# PLANNING FOR THE NEXT STEP IN THE FAMILY BUSINESS

During the course of my career, I have represented family businesses of all shapes and sizes. It is an accepted fact that 95% of the businesses in the US are family owned and in many cases survive into two or more generations. The successful business owner devotes most of their life building the business, and the business represents the primary income stream and net worth of the owner. The thoughts outlined below are based upon my career of representing family businesses through difficult and smooth transitions.

The "what's next" stage in the family business owner's life is challenging in that decisions have to be made in terms of succession to family members or selling the business and retiring. Yogi Berra would say that when you arrive at this fork in the road "take it." The challenge for the decision maker in taking the fork in the road is when the interests of the owner and family are not aligned. The questions to be answered are not easy and in most cases create further challenges within the family structure:

- "Do I sell to an unrelated third party?"
- "Do the children have the capacity to sustain and grow the business?"
- "Do I want to stay on in some capacity or simply retire without any more pressure?"

Status quo is rarely the answer to the question, which means the owner must confront the inevitable: "What is next?" Succession planning is a process that requires a well-thought-out plan and the ability to execute on that plan. The Family Business Institute statistics and what is often thought to be the case by the business owner do not match in most cases. According to the Family Business Institute, 88% of current family business owners believe the same family or families will control their business in five years. Succession statistics, however, undermine that belief. Only about 30% of family businesses survive into the second generation, 12% into the third generation, and 3% into the fourth generation or beyond.

The family business dynamic involves an overlap between family issues and business issues without clear lines of distinction. To be successful, wealth transfer requires careful planning for both the business and individuals. The owner of a successful family business faces significant challenges when the time comes to either transition the business to other members of the family or sell to a third party. Questions to be confronted when one reaches the fork in the road include:

- "How do I distribute the business, i.e., equally to all my children or only to those who will operate the business?"
- "Should control of the business be with only the child that is active?"
- "How do I structure the decision for transferring ownership and control to one or more family members?"
- "How do I prevent family discord about the decision, and how do I navigate resolutions to disputes in the future?"
- "How might I structure the sale to a third party in view of tax and estate planning issues?"
- "After a major liquidity event, how do I maintain that wealth to live on and preserve it for future generations?"

Planning for and implementing a transition should be in concert with experts who routinely assist family owned businesses in this process. The experts include accountants, business and estate planning lawyers and consultants who are well versed in these matters. For many owners, the family business represents job security and control over financial destiny. It is also a legacy that provides the family with a sense of identity, now and in the future.

For those who have a strong desire to see a business continue in the family for generations, the business represents the entire spectrum of human emotions, which is why the owner needs a filter to assist in addressing the issues and concerns such as the following, without emotion:

• "Do my children have the competence to operate the business?"

• "Do I need to retain key employees?"

• "What is the control mechanism to prevent and/or resolve disputes if and when I am no longer involved?"

Many times it is better to engage outside assistance to facilitate the discussion that will be emotional and difficult to navigate. Giving up and passing on a family business is a major life-changing event with a whole host of complex issues and often difficult decisions. While it can result in family strife, if done well, it also has the potential to be a golden opportunity to realize business, family, legacy, and philanthropic goals after years of hard work and sacrifice.

It is very likely that after examination of all the issues involved, the founders conclude that transitioning the business to unrelated outsiders rather than family members will best serve the family in the long term. Not only do the emotions of selling the business need to be worked through, but it is essential that the business itself be best positioned for sale.

If outsiders become the owners, the founder will have to resolve balance sheet items for expenses that have been charged to the business that would not be absorbed by a new owner. Loans to family members are in the same category, and receivables must be current or written off in order to accurately reflect the financial status of the business. Most important is the structure of the business. Are there valuable strategic alliances and long-term contracts with suppliers or vendors? If so, they need to be locked down. If the business requires real estate to operate, long-term leases need to be in place.

Securing agreements with essential employees and key management is key to a successful transition of a business. Agreements such as these add value to the business when the time comes to sell. There are numerous ways to structure the sale of a closely held business: a lump sum sale; an installment sale; an earnout sale based on a percentage of future profits, or a sale to a charitable trust.

The owner may sell the business by transferring either the entire ownership interest (stock, partnership interest, membership interest) or just the assets of the business. The desired "end result" will help determine a sale's structure.

The most common valuation methods for this purpose are using a fixed price decided upon by the owners, a formula provision or a formal appraisal. The fixed price method may be attractive at first glance because of its simplicity. The owners decide on a price and agree to it. However, this approach is not flexible and may not reflect a true value of the business in future years unless a mechanism to periodically reevaluate the appropriateness of the price is included in the agreement. A formula provision provides flexibility to value the business interest in future years and may include some combination of capitalization of earnings and book value of the business assets as variables of a formula to determine appropriate value.

The founding owner of a family business may have spent decades in the business and everything about it feels comfortable and controllable — the routine, the risks and the rewards. Even the fact that their individual wealth — and, by extension, the family's wealth — is concentrated in the business feels comfortable.

Developing a succession plan for the business owner will make certain that the business owner's financial well-being is protected. They should explore their financial well-being after the sale or transfer of the business. Questions a business owner should answer include:

- "Will I be able to retire and maintain the same lifestyle?"
- "Will my surviving spouse be able to enjoy their lifestyle independent of the business?"
- "Is there enough liquidity to pay estate taxes, so the family won't lose the business or see it financially crippled?"
- "What estate and trust options should I consider?"
- "If I sell, how will the assets I receive be invested?"
- "What means of support do my children have?"
- "What are my charitable objectives?"
- "What is my comfort zone on giving up control, when and to whom, and potentially paying gift taxes now to achieve my goals?"

Addressing estate planning issues is a family responsibility. Engaging family members in this discussion may be uncomfortable; however, it is essential to knowing that your transparency will aid in the success of the plan. As it turns out, many founders find this kind of conversation provides great insight into what life will be like for their children after the parents are gone and shapes the planning in ways that will likely avoid disaster.

The more enlightened path is to resolve these issues in a family conference. If resolution cannot be reached while the parents are alive, it almost certainly will not magically be reached after the last parent dies.

The wise family leader will ensure that the children are educated and informed about the issues and then involve them in the solution to these dilemmas (after all, it is the children who will have to deal with the consequences, and the last thing most parents want is to sow the seeds of inevitable dissension).

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