



READY FOR ANYTHING

How succession planning propels successful businesses to become thriving ones



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INTRODUCTION

Few business owners get excited about succession planning, and who can blame them? At first blush, it sounds like an end-of-life word: You've created success and are passing on the fruits to the next generation. Thankfully, you plan to live a long life, and it can be done next month or next year; there's no rush.

From the perspective of attorneys, CPAs, and lenders, the reality is quite the opposite. The time to plan is now. And they don't believe it because they help with succession planning; it's experience talking:

A complete succession plan, they say, establishes and formalizes all the elements that make a business run in legal documentation, preparing it to show its strength to anyone - buyer, banker, broker, or successor. Plans also protect the company and prepare owners to grow, expand, or buy businesses, rather than worrying about the unexpected.

A succession plan means your business is truly ready for anything.

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PLAN TO SUCCEED, PREPARE FOR THE UNEXPECTED

The funny thing about succession plans is they're not really just succession plans, according to Dylan LeValley, an attorney at Adams & Duncan, based in Everett, Wash. A more accurate name could be succession and planning.

People can get caught in unexpected situations in their business because they left succession for another day, but the planning needed to happen today. "It all gets done eventually. The question is: Will you do it in a rush when it will cost a lot more money?" LeValley observed. "In cases where the owner is incapacitated or passes away, it can have big tax consequences or force undesirable decisions."

Succession doesn't need to be about death. "People have emergencies where they are unavailable for months, and then they return to their business," LeValley said. "You also can survive an illness, but remain incapable of returning to work; either way, you want a plan for the business to function without you."

The two key questions are: What do you want to happen in unexpected circumstances? And then, what do you want the future of the business to look like?

These are big questions, often with many unknowns, but this guide will help you answer them by taking you through the four primary steps in succession and planning:

CLARITY

CONTINUITY

SUCCESSION

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CLARITY

Conduct an operational, asset, and legal inventory.

CONTINUITY

Determine what happens when something happens, and align all legal documents with that plan.

SUCCESSION

Mentor a family member, train a manager, or prepare for a buyer.

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Formalize the plan in documentation, and utilize it to grow, expand, acquire, or sell.

GAINING CLARITY

Businesses need so many documents, agreements, accounts, and assets to operate. The bulk of the work is gathering that inventory and figuring out where you are with it all.

“Do you know what you own, who owns it, and who has authority over what,” LeValley asked. “Just this step alone can get you far and can be as important as the actual succession planning step.”

People often forget digital assets like social media accounts or an Amazon vendor account. “Are they set up with only one person having access?” LeValley observed. “If that person disappears, often the account is gone, sometimes permanently. Some business’s entire revenue model is based on that one ecommerce account. Without a clear inventory of the business’s assets (tangible and intangible), even a thoughtful succession plan can be lacking.”

The clarity steps also include familiarizing yourself with the documents you have, those you don’t, and what they say. “What does the operating agreement actually say about divorce situations, the death of a partner, buyout demands, or force-outs?” LeValley said. “You’re also looking for who owns the real estate? Is it the business or the owner?”

“Everyone should know where the inventory is stored. Copies should be stored in separate places, such as the business safe, one on the owner’s computer, another on a server, and a couple at home.” — Dylan LeValley

QUESTIONS AND ITEMS TO GUIDE THIS STEP:

GUIDING QUESTIONS:

- What tasks are necessary for the business to function and who is responsible for them?
- What assets are owned by the business? What assets belong to the owner/s?
- Does the business have documentation for its assets?
- Are assets financed? Or pledged as collateral?
- Does the business have an operating agreement?
- What does the operating agreement say about divorce, changes in ownership, or long-term absences from the day-to-day of the business?
- Who has authorization - and the keys - to open doors?
- Who can process payroll, sign checks, and access banking platforms?
- Who has authority to manage banking accounts?
- Does anyone have power of attorney to access and/or manage banking?
- Who has the account/password to key software and hardware technologies?
- Who has access to social media, websites, and ecommerce accounts?
- Who can check key leaders’ and/or owners’ voicemails and emails?

COMMON ITEMS REVIEWED:

- Company operating agreement
- Titles and deeds
- Loan & lease documents
- List of duties and backup personnel for those duties
- Passwords for software and hardware
- Passwords for online accounts, such as social media or ecommerce
- Secondary admin for online accounts
- Payroll and business expense processes
- Check signing authority
- List of essential vendors
- Bank account authority and access
- Power of Attorney/s

CREATING CONTINUITY

You're ready to begin formalizing your approach to business continuity. Now you're asking: What do I want to happen in unexpected circumstances? And, do your legal documents formalize and provide a complete record of your plan?

Often when people run a business on their own, they don't know who will succeed them. "Not knowing the answer, they don't feel they can write a plan or formalize a will," LeValley said. "But they can know who will open the shop the next day if they were to be hospitalized."

