Water Street Insights
Success Matters

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KEYS TO EFFECTIVE SUCCESSION PLANNING – SINS TO AVOID

This will be the first in a series of short articles on **effective succession planning.** While in a large company succession planning is often focused on the replacement of key people in the organization, in a smaller privately held company succession planning takes on a broader perspective. With the business oftentimes being the most valuable asset of the owner, succession planning needs to encompass filling critical roles in the business and ensuring there is continued value creation in the business at the point the owner decides to retire or suddenly leaves due to illness or death.

The very first "sin" to avoid, and by far the most critical and obvious key to succession planning, is to **create and maintain a plan**. This seems like a good place to start. In developing the initial plan our recommendation is to keep it as simple as possible. Let it be the foundation for refinements as events require changes. Some basic things to consider in the initial plan are the need for buy/sell agreements[1] or cross purchase agreements[2] which can possibly be funded by life insurance. These types of plans, especially when funded, can ensure the passing of the ownership in a smooth fashion with resources available to complete the transaction. While these types of plans do not need to be funded the concern is where the money will come from.

The initial succession plan should also discuss who should run the company in the event of death or disability of the owner. This is critical to avoid confusion especially among siblings who may or may not be involved in the company.

Remember…a succession plan is not an "estate" plan. The succession plan is focused on the profitable continuation of a business. A well-crafted and thorough succession plan will create value if the ultimate succession is the sale of the business. More on this in future articles.

So, "sin 1" is not having a documented succession plan. If you don't know where to start, contact Water Street Advisors.

[1]Buy-sell agreement
A binding agreement used by sole proprietorships, partnerships and close corporations that governs what happens to an individual's ownership interest when that individual withdraws from the business, dies or becomes disabled (also known as a "buyout agreement").

[2]Cross Purchase Agreement
A cross-purchase agreement sets forth how ownership in a business transfers if the owner dies, retires or becomes disabled. The parties to a cross-purchase agreement always include a seller and a buyer. Cross-purchase agreements aim to ensure that sellers (or their beneficiaries) receive and buyers pay a fair price for their interests. Some cross-purchase agreements use a dollar amount to calculate the buy-out price, while others use a formula. A valuation of the interest that is the subject of the agreement should be made periodically.

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