



Succession Planning for Privately Held Companies

Succession and liquidity planning go hand in hand: Entrepreneurs should consider these dual issues.

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In early 2007, CEO David Kalt began thinking about the next stage for himself and his firm, optionsXpress. Passionate about starting new businesses, Kalt had co-founded optionsXpress in 2000 and helped grow the company -- an online broker specializing in options and futures -- into a \$1.5 billion publicly traded firm. Believing that his skills were better matched with starting new companies than they were for growing existing ones, Kalt asked the Board to start focusing on the next generation of leadership.

Fortunately, optionsXpress already had talent in place. CFO David Fisher had been hired shortly before the firm's 2005 initial public offering, and was being groomed for a senior leadership position. In turn, Fisher had hired a seasoned VP of finance who could easily assume the CFO role. Upon Kalt's request of the Board, Fisher and the VP of finance moved up into their new responsibilities, and the company continued to grow. This allowed Kalt to leave the company in late 2007, well ahead of his target date.

Succession planning is important for owners of privately held businesses. Like all senior executives, they need to ensure that their companies can thrive without them. Yet, these entrepreneurs must often rely on their ownership interest in the company to fund their retirement. Therefore, succession planning and liquidity planning are intertwined.

Consider liquidity options

If you want to pass the baton to the next generation of managers, consider ways to help them either purchase your share of the company or take some of your money off the table. For most private company owners, liquidity planning is critical to their succession strategy.

Here are some alternative liquidity options to consider:

Private investment

You may decide to take liquidity out of your business by selling part of your company to a private equity investor. Many private equity investors will want you to continue playing a role in your company for the duration of the investment and will help you find and groom your eventual successor, while others will prefer to install their own team. Be sure you know the philosophy of each private equity firm before making your choice.

IPO

Going public can make it easier for founders to sell once the lock-up period has passed. In the interim, however, a CEO's ability to sell shares may be constrained. Even when sales by CEOs are allowed, they can adversely impact the market value. Thus, when a CEO owns a substantial share of a company's value following an IPO, it may take several years to realize full liquidity.

As a result, some CEOs of companies preparing to go public will reduce their role in the business prior to the IPO by bringing on a new executive as president and remaining only as chairman. As the ex-CEO's role changes, he or she will have progressively more freedom to sell stock in the company.

Strategic acquisition

In some cases, strategic acquisitions can work as a way to both generate liquidity and ensure the continuity of your business after you leave. Typically, this occurs when an acquirer is in an industry close to yours and already has people inside its organization who can manage your company. Acquirers who are seeking to expand into new markets, businesses, or geographic territories are more likely to want you to stay on with the company.

Overall, the key point to remember is: However you structure your succession and whatever liquidity strategy you choose, the two processes are inextricably linked. Your company's future - and your future - depends on your ability to develop a workable succession plan for your business