BUSINESSDIMENSIONS

FINANCIAL STRATEGIES FOR THE ENTREPRENEUR

Keep it in the family: succession planning for franchise owners

How a clear succession plan helps ensure generational continuity

More than 90% of businesses in the United States are family owned – hundreds of thousands of them franchises – but only 30% of them survive the retirement of the original owner.

If you're a franchisee and your goal is for a family member to eventually take over the business, you need a succession plan in place at least three years before you plan to retire – ideally, much sooner than that. You never know when the unexpected can happen and the successor will need to take over.

Implementing and executing a strong succession plan can help create generational continuity and enable you to enjoy your hard-earned retirement. While the core concepts of succession planning are similar for all family businesses, franchisees will have a few special considerations.

AN IMPORTANT CONVERSATION

The first step toward succession is to have open and honest conversations with your family about the future of the business. These discussions can be uncomfortable – especially if family members have competing interests – but they are essential to implementing an effective succession plan.

A framework that might help you structure these conversations is to consider the why, what, how, who and when of the plan.

Why do you want to keep the franchise in the family? Your reasons for becoming a franchise business owner may have been to build long-term value and generational wealth – but often, the "why" extends beyond the family. Over the years, your business may have become a pillar of the community, reliably providing necessary products and services for your customers or clients. Make sure your family can identify these "north star" reasons.

What does the business look like now and in the future? Share your business roadmap with family members, along with information about your differentiators and investable assets. Are you hoping – and able – to expand your business into more units

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or even new concepts? How will doing so further your family's values and financial objectives?

How do you want your business to be governed once you retire? Establish whether you plan to continue to play a role in running the business after you retire. Often, franchisors will not release the original franchisee from liability after the transfer.

Who will have a say on the future of the franchise? Determine and make clear which family members and non-family stakeholders will participate in the decision-making process once you retire, and what their involvement will require. The franchisor will need to approve your choice of successor and is likely to require they have certain qualifications, such as education, experience and business acumen.

When should all this happen? The sooner, the better. As soon as your children show interest in the business, start involving them in conversations about the business and, once they're college age, consider including them in business decisions.

Another important consideration is your personal financial goals and retirement needs, and how your succession plan will accommodate your heirs.

THE FIVE STEPS OF SUCCESSION PLANNING

With clear and open communication established within your family, it's time to begin the process of implementing your succession plan.

1. Build a team of advisors.
You might choose to work with just a few family members to help decide on a successor, or you may want to bring in professional advisors, such as your attorney. It can be beneficial to do both: Ensure your family has a say, but also include business experts who understand what will be required of the person you ultimately choose.

2.Identify the qualities needed in a successor.
From general intelligence and enthusiasm to highly technical abilities, determine the attributes, skills and experience your successor will need to have. Remember, franchisors will require the transferee to have certain qualifications – though they may be less stringent for family members.

3. Choose a successor.
With your advisors and criteria in place, it's time to identify your potential successor. Doing so can be difficult if, for example, you have to choose one child over another, which is one reason business owners put off creating a succession plan. You might even find you have two strong candidates, in which case you may work with both of them to ensure one or both are prepared to effectively operate the business in your absence.

4. Get approval from the franchisor.
The franchisor has the right to approve or deny your choice of successor. It's a good idea to get the approval in writing so there are no misunderstandings when the time comes to transfer the business. The approval will typically state any contingencies, such as the successor completing specific training programs.

5. Train the successor.
It can take one to three years to prepare a successor, giving them time to complete any educational or other training requirements, absorb business knowledge and make the mistakes you can turn into learning experiences. Your successor might start their training by simply shadowing you, and gradually take on more tasks as you delegate them.

Not only does the transition period give your successor time to get acclimated, it also gives your employees, customers and other stakeholders time to develop confidence in your successor's abilities and get comfortable with the change.

LEGAL AND TAX CONSIDERATIONS

Estate and liquidity planning is a critical component of your succession plan. Failing to consider the impact estate and inheritance taxes may have on your family could result in your heirs needing to sell the business to pay the tax bill.

It's important to work with your attorney and CPA to help minimize the tax consequences for your family members – say, by using a vehicle such as a family limited partnership, trust, or buy-sell agreement. Be sure to check with your franchisor to get permission before implementing one of these strategies.

Implementing and executing an effective succession plan can be a complex undertaking, which is another good reason to start the process early. But having a viable plan in place can help you and your family maintain business continuity and enjoy the benefits of your years of hard work. ■

Sources: Franchise.org, Franchisewire.com

Four ways to teach your kids about business

Set them up for professional – and personal – success

Whether your children will grow up to be entrepreneurs or to work for someone else, teaching kids early about business helps them establish valuable skills that can serve them in both their professional and personal lives.

