Pearlstein's Corner

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Estate Planning vs. Succession Planning – Know the Crucial Differences and Save Your Business

Business owners are constantly planning – it's inherent in running a company. That might include quarterly and annual plans, staffing plans, growth plans, tax plans, retirement plans, etc.

Many of these are short-term exercises. However, the most important one – a succession plan – is a longer term plan, and that's why so many business people put it off. That is a critical mistake.

I've heard all of the excuses: I'm not retiring for another five years, I've got a good estate plan, I've talked to my kids about it, I've talked to my accountant about it… any one of these non-plans could be fatal to your retirement and the legacy of your business.

Transferring Assets Vs. Transferring Assets and Leadership

Estate planning is the tax-efficient transfer of a family's assets from one generation to the next. It rarely involves transfers to anyone outside of the family.

Succession planning is a roadmap for the transfer of the leadership and ownership of a business. That may involve family members, but could also incorporate employees and/or third parties.

Both can be complex, but they're not the same.

Estate Planning is Part of Succession Planning

Not having a well-considered succession plan may completely sabotage your estate plan, especially if the bulk of your estate is tied up in your business. To illustrate, here's an example based on a real-life situation.

Business Owner 'Bob' Planned to Exit Within a Year Based on an Estate Plan

Bob was in his early 60s and owned a profitable business with his wife Betty. Betty was involved when the business started, but was no longer active in the enterprise.

After 30 years – from humble beginnings in his garage – Bob grew his company to generate annual sales in excess of $10 million, with net profits of $2 million. A nice little business.

Forecasts indicated continued growth. Bob hired a third party to develop an estate plan that established various tax structures to provide a comfortable retirement when he chose to slow down.

He had faith that two of his three adult children, Tom and Sue, who had worked in the business for a handful of years would succeed him. Bob's third adult child, Peter, was not in the business.

Based on the estate plan, Bob wanted to scale back within a year.

Bob's Situation 12 and 18 Months Later

Throughout the following 12 months things weren't progressing as Bob had planned. He was ready to retire but Tom and Sue were struggling to handle more responsibility. In order to meet his sales plan, Bob relied more on non-family employees. Tom and Sue became unhappy, feeling they were being undermined. Meanwhile, Peter felt that his siblings were overpaid and were receiving perks he felt he also deserved.

After the twelve months, Bob stepped away from his company. Soon after he retired, some of his top managers and salespeople left. It wasn't the same without Bob around. Then a few of his big customers left. They missed Bob too.

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It wasn't long before Bob began to worry about the value of the stock he owned which represented much of his funding for retirement.

Six months later the company's operations continued to suffer. Bob's children were no longer on speaking terms.

Bob had no choice but to come back in, get some help evaluating the business, and then sell it for cash. He got much less than he wanted to, and half the proceeds were eaten up by taxes.

Ultimately, Bob and Betty had to revise their retirement plans. The family legacy was gone, the estate plan was of little value and now none of the children were happy.

Why did Things Go Wrong?

First, thinking about retiring one year ahead of the date is unrealistic. A succession plan likely takes three to five years to put into place.

In this case, that extra time would have allowed Bob to hold a management talent review and see how his children were handling their responsibilities. Roles and responsibilities for family and non-family officers would have been clarified.

After a review, it may have become apparent that a key employee should become a shareholder. The extra time could also have been spent managing clients, getting them accustomed to seeing less of Bob and more of the incoming owners.

At the very least, there would have been more time for Bob to correct any issues as they came up.

It would have been obvious whether or not the plan was working. Maybe selling the business to an outsider would have been the best idea after all – but not at a fire sale price in a grim situation.

What Bob and his family learned the hard way, is that for most business owners, estate planning is actually a subset of succession planning. Without a successful transition, there may not be much of an estate.

Do you know someone who should read this?

Some of my clients have mentioned that they've shared my newsletters with other family members, friends or colleagues. If you know someone who might benefit from this, why not pass it on?

Red Flag: Canadian Federation of Independent Business (CFIB) Says Baby Boomer Owners Aren't Planning

According to a current CFIB survey there is a huge transfer of business ownership coming up – $1.5 trillion over the next five to 10 years.

But only 8% of owners have a formal written succession plan. That is frightening! More than half – 51% don't have any plan, and 41% have an informal plan (sounds like Bob's plan).

What's more, the survey suggests that 47% of small or mid-size business owners intend to exit their business in the next five years and 72% within a decade.

You Can See the Problem – Many Businesses Changing Hands, Few Real Plans

With these big ownership changes looming in the next five to 10 years, it's going to be a buyer's market. Lots of buying opportunities, few real plans, deep discounts… like shooting fish in a barrel if you're a buyer. A real nightmare if you're a seller.

The real winners here will be sellers with detailed succession plans. It may even be an opportunity to snap up a competitor going through a less successful transition.

Next Steps: 3 Key Questions to Ask, Plus Learn More on my Podcast on Succession Planning

- If you received your ideal purchase price offer from your ideal buyer, would you sell your business today?
- Do you know the fair market value of your business?
- List the five things you'll do after you slow down or sell your business.

The first step in creating a solid succession plan is to understand what's involved. That's where I can help.

Listen to my podcast and learn how you can beat the odds by clicking on markpearlsteinwealthmanagment.com and then the white arrow under Listen Now.

Questions? I look forward to hearing from you. Call me at 416-733-5257 or email mark.pearlstein@rbc.com

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