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MARKET MATTERS: The family succession plan — Passing on the family business

By Joseph Matthews
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Just as a succession plan is necessary for our personal wealth, a succession plan for our business is equally critical. When we write our will, we carefully consider how we want our hard-earned wealth to be distributed upon our passing: to whom, when, and how much. Similarly, if we own a business, we should plan for what will happen to it when we are gone, making thoughtful decisions as to its ownership and management. Will it be transferred to the next generation? Or will it be sold?

From the passing down of a mom-and-pop grocery store to the changing helm of an aerospace manufacturer, a generational transfer may be tricky business. When there are multiple heirs involved, sometimes a few may want nothing to do with it. Other heirs may have “grown up in the business” and want to keep it in the family.

If the business owner decides to transfer the business to the next generation, he or she may want to embark on a succession, family governance or legacy plan to help guide the transition. A family governance or legacy plan outlines the structure for future business scenarios. It can help answer the following questions: Who among the family will take over the business? Which aspects of the business will they manage? What will the configuration look like? When will changes take place?

A formalized working agreement can help make the transfer seamless, addressing not only current concerns but issues the family may not have considered. What is the ownership structure, including buy-sell agreements? How are dividends paid, and how are family members compensated? What are the employment standards, career development policies, retirement ages, and approaches to charitable giving?

Ultimately, the goal of a business succession plan is to generate a multigenerational team in which the succeeding generations participate in decision-making and leadership long before their parents pass on.

If there are no children interested or available to carry the business forward, many owners may decide to sell the business outright. They may decide to sell to a partner or manager, to an investment group, or to an outside third party.

Moreover, many business owners bank on the proceeds from the sale of their business.

According to a 2015 survey, 78 percent of small-business owners plan to fund their retirement by selling their business. The survey added that many business owners bank on funding 60 percent to 100 percent of their retirement needs from the sale of the business.

If a sale is looming, planning long before the target date of the sale is recommended. Starting the process at least three to five years early usually allows for enough time to prepare the business for sale and allow for a series of negotiations with a third-party buyers.

It's important to consider personal objectives and financial goals early, to ensure that the sale of the business fits into an overall financial plan. That also means arriving at an accurate valuation of the business early on.

Selling the business requires two basic decisions. The first one outlines the current owner's role. Will he or she remain involved in the business after the sale? If so, how and to what extent? The second decision is what will happen to employees, customers, suppliers, stakeholders, etcetera. How and when will the sale be communicated to those involved in the business? What will happen to them in the process?

Regardless of the path chosen for future of the business, it is advisable to engage legal counsel, an accountant, an investment banker or business broker, and a financial adviser. If transferring business ownership and interests to family members, an investment banker or business broker might not be needed, but an outside business appraiser might be worthwhile.

A carefully thought-out and professional plan for the future of a family business can make the difference between a process that is fraught with disagreement and secession, and one that is harmonious and profitable to boot.

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