BUILDING A SUCCESSION PLAN

By Carl Oliveri, *Grassi & CO., CPAs*

Over the past few months, there have been at least three construction companies who celebrated big anniversaries: one celebrated 75 years, the second 125 years and the third 130 years. It is not by luck or by accident that these companies have endured and continue on their trajectory with no signs of slowing down. While they are different in terms of building type and market specialties, there is one thing they do have in common; a well-designed, actionable succession plan. While there are many ways to develop succession, the most common are generally: familial ownership transfers, giving key employees the opportunity to buy–in, or selling to a third party.

Familial Ownership Transfers

Typically, a successful construction company is built with the vision of indoctrinating offspring and other family members. It is generally the most popular and easiest transition plan, especially when offspring are involved in operations, are market facing, and are driving growth. The first step in a gifting plan is to have the company valued, inclusive of appropriate discounts.

Once a valuation method is selected and performed, the owner has a multitude of options from gifting ownership interests to transferring interests into a variety of trusts (which, if used correctly, serve as great tax-saving-vehicles designed to get appreciated assets out of the owner's estate), to outright selling their interests.

Matters of family are generally messy with potholes on the road to consider—especially when dealing with working and non-working family members. For parent-owners with multiple offspring, some active within the company and the others inactive, the succession plan must address how to transfer ownership to the next generation in a way that does not slight the inactive offspring. Further, just because an offspring is active in the business does not necessarily mean s/he is the best individual to lead the company in the future. Yes, this is a tough concept to process, especially if ownership is viewed as a birthright. One solution would be to consider transferring the owner in a non-voting fashion. While day-to-day operations would be dictated by non-family key employees, profitability remains within the family.

Vesting Key Employees

Key non-family-member-employees have much to offer and should be rewarded. While increased compensation is always a great reward, ownership has a variety of options to help get golden handcuffs on key employees. Popular concepts include, but are not limited to, structured annual bonus plans (which vest over time), project specific profitability sharing plans, and common stock purchase options.

One idea to consider is the transition via OldCo to NewCo. Rather than buying the common stock of the existing company, a new operating company is formed and owned by key employee(s). NewCo becomes the active operating company over time, by procuring contract work—which would have generally been performed by OldCo, which supports NewCo through contributions of capital, equipment, infrastructure, etc. In exchange for this support, OldCo receives a share of earned profits/return on capital, which is distributed to the outgoing ownership group in the wind down of OldCo operations. This is a process that happens over time, with the ultimate goal of transferring all operations, profits, and decision making to key employees.

Another popular ownership transfer tool used in key employee scenarios is the implementation of an Employee Stock Ownership Plan ("ESOP"). This is a qualified retirement plan that purchases the stock of the construction company. There are approximately 11,500 ESOPs in the United States, 250 of which are construction companies. With so few in the construction space, why would an owner consider an ESOP? For starters, the ESOP creates an internal market for the owner(s) to sell shares of the construction company. By leveraging the company's balance sheet, the owner(s) is able to sell shares of the company and get cash out. Key employees are rewarded as they are now owners of the company, which helps retention, motivation and overall profitability. As you can see, this solves the ongoing succession issue in a broad stroke. It also aligns the goals of management and labor, and as an added benefit, since the company is now owned by a retirement plan; income taxes can now be deferred.

Selling Out

There is also the possibility that there is no succession plan for the construction company. In these instances, ownership would be considering the outright sale of the company to a third party; be it a competitor or another construction company looking for an entry way into the geographic market. The structure can be as simple as direct sale of company assets/stock, with ownership retiring immediately, or contain an earn provision whereby the owner stays on for a specified period of time to properly transition operations and then retires.

Once the construction contractor determines what succession plan s/he wants to implement, the key is to develop actionable items to ensure ownership transition is successful. While the succession plan vehicle may vary, there are characteristics every version should consider:

- The plan should be a written document;
- The plan should be flexible—revisit and revise, as needed. As the business changes so should the succession plan;
- Share the plan with the successors and actively seek their feedback;
- Execute it.

The successful development and execution of a succession plan will carry your construction company well into the future towards your 100 year anniversary!

For more information about succession planning, contact Carl Oliveri, CPA CCIFP CFE, Partner-in-Charge of Construction Practice at Grassi & Co., at coliveri@grassicpas.com.