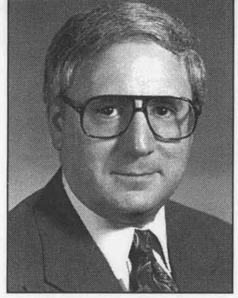
Succession planning opportunities



BY LAWRENCE R. LEVIN

The long, cool summer has done little to heat up soft drink sales. With the economy still sputtering, the beverage industry has continued to experience poor sales and profits with little growth in sight. But there's a silver lining here: The soft economy and recent changes in the tax laws have created the best opportunity in the last 20 years for cost-effective transition planning. Despite this window of opportunity, few family-owned bottlers are taking advantage of it by focusing now on succession planning.

Effective succession planning requires a critical analysis of all aspects of the family–company relationship and the future needs of each. It is crucial to develop a comprehensive strategic plan, followed by an operational plan, with institution of a proactive implementation plan for each of the steps.

To develop the strategic plan, there must be a thorough analysis of 1) the family financial needs at all generational levels and 2) the business and its management needs. These analyses are complex and intersect at many points.

For the family, first review present and future needs for income and capital appreciation. This includes protecting a wide variety of company-related resources that can support spouses, children, grandchildren, parents or others within the extended family who may be dependent on the business for their future income. Next, assess the skills family members possess that can provide the company future leadership.

With respect to the company, the strategic plan is based on a thorough analysis of the size and nature of the company's business, the direction of each of its industry segments, the changing marketplace and future challenges. In looking at the company's resources, it is also important to examine its future needs for capital and cash flow potential. Most important is an objective assessment of future management potential from within the family, the company and, if necessary, from outside sources.

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Making these analyses and formulating a strategic plan can seldom, if ever, be objectively achieved without the help of highly skilled outside professionals who know how to assist the present owners in performing the task. Children have spent a lifetime learning how to deal with their siblings and how and when to involve a parent in problem-solving. Thus, a father who is CEO of a company may not be objective about how his children will interact in a business setting once he's no longer present to resolve disputes.

It is only after a management skill inventory is completed that a strategic plan can be prepared. Until then, it is impossible to know which family members should or should not be involved in the business, and how—or whether independent managers from outside the company should be recruited.

The third dimension of strategic planning is determining how long-term family needs can best mesh with long-term company needs. In this process, the strategic plan looks at who will be active in the business over time, what is required to handle the family members' various needs and the management and financial needs of the company.

The operational plan is the blueprint of how all the aspects of the strategic plan will be accomplished. It must deal with all of the estate planning and tax issues and all of the governance issues in running the business through the period of succession.

The operational plan would, for example, determine which family members will hold securities of the company at the various stages of transition. There may be different classes of stock, or preferred shares, debt instruments, stock option plans, etc. Some family members may have their needs funded by insurance or family assets other than the company. The company's bylaws may need to be carefully tailored to effect the strategic plan, or there may need to be a carefully drafted shareholders agreement, buy–sell agreements, retirement plans or similar programs. The family may need to select and train totally independent management who are not family members and retain the company as a passive investment. To achieve its financial objectives, the company may need to be sold. This could require very careful planning to optimize value at the appointed time.

There is presently pending in Congress a bill to reduce the Unified Estate and Gift Tax Exemption from $600,000 to $200,000 in 1994. The $600,000 exemption has been a key to much estate planning in recent years, since it permitted a husband and wife to pass up to $1.2 million tax-free to their children.

If the pending bill were enacted, a transfer of $1.2 million in stock or other assets would result in $373,000 in new taxes. Because of this and other aspects of the tax laws, timing may be very important to avoiding significant tax liability in the future.

The present state of the economy, the increased cost of doing business and reduced free cash flow, along with other changes, have reduced the value of many bottling operations for tax purposes. This permits the use of lower tax valuations for many intergenerational transfers of stock ownership.

Moreover, the use of ESOPs, and other financing tools to effect succession plans is especially advantageous at this time because of lower interest rates. Reduced interest rates, a slow economy, favorable tax laws, a broad range of planning tools, and a mature soft drink industry create a window of opportunity—making this the best time in 20 years to take advantage of substantially easier and less costly succession planning.

Lawrence R. Levin is a founding partner of Chicago-based Levin & Funkhouser, Ltd., a full-service corporate law firm. Levin has handled a number of noteworthy cases in the beverage industry as well as cases in the U.S. Supreme Court of Appeals, U.S. Tax Court and the U.S. Suprême Court.

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