SMALL BUSINESS

What Role Should Your Children Play in Your Business Succession Plan?

A well-structured business succession plan covers a lot of ground: taxes, trust strategies, market valuations and much more. But some of the trickiest issues involve something much closer to home: your kids. What makes sense and what's fair?

by: **Timothy Barrett, Trust Counsel** - June 28, 2021

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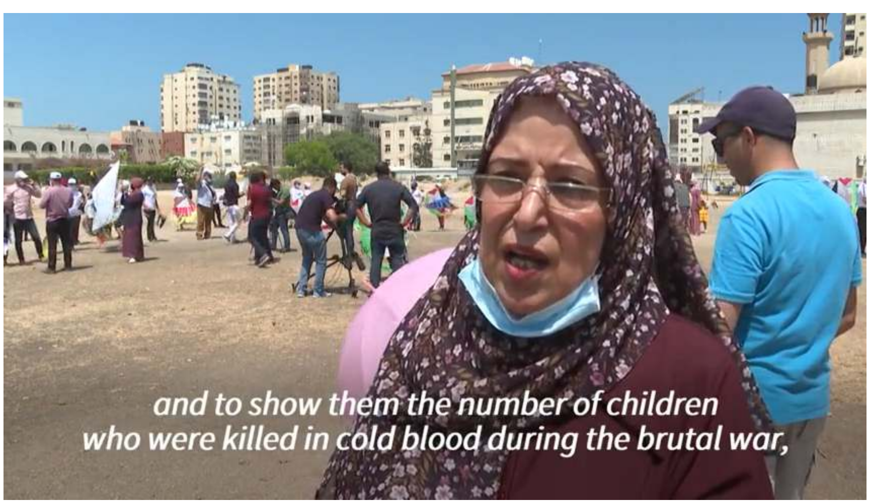
As a financial adviser, I meet with many successful business founders. Most of them have a vague idea of what should happen if they were no longer able to lead their operations. They have life and disability insurance and sometimes long-term care insurance, but they lack confidence in the infrastructure for maintaining the business if they were not at the helm. However, they have some appreciation for the expense and hard work that will be required to plan for their eventual retirement or death, because I am not the first financial adviser seeking their business.

Generally, these informed business founders' goals depend on whether they have children interested in taking over the company. Those without potential heirs to the business may be looking for the best exit strategy at the proper time, while parents with adult children may be seeking the means to efficiently transfer equity and control in the right proportions to the right children.

Starting the conversation

Most business founders require several discussions over a few years before they decide to expend the energy to actually develop and implement a foundation for the sale, transfer or succession of their business. Others are too busy running their company to give more than a polite listen to such planning. Still others are actually entrepreneurial private business investors whose business is not *operating* a business but *investing* in businesses. I am happy to hold such discussions even while I can plainly see that they are not ready yet to act on any proposals.

The most productive meetings are with successful business operators who have heard it all before and are now ready to implement business succession options. They already understand the time it takes to develop a viable plan; they appreciate how complicated trust strategies and related transactions can be, and they accept the requirement for independent and defensible market valuation. In addition, they have a strong relationship with estate planning and business transactional attorneys. Finally, they have learned the questions to ask to discover if my trust company and I have the capability and expertise to do the work.



Most such founders begin with questions about the trustee's role and costs to implement already selected strategies to withdraw the most market value from the business, to reduce estate tax exposure and/or to maintain management control while transferring value to their children. They already know that these strategies require the use of irrevocable trusts and other tax entities. They already know whether they are willing to sell the company, if that is the best option.

Thinking beyond customary advice

An adviser's first inclination may be to follow their lead and launch into a discourse about the structure and administration of complex trusts, or an argument in favor of an experienced corporate trustee situated in an advantageous jurisdiction. From there, an adviser may address how these arrangements go hand-in-hand with some undesirable limitations on access to funds, control elements and fiduciary duties, and the related fees and tax costs.

What an adviser can miss in this approach is just how this kind of planning marks the beginning of the end of something vital and integral to the founder's sense of self, disrupts her useful purpose or inflames her resistance to sharing control and discretion with strangers, much less with her own children. The better approach is to focus on the founder's current and anticipated lifestyle, her thoughts on the purpose of wealth, and a frank recognition of her real values, goals and priorities, not the ones we first think are important.

Dream of Working Abroad? Beware of Some Serious Financial Pitfalls

Rather than impressing the business founder with your experience and knowledge, a more helpful approach could be to determine just what he wants to accomplish. What interests does he have outside of the company? What will be his focus if we were to free up time away from the business? What does he value most: wealth preservation, lifestyle, entrepreneurialism, charitable giving or service, investment in children and grandchildren, etc.? How do the children, both active and passive, factor in the sale or transfer of the company? If the primary desire is that one or more of the children take over the company as their life's work (not an unusual expectation among founders) what factors have priority in dividing income and wealth: fairness, equality, sweat equity, something else?

Prioritizing personal fulfillment

Business founders do not typically think in terms of family governance. But the most useful planning encourages positive values and fulfilling pursuits in the next generation, whether they are recreational, entrepreneurial, charitable, political or some other focus. The founder may not think in terms of life balance, having spent so much time and energy on that one enterprise. And she is often troubled to discover that even the adult children actually working in the business will only accept a balanced approach to family and work.

The second generation of family business owners tends to see the business as a reliable constant and not fully appreciate the relative risks the founder took in the early years to nurture it through many thin business cycles. This is especially true if they were always well sheltered, fed and educated, with money for plenty of activities and interests. They have many choices and continuing to work in the family business is just one option open to them.

Confronting issues of fairness

So, how does the founder encourage the necessary industry and financial acumen for the next generation to be successful? Can the founder efficiently transfer control of the business to the proper people and still appropriately distribute the beneficial enjoyment of his estate among all his children? It is too easy to assume that the most adept child should accept this great opportunity and run the business, while the other children take a backseat. Is it fair to place the children’s financial future in the control of one or two active owners, while the passive owners have little input in business decisions? Is it fair to place the burden of that success or failure just on active owners? Any business succession plan will be fundamentally flawed if it does not address the most important underlying motivations, desires and tensions among these family members.

It is a fact that 1 out of 3 businesses start and end with the founder. Plans to equalize inheritances when a business is involved often end up wrecking fragile sibling relationships. Children with passive ownership can resent their lack of control over business decisions and how profits are used, while the active owners may resent uninformed sibling interference or an estate division that undervalues their sweat equity.

The best planning results follow when the founder includes her adult children in the process of setting clear and fair rules. I encourage even young entrepreneurs to develop and update standards and operating procedures that address adding new investors, funding buyouts, identifying permitted transferees, board membership, business strategy, employment, advancement in the company, compensation, distributing profits and encouraging estate planning.

The corporate trustee must be more than just an administrator. In all likelihood, the business that was the source of income and then wealth for the founder will break up or be sold off even if the trustee continues to custody closely held business interests for his grandchildren. The founder must have the foresight not only to structure the business operations, ownership and the trusts for flexible stewardship that will benefit future generations regardless of the paths they take, but to foster the values, priorities and practices that support a fulfilling life.

How to Get Sued for Age Discrimination

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