John R. Daly, attorney with Feirich/Mager/Green/Ryan, Carbondale, Illinois, e-mail correspondence, April 12, 2001.

⁶ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger’s, 1999, p. 77.

⁷ *Ibid.*, p. 76.

⁸ *Ibid.*, p. 83.

⁹ *Ibid.*, pp. 83-84.

The family limited partnership structure is not an option in Canada, according to Scott vanEngen, a succession-planning consultant based in Guelph, Ontario. However, vanEngen stated that estate freezing can be an effective family succession strategy for Canadian businesses.¹⁰

Regardless of the specific ownership structure used to transfer the business to the next generation, the succession plan needs to include procedures to be followed in the event that a family member wants to sell his or her shares of the business.

Challenges of Family Succession

Even if keeping the business in the family is viable from a business standpoint, owners should anticipate facing a number of other challenges. Some of the more common challenges are discussed below.

The Search for Equality

For family business owners with more than one child, a major concern is often how to treat all children equally in the succession process. But simply leaving children equal shares of the company's stock may not be what's best for the company or the heirs. In many cases, a perfect split is not even practical: one or more of an owner's children may have no interest in working in the business, and aptitudes may vary considerably among siblings.

One way for family businesses to deal with this issue is to embrace a broader concept of "equality." Joseph F. Blum, whose firm specializes in estate preservation techniques, says the key is "satisfying everyone's most pressing needs."¹¹ For the business owner, those needs may be to retain control of the business for the time being and to guarantee sufficient retirement income. For children actively involved in the business, the most pressing need is likely to be the assurance that they will control the business upon the owner's exit. For children not actively involved in the business, the need is probably receiving an equitable inheritance.¹²

Numerous options are available to the business owner who wishes to treat children equitably without choosing technical equality. While it is impossible to discuss all of the options here, two general principles noted previously are worth repeating. First, most succession-planning experts agree that voting stock should be reserved for heirs who are actively involved in the business. Second,

¹⁰ Scott vanEngen, C.A., C.F.P., Robinson and Company LLP Chartered Accountants, Guelph, Ontario, phone interview, April 16, 2001.

¹¹ Joseph F. Blum, "One Answer to a Family Business Owner's Wish to Treat His Children Equally," Northeastern University Center for Family Business, Family Business Quarterly, <http://www.fambiz.com/contprov/cfm?ContProvCode=NECFB&ID=834>.

¹² Ibid.

life insurance and other assets can be valuable tools for providing a fair legacy to family members who won't be actively involved in the business.

Sibling Rivalry: Not Just for Kids

Sibling rivalry can pose another obstacle to smooth succession in cases where the retiring owner is transferring company leadership to more than one child. While some rivalries are inevitable, these must be managed so as not to impair business judgement or prevent collaboration from taking place.

A wide variety of approaches – such as enlisting one of the retired owner's trusted advisors or a very senior non-family manager as a mediator – can prove successful in preventing rivalry from becoming destructive. As noted by Ivan Lansberg in *The Family Business Succession Handbook*, "What seems to matter more than the substance of . . . conflict-management techniques used by sibling groups is that some sort of functional process is put in place on which they all agree." Lansberg also says that openly acknowledging rivalries, and diffusing them with humor, can help successors to rise above them.¹³

The Entitlement Issue

Another challenge to family succession occurs when members of the next generation believe they are entitled to a future ownership/leadership role within the company. Succession-planning experts caution – and common sense dictates – that this belief can spell disaster for the entire business if left unchecked.

Many family businesses that have weathered succession have established specific criteria that family members must meet in order to assume a management role within the business. Earning a college degree and obtaining outside work experience are among the most common of these requirements.

Research indicates that a commitment to the principles and practices of *stewardship* – the sense that the family business "is not a personal possession, but a trust that has been given to [family members] for safe keeping and for which they have deep caring and respect" – is critical to the success of the succession process.¹⁴ The practice of stewardship begins with the business owner, who must model the attitude that business ownership is a privilege and not a right.¹⁵

¹³ Ivan Lansberg, "Making Sibling Teams Work," *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 103-104.

¹⁴ Edwin A. Hoover, "Promoting Stewardship," *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 9-13.

¹⁵ Ibid.

