SUCCESSION PLANNING FOR FAMILY BUSINESSES

Family conflicts can wreak havoc on a family-run business— especially when it comes time to transfer ownership of the company from one generation to the next. Here's a look at how a well-designed succession plan can reduce that risk—and help facilitate a transfer that leaves everyone in the family satisfied.

KEY TAKEAWAYS

- Effective succession planning results in a technically successful transfer of the family business and mitigates family dissent.
- Issues of taxes, leadership competency and family relationships should be factors in a succession plan.
- Agreements and plans should be formally documented along the way.

Where there is a desire to pass the baton that is the family business from one generationto the next, succession planning is usually essential. The absence of a solid succession plan can potentially result in family differences and financial complications that may bring down the family enterprise—as well as inflict considerable damage on the wealth of the family members.

We have seen, more than once, how poor succession planning can lead to conflicts that literally destroy a family. These confrontations commonly binge-eat resources, draining family wealth. Moreover, they tend to cause irreparable harm to family relationships.

Keep in mind that often it's one thing to craft and put into place a well-designed succession plan and quite another thing to ensure that the plan endures and is adhered to as expected. While legal structures such as trusts can guarantee the desired transfer of ownership of the family business between generations, they alone cannot guarantee that family members won't fight over the company and who is at its helm.

Example: A disgruntled family member can always file a lawsuit. Even if that lawsuit does not prevail, the problems it can cause the family may be considerable.

The upshot: *Truly effective succession planning results not only in a technically successful transfer of the family business between family members but also in the mitigation or even the elimination of family dissent due to the transfer. This is the type of planning you should be thinking about if you own a family-run business!*

It can be especially useful for a family to think of succession planning more as an ongoing process than as a one-time event. When succession planning is inculcated in a family's thinking, the probability of the transfer going well can increase dramatically. For example, by making succession planning a regular and recurring topic on the family agenda—at family meetings, say—it's likely that many potential complications will get worked out before they come to a head and before the actual ownership transfer.

THE NATURE OF A WELL-DESIGNED SUCCESSION PLAN

There are a number of components we see in a well-designed succession plan. Often, the starting point of a such a plan is deciding on the future of the family business. Some of the questions family members usually need to answer include:

- Does it make sense to continue as a family business, or is it smarter to sell the company while it has significant value?
- Are the potential inheritors of the family business up to the task of capably managing the company—and if not, what steps are needed to ensure the continuity of the business when it's transferred?
- What will be the arrangement between equity inheritors who work in the family business and those family members who have chosen not to?

If the decision is to keep the company in the family, then a well-designed succession plan is needed.

The best succession plans we see are flexible. If a succession plan is not adaptable to changing conditions, unforeseen events can prove ruinous. At the same time, a welldesigned succession plan has clear objectives and targets. What will happen and how it will happen are clearly delineated. Therefore, the roles and responsibilities of family members—those who will inherit the company and those who will not—are spelled out in detail.

The goals of any succession plan need to be clearly communicated to all impacted family members. This best happens personally between family members. Explaining the logic in family meetings, for instance, often proves useful if family members can voice their concerns.

At the same time, it can be beneficial if the succession plan—at least the big picture—is shared with any senior nonfamily executives at the family business. Doing so tends to help the family deal with the possibility of losing talented personnel who are largely responsible for the company's success.

Not surprisingly, most well-designed succession plans aim to also foster family harmony. Transparency can be instrumental in avoiding serious family confrontations down the line. And by involving inheritors in the future of the family business as opposed to responding to decrees from the senior generation, there usually are fewer bad feelings (and the often accompanying lawsuits). When family members understand and accept how the family business will transition, it's more likely serious problems can be avoided.

Important: *It is impossible to guarantee all major disagreements between family members will be avoided. Different personalities can easily lead to disagreements that cascade into major altercations. Therefore, it's useful to have a methodology in place to resolve disputes as the succession plan is formalized. Family business mediation can be quite effective, for example. This approach can help ensure that all the relevant family members have a say and can be heard. Given time, it is a way to get consensus and sidestep potentially awful confrontations.*