Often succession is more like gardening than it is like buying a product. It's about planting a seed by identifying and training the team or person who would manage the day-to-day in an emergency. No one knows the future, but an emergency leader may already be apparent. Perhaps, they also can allow the owner to take a vacation day once in a while.

Then, clean up any misalignment between the continuity plan and legal documentation. Owners often create new documents as well to define conditional authority.

"You can write a power of attorney document that has limited authority, conditional authority, or both," LeValley explained. "It can grant an emergency leader the authority to sign checks up to a certain amount, or to process payroll, but only in the event of incapacitation or death. You can get pretty granular, especially when you already know the list of responsibilities that must continue."

QUESTIONS AND ITEMS TO GUIDE THIS STEP:

GUIDING QUESTIONS:

- What's the plan?
- Who are the emergency leaders for the core duties of the business?
- Who will receive ownership should something happen to the owner?
- Who will carry on day-to-day operations?
- Does the operating agreement deal with force-outs, absentee owners, or long-term absences as desired?
- If ownership passes to family, and the owner was a key part of the day-to-day operations, what happens?
- Can a partner or manager pay bills and payroll?

COMMON ITEMS REVIEWED:

- Documented authority heirarchy and personnel backups
- Company operating agreement
- Titles and deeds
- List of duties and backup personnel for those duties
- Passwords for software and hardware
- Passwords for online accounts, such as social media and ecommerce
- Secondary admin for online accounts
- Payroll and business expense processes
- Check signing authority
- Bank account authority and access
- Power of Attorney/s

KEY QUESTIONS:

- Who will be the attorney-in-fact?
- Is it limited or conditional?
- Can they only move money and sign checks?
- Can they change key aspects of an account?
- Who receives POAs if that person passes away?

DOCUMENTS REQUIRED DURING BANK VISITS

PRINCIPAL OR OWNER:

- A copy of the original
- Identity verification
- Complete an affidavit of Attorney-in-Fact at the branch

ATTORNEY-IN-FACT:

- A copy of the original
- Identity verification
- Principal/s also will need to verify via a phone call or signature

BANKING AND POWERS OF ATTORNEY

When using Powers of Attorney in continuity planning, there are some best practices owners should follow for banking relationships:

Businesses should involve their retail bankers and lenders in transition plans, said Katy Woods, Coastal Community Bank Branch Manager. Lenders and retail bankers require different documentation, so it's important to involve both.

"It helps make it much more seamless when businesses include their retail banker because that dialogue allows us to provide options," she said. "We also can provide information on the steps and documentation needed to change how their accounts are managed."

For example, generally, powers of attorney (POAs) are not recorded with the county. Some banks, like Coastal Community Bank, require the POAs to be recorded with the county, she said.

Woods recommended a kickoff meeting with the bank as a best practice. "I'm working with a business right now where a new owner is purchasing it," she said. "It's been a six-month process. About four months ago, he brought in the current business owners, controller, and day-to-day office manager - everyone on the accounts - and we met to discuss their deposit account plan."

She also urged family businesses to add a backup to their accounts. "Larger businesses are usually more prepared, but for smaller ones, especially family businesses, it can often happen that the older generation does not want to talk about succession," she continued. "Parents think the kids will figure it out after they're gone, but that often makes it more challenging."

Woods has seen the "attorney-in-fact," the person given power of attorney, pass away without a successor in place. "It caused infighting within the family," she said.

**Bankers will review POAs for limitations, such as incapacitation or death. In the case of incapacitation, a letter from the principal's physician may be required.*

APPROACHING SUCCESSION

As you define what you want the future to look like, remember that financial and legal decisions are often more about life and relationships. In family businesses, a son's or daughter's interest in the business is the starting place for everything else. The same is true for a talented employee. Do they want to lead someday?

Owners can incentivize retention for key staff. But, as with most career decisions, people can change their minds. Here continuity plans ease uncertainty because they introduce staff, or an up-and-coming family member, to the business. It provides them with firsthand experience in deciding how much they want to be involved.

As they're trained as an emergency leader, they gain the ability to operate the company in a pinch. And, with more experience, they could preserve the business if owners were out of commission for months. Whether the staff chosen are family or a talented manager, owners can use their familiarity with the day-to-day to nurture someone who can run it every day.

Down the road, these successors might allow owners to move out of the day-to-day, or to sell the business at a much higher price point. A successor may even become an acquirer or lead a staff purchase of the business when the owner needs or wants to retire.

Here prior work on responsibility lists and documentation makes succession training much more efficient. "When you're talking about seller's financing or buyout over time, the best buyer can be that manager or a handful of employees," LeValley said. "You're putting the business at much less risk to the market, and it can also have tax advantages."

QUESTIONS AND ITEMS TO GUIDE THIS STEP:

GUIDING QUESTIONS:

- Can owner/s take vacations today without an interruption in operations?
- Do key personnel or family have the experience to decide their long-term interest in business?
- Who on staff is showing promise?
- Would owner/s consider an employee buyout? Or, would they prefer to exit via sale to an external party?
- Many employee purchases are accomplished through retirement plans; can the company's 401K plan be used in this way?