The Third Generation Juncture

In addition to the challenges already described, many family-owned businesses face an especially critical succession challenge as they make the transition from the second to the third generation. There are several reasons for this. First, the third generation typically includes many more family members who wish to work in the company – sometimes cousins who have been raised in different households and have very different styles and points of view, not to mention differences in competency and financial need. Additionally, the third generation may carry over unresolved problems, such as feelings of injustice, from the second generation, and their parents may be too caught up in the conflict themselves to help resolve the dispute.¹⁶

Those family businesses that successfully make it to the third generation are most likely to adopt a “business-first” philosophy at this stage in their history. In a “business-first” company, power and influence are typically shared with non-family managers, with people outside the family and outside the company serving on the board of directors.¹⁷

Selling Outside the Family

Once again, having a written succession plan in place is valuable even when the business owner plans to sell upon retirement. In some cases, the succession-planning process itself may help the owner to determine whether passing the business on to the next generation or selling outside the family is the better option.

Selling outside the family may be the best option if the business will have a difficult time supporting both the retired owner and the next generation, if no willing or suitable family successor is available, or if the family is divided as a result of divorce or other circumstances.

Selling to Employees

One option for selling outside the family is selling to employees through an employee stock ownership plan (ESOP) or other stock-option program. As Andrew Sherman notes in *Parting Company*, this strategy may offer significant tax advantages and “can be a very useful tool for increasing employee morale, productivity and loyalty.” However, Sherman also emphasizes that employee-based succession strategies typically must be implemented in stages, and

¹⁶ Peter Davis, “From Second to Third Generation,” *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 43-44.

¹⁷ Ibid.

therefore do not provide for an immediate transition of ownership and management.¹⁸

Most ESOPs utilize bank loans to buy stock from the company's owner; the company stock is then distributed to individual employees. The owner may use the proceeds from the sale for business expansion or retirement savings. In the United States, the ESOP offers several tax advantages, the first being the ability to deduct both principal and interest on loans obtained through the ESOP. The second is the ability to defer capital-gains taxes on the sale of stock to the ESOP, if the ESOP owns at least 30 percent of the company after the sale *and* if the proceeds are invested in other securities, such as stocks and bonds.¹⁹

In order to provide these tax advantages, ESOPs in the United States must meet a number of IRS requirements. Among these requirements are establishing a trust to make contributions and administer the plan, structuring the ESOP so that at least 70 percent of all non-highly compensated employees are covered by the plan, complying with either a five-year or seven-year vesting schedule and establishing voting requirements in compliance with IRS rules.²⁰

In Canada, there are no *federal* tax incentives to encourage employee ownership; however, many Canadian provinces have established legislation providing such incentives. The Employee Ownership & Incentives Association (EOIA) or the ESOP Association of Canada can provide information on tax incentives in particular provinces.²¹ (Contact information for these associations is provided in the Resource section of this report.)

Alternate forms of employee-ownership plans are stock-bonus award plans, which award company stock as bonuses to key employees only, and stock options, which grant key employees options to purchase shares in the future at the per-share price on the day the option is issued. Sherman notes that business ownership is generally transferred more gradually under such a plan.²²

Selling to a Third Party

If no suitable family successor exists and selling to employees is not feasible, a third-party buyer may offer the best way of preserving the legacy of a business and/or providing for the owner's retirement. Because getting a business in good

¹⁸ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger's, 1999, p. 105.

¹⁹ *Ibid.*, pp. 107-108.

²⁰ *Ibid.*, pp. 107-111.

²¹ The National Center for Employee Ownership (NCEO), <http://www.nceo.org>; Employee Ownership & Incentives Association, <http://www.esopcanada.org>; ESOP Association Canada, <http://www.esop-canada.com>; all accessed April 13, 2001.

²² Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger's, 1999, p. 114-115.

selling order and locating a third-party buyer typically requires considerable work and time, selling is a process that should be planned for like any other transfer strategy. Allowing plenty of time gives an owner the best chance of receiving a fair value for the business. Under pressure, the owner might take a less-than-acceptable offer or fail to find a suitable buyer altogether.

While all aspects of selling a business cannot be discussed here, perhaps the most important is the role of an advisory team. Going it alone can be extremely risky, as emphasized in the following passage from the *SOHO [Small Office/Home Office] Guidebook*:

“Even if you’ve been a determined do-it-yourselfer from day one, selling your business is not a job you should attempt to do alone. Even for a relatively small business, there’s a myriad of federal, state, and local regulations and tax issues to consider, not to mention one or more extremely important contracts to negotiate. Selling your business is something you’ll probably do only once – there’s no opportunity to take a trial run or build up any experience before you do the real thing.”²³

Sherman recommends that the advisory team include a financial advisor or investment banker, a certified public accountant and legal counsel.²⁴ While the financial advisor/investment banker will play a key role in identifying potential buyers, the owner can contribute to this process by developing a list of potential buyers, including suppliers, customers and competitors.²⁵

The advisory team can also help the owner perform a legal audit, determine the value of the business and prepare an offering memorandum. The offering memorandum is important both as a source of information for potential buyers and as an internal plan for the seller. It contains the following components.²⁶

- Overview of the company;
- Description of products and services;
- Description of management team and organizational structure;
- Summary of company’s financial performance to date;
- Description of key customer relationships and intangible assets;
- Hurdles (if any) to accomplishing the sale; and
- Supplemental materials.

