SUCCESSION PLANNING AND THE FAMILY BUSINESS

One recent survey confirmed that the majority of owner managers intend to pass the business on to their children, but less than 30% have a succession plan. It is also generally accepted that only 30% of owner-managed businesses are passed on to the first generation, and that only 10% make it to the third.

The Volatility-Resentment Matrix

The issue is not lack of willpower with succession planning in a family context. It is the vexing problem of family and money – the most volatile combination known to lawyers.

Consider this equation:

<u>Volatility = the amount of money involved squared by the amount of emotion at play.</u>

Family emotions can run silent and deep, especially where money is concerned, and you might not know the extent of emotion around the table until after you have begun succession planning.

These problems are compounded in owner managed businesses, as the driven, independent and control-oriented mindset of many owner managers is often as evident at home as at work.

Many owner managers are surprised to find out that their children want nothing to do with the family business because *living* with dear old Mom or Dad is hard enough, and *working for* dear old Mom or Dad is downright unthinkable.

However, even children who do not want anything to do with the business can an emotional connection to it, especially if the "business" is a major source of parental absence, family sacrifice, or the sense of parental preference to one child over another.

If you have family in your business, or you want your family to take over your business, or you have family members who think they are entitled to take over the business, then you need to start planning early with help from some very experienced professional advisors.

The worse thing you could do is nothing at all.

Beware Your Motives

Some of the most common reasons clients give for having their business pass to family on succession include the following:

- "Let's keep business in the family."
- "The business is the best way to provide for my family's future."

However, you must be aware of hidden agendas as well, including:

_ “If family owns the business I will never have to retire.”

_ “If family owns the business I can stay in control for as long as I want.”

_ “I can continue to fulfill my dreams and live through my kids.”

The first two reasons are themselves questionable. Often the best way to secure the family’s future is to move equity from a private company to more professionally managed, less risky and more liquid portfolio.

But the next three reasons get the whole process off on the wrong foot. Remember that formula about money and emotion. The emotions of the owner manager are just as likely to spark an inferno as the emotions of other family members.

The Most Common Mistakes In Family-Based Succession Plans

Here are some common difficulties when family is part of a succession plan:

All the usual mistakes. All the mistakes that apply to succession plans generally apply to family based plans as well, especially:

_ Not preparing yourself.

_ Not preparing your successor.

_ Not preparing the business.

_ Not really giving up control.

_ Hanging on too long.

_ Not securing your retirement money.

_ Not including your successors in the planning process.

_ Not doing a commercially sensible deal.

Control-oriented parents. Owner managers are often control-oriented, and so are parents. Control often involves money and works in subtle ways. Additionally, Control-oriented people tend to get told (or hear) what they want to hear. Unless any issues of control are resolved, your succession plan could be built on illusions that will undermine your plan when you try to implement it, or after you are gone.

Intra-family communication problems. Communication within families is not as reliable as communication between strangers. Communication issues need to be worked out and dealt with as part of the planning process. Parents need to be willing to truly listen to their children, and not punish them for thinking differently or try to control them with money. Children need to be open to communication as well, and to consider and respect the advice and suggestions of the older generation.

Sibling rivalry. Without careful planning and parenting, including outside counselling, sibling rivalry can wreck a succession plan. Unfortunately, sibling rivalry often stays buried until after the parent is dead. Deal with sibling rivalry right at the beginning, and build a plan that will not fall apart over this issue. Problems can arise either when more than one sibling is involved in the business or when only one of your children is involved. The decision you make with the business can affect how other family assets are considered, including houses and cottages.

Preferring blood to management ability. Whoever succeeds you should be truly qualified. They will need the support and loyalty of your management team, your employees, your suppliers and your customers. If they cannot lead as well as the competition, maybe they should not be leading your business. While it may fulfill a family dream for a relative to take over the business, if they are not sufficiently skilled or respected, the dream could become a nightmare.

Familiarity breeds contempt. Some owner managers do not recognize the management ability of their children, siblings or spouses. They put succession plans in place that prefer professional management or third parties over family members. People are people. Resentment is resentment. Underestimating your family could be as damaging as overestimating them.

Not preparing the family. It's impossible to include everyone in the succession plan. Resentment can easily result if the family is not prepared for your plan, especially if you are not around to explain it. Preparing your family is as important as with preparing yourself, the business and your successor.

