Start with a Plan

In June 2016, the Securities and Exchange Commission issued a proposed rule that would require investment advisors “to adopt and implement written business continuity and transition plans designed to address operational and other risks related to a significant disruption in the investment adviser’s operations.” Release No. IA-4439, 81 FR 43530. Similarly, the North American Securities Administrators Association adopted Model Rule 203(a)-1A that would require investment advisers to “establish, implement, and maintain written procedures relating to a Business Continuity and Succession Plan.” Finally, the adviser industry awaits implementation of the Department of Labor’s fiduciary rule set to take effect in April, 2017, a rule which sets forth an investment adviser’s obligation to act in the client’s best interest.
So why mention investment adviser issues in a periodical for Rhode Island independent agents? We are glad you asked. Even though these “rules” do not directly apply to independent agents, the overall theme, especially when taken together, speaks to the nature of the demands of a client-service-driven industry.

On a daily basis, independent agents serve their customers by helping them plan for and mitigate unanticipated risks. While consumed by the risks of others, agents may forget to take the same advice they dole out to others. Succession planning mitigates similar risks for you and your stakeholders. We know, no one can take your place. But, whether you like it or not, there will come a time to pass your agency on. Will you be ready?

There are several methods to pass your agency (and your legacy) over to a successor and multiple issues to consider for each. But before you feel overwhelmed, to quote Glinda from the Wizard of Oz, “It’s always best to start at the beginning.”

Start with a plan. Lack of planning is one of the more common reasons why a business fails after the initial owners pass on control to another generation. Thus, for any business, it is important to create a business succession plan and commit to benchmarks to monitor progress in implementing the plan. The key is to make certain that the plan is properly designed to preserve owner wealth, direct and facilitate proper control of the business, and ensure continuation of the business in accordance with the owners’ goals. With this as the premise, following are the considerations that owners need to take into account in developing an effective succession plan.

1. Assemble a team. Putting together a successful succession plan requires contributions from many professionals, and the development of a succession plan should be viewed as an investment in the business, no different than advertising for new customers, purchasing new equipment or providing additional employee training. Owners should involve their attorneys, accountants, insurance advisors, bankers and other consultants, including family counselors, to deal appropriately with the myriad of issues that must be coordinated. The expertise of the team is essential to developing a workable business succession plan.

2. Assemble information. Once the team is assembled, the owners and the team should pull together all relevant information about the business, its history, owners, operations, finances, employees, and family relationships. The compilation and analysis of this information may highlight key issues that need to be addressed by the team in order to develop and implement a plan successfully. Issues include the following:

- *Legal framework.* It is important to know what limitations exist on the right of an owner to transfer an interest in the business. These include rights of first refusal, restrictions on transfer and purchase options that are often found in the organizational documents for the business or ancillary agreements entered into among the owners (or others). All of these rights and agreements form the legal basis that controls what an owner may do with a business interest in the absence of approval by the other owners.
- *Prior history.* Dormant family or owner disputes may be uncovered during the information gathering process that may profoundly change the substance of the plan or may lead to the conclusion that no plan involving a next generation can be effectively achieved because of the conflicts. Identification of

these issues early on is important so that time and resources are not wasted.

- *Expectations.* Owners must have honest and realistic discussions with each other about the strengths and weaknesses of their potential successors and what makes sense for the business. Pushing a successor on another owner might work in the short term, but it will not contribute to the long-term success of the enterprise. Even an owner with a controlling interest should think carefully about the implications for the business of forcing a designated successor on an unwilling co-owner.
- *Affordability.* The profitability of the business may affect planning and limit options. Owner needs for current compensation, costs of premiums for insurance to provide liquidity, compensation needs of designated successors, and lifestyle demands can all drain cash from the business. In some cases, the desired succession plan may be unaffordable or it may leave the business with inadequate cash to fund growth and the change necessary to meet market needs.

3. Developing goals. In conjunction with assembling information, owners working with their team need to develop the succession plan in light of their personal goals. Goals vary among owners and may include:

- providing for the business to be owned by one or more successors;
- providing for the business to pass to certain members of the owners' families;
- protecting each owner's business interest from falling into the hands of the owner's creditors;
- providing for effective management of the business including resolution of disputes among owners and the orderly buyout of an owner who wants to leave the business;
- providing for the buyout of an owner's interest upon disability or death. This assures that funds are available to pay for a disabled owner's needs or for the needs of a deceased owner's spouse and children (including funds to pay estate taxes and estate expenses), and keeps ownership within the original owner group rather than permitting it to pass to a surviving spouse or children;
- requiring potential successors to achieve certain benchmarks outside the business in order to be considered as a successor, thus lessening any sense of entitlement in potential successors and benefiting the business with fresh ideas learned elsewhere;
- maintaining beneficial tax attributes of the business, such as, in the case of certain corporations, the corporation's tax status as an "S Corporation;" and
- the underlying goal, preserving the business.

4. Whose business is it, anyway? In developing goals, it is important for owners to take into account the various constituencies interested in the succession plan. These may include other owners, who may or may not be from the same family and who have their own interests in planning for succession; spouses, who often envision a different succession plan than that of the owner; successors, whose expectations, financial needs, and lack of training or expertise must be taken into account; uninvolved children, who may have financial needs or who may need to be treated "fairly", particularly if the children lack the skills or interest to enter a business that represents a significant portion of the owner's wealth; and finally, key employees, who may be necessary to the implementation of a succession plan but whose expectations may be adversely affected by bringing in successors to the business. The only way to manage these constituencies is by having definite goals for the succession plan, by testing all decisions against these goals, and by constant communication with each of the constituencies. All constituencies must align with the ultimate goal – the long-term success of the business – in order for the succession plan to be successful.

Going through the rigorous exercise of developing a succession plan has multiple benefits for a business. It can align the owners and clarify their expectations for the business. It can help the owners determine whether succession from among their families is realistic and affordable and help them embark on the training and development of supporting management necessary to implement the desired succession plan. Or, if family succession is unrealistic, it can help identify the appropriate time when the business should be sold, thus enabling the owners to manage the business to maximize its value for sale. Regardless of the exit strategy decided upon, proper succession planning positions the business for success.

Date Created
April 24, 2017