²³ The SOHO Guidebook, Chapter 11: Getting Out of Your Business, CCH Business Owner’s Toolkit, <http://www.toolkit.cch.com>.

²⁴ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger’s, 1999, pp. 125-126.

²⁵ The SOHO Guidebook, Chapter 11: Getting Out of Your Business, CCH Business Owner’s Toolkit, <http://www.toolkit.cch.com>.

²⁶ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger’s, 1999, p. 128.

Giving potential buyers credible financial data is particularly important; sellers should plan on providing several years of audited or reviewed financial statements. This will also help shorten the due-diligence phase of negotiations, during which both parties have the chance to investigate each other thoroughly before proceeding with the deal.²⁷

Another key issue for owners engaged in the selling process is when to inform key employees that a sale is under consideration. This may be of particular concern in small or medium-sized businesses where employees have developed high expectations for being “kept in the loop” on company matters. Employees who learn too early in the process of an owner’s plan to sell may fear for their job security and seek employment elsewhere, in turn damaging customer service and the company’s reputation.²⁸ A loss of key talent can also jeopardize the deal at stake. At the same time, waiting until the last minute to inform key employees can cause resentment and loss of trust.²⁹ While there are no definite answers as to when key employees should be informed, owners should give the issue considerable thought early in the selling process.

Businesses With Co-owners: The Role of the Buy-Sell Agreement

Businesses with co-owners face some unique succession-planning issues. Often, succession options for the co-owned business are limited by the presence of a buy-sell agreement enacted when the company was established. The buy-sell agreement is a legal document providing for the redistribution of shares of the business following the departure of one of the owners due to retirement, death, disability or other cause – including failure to perform key responsibilities, embezzlement or breach of a non-compete clause.

By allowing either the remaining owners or the company to purchase the shares of the departing owner, the buy-sell agreement can effectively prevent those shares from being passed on to the departing owner’s spouse and/or children. Sherman believes that this is an advantage for the company because it eliminates the problem of unintentional owners who may lack the qualifications to participate in running the business. Sherman notes that the buy-sell option also helps provide for the continuity of the business and thus provides assurance for the company’s employees, customers, suppliers and creditors, as well as for the owners themselves.³⁰

²⁷ Abby Livingston, “Avoiding Pitfalls When Selling a Business,” *Nation’s Business*, July 1998, http://www.findarticles.com/m1154/n7_v86/20797611/p1/article.jhtml.

²⁸ *Ibid.*

²⁹ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger’s, 1999, p.130.

³⁰ *Ibid.*, p. 89.

In addition to specifying how shares of the company are to be redistributed following one owner's departure, the buy-sell agreement specifies a method for establishing the price of the redeemed shares, how the proceeds will be paid and how the transfer of shares is to be financed. Sherman emphasizes that owners should consider different provisions for each of these areas based on different departure scenarios (e.g., retirement vs. termination for wrongdoing).³¹

The method used for determining the price of redeemed shares is typically a formula price such as book value, book value adjusted to the fair market value of certain assets and liabilities, a multiple of earnings, a multiple of weighted earnings over a period of time or a combination of book value and a multiple of weighted earnings.³² Payment for redeemed shares to the departing owner or survivors may be paid in one lump sum or spread over a period of years; again, the best payment method will depend on the reasons for the co-owner's departure.³³

The transfer of shares in a buy-sell agreement is often financed by key-person life insurance policies. These policies may be owned by either the co-owners or the company itself. The face value of a key-person policy should be reviewed periodically to ensure that it reflects the changing value of the company.³⁴

Key Steps in Effective Succession Planning

1. Revisit the Company's Mission

Even owners who already have a succession strategy in mind can benefit from this exercise. Asking the questions, "Who are we, and what do we stand for?" can establish a critical framework for identifying which succession strategy is the best fit. Rather than relying on their perspective alone, owners should invite key employees and family members to participate in revisiting the company's mission. Everyone may be surprised to discover that the mission has changed over the years, or that the mission and company practices are no longer in alignment.