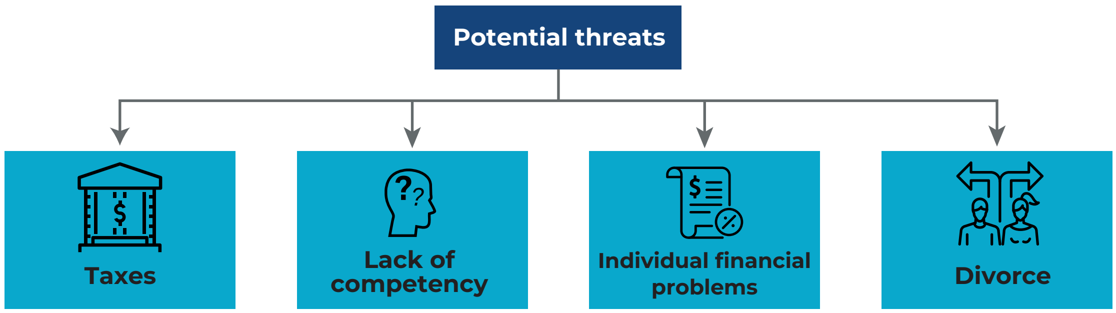
MITIGATING THREATS

A well-designed succession plan will also ensure that potential threats to the family business are mitigated. Such threats can include the following (see Exhibit 1):

- **Taxes.** When estate and transfer taxes are not properly addressed by the succession plan, the money owed will likely come out of the family business. That can potentially make it difficult to maintain, let alone grow, the company.

- **Lack of competency.** The succession plan also needs to address the capabilities of the inheriting family members. If they are not up to the task of managing the company well, steps need to be taken to ensure that they are. Otherwise, a different course of action would probably make more sense.
- **Individual financial problems.** If a family member inheriting the business has serious financial problems—bankruptcy, for example—he or she could take actions that would severely harm the company and consequently adversely affect the welfare of other family members.
- **Divorce.** If the succession plan fails to take into account the possibility of divorce among inheritors, there is always a chance that the company can suffer.

EXHIBIT 1
POTENTIAL THREATS TO A FAMILY BUSINESS



CODIFYING THE SUCCESSION PLAN

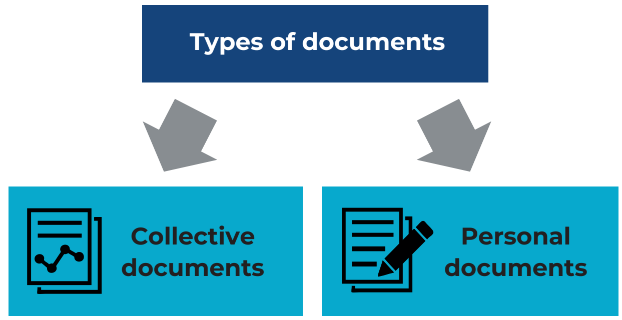
A key step is to codify the succession plan, which usually involves putting everything down on paper. Having everything set out and made part of the legal documents makes it much harder for unhappy family members to contest the transition and related decisions.

Additionally, codifying a well-designed succession plan is valuable because it gives all family members and other involved parties a formal record of what was agreed to. (It's also a wise move is to regularly review and update the documents.)

There are two types of documents in this process—collective documents and personal documents (see Exhibit 2).

- **Collective documents** explain the relationships within the family business. Examples include board agreements, operating agreements and shareholder agreements. It's best when these documents are concise and easy to understand so they make sense to all involved family members. If they are complicated, providing a "plain English" summary of them is usually very effective.
- **Personal documents** explain the ways an individual family member has prepared his or her estate. Examples include wills and trusts. It's in the personal documents that the transfer of ownership in the family enterprise might reside.

EXHIBIT 2
TYPES OF DOCUMENTS



Conclusion

Without a well-designed family business succession plan, there is a strong possibility that a family enterprise might not survive the transfer between the senior generation and the inheritors. If you own and run a family business, it's worth it to take the time and effort to not just create a plan but also make it one that really addresses the myriad key issues that need to be confronted.

Do it right, following the advice outlined above, and you will likely dramatically boost the probability that the transition of the family business will be very successful. You'll also likely dramatically reduce the types of family conflicts that can hobble or destroy a successful family business.

Mark Wade
President and Director of Wealth Management

ADOPT BEST PRACTICES

By and large, the self-made Super Rich have proven that they know what to do—and what not to do—in oder to create, grow and maintain sizable wealth. By avoiding major slip ups on your own path to wealth creation, you can potentially encounter fewer financial potholes along the way.

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