THE ACADEMY OF ELECTRICAL CONTRACTING

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BUSINESS TRANSFERS TO SECOND GENERATION

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Business transfers can be done in as many ways as there are to run conduit from one point to another. There are several acceptable ways (depending on your objective) and there are several unacceptable ways. We're going to touch on a few different methods of accomplishing transfers - some will be better for one business, some will fit another – but there are some methods of transfer that are almost always detrimental to a business. All good plans should incorporate factors to address critical areas such as important tax issues, equal distribution of assets to children, and avoiding conflict among family members and current employees. The continued success of your business depends of a smooth transition of leadership, and the acceptance of that leadership by employees and customers.

The leadership ability of a successor is a very important consideration: Knowledge of the industry, qualifications, capabilities, and current and past involvement must all come into play. A good plan must address whether or not a successor has been given enough time to learn all the aspects of the business.

Impact on current employees is another key area of consideration. Can the business continue successfully when the new owner takes over? Will the employees work with him during and after the transfer?

The majority of businesses are transferred to children, usually sons. A number of those sons have entered the electrical industry in the same way their fathers did; completing the electrical training school, working as journeymen, foremen, supervisors, estimators, etc. While they may have knowledge of the electrical industry after such experience, they may not necessarily possess management skills. We're not born with these skills: They are obtained through various methods, such as formal management education, seminars, and hands-on managerial experience. It is not wise to place your son or anyone else in a management position and expect him to perform effectively with little or no previous experience or training. Therefore, the earlier we're able to involve our successor in management decisions, the less disruptive it will be for the company, and the more experience he will gain before Dad is no longer around. Gradual involvement over a period of time is extremely important.

The worst possible transfer strategy is to do nothing. If the business is inherited at the time of death, the company suffers on many levels. Inheritance taxes are a major concern which may force selling or liquidation of the business to settle with the IRS. Loss of leadership will cause a loss in value of the company. Due to the nature of the contracting business, the owner (in most cases) has developed a long-term relationship with the employees and customers. When he dies, the same relationship does not exist between them and the new leadership. It will take a considerable amount of time to develop working relationships with customers and employees; during this time the company will suffer financially. There are no advantages to this type of transfer.

Taking action includes developing a plan and putting time lines, goals, and objectives in writing. When the plan is written out it can then be used to monitor whether or not the goals and objectives are being met within the allotted time frame. It is important to understand that it is never too early to begin planning.

The most common plan is the selling of company stock to a son, daughter, or family member who is employed by the company. Since in most cases, family members do not have the capital for an outright purchase, this may require a financial arrangement over a period of years. A bank loan may be considered, but the more popular way is to fund the purchase of the stock through the declaration of a schedule of bonuses from the company profits. The IRS allows the discounting of the value of the stock if certain conditions are met involving minority stockholders. The negative side of this plan is that the purchaser pays income tax on the bonus and the owner must pay capital gains tax on the sale of the stock. The beauty of this method is that the bonuses and purchases of additional stock could be adjusted depending on the profit fluctuations of the company.

Another common plan is to sell the company to key employees. In many cases, these key employees are already in second tier management positions and are already familiar with the responsibilities of top management. They usually have developed relationships with customers and are established within the company. In these cases, the transition is not as difficult as it would be to transfer to an unknown. These employees may face the same financial problems as family members; again, long-term financial arrangements must be considered. Although owner financing can be one such arrangement, a danger that needs to be considered is the very real possibility that the company could lose its ability to make payments over a period of years if poor management besets the operation. Repossession may become necessary in this case, and when repossession occurs, the company will be worth less at that time than when it was originally sold.

A third plan is to make a gift of the stock to the new management. This method is the one that we at Lone Star Electric have chosen. The first thing

to do is to hire a qualified private appraiser to appraise the stock, using all available stock discounting methods to establish the lowest value acceptable to the IRS. Next, we made a gift of part of the stock to our son, Mark, using a portion of our lifetime IRS exemption. Our intention is to continue this gifting. Two reasons stand out for choosing this method: 1) the stock will appreciate in his estate instead of ours, and 2) when a gift like this is made it does not become part of the community property laws.

We understand that our choice would not work for everyone, but whether you sell to your children, sell to your employees, or follow our example, it is extremely important that your successor's knowledge and ability give you an acceptable comfort level. If you are dependent on income from the sale of the company to maintain your standard of living into retirement, every effort must be made to prepare your successor for the challenge. As we mentioned earlier, due to the nature of the contracting business, it is extremely difficult for us to relinquish control of a business in which we have been so dedicated for so many years.

Yet this is exactly what we must do to assure the survivability of our businesses, which represent our lifetime of investment and dedication. In any event, the key elements to successful transition are:

- start early,
- have a written plan,
- examine equal distribution among children,
- assure that your successor is adequately trained and willing to accept the responsibility,
- make sure your employees and customers are willing to accept and work with the new leadership.

But above all, make certain that you have addressed your own needs. Don't just sit back and do nothing until it is too late.

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