2. Conduct a Business Valuation

Business valuation is a critical aspect of succession planning, and one that should be undertaken at the beginning of the planning process. A business owner needs to know exactly how viable his or her business is before making

³¹ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger's, 1999, p. 91.

³² *Ibid.*, p. 90.

³³ *Ibid.*, p. 91.

³⁴ *Ibid.*, pp. 94-95.

major decisions about its future.³⁵ Furthermore, the owner needs to understand the fair market value of the business in order to make a sound decision about how much to spend on outside advisors to assist in the succession-planning process.³⁶

While self-valuation and a study of comparable companies are two methods of arriving at a valuation for a closely held business, most succession-planning experts recommend using a professional business appraiser to conduct the valuation, since it is part of the succession plan's very foundation.

A professional appraisal can cost from \$5,000 to \$15,000 and take two weeks to two months to complete.³⁷ When hiring an appraiser, the owner should clearly define the terms under which the appraiser will be working, including an expected time frame for completion and a fee structure.³⁸ There are a number of accepted methods for business valuation, including the comparable-worth method, the asset-valuation method and the financial-performance method. Most professional appraisers will try out a few different methods in order to pick the one or two most appropriate for the business at hand.³⁹

3. Seek Advisory Help

No matter which succession strategy a company pursues, advisors should play a role in identifying and implementing that strategy. The importance of advisors has already been discussed in the context of selling a business; however, advisory support is just as important for owners who plan to keep a business in the family.

While owners may be tempted to get by on as little outside help as possible – for example, using their accountant or legal counsel only – experts recommend enlisting a much broader group of advisors, including an external advisory board or committee in addition to individual consultants. Without this external perspective, family businesses may lack the objectivity needed to make the best decisions about future leadership, company structure, etc.

A growing number of businesses are turning to consultants who specialize in succession planning. In addition, many family businesses are seeking the assistance of consultants trained as psychotherapists for help resolving the interpersonal issues involved with succession.⁴⁰ While all companies may not be

³⁵ Laura Koss-Feder, "Business, Too Close to Home," Time Magazine, July 17, 2000, B27.

³⁶ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger's, 1999, p. 15.

³⁷ Laura Koss-Feder, "Business, Too Close to Home," Time Magazine, July 17, 2000, B27.

³⁸ Andrew J. Sherman, *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*, Washington, D.C.: Kiplinger's, 1999, p. 130.

³⁹ *Ibid.*, pp. 21-25.

⁴⁰ Valerie Marchant, "A Good Therapist Might Help," Time Magazine, July 17, 2000, B29.

able to afford these services, owners should seek external assistance from as many perspectives (financial planning, family relations, estate planning, etc.) as possible.⁴¹

4. Involve Family Members in the Process

The effectiveness of any succession plan ultimately depends on buy-in from family members who will play a role in the company's future. Many factors can act as barriers to discussing succession candidly, and an owner may not know how members of the next generation truly envision the future of the company and their specific roles within it. Without the involvement of the rest of the family, a business owner risks creating a succession plan that no one else is able or willing to support.

Family participation in succession planning can take a number of forms, but many experts recommend the creation of a "family council" for this purpose. The council can begin with a family retreat, perhaps assisted by a family business consultant.⁴² One of the council's first steps may be to revisit the company's mission, as previously discussed.

Owners may be concerned about giving family members too much of a voice in the succession-planning process. However, as stated in *The Family Business Succession Handbook*, "Setting up a council does not mean that the business becomes a democracy and the owner gives up the last word. Family councils usually act responsibly, and it is rarely necessary for owners to exercise their veto powers."⁴³

5. Establish a Plan for Preparing Successors

Planning for the transfer of company *management* is as important as planning for the transfer of company *ownership*. Thus, the mentoring of potential successors should begin early and follow a planned, sequential process. Experts note that this aspect of succession planning is often regarded too casually.

Mentoring includes providing direction on the kinds of opportunities and experiences that the successor should pursue, evaluating the successor's performance, serving as a role model, explaining company dynamics and politics, and introducing the successor to key contacts inside and outside of the

⁴¹ Bernard L. Erven, "Management Succession Issues in Family Business," Cornell University Family Business Research Institute, Bronfenbrenner Life Course Center, <http://www.fambiz.com/contprov.cfm?ContProvCode=Cornell&ID=357>.

⁴² Benjamin Benson, Edwin T. Creago Jr. and Ronald H. Drucker, "Family Councils: The Key to Communication," *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 30-31.

