

Letting Go While Keeping Control

Active business owners often put off thinking about how to pass their business on to a child, or other family or non-family successor, because they don't want to think about retirement--just like they don't want to consider the possibility of premature death.

Yet this failure to carefully plan for their succession, both as regards management control of the business as well as business ownership assets, is cited as the main reason why only 30% of family-owned businesses continue into the second generation and only 10% make it as far as the grandchildren.

One major dilemma owner's face is determining how to pass along operational control to the successor they've been grooming while still maintaining the ultimate ownership control of the business. For estate planning and other reasons, family business owners know that there are important tax reasons for gifting ownership interests to those offspring who ultimately, will own the business when they are gone. Yet they also want to be sure that they and their spouses will have financial security when they retire. In some cases, the owner may not be sure whether offspring have the interest, or competence, to run the business--and may want to maintain control until that issue has been settled.

Strategies For Building a Secure Future

- By creating two classes of stock--a class of preferred stock with voting rights and a fixed dividend and a class of common stock without voting rights--the owners can retain the voting stock even as they pass along the non-voting common stock shares to offspring chosen to succeed them in the business.

In effect, they pass along equity ownership but without surrendering control or the right to a guaranteed annual income stream as long as the business is health.

- Non-successor offspring can be provided for equitably by gifts of non-business assets, or through the use of insurance trusts that will allow those remaining in the business to eventually buy out siblings and other relatives.

- However, parents who want all their offspring to benefit from the growth of the business may decide to gift non-successor children stock equally with those who they are grooming to succeed them. Buy-sell agreements that allow the successor heirs to buy out their siblings' or cousins' interest after the parents are gone is a workable strategy for achieving this.

- Detaching real estate assets from other business assets, with the parents retaining ownership of the real estate and negotiating a long-term lease with the business is another way to ensure a stable income stream.

- By retaining control of the Board of Directors, while leaving day-to-day management of the business to offspring, the owner is able to intervene in the

most important strategic decisions and will also be in a position to approve all major investment decisions.

- Also, the owner can continue to serve in a consulting capacity to the business, perhaps with a long-term contract providing fee income--after retiring from board involvement as Chairman. This will allow the owner to continue to keep an eye on the business, while also keeping active in ways satisfying to himself and helpful to children.

- Asset diversification should also be part of the strategy. If the owner has built up sizeable non-business assets through retirement plans, real estate investments and the like, there's apt to be less financial concern over passing control of the business on to offspring.

(Of course, there may also be other concerns, including the ownership interests of other children or an emotional commitment to making sure the business continues as part of the family legacy.)

Active owners in good health often want to stay involved in business. Yet if they don't provide offspring with the opportunity to take charge of the family business, and make the inevitable mistakes, they limit the successor's ability to grow in the business.

- With a sound estate and business succession plan, owners can protect the business' assets while still allow offspring in management enough control to learn how to run the business.

- For example, if they chose not to remain involved because of other post-retirement interests, or if they worry that their involvement would be resented, they might consider bringing in an interim CEO, while also adding outside specialists to the board, to mentor the family successor during the transition period.

Letting go of the business in a manner that will secure the financial and other interests of the owner--while also satisfying the needs of other family members and offspring wanting to take over the business--will require very thorough and skillful review of a number of estate planning options. Considerations include the pros and cons of different kinds of trust arrangements, insurance plans along with the estate and business tax consequences of the various planning options.