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The Family Business - Passing The Torch

Within five years, 56% of Founders of small and medium sized enterprises will transfer their businesses. Nearly 70% of these Founders have not made plans for the successful transfer of these enterprises, whether to family members or to third parties. Only 10% of family-owned businesses will survive beyond the second generation as a result of this lack of planning. This is perhaps due to the Founders' inability to give up control to anyone including capable family members, as well as in many cases, the reluctance of parents to choose a successor among their children.

Inevitably, most Founders will have to deal with the different, or even conflicting, interests of their children. For instance, some children may aspire to control the family business, while others may not want to be involved at all but still feel that they are entitled to some compensation for their share of the family inheritance. Inversely, a situation may arise where the Founder would prefer that one child control the family business as opposed to another, given that a particular child may have better management skills. Unless the process is properly managed, inter-family conflicts are almost inevitable.

In light of these potential conflicts, efficient planning is essential in order to ensure the successful transition of a family-owned business. Once a Founder makes a decision as to transition, then proper tax and estate planning are essential elements to the successful transition of the ownership of a Founder's business. This planning will result in the preparation and drafting of not only wills, but also agreements between family members, dealing with issues such as who will take control of the management of the business and who will remain passive shareholders, etc.

Generally, these shareholders' agreements provide for the rules governing the management of the family-owned business, as well as the manner in which to deal with the conflicts which may occur among the various shareholders. For instance, it will allow shareholders to avoid any possible conflict which may arise in the event of the departure of a shareholder, the termination of a shareholder's employment or the incapacity or death of a shareholder. A shareholders' agreement may also prevent a shareholder from selling his/her shares to a third party without first offering the shares to the other shareholders, or at least obtaining their consent. In doing so, the remaining shareholders may choose to keep the business "in the family".

Prudent planning can also reduce future tax liability of the estate. When a person passes away, he is deemed to have sold all of his assets at fair market value. When those assets include shares of a successful private company, the estate may be burdened with a large tax bill with little funds to pay. The heirs may be forced into a fire sale of certain assets to pay the taxes, which could threaten the viability of the business. Through the use of wills and other instruments, these types of serious problems can be avoided.

It is possible for a Founder to minimize, defer and even in some cases avoid most tax liability, thus leaving the business in a healthy financial state at the time of transition to the children.

It is important to realize that the successful transition of a family-owned business is a process which requires the coordination of family, financial, legal and estate planning. Statistics reveal that family-owned businesses which have experienced successful transitions have called upon the services of attorneys, tax planners and accountants.

In light of the fact that a number of "baby-boomers" are Founders of family-owned businesses and are approaching retirement, they will need to consider what will happen when they retire or face a significant illness or even death. As a result, the transition of family-owned businesses is an issue which, while sometimes difficult to face, should be attended to while the Founder is still active in order to avoid the multitude of problems that usually result from the lack of planning.

As hard as it seems, implementing a successful transition plan is the ultimate reward for any Founder of a family-owned business, resulting in the business he or she founded continuing on with even greater success than the Founder could ever have imagined possible.

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