⁴³ *Ibid.*, pp. 30-31.

company.⁴⁴

While business owners may assume that they themselves should mentor their successors, this can be a dangerous undertaking. Owners preparing their children for eventual management of the business may find it difficult to differentiate between parenting and mentoring tasks,⁴⁵ and a successor receiving career guidance from a parent may find it difficult to “hear that advice in an unfiltered and open manner.”⁴⁶ When available, a well-prepared non-family executive may prove the ideal mentor. Such an arrangement offers the mentor an opportunity to deepen his or her relationship with the future generation of ownership and to strengthen his or her job security by ensuring the future success of the business.⁴⁷

Regardless of who officially serves in the role of mentor, mentoring is likely to be most effective when all involved in the business are committed to the idea.⁴⁸

6. Plan for Contingency

Ideally, a business will experience planned succession – succession that occurs according to a timetable set by the business owner and other key players. However, a thorough succession plan must address how the transfer of leadership is to proceed in the event of the owner’s unexpected death or incapacitation. While the main succession plan looks ahead to the long term, the contingency portion of the plan looks at shorter-term issues. It requires the owner to answer the question, “What will happen to the company if I die or become incapacitated today?”

A contingency plan also provides employees and family members with instructions for the first 48 hours following the owner’s death or incapacitation. These instructions must answer such basic questions as where the keys to the desk are, who has access to important documents and who is authorized to sign the payroll checks.⁴⁹

⁴⁴ Edwin T. Crego Jr., “The Nonfamily Mentor’s Guide,” *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 51-52.

⁴⁵ Ivan Lansberg, “The Difference Between Parenting and Mentoring,” *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, p. 50.

⁴⁶ Edwin T. Crego Jr., “The Nonfamily Mentor’s Guide,” *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 51-52.

⁴⁷ Ibid.

⁴⁸ Léon A. Danco, “Mentoring the Next Generation,” *The Family Business Succession Handbook*, Ed. Mark Fischetti et al, Philadelphia: Family Business Publishing, 1997, pp. 49-50.

⁴⁹ Richard Narva, “Will the Circle Be Unbroken? Managing a Family Business Disaster, Genus Resources, Inc., <http://www.fambiz.com/contprov.cfm?ContProvCode=Genus&ID=385>.

It is important to remember that in companies faced with crisis succession, family members and key employees are left to maintain business operations and make important decisions about the company's future while dealing with what is often considerable grief. Business owners who leave behind a contingency plan not only increase the chances that their intentions for the business will be realized, they make the aftermath of crisis much easier for those who have contributed to the company's success.

Summary

Succession planning is critical to ensuring the continuation of any family-owned business, particularly if the owner plans to retire within 10 years. When effectively developed, a succession plan provides for a smooth transition in management and ownership, whether the business is to remain in the family or succeed to non-family owners. Given the number and complexity of succession options available, effective succession planning requires time, outside advisory assistance and the input of other family members, as well as the willingness to address interpersonal conflicts that can arise during the planning process. As seen in the NTA member case studies that follow, succession planning can also yield many rewards, including peace of mind for the business owner, personal satisfaction for family members and new opportunities for the company itself.

Case Study #1 – Dan Dipert Tours, Arlington, Texas

Dan Dipert founded Dan Dipert Tours in 1972. Today, the company is the largest independent operator of motorcoach tours in Texas and in the four surrounding states, operating tours throughout the United States, Canada and Mexico, as well as overseas air tours.

Like many children of family business owners, Dipert's son and daughter grew up in the business. "My daughter was making name badges when she was 11 or 12 years old," Dipert recalled. However, Dipert did not expect in those early days that he would one day pass the business on to his children. That possibility was not born until many years later, following a series of events that neither Dipert nor his children could have predicted.

After graduating from college and running his own successful entrepreneurial venture, Dipert's son, Dan Watson Dipert, operated a motor inn that the family owned in addition to the tour company. Although the younger Dipert enjoyed the work and the venture was profitable, the family decided to sell the motor inn after a fire destroyed a significant portion of it. Dipert's daughter, Autumn Dipert, enjoyed a successful banking career in Houston and earned an MBA.

The turning point for all of the Diperts – and for Dan Dipert Tours – came in the late 1980s. First, Dan Watson returned to help his father build the motorcoach business. Later, in need of additional help in operations, Dipert invited Autumn on board, and she accepted.

Although his children's return to the business was unplanned, the process by which they became majority owners in Dan Dipert Tours was carefully orchestrated. "The minute I had both my daughter and son working with me, I began to think about succession," Dipert said. "If I did anything right, I did it early – when I was in my 50s."

