Can You Take a Vacation Without Calling the Office? If Not, You Need This Plan

When you're building your business, typically the last thing on your mind is leaving it. So when entrepreneurs ask me, "Isn't it too early for me to have a succession plan?" my answer is a resounding "No!" That's because, as an entrepreneur, you juggle several roles at your company—chances are, you're involved not only in management, but also in sales and marketing, HR, accounting and any other function your company happens to need on a given day. As a key employee, you should be asking (and if you don't, your investors will): What would happen to the company if something were to happen to you? How long would it take the company to recover? Could it recover? What about when you're ready to move on to a new challenge, or even retire? Wouldn't it be beneficial to identify a management team whose values align with your own? A team that believes in your company's mission and vision and is developed while you're still around so they can benefit from your experience?

One-question test

Let's test whether you need a succession plan with one simple question. Can you go away for 15 days and not call the office to see how things are? Or do you worry that a last-minute task wasn't finished, or that the customer's needs weren't met? If you're like most entrepreneurs, getting away without your phone or iPad is really tough. It also means you don't have a succession plan. Which means you don't have a company—you have a job!

A successful succession plan makes it clear that you don't work in the business, you work on the business.

Is a succession plan the same as an exit plan?

No, there's a clear distinction between an exit plan and a succession plan. Put simply, one is about money, and the other is about people. Exit planning is about wanting to leave the company and take your money with you, or wanting to know ahead of time how your family will go about selling the company if you die. Succession planning, on the other hand, is about leadership development. It includes forming teams, training employees on problem-solving techniques, creating mentoring opportunities and fostering empowerment through risk-taking and creative experiences.

Are you still not convinced?

Look at it this way: Your role changes over the business life cycle. In the early stages, you're focused on revenues and customer needs. As the company's success continues, profitability increases, allowing you to hire others. As profitability improves even further, you have money to invest in new assets and to fund increasing operating expenses. So, why invest in a succession plan?

Before I answer that question, let me share a few statistics. (1) The IRS reports that there are about six million corporations that file a corporate tax return annually, split about evenly between an S corporation and a C corporation, and there are only about ten thousand publicly held companies in the United States. (2) There are millions of partnerships, sole proprietorships and other business entities where the company is one person, such as a plumber or dog walker. (3) The typical company that survives the first 10 years of existence has a 50 percent chance of surviving the founder's transition, with subsequent generations surviving around 50 percent of the time. This means that of 100 companies that survive the first 10 years, 12–13 companies will survive through the third generation. By the fifth generation, there are only three companies left. (4) Studies have identified several steps that can improve a company's survival. The first is to create a succession plan.

Business owners who successfully pass the torch on to the next generation, regardless of generational ownership, pass it to management teams they personally create, even if they are not family. They also invest in developing multiple candidates in case of sudden changes or losses. And they know that each generation needs to expand the business with higher levels of risk, which means the business model usually has to change as well.

Business valuation experts commonly use the discounted cash flow (DCF) method as a way to develop valuation models for the sale of the business. What the DCF method requires is the valuator's confidence that the management team, without the owner, can continue meeting the projections as explained. If not, the valuation experts discount the company's value by reducing the growth and profitability assumptions, usually significantly. So if you want an exit plan with higher multiples, you'll need a management team that can perform without you and grow the business with risky ventures.

Still wondering whether you should start developing a succession plan? I say, "YES!" Just accepting that you should start the process is a great start. If you are under 40, you have time to adjust and adapt. If you are 55 or over, consider engaging a professional who won't prepare the company for sale, but will enhance your ownership experience so that your family and your employees' families have a safe and predictable company that will continue to support them during difficult times.

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