SAMPLE BUSINESS PLANNING ARTICLE

"Keeping it all in the Family"

Vito Corleone had built a vast empire in his 50+ years in the wine business. It was important to him that the business remained in the family, and he expected his three sons to take over when he was gone. They were already involved in the business, and quite passionate about it, and each had a defined role. Vito's wife Mary was a stay-at-home Mom who was never really involved in the business, and knew very little about day-to-day operations. Vito consulted with his top executive and in-house counsel, Tom Hagen, on ways to ensure the business will pass to the three boys. Tom suggested several ideas for Vito's consideration.

Many business owners assume that their children will want to carry on the family business, but this is not always the case. So begin with a heart-to-heart discussion. It's important to understand what the children want and expect. If any of the children are interested in carrying on the business, you'll need to realistically and objectively assess each child's qualifications and abilities to do so.

To have someone in charge of a business who doesn't have the personality, skills, or knowledge to successfully run the business is unworkable – even if that person is your child! However, the best person to run the business is often not the same person that a family's dynamics would indicate. It's not necessarily the oldest child, the "born salesman," or the daughter with the MBA. Every business is unique, and there are no easy answers in succession planning.

If your children already work in the business, you can evaluate their performance and their strengths in such areas as marketing, administration, finance, and operations. If a child is interested in the business but not working in the business, you should get them involved as soon as possible. You should provide that child with the necessary experience in the day-to-day operations of the business. Let that child work his or her way up the ladder in non-management positions, gaining important experience. This will help non-family employees accept that child more readily.

One of the biggest obstacles in transferring to family is how to ensure that the business will continue to be profitable and growing. Selling or transferring to family has the same problems as transferring internally to employees. The big hurdle is management training. If you have been running the company successfully then you will now need to train family members to do "what you do." This takes time, often three to five years.

It is helpful to have your business plan outline the steps of the transfer, and establish goals that can be monitored and measured at regular intervals. If enough time is allowed, the training can be carried out in a slow, purposeful, and organized fashion. A multi-step transfer allows you to control the process, and relinquish management duties over time in small pieces.

In addition, as a parent you may be hesitant to face the emotions or even accusations about having a favorite child, or arguments about who is smarter, or better with people, or better with money. It's easy (and not uncommon) for emotional issues to cloud and confuse the discussion about what is best for the business. Using an outside advisor who specializes in both family and business dynamics allows a more objective input into the decision. Once that decision is made, ensuring that the family members are groomed to be successful becomes equally as difficult to do.

There are several issues to be dealt with in a transfer to family members upon death. First is the obvious problem of the lack of liquidity of a non-spouse survivor, inheriting an illiquid asset with a substantial taxable value. If there are estate taxes to pay, how will the beneficiaries pay them? If a minority owner can't get along with the other owners, how will the minority owner receive fair value if they try to sell their ownership? The minority owner might be forced to accept less than fair value for their ownership just to get out of the business.

Transfer of a business to unprepared survivors usually causes immediate and obvious problems. Grieving the loss of a loved one while also assuming new responsibilities, can cause panic, exhaustion, family squabbles, and ultimately, failure. Vendors, competitors, and other adverse parties might be able to take advantage of the situation. This is exacerbated if the heirs are not familiar with the business.

Transfer of a business to heirs who have no interest in operating the business will also cause problems. Perhaps some of the heirs don't want to participate in management, but don't want to sell their share to the other owners, either. Uninvolved owners can cause friction between other owners, employees, even customers, if they disagree with how the business is being run.

Valuing and selling the interest of those who want to be "bought out" will likely be contentious. The deceased owner won't be available to provide wisdom and advice. The business may lose value due to the absence of the founder and a subsequent reduction in activity or sales. Buyers will likely know the situation and offer a reduced price. Liquidity issues may grow as time goes by. Inadequate offers may start to look appealing. If the business is unique there may be few potential buyers available to begin with.

There may be legal and tax issues to resolve. There are often valuation disputes with the IRS. They often result in litigation or settlement at higher-than-expected values. Understatement of values can result in estate tax penalties.

Obviously, there is no shortage of problems that might occur. That's why it is so important to plan well in advance of a transfer. And in many cases, it is advisable to actually carry out the transfers of closely-held business interests prior to death.