ASK ALAN I BY ALAN FRIEDMAN

Succession Planning, Pt 2

So this is the second part of a series of articles addressing the importance of taking proactive steps to planning for the eventual (and hopefully successful) transition of your business, even if you're not quite ready to move on. Why is this important? Go back and read Part 1 in May's issue.

Just a quick clarification. The terms "estate planning" and "succession planning" often tend to be used synonymously, but they are two distinctly different processes. Succession planning is the process of resolving issues related to transferring management and leadership of a business. Estate planning is the process of resolving financial issues related to transferring business (and other) assets and ownership, while minimizing taxes in the process. To do it right, you can't do one without the other. But now, thanks to a fairly large federal estate tax exclusion, I'll only briefly address the estate tax issue music store owners should be aware of and then move on to the bigger issue of business succession.

'Plan to transition before God does it for you.'

TAXED TO (AND AT) DEATH

As if it's not scary enough, talking about the eventual death of a loved one, the complexity of wills, trusts and other estate documents make the planning process both expensive and error-prone. But worst of all, store owners now must deal with the realities of the management ability (or lack thereof) of family members, or be forced to figure out who, when and how to sell the business before their demise.

Luckily, recent estate tax law changes give taxpayers a one-time $11,180,000 reduction (known as the "Estate, Gift and Generation-Skipping Transfer Tax Exemption") in calculating the value of their taxable estate; this exemption is up from $5,490,000 in 2017. Above this new threshold, assets can be taxed at a rate as high as 40 percent, or even more taking into account state estate taxes. And if a business owner dies with assets worth more than this estate tax exclusion, but without an estate plan and sufficient cash, heirs could be forced to borrow heavily or sell the business to pay the estate tax bill. But with this new increased exemption, estate taxes aren't nearly as much concern as the continued problem of how to transition a business.

TRANSITION FAILURE

Here are 10 common reasons why closely-held businesses, like most music stores, struggle and often fail to transition from one generation the next:

1. Poor succession planning. We've found that less than half of music store owners have a succession plan and even less have a designated a specific person to take the reins. Why? For the simple reason that store owners are either hesitant to place their lifelong work in the hands of another, or they are too caught up in the day-to-day business challenges.

2. Lack of trusted advisers. While lawyers, accountants and other business advisors have formidable technical skills, many lack understanding of the music retail business and its unique challenges. Qualified trusted advisers should be able to work collaboratively to provide the best outcome for the family and avoid giving conflicting advice.

3. Internal conflict. Mutual support among relatives and key employees is paramount for instilling loyalty to the business. Stores that lack procedures to help manage conflict in an objective and productive way should seek outside counseling.

4. Different visions between

generations. Generational conflict can hinder the growth of the business, especially if there's a disagreement in core values and missions. The next generation should be careful not to reject established work methods and entrepreneurial vision, just as predecessors should demonstrate flexibility in exploring new management strategies and ideas for innovation.

5. Governance challenges. Productive business governance requires the time and commitment to collaborative meetings to communicate information critical to the survival of the business. Many participants fear raising sensitive issues, losing control or sharing too much information. But without open dialogue, the detriments from exclusion, secrecy, assumptions and procrastination will creep in.

6. Exclusion of family members outside the business. Every family member has a vested interest in a family business, whether or not they're active in the business. Because the business often impacts the lifestyle, health and happiness of everyone, a forum for family members outside the business is critical.

7. Unprepared next generation leaders. In successful transitions, the next generation is not immediately catapulted to the top. It's important for successors to learn the ropes and all aspects of the business, while gaining requisite education and experience before taking the reins.

8. Poor strategic planning. Thoughtful planning can help create motivation to sustain a business through challenging times. Balancing the needs of both the business and its employees during normal times can create a business team dedicated to riding out tough economic times.

9. Ignoring the family feel. Many of the world's oldest and most respected businesses are family-owned or closely-held. By exploiting the healthy family values embedded within the business, a business can promote a brand of security, loyalty and commitment.

10. Traditional business education is not enough. Subject matters like family dynamics, succession planning and what to do during economic downswings rarely are taught in traditional business education courses. Store owners wanting to ensure a successful succession of their businesses should seek out this specialized education (like NAMM U education).

WHAT'S NEXT?

My final article will offer up some sage and time-tested wisdom to help you start the succession planning process and figure out what to do next before God does it for you. You might not be able to escape death and taxes, but with proper estate tax and succession planning, you can minimize one while trying to cryogenically fix the other. **MI**

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