FACTS AND FACTORS IN BUSINESS SUCCESSION PLANNING

1. Only 30% of family businesses successfully pass to the 2nd generation, 12% pass to the 3rd generation, and 3% pass to the 4th generation.[1]

2. 85% of the crises faced by family businesses focus around the issue of succession.[2]

3. More than 90% of all U.S. businesses are family businesses.[3]

4. Over 150 of Fortune 500 companies are family businesses.[4]

5. According to a 2007 survey, 40.3% of business owners expected to retire in 10 years. Of the business owners expecting to retire in 5 years, less than half (45%) had selected a successor. Those expecting to retire in 6-11 years, only 29% had selected a successor. 30.5% of business owners had no plans to ever retire (essentially planning to die in office).[5]

6. 79% of senior generation/owners want their families to retain the family business and 70% of the next generation has the same hope.[6]

7. Analysis of family business succession failures indicate that of typical breakdowns: 1) 60% arise from relationship issues (how they get along); 2) 25% from lack of competence/being unprepared issues; and 3) 10% tax and traditional estate planning issues.[7]

8. Family business owners usually feel emotionally connected to their businesses and employees.[8]

9. Family businesses usually have a centralized management structure which makes business more flexible and responsive to changes in marketplaces.[9]

10. Family business succession planning is difficult because:[10]

    a) Smaller pool of potential successors with issues including;

        i. Nepotism – 2007 survey by PricewaterhouseCoopers found that almost 2/3 of family businesses award family members roles in business without measuring them.[11]

        ii. Sibling rivalries.

b) Failure to separate home and work – emotional conflicts at work and home;

c) Larger age differentials – large generational gaps in typical family businesses; and

d) Different outlook and perspective – founders usually have a more entrepreneurial outlook and are comfortable taking risks whereas 2nd generation more risk adverse/focused on preserving gains of 1st generation.

11. Multi-generational family businesses are often an "accidental partnership" of people with different values and goals who find themselves in common venture because family.[12]

12. Six Transitions of Family Business Succession To Consider:

a) founder's transition;

b) family's transition;

c) business's transition;

d) management's transition;

e) ownership's transition; and

f) estate's transition.[13]

13. Sibling rivalry is a frequent problem – children compete for approval of parents; difficult to have one sibling reporting to another; parents try to separate siblings geographically or by function in order minimize sibling rivalry.[14]

14. Parent/owner may delay/avoid planning all together because doesn't want to favor one child over the other – which only causes more problems down the road.[15]

15. Conflict between siblings inside the business and those outside the business. Those inside the business want to keep cash in business and only provide compensation for those who earn it. Whereas those siblings outside the business want cash flow and feel those inside are being overly rewarded.[16]

16. Inherent conflicts between family and business:

    a) families value tradition/resist change – businesses succeed and grow during changing times;

    b) families are emotional - businesses are logical;

    c) families seek equal rewards - businesses reward based on performance/responsibility; and

    d) families accept members unconditionally – businesses rank employees and fire those who are not productive.[17]

17. Typical management problems in family businesses include:

    a) inadequate, informal organization (okay when smaller, doesn't work when business grows);

    b) attempting to ignore conflicts (leads to stressful situation when owner dies);

    c) disgruntled family members (some leave the business but continue to second guess those remaining in business); and

    d) compensation (some pay children same amount regardless of value of contribution).[18]

18. Succession planning for family business must recognize that it involves a BUSINESS. Family aspects should be considered, but at the end of the day, planning for a BUSINESS.[19]

19. Generally, the owner is the founder of the business so succession planning must also involve a method to achieve the owner's retirement goals and his financial security.[20]

20. Use of business consultants and mediation to solve family business succession issues relatively new – traditionally most professionals, lawyers, and CPAs treated family business same as any other business transaction or estate plan.[21]

21. Owners need to prepare 2nd generation for transition and to manage the business (instead of transferring control to 2nd generation without a transition/learning period because 2nd generation has not had benefit of owner's 20-30 years of experience being in charge).[22]

22. In light of recent recession, many family business owners postponed retirement because of financial concerns.[23]

23. Succession planning should be done and put in place while owner living and well (no crisis) for higher chance of success – and not when crisis occurs (ill or death).[24]

24. Even if the federal estate taxes and federal income taxes were repealed, business succession planning would still be necessary.[25]

25. Family businesses generate about half of the U.S. gross national product and are prominent in retailing, distributing, and services.[26]

26. For most family business owners, the business represents the most valuable and often the most illiquid asset in the owner's estate.[27]

27. During the owner's lifetime, the family business is the main source of economic and emotional support.[28]

28. Without proper planning, the family business may have to be sold to meet the liquidity needs of family, including paying owner's estate taxes.[29]

29. Owner feels he/she has a right not to be forced to retire.

30. Families fear the impact of the estate tax