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Transition & Succession Planning: What a Lender Needs to Know

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Date: May 19, 2014 @ 07:00 AM

You have been lending millions of dollars to Manufacturing Company "A" for two decades. They are a model customer; never missed a payment, they finance their equipment and divisional acquisitions with your institution; have great vision as to where their company is headed and their position within the industry. They provide information timely and are one step ahead instead of being one step behind, if you will pardon the cliché.

At a recent social event, the owner and patriarch of the business mentioned he was having some health issues. The credit facility is up for renewal and his comment gives you pause for concern. Despite having both a son and daughter in the business, for as long as you have known him, the owner has never clearly discussed or articulated any succession plan.

You don't want to be intrusive. Yet with most family-owned businesses, a properly thought out transition/succession plan usually means the difference between success and failure for the coming generations as well as a success for the long term customer for your institution. How do you approach the subject? Here are some things to consider:

Is there a competent leadership/management team in place under the owners? Is the next layer of management capable of taking over and leading the organization? We had worked with an eight store restaurant chain that faced this question. Each of the stores managers had been with the company in a leadership capacity for seven years; the CFO had been with the company for ten years. Although it was never stated; it was clear in this situation that the next level had the experience not only within the industry but at the company to step in, direct and lead.

If there are multiple siblings or relatives that work at the company, look to see if one has clearly emerged; observe how the employees treat the family members. Most likely they will subtly treat them differently. Remember that respect is earned … never or rarely automatically given. Being involved for the organization for some time you'll see the differences ... again, as subtle as they maybe. Even if you as the loan officer are relatively new to the situation, ask other members of the company's management team as to whether there is a succession plan in place? Too many times, we are asking the next question before somebody is finishing answering. Take the time to really listen to their answer. Listen to what they may or may not be saying and determine what they are really trying to tell you.

Is there key person life insurance in place? While it may seem a bit morbid and perhaps an uncomfortable topic to discuss, there is nothing wrong with asking this as part of normal diligence and review. And if in fact there is a policy in place, find out if it is it "a token" or is it enough to ensure continuity? The answer will give you an initial indication about next steps. The follow up question to ask is whether the company had one in place or was it forced to put one in place. Although rarer, the company or organization that put one in place rather than being told to have one in force, usually gives an indication that they have given planning the next steps real consideration.

Is compensation proportional to contribution? Is it affecting the company's free cash flow? There are times that family members working at the company think it is their right not privilege to have a job, to have a car, work in the family business etc. During your diligence or update process, analyze what is truly being distributed. Make sure you consider it in a broad perspective. For example, if you ask the question how much does so and so earn, at times the corporate family members think about it (or answer only what is asked) in terms of W-2 compensation only. However, anything a family member may takes out, whether it's a car allowance, travel entertainment, country clubs memberships, trips, usually comprise a much more significant portion of the compensation than just their salaries. Think of compensation in the broadest sense. I have recently been involved in a situation where the chairman's salary is more than the CFO/COO and EVP's combined, but doesn't make nearly the contribution the others do. It is a tough conversation but one that needs to be had.

Succession planning is not just about the CEO, but also at most executive levels. I am reminded of two situations; one in the past and one I am currently involved with that is evolving in real time. In the first situation, we were interviewing for a chief financial officer to replace me as the interim. The controller, who was a family member, asked why he wasn't being considered. I told him from what I had seen; I wasn't ready to place the livelihood of the company and 350 families in his hands.

In the second situation, I am working with a business that has been owned by two families for more than a century. One of the family members believes he is ready to step in as CEO in spite of the fact that he has never been responsible for supervising more than two people and never has had true overall decision making authority. Currently, his only true qualification is that his family is one of the owners.

If there is a longstanding relationship, the owner may be a bit taken back by a question regarding the next generation of leadership for the company. That same owner may even be somewhat chagrined. One hopes the owner's ultimate concern is for the longevity of the company, its employees and the family's financial security.