

Succession Planning Overview



What is succession planning?

Successor – a person who follows you in running your business or in your family life

Succession planning is creating a plan for someone to either own or run your business after you exit the company, retire, become disabled, or die. It is the process of passing control of the business to others and it includes all aspects of a small business owner's life: business and personal financial planning, management succession planning, estate planning, and ownership transition planning.

Planning for succession ensures that the owner's goals shape the tools that are used, not the other way around.[8] Although it's a difficult topic for many people, the succession planning process provides the necessary information needed to make your next venture a successful one. Planning provides you the flexibility needed in making important decisions on your own timeline and retaining the maximum value for your business.

A few more definitions before we go any farther:

Business Financial Planning – securing and growing your company's transferable value

Personal Financial Planning – creating enough cash and net worth to fund your lifestyle and family's needs and interests

Management Succession Planning – developing key successors to enhance long-term performance, value, and transferability

Estate Planning – planning for the family legacy while helping to reduce the estate tax burden

Ownership Transition Planning – structuring the transfer of the business to a successor[9]

Why is succession planning important?

Beneficiary – a person who receives funds or other property under a will, trust, insurance policy, etc.

It's important to know that even if business owners do not have a formal plan in place, their state government has a plan for them that they likely will not benefit from. An effective succession plan allows business owners to carefully consider when and how they would like to retire or step back from the business. Stepping away from your business at its maximum value depends on your ability to demonstrate its worth. There are many factors to consider when transitioning a business, which can be tricky. We encourage owners to begin early and seek guidance from professionals.

If those aren't compelling enough, here are five more reasons that may convince owners:

1 – Taxes

No one likes to pay, but a succession plan can reduce and sometimes avoid taxes, and ensure that the family and important employees get what they deserve, instead of what is left after taxes.

2 – Risk

The longer owners wait to design and implement a succession plan, the greater the risk that the plan will not meet their goals. Risk can also be reduced when the owner assesses their business and its environment to better understand where there are opportunities and threats.

3 – Options

The longer succession planning is delayed, the fewer options owners have to meet their goals, especially for continued income and jobs for family members and colleagues.

4 – Control

By planning for succession, the business owner retains control over the outcome. When business owners don't plan, the government or various attorneys involved will take control.

5 – Value

When a business owner does not implement a succession plan before they are disabled or die, the value of the business often drops rapidly, and the owner's intended beneficiaries will not receive the full value of the business that they could have if the owner had a plan.[10]



Business entities for succession planning

Succession planning isn't the only factor that determines which structure or business entity suits a company's long-term needs. Exposure to liability, access to capital, and the personal financial needs of the owner and other stakeholders all enter the equation.[11]

Liability – money owed or debts

Capital – wealth in money or property

Your first decision will be to decide if it would be beneficial to change the type of legal entity you currently have before retirement. Options are sole proprietor, partnership, C-corporation, S-corporation, and limited liability company.

Each of these business entity options has pros and cons depending on your concerns with taxes, family dynamics, or your timeline for retirement. Often, the best structure for you becomes apparent when considering how your estate will be taxed after the sale, how complex and expensive it is to set up and maintain, and who will run your business after you're gone.

Once you have decided on a business entity, owners must decide how to sell the business. Options include: keep the business in the family, use a buy-sell agreement, gifting shares, trusts, management buyout, sale to employees through an employee stock ownership plan (ESOP) or a cooperative, sale to outsiders, liquidation.[12]

Entity Options in Michigan

Type of Legal Entity	Limited Liability Protections?	Tax Treatment	Level of Gov't Requirements
Sole proprietor - A business owned and run by one individual with no distinction between the business and the owner.	**No.** The owner is personally liable for all debt.	**Personal Tax Rate**	**Low**
Partnership - The biggest disadvantage for partnerships is that the general partners have unlimited personal liability which can affect their personal assets. Also, one partner can put all the others in legal jeopardy.	**No.** Partners are liable for all debts or liabilities.	**Personal Tax Rate**	**Low**
Limited liability company – There is no stock, so owners have a 'membership interest' instead.	**Yes.** Liability is limited to the assets of the corporation, not personal assets.	**Can choose how to be taxed.** It is most commonly taxed like a partnership.	**Medium**
C-corporation - A legal entity that is separate from its owners. It is a common business entity choice for large, publicly owned companies, and sometimes for private businesses because of special tax advantages.	**Yes.** Liability is limited to the assets of the corporation, not personal assets.	**Corporate Tax Rate**	**High**
S-corporation - A legal entity that is separate from its owners. It divides the income or losses among its shareholders, who then pay taxes as part of their personal income.	**Yes.** Liability is limited to the assets of the corporation, not personal assets.	**Personal Tax Rate**	**High**