Following eight years of succession planning – during which time Dipert passed up the opportunity to sell Dan Dipert Tours to a national motorcoach company – Dipert and his children established a family limited partnership. According to the terms of the partnership, Dipert remains the company's CEO while Dan Watson Dipert serves as president and Autumn as CFO and COO. Together, the younger Diperts own 60 percent of the business. They lease the company's motorcoaches and facilities at market value from their father – an arrangement that generates most of his current income.

The family limited partnership proved a good choice for everyone concerned, according to Dipert. "The family limited partnership and the related coach leases provided a means for me to transfer majority ownership of the business to my children in exchange for their sweat equity, while I retained control of the business," Dipert said. Dipert emphasized, however, that this ownership

structure is not right for every family-owned business, and that owners who need to sell because they need the income to live on may be better off exploring other options.

While Dipert retains the title of CEO, he said it is clear to everyone – most importantly, the company’s employees – that his son and daughter are in charge of day-to-day operations. Dipert believes that difficulty in giving up control is one of the reasons many owners never get around to succession planning. And his own experience has given him an appreciation of just how difficult a task letting go can be.

“In many ways, I would have preferred to keep things the way they were, with my children just working with me,” Dipert said. “The business was my baby. I founded it. I nursed it. But I began to see that if I didn’t make a decision quickly, it would mean a family crisis.”

In planning for succession, Dipert relied heavily on recommendations from his advisory committee, which included his attorney, insurance agents and trusted non-family friends. Dipert and his children also participated in some professional business counseling – “Not because we had a big problem, but because we had the same little issues that every family business faces.”

Still, it hasn’t all been smooth sailing. For a period of time after his children became owners, Dipert continued to hold the reins too tightly, generating some family tension and leaving non-family employees confused about who was in charge. With encouragement from his advisory committee, Dipert decided to spend some time overseas and moved out of his office. These steps allowed his son and daughter to solidify their leadership, according to Dipert.

Another key element in managing a successful transition, according to Dipert, is recognizing the need for successors to manage the business differently than the founder. He said, for example, that while his thrust was marketing, his children’s is accountability. These differences in focus have resulted in significant changes in the company’s operations. Dipert explained, “I paid my employees strictly with salaries, but they [Autumn and Dan Watson] offer an incentive program, which they can because of the strong accountability they’ve built into the company’s operations. I could never have pulled that off.”

As for sibling rivalry and conflicts about one successor contributing less than another – both problems frequently cited by succession planning experts – Dipert said it has been important for all family members to stay invested in the big picture. “It’s not an equal thing,” he said. “My children don’t have the same strengths, and at different times even I may think that one or the other makes a greater contribution in a particular area. We have all had to be honest about this and to believe that it doesn’t matter – that the whole package is worth whatever little personal gripes are involved.”

“It doesn’t hurt that my son and daughter have offices in two different locations,” added Dipert.

Dipert is also a staunch believer in the widely held view that the second generation needs to work outside of the family business for a time before taking on a leadership role within the company. He thinks his children’s outside employment played a critical role in the continued success of Dan Dipert Tours.

Another factor he believes contributed to a smooth transition is his children’s assurance that they would not have to compete with his wife (Dipert remarried 18 years ago) for control of the company after Dipert’s death. That possibility was eliminated through a prenuptial agreement and stipulated in the partnership agreement. Dipert said he has seen cases where conflicts between the founder’s children and the founder’s spouse/significant other have been tremendous obstacles to the succession process. He noted that this important aspect of succession planning is not discussed frequently enough.

Having successfully managed a transition in company ownership and leadership, Dipert believes that the key lesson to be learned from his experience is the importance of relinquishing control. “The bottom line is, you have to be able to let go,” he said. “But it’s not easy.”

Case Study #2 – Biss Tours, Rego Park, N.Y.

In 1981, Martin Elson was a practicing attorney negotiating the sale of Biss Tours for a client. After the deal fell through, Elson decided to buy the company himself.

“I knew nothing about the tour business,” Elson said. Nonetheless, Biss Tours flourished under Elson. And Elson’s son Reed, who was 13 when his father acquired the company, was active in its operations almost from the beginning.

“He began hanging around the business, doing clerical jobs and having fun with them,” Elson said. “Before we knew it, he was 17 and escorting day tours.” Minus some interruptions for his college education, the younger Elson continued to work for Biss Tours for the next several years, taking on increasing responsibility for the company’s operations.

