Think about the future

Why it's important for your bank to know your succession plans

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Succession plans show a bank that a business owner is focused on the company's future and is taking steps to ensure that if something happens, the business can succeed without him or her at the helm.

"When an owner is engaged and is thinking ahead, it gives a bank confidence," says Kurt Kappa, chief lending officer at First Federal Lakewood.

Still, many business owners don't want to think about the business existing without them. They might know they need a plan, but resist putting one in place. That can create problems in a banking relationship.

Smart Business spoke with Kappa about the importance of a succession plan and why banks want to know about it.

Why does a business's succession plan matter to a bank?

When an owner's exit involves transitioning the business to the next generation or to employees, it's important for the bank to get to know and build relationships with the next generation of ownership. The relationship between a bank and a business owner is personal, and banks want to know that the people lined up to take over the business know the industry, understand operations and have a vision for the business's future.

A sale or transfer could also affect existing loan covenants. Companies that are headed toward a sale event are going to put significant emphasis on growth, building up their balance sheet and income statements. That growth could trigger a loan covenant.

Additionally, in a transition, an owner will likely pull money out of the company ahead of his or her exit. That makes sense for owners because they built the business and have earned their share. A bank can be the source of financing if the newly transitioned business owner needs additional cash flow to maintain the business through the transition.

How does a business's succession plan affect the decisions a bank would make regarding that business?

Banks want to know that business owners have a contingency plan in the event that they're suddenly unable to operate the business — they want to know what happens to the company, who takes over, and if that person or people are capable of taking it over in that event. For example, if the owner's spouse inherits the business, will they be able to run it, or do they plan to sell? Is there a life insurance policy in place that will be able to cover the company's debt? If there is no plan in place, a lot could go wrong that would negatively affect the lending relationship.

When should a business owner talk with his or her lender about the business' succession plan?

The business's bank should be made aware of the company's succession plans very early in the relationship. The relationship began with the current owner, so the bank already knows his or her story and feels comfortable with that lending arrangement. But once a transition plan is in place, the sooner the bank can know the plan and the players in the succession plan, the better.

Without a succession plan, the business could be put in a tough place if a sudden transition in ownership is made. This situation could disrupt the current lending relationship if the bank doesn't feel confident in the new owner and his or her ability to run the company.

When should succession planning begin?

Succession or exit planning should begin as soon as an owner decides whether to transfer the business to an heir or an employee, or to sell it. Either way, the process can't be done overnight.

And while it might be tempting to put a plan together and then forget about it, understand that the conditions that exist at the time the plan is created could, and probably will, change before the plan is implemented. It's a good idea to start assembling a plan at least five years before an exit and revisit the plan if circumstances change that require the plan to be updated. ●