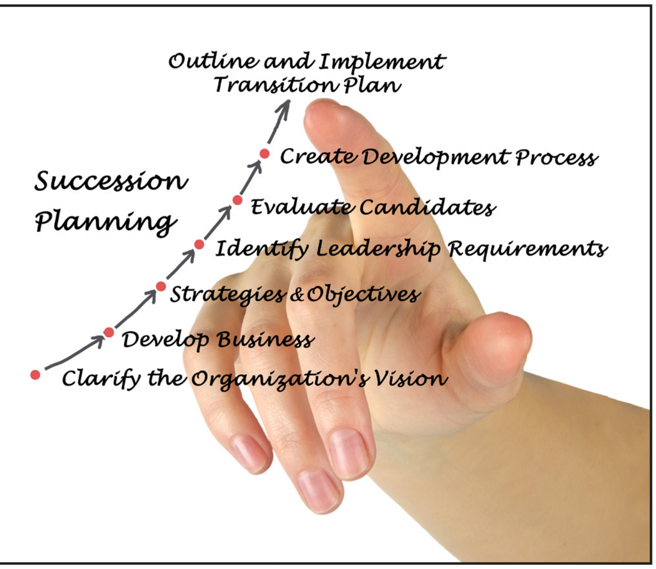
BUSINESS SUCCESSION PLANNING IS NOT "ONE SIZE FITS ALL"

Succession planning has different meanings depending upon whether one is referring to a change in ownership of a business, transfer of an estate or developing a management team to take over for an owner desirous of retiring. In the business context, succession planning is not limited to the preparation of wills and trusts in an estate plan or providing equity compensation to key employees.



A succession plan for a closely held business should be designed to identify a leadership team capable of implementing an orderly transition of ownership and manage the business effectively subsequent to the transfer. The options for transferring ownership includes family members, key employees or third parties. Determining an optimum course of action is critical to the preservation and future success of the business. The founder or transferor of the business should engage a competent business consultant, and accounting and legal advisors to navigate the due diligence process and to confirm that the goals and objectives of the founder or transferor of the business are critically aligned with the ultimate transferee(s).

Transferring a closely held business to family members involves a complicated dynamic that extends beyond business considerations. The division of the owner's estate equitably and dealing with potential disputes by and among siblings is a significant challenge that requires outside expertise in order to be effective. Making a decision as to whether the potential transferee has the requisite skill, experience and maturity to be successful is as important as the timing of the transfer. If you "move" the business down to the next generation too early, they may not have the skills necessary to run the business. The older generation may have to reinsert themselves into the business, thus undermining the confidence and authority of the younger generation. Likewise, transferring the business too late, and the younger generation becomes impatient and may move on to other opportunities.

Selecting key employees to take over the business is also a challenging concept in that they may not be perceived by fellow employees as potential owners and evaluating the ability of a potential transferee of the business sometimes requires a dry run for a period of time before making the transfer. It may be difficult to evaluate which, if any, employee has the ability to "think like an owner." If no employee appears suitable to take over the business, then a long-term plan to recruit such an employee, integrate the employee into the business, and implement a transition plan is necessary. Such a process can take five or more years.

When selling the business to an outside third party, there are essentially two buyer groups to consider: economic buyers and strategic buyers. An economic buyer buys the business strictly as an investment and will base the purchase price in large part on the financial performance of the business and the expected return. A strategic buyer may be looking to expand a product line, develop an additional distribution mechanism, or otherwise add value to its existing business. Selling the business to a strategic buyer may bring a better price because it may fulfill a strategic need for the buyer. But this also runs the risk of exposing confidential proprietary business information to competitors.

What is not commonly understood is that control of the business does not necessarily have to follow ownership of the business. While it typically does, that is not necessarily always the case. Control of the business, whether at the ownership (shareholder) level, governance (board) level, or management (officer) level, can be allocated in any number of ways. Use of voting and nonvoting ownership interests, ESOPS, or trust arrangements can pass on the economic value of the business without passing on control of the business. Similarly, use of outside directors or professional management can effectively put operational control of the business beyond reach of the owners of the business.

Transition of the management of the company is often the most overlooked element in developing a succession plan. An owner may simply be looking to sell his or her ownership interest in the business and move on. However, if the purchase price involves a significant portion that is to be paid over time or the purchase price includes earn-out provisions, it is incumbent on the owner to make sure that the next generation of management can successfully manage the business in order to ensure payment of the deferred purchase.

It is also important to remember that the transition of the management can be separated from the transition of the ownership or control. That is to say, the business owner can retain ownership of the business while shifting the management to key employees or professional management. Transfer of the ownership or control can occur later, through the owner's estate plan or other tools.

Suffice it to say, each circumstance is unique and requires independent evaluation on multiple levels. In addition, the time line is often extended or delayed due to reluctance by the owner to pull the trigger or the potential successor may decide he or she is better off continuing as a key employee rather than the "owner." There is no "one size fits all" technique available and the process involves careful planning and documentation in order to implement the plan successfully. For more information about the construction industry and related business and legal issues, please contact PLDO Managing Principal Gary R. Pannone at 401-855-2601 or email gpannone@pldolaw.com.

Gary R. Pannone
Managing Principal

PANNONE LOPES
DEVEREAUX & O'GARA LLC
counselors at law