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Why Business Owners Don't Plan for Succession...and Why it's Critical

Many business owners procrastinate putting a well-conceived succession plan in place. The reasons are understandable. It can be difficult to plan for your replacement and deal with your mortality.

Here are five of the top reasons why business owners don't have an exit strategy, along with the reasons why it's best to make a proactive plan.

Reason number 1: No time. Business owners are busy with the day-to-day tasks involved in running their companies. There are deadlines to meet and deals to be made. Succession planning can be done ... later.

Why this thinking is wrong: Waiting too long can cause the outcome to be less beneficial to the owner and his family. If a rushed decision is made, the owner may get a low price or pay more in taxes than he or she would if adequate planning was done. And in a worst case scenario, "later" may never come. An unexpected death or disability might result in succession occurring sooner than expected and without a solid plan, the future of the business can be placed in jeopardy.

Reason number 2: Loss of control. In some cases, business owners may not want to stop working for the companies they spent years building. Giving up control is difficult. Owners may worry they will be bored in retirement or their companies will no longer flourish if they are not in charge. So they hang on.

Why letting go is a better approach: The most successful exit strategy takes months or even years to complete. With proper planning, you may be able to secure a position after the sale as a consultant. If you want to pass on the business to your children or grandchildren, you can be involved in training them to help them achieve success. In other words, a proactive approach brings more control over the end result.

Reason number 3: Ignoring tax issues because they're too complex. There are obviously a number of ways to structure a succession transaction. The most tax-efficient way depends on the company, the parties involved and when you sell (federal tax capital gains rates may increase in the future). The tax implications of a sale or transfer can be extremely complex.

Why it's best to get professional tax advice: You have to make several decisions that will affect the tax bill, such as whether to sell assets or stock. Your company may wind up with unknown, costly liabilities if the transaction isn't structured properly. Handling the sale in a tax-wise manner can save you a fortune in the long run — not only with income and capital gains taxes but also with estate and gift taxes. Consult with your tax advisor well in advance of the actual sale.

Reason number 4: Not sure who is going to take over. For many owners, there is not a clear-cut successor. Are there partners? Should you sell to employees via an Employee Stock Ownership Plan (ESOP)? Sell to a third party?

In the case of a family business, there are even more questions. What if some children are active in the company and others are not? Which child is going to run the company? Does the "heir to the throne" have the business skills to succeed? Will a formal succession plan cause family conflict?

Without all the answers, a business owner may do nothing.

Why this is a mistake: Without a solid plan, the company you spent years building could cease to exist. There are many options for ownership transfer. You can sell outright, sell to your children, gift interests to family members at a low tax cost — and more. But if you don't explore the possibilities, you leave the outcome to chance.

Reason number 5: Not enough retirement savings. While building their businesses, many owners put off making adequate contributions to retirement plans. The result may be insufficient savings. Where is income going to come from during retirement — especially if the owner wants to pass the company onto family members? Often, there is a conflict between wanting comfortable golden years and wanting to transfer the company to heirs as part of an estate plan. So the owner just keeps working.

Why continuing to work without a succession plan is a mistake: By planning ahead, you can take care of your retirement and your heirs. With certain financial strategies, you may be able to retire comfortably and plan for the eventual sale or transfer of the company.

These are just some of the reasons business owners procrastinate and why they need to have proactive exit strategies. Start well in advance. Assemble an advisory team that includes your accountant, estate advisor, corporate attorney, and possibly other professionals.

And if transfer your business to your children, urge the next generation to start thinking about *their* succession plans.

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