COMMON ACTIONS AND CONVERSATIONS:

- Engage key family member/s or managers about their aspirations.
- Dig into the performance of key players in the business.
- Gauge training needs for essential staff.
- Create development plans for succession candidates, even emergency leaders.

READY FOR ANYTHING

A good succession plan allows anyone to look at your business and see how it works. It's similar to a home renovation schematic drawn by an architect, LeValley said.

"You can sit in your house and wish you could knock down a wall and make the kitchen twice as big, but a professional can tell if and how that's possible," he said. "We can provide you the options and tools, and that often helps people sift their way to the decision."

When a business has a complete succession plan, it's the full design down to the detail. Reaching that stage means you have an estate plan; wills are finished, trusts are established, and final amendments are made to the operating agreements. Owners will purchase what's known as "key man" insurance. They may also decide to put a Buy-Sell Agreement in place, which is a legal contract that dictates how equity is handled in the event a partner leaves the business, retires, dies, or becomes disabled.

Tax savings also often are substantial for companies with complete succession plans - across business sizes and ownership types - compared to situations without those plans, LeValley said. "You will pass on more if you plan," he said. "It almost always produces better tax consequences when events are laid out in advance."

With the unexpected accounted for, owners turn their attention to growth and expansion, buying businesses, or selling their business. Succession plans make selling the business and obtaining a loan much more efficient.

Often they'll turn to a bank or lender to provide funding for an expansion. "Anytime I meet a lending customer for the first time, I ask them about their succession plan," said Debbie Webber, Vice President, and Relationship Manager at Coastal Community Bank. "Succession plans are also an important part of valuing a business."

When analyzing a business, both lenders and brokers gather five years of financials, profit and loss, balance sheet, accounts receivable, accounts payable, work in process, tax returns, and a list of assets. "In valuing a business, succession planning helps make it very efficient," Webber said. "You will go through the same steps in borrowing or selling; you waste no time putting the succession plan together."

QUESTIONS AND ITEMS TO GUIDE THIS STEP:

GUIDING QUESTIONS:

- What are the best ways for my business to grow?
- Would I grow it through acquisition?
- Now that my legal and banking are in order for succession, should I meet as well with a tax accountant?
- How would my team or my children purchase the business?
- Would I provide seller's financing to a buyer or successor?

COMMON ACTIONS AND CONVERSATIONS:

- Meet with accountant and/or tax accountant.
- Shop key person insurance.
- Network with sellers, buyers, bankers, and brokers.
- Develop a successor.

USING BUSINESS LOANS TO BUY A BUSINESS

There are two common ways to finance a succession plan, Webber explained. Successors can buy the business from parent/s after working out a repayment plan for funds borrowed from friends and family, which may include seller financing. Or, the successor or buyer obtains a loan from the U.S. Small Business Administration.

Succession planning lays a more solid groundwork for that ownership transition, which also opens up financing options for buyers and successors.

"I ask every buyer or successor about their industry experience," Webber said. "Do you have experience in this industry? Because if you have zero experience in the industry, it may be very difficult to obtain a loan."

Every business has ups and downs, successors face those better on their own when they've been mentored through them already. Owners who've followed the steps of Clarity, Continuity, and Succession are the most likely to have a manager, or a next-generation, prepared with sufficient experience to satisfy lenders or buyers. What's more, a well-trained successor makes a better creditor for seller's financing.

For example, successors often combine an SBA loan with seller's financing, Webber said. "Borrowers usually bring in the first 20% of the purchase amount as a downpayment," she said. "You can finance a portion of that 20% with a note from the seller. But, payment on that seller's note would remain on standby for two years, or longer, depending on the debt service level of the business.

If debt service deteriorates," Webber continued, "the bank may require no payments on seller financing until the bank is paid in full. The seller may have to wait 10 years to collect their 10% on the note. The seller is standing behind the quality of their buyer when they provide financing."

The same process occurs when an owner passes away, and the business has key man - also known as "key person" - insurance, which protects the business when they lose essential personnel by paying off debt or acquiring the equity of deceased owners. "The insurance company will value the business in that case as well," Webber explained. "They will need to see the same information as a lender or broker."

Key person insurance is relatively inexpensive. Webber has seen a business with \$4 million in debt, and an owner aged 74, pay \$11,000 in annual premiums. And, premiums are often deductible as a business expense.

Succession is a thread that weaves present and future together by documenting all the facets that make a business stable and valuable. Today, you're running a business, you have plenty to do besides thinking about growing old. But, once you take the steps and get through the conversations, it will bring you personal benefit immediately: The payoff of succession planning is peace.

To talk with a local banker at Coastal Community Bank, call us at 425.257.9000. To see our full range of business banking solutions, visit coastalbank.com.