Coercing kids into the business. Some kids don't want to take over the family business. Your family and the business will be better off in the long run if you make sure your successors are committed and enthusiastic.

Asking the business to support too many families. As time goes by more and more families can become dependent on the business for financial support. This can be a terrible drag on the business, and may expose the whole family to economic disaster if there is a problem in the business. Many owner-managed businesses are too small to support too many families. In some cases the retiring owner manager remains dependent on the business. This increases the risk to the business and the family, and could create a scenario where a downturn in business fortunes leaves both the older and the younger generations unable to support themselves at a time when the younger generation would typical need support from their parents or grandparents.

Not doing what is in the best interests of family. The family should be independent of the business. Sometimes the family is better served by selling the business to a third party and using the surplus money to help family members start their own businesses. Or sometimes the best thing is to sell part of the business to secure your retirement, and divide up other parts amongst the family so they do not have to work with each other. In any case, do not automatically assume that keeping the business intact and in the family is automatically the best course of action.

Phil's Test: What's Best For The Grandchildren

In the end, I think family issues can be best addressed by doing what is in the best interests of the "grandchildren", even if they are not born yet or your circumstances are such that there won't be any. The point is to look at least two generations ahead in your family.

Succeeding in an owner-managed business is like winning the lottery. Many, many people try. Only handfuls succeed. You should make that money last as long as possible.

It also helps avoid tricky issues among the children. Choosing among several suitors for the business, or dividing assets equally, can be avoided.

Sometimes, cashing out is the best thing to do. Not in all cases, but in many of them.

After all, grandparents want their grandchildren to grow up in a loving, united and prosperous environment. They want their grandchildren to be better off than they (or their children) were... If you do what is in the best interests of the “grandchildren then you will have made a real contribution to the family that can last longer than most businesses.

Suggestions for Doing It Well

Here are some suggestions for successful succession planning in a family context:

☑ Commit to having an open, transparent and written succession plan.

☑ Commit to having a safe, open and objective process to uncover all the issues.

☑ Give everyone a chance to have their say and express their thoughts and feelings, privately and repeatedly.

☑ Hire experienced and objective advisors to help you develop the plan, and give them access to all the principal players, including your family members.

☑ Listen. Consider. And listen some more.

☑ Consider all the different opportunities and choose the one that is best for your circumstances.

☑ Prepare yourself.

☑ Prepare your successor.

☑ Prepare the business.

☑ Prepare your family.

☑ Involve your successor in the planning process.

☑ Involve your family in the planning process.

☑ Do the succession plan as part of an overall estate and retirement plan, including your will.

☑ Make sure your successors and the business have been objectively assessed by independent third parties.

☑ Get your business valuated – know what an arm’s length party would pay for your business.

☑ Determine what you need to be secure in retirement.

☑ Do a commercially sensible deal, not only for you, but also for your successor and the rest of the family.

☑ Build in a realistic timetable that is not too long.

☑ Empower your successors, and disempower yourself, in a timely and realistic fashion.

☑ Consider how the plan will work if something unexpected happens, such as death, critical illness or a change in economic conditions.

☑ Consider how to integrate insurance into the plan.

☑ Put the interests of the business ahead of personal agendas.

☑ Once you have secured your financial future, put what is best for the family as whole ahead of what is best for any one family member – including you.

☑ Put the plan in writing.

☑ Integrate the plan with other legal documents, including wills and estate planning.

☑ Share the plan with others, as needed, especially anyone affected by the plan financially or emotionally.

A Closing Thought

We always say that the best side effect of a good succession plan is the plan itself:

_ You and those around you will know where you are headed.

_ Everyone who can help you get where you want to go will know your plan and will be committed to making it happen.

_ You will end up doing a lot of things that will have immediate impact on improving the value of your business and your peace of mind.

For most of us, just having the plan is worth the effort.

However, for family businesses, there could be a significant added benefit. The *process* of making a plan could be more important than the plan itself. Devising a succession plan in a family-owned business will force you to identify and deal with many emotional issues that make up the family dynamic. Identifying and resolving those issues may have a bigger, more immediate and longer lasting impact on the family than the financial outcome of the plan itself.