Reed was the first to address the issue of becoming his father’s successor. “Although he was becoming more and more involved in the business, Reed was always subordinate to someone in operations,” said Elson. “The time came when he told me he felt ready to take over the business.”

Shortly thereafter, in 1995, a third career opportunity presented itself to Elson and he decided that the time was right to move his son into a leadership role. Reed was named vice president of Biss Tours, with the expectation that he would run the company while his father focused on his new venture.

During this period, a key challenge that emerged was how to transfer to Reed the personal relationships his father had established with Biss Tours' clients. With its own travel club, the company was (and still is) heavily dependent on repeat business, making a seamless transition crucial. After much consideration, Elson decided that the company's annual brochure offered the solution.

"The inside of our brochure cover always contained a letter from me to our travelers," said Elson. "When it came time to do the 1996 brochure, I wrote that this would be the last time they would hear from me directly . . . that from then on, they would be hearing from Reed, my son, whom many of them already knew."

The move had two important outcomes, according to Elson. "I let these 150,000 people know about the change – that they could look to Reed instead of me. At the same time, I sent my son the message that his new role was not something I could take back at will."

However, when Elson got his third career running smoothly and wanted to resume more day-to-day involvement with Biss Tours, it became apparent that roles needed to be defined even further. "At that point, Reed felt he was being asked to give up his newly acquired role, and he wasn't willing to do that," Elson said. The two were able to strike a deal whereby the company's operations lie solely with Reed, while Elson retains the title of president and control of overall company management and finances. Two other members of the Elson family also play key roles in the company: Betty Jane, wife of Martin, writes the annual Biss Tours brochure, as she has for the past 20 years, and Monika Bialokur, Reed's wife, oversees the company's marketing efforts.

Elson believes that accepting the differences between his business style and his son's has been essential to making the management structure work. "Reed has been much more aggressive in making changes, in taking chances," Elson said. "I was more content to keep doing things that were working. At first, when Reed wanted to make a change, my response was 'Why?' Now, my response is 'Why not?'" Among other changes, Reed has expanded the Biss Tours product line, particularly its international offerings.

The two Elsons are currently in the process of planning for a complete transfer of the company's ownership and management from father to son. While a course of action has not yet been formalized, they are considering a recommendation from advisors that Reed acquire the company through stock purchase rather than inheritance.

Elson believes that other NTA members can benefit from planning for succession as he has, and that the issue is one to address “sooner instead of later.” “I was driven into an accelerated posture by the development of a third career opportunity,” said Elson. “But it has worked out well. It’s important to consider these issues even if you don’t know if a son or daughter will make the business a career. A potential successor might disappear because he or she doesn’t know where things will go.”

Case Study #3 – Shepler’s Mackinac Island Ferry, Mackinaw City, Mich.

For over 50 years, the Shepler family has focused on offering visitors the most comfortable ride possible to and from Mackinac Island, and on exceeding guests’ expectations with consistency, attention to detail and “lots of smiles and hustle.” The company that began as a charter service using family-built wooden speedboats has evolved into a full-scale ferry, freight and marina operation. In addition to its marine services, the company operates Mackinaw Crossings, a shopping, dining and entertainment complex developed in 1997.

With the third generation of Sheplers well established in the company, the family has recently begun the process of succession planning. Company owner and president Bill Shepler noted that while the business passed from his father to him without any formal process (“It just evolved – I slowly took over”), handing the company over to his children is a much more complex undertaking. His son Chris currently serves as vice president and manager of the company’s St. Ignace operations, while daughter Patty is office manager. Billy, the youngest, is fleet captain.

“Because of the new tax laws and the size of the company compared to when I took over for my father, we’ve got a lot more to address,” Shepler said. “The process will be somewhat slow and methodical. And honestly, with three children active in the company, the hardest part is identifying who does what, who has seniority. There is the potential for some very serious concerns if that part isn’t handled to everyone’s satisfaction.”

Discussing individual goals will help define the siblings’ eventual roles in the business, said son Chris. As for his own goals, he would like to take on the responsibilities currently handled by his father. According to Shepler, a series of family meetings is currently in the works, and he will encourage all three children to engage in serious reflection on the “level of commitment” they can bring to the company.

While the family has yet to determine each member’s future role in the company, it has been decided that a limited-liability company (LLC) will serve as the mechanism for transferring ownership.

Shepler noted that it would be easier to sell the company outright than to go through the succession-planning process to which the family has recently committed. The decision to keep the business in the family has been shaped by many factors, he said, but his children's enthusiasm for growing the business has been paramount.

"Just as I welcomed the challenge of taking the company to the next level when I took it over from my dad, so Chris, Patty and Billy have embraced the same challenge," said Shepler. He added that in order to remain successful, the company would have to continue adapting to changing market conditions, and cited the creation of the company's freight business as an example of needed innovation.

Shepler also believes that fostering his successors' creativity is essential if the business is to thrive for a third generation. "I won't micromanage my kids," he stated. "They must be creative. Sure, they come to me if they have a problem. But there is more than one way to solve a problem, and I have had to remain open to that. As any NTA member will tell you, nothing in this business will remain status quo, so we can't keep doing things the way we've always done them."

Succession Planning Checklist

Answering the following questions can help those involved in a family-owned business determine how effectively they are preparing for succession.

Has our company re-examined its mission lately? Do all key players agree about who we are as a company and what we represent?

Do we know what our company is worth in terms of fair market value? Does this valuation include intangible assets?

Have we assembled a group of outside advisors we trust to assist with succession planning? Do these advisors represent all of the perspectives the company needs to develop an effective succession plan (estate planning, financial planning, family relations, etc.)?

Does the succession option we have chosen take into account the viability of our business given today's market conditions and emerging market trends?

Have family members had a chance to contribute to the succession-planning process? Does the plan meet the most pressing needs of all family members?

Does our succession plan include a contingency provision? Is it clear what will happen to the business in the event of a crisis, such as the owner's unexpected death?

Is our company's succession plan fully documented?

Have we designated a time for conducting an annual review of our succession plan?

If you have decided to keep the business in the family:

Has a successor (or successors) been identified? Is this choice based on a sound appraisal of that person's business acumen, interest in and commitment to the company?

Has a plan for preparing successors been established? Are mentors clear about their role in guiding successors? Do all key players in the business actively support the mentoring process?

Does our succession plan specify the criteria family members must meet to work for the company (e.g., college degree, outside experience)?

Succession Planning Resources

fambiz.com, <http://www.fambiz.com>. This site offers a library of 300 articles on family business topics, including succession, valuation, transfer of ownership and using outside consultants.

Fischetti, Mark, ed., *The Family Business Succession Handbook*, Philadelphia, Family Business Publishing, 1997. From the editors of Family Business Magazine, this highly readable book brings together expert succession-planning advice and profiles of actual companies that have weathered succession. The interpersonal aspects of succession receive particularly good coverage here.

Gersick, Kelin E., Marion M. Hampton, John A. Davis and Ivan Lansberg, *Generation to Generation: Life Cycles of the Family Business*, Boston, Harvard Business School Press, 1997. This book examines family businesses from the three aspects of ownership, family and business, and provides a development model for understanding and managing change.

Sherman, Andrew J., *Parting Company: Innovative Strategies to Plan for Succession, Manage the Transition, Sell or Transfer Your Business*. Washington, D.C., Kiplinger's, 1999. One of the newer succession-planning guides on the market, Sherman's book offers a particularly

thorough discussion of ownership structures and their U.S. tax implications. The book also includes useful tables and charts.

Small Business Legal Guide, <http://businessweek.findlaw.com/book/toc.html>.

This guide provides a useful discussion of ownership structures and how to determine which form is best for your business. It also includes a chapter on buying and selling a business.

The SOHO Guidebook, CCH Business Owner's Toolkit,

<http://www.toolkit.cch.com>. This guidebook offers thousands of pages of information for small businesses, including a chapter on succession planning ("Getting Out of Your Business").

The following resources are for those interested in employee ownership as a succession option.

Employee Ownership & Incentive Association (EOIA),

<http://www.esopcanada.org> or 877-687-3767. EOIA is Canada's largest non-profit membership association specializing in employee share ownership, stock options, gainsharing and employee participation.

ESOP Association Canada, <http://www.esop-canada.com> or 416-749-

0712, is a non-profit organization devoted to promoting the concept of employee ownership for business in Canada.

National Center for Employee Ownership (NCEO), <http://www.nceo.org> or

510-208-1300, is a nonprofit membership and research organization providing accurate, unbiased information on ESOPs, broadly granted employee stock options and employee participation programs in the United States. Inc. magazine called NCEO "The single best source of information on employee ownership anywhere in the world."

If you know of additional succession-planning resources that would benefit NTA members, please post a message in the Research and Development forum of NTA Online or e-mail Suzanne Austgen, NTA's assistant director of research and development, at suzanne.austgen@ntastaff.com.