Among other things, learning about business can teach kids problem-solving, time management and the importance of planning. It can also help them understand the value of money and hard work, perseverance and risk-taking.

> **Raising problem-solvers.**
> When teaching your kids about business, emphasize the planning process. Encourage your child to think ahead, troubleshoot and establish preventive systems.

Here are four ways to help set up your child for success – both in the workplace and in life.

1. Teach them financial literacy.
The sooner you educate your kids about money, the sooner they'll understand the importance of managing and investing their earnings. Talk to them about income and expenses, budgeting and taxes, and show them how you handle your household finances, pointing out the difference between "wants" and "needs." Let them experience the consequences of their choices – for example, that buying a new video game today means it will take them longer to save up for a skateboard.

2. Let them learn from their mistakes.
It can be tempting to step in to help your children solve their problems, but eventually they'll need to be able to manage on their own. Allow them to make mistakes while they're still in the safety of your home and the stakes are low. Help them explore the factors that contributed to the problem – this builds confidence and resiliency and teaches them not to give up when things become difficult.

3. Take them to work with you.
During summer or spring break, bring your child to work with you to experience a normal day at your business. Talk about the jobs they see being done and how these fit into the broader business picture. Let them shadow you and your employees as you explain what you do each day and why. You could even give them tasks to complete – like filing, shredding or making copies – if you feel they're ready.

4. Have them run their own business.
Experience is the best teacher, so let your children be CEO of their own business, whether it's a short-term project or a years-long endeavor. Help them identify their marketable skills and create a business plan, determining how much they'll need to spend and what they can charge for their products or services. Whether it's mowing lawns, walking dogs, babysitting, or selling lemonade, running their own business helps kids learn the importance of punctuality and professionalism, as well as marketing and customer service.

Nurturing these skills in your kids today can help them become successful adults tomorrow. ■

Sources: Gohenry.com, Rampton, John. How to Teach Your Kids Entrepreneurship Early in Life, LinkedIn, Nationwide.com

Protecting your business from the loss of a key contributor

Key person insurance can help you maintain business continuity

Your business, like many others, may rely on someone for the majority of its earnings. This someone is often referred to as a "key person" because their knowledge, skillset or contribution is critical to the company's success.

It's important to protect your company against the sudden loss of this individual. Key person insurance can help you maintain continuity and cover any losses that may occur from a decreased ability to conduct business while you identify and train a successor. It can also serve the secondary purpose of benefitting the insured in retirement.

TYPES OF KEY PERSON INSURANCE

Key person insurance isn't a type of insurance policy in and of itself, but it's the name given to life insurance that pays upon the death of a specified individual within the company to help a business survive financially. The company usually chooses between two types of policies:

- Term life insurance: a policy purchased for a specified period – five, 10 or 20 years – that only pays a benefit if the insured dies during the term of the policy.
- Permanent life insurance: a policy in which the face value of the policy is paid upon the death of the insured. It also accrues a cash value that may be paid out at the end of the policy.

DETERMINING WHO IS A KEY PERSON

A key person can be a founder, owner, partner or any employee whose death may result in catastrophic financial losses to the business. A business identifies a key person using several factors such as:

- Special knowledge of the operations and products
- Vital for meeting sales goals
- Loss would give competitors an advantage
- Builds customer relationships
- Has contacts to get results in an emergency situation

HOW KEY PERSON INSURANCE WORKS

With key person insurance, the business is owner and beneficiary of the life insurance policy, both paying the premium and receiving the death benefit. The proceeds from key person insurance can be used in several ways:

- Keep the business running
- Assure customers that business will continue as usual
- Assure creditors that bills will be paid
- Cover the expenses associated with hiring and training a replacement

The business can also access the potential cash value of the policy to use as a retirement benefit for the key person.

DETERMINING THE RIGHT AMOUNT OF COVERAGE

Key person coverage typically ranges from five to 10 times the individual's annual pay. Also consider a person's replacement costs, their value to the business and the extent of company losses you're willing to insure. You can also use this formula:

1. Estimate the key person's average income over their lifespan *(deduct federal and state taxes)*
2. Determine years until retirement
3. Select a discounted rate of interest for future earnings
4. Multiply the result of #1 by the present value of $1 per year for duration form #2, discounted at the rate from #3

Talk to your financial advisor about the potential benefits and options of key person insurance for safeguarding your business's financial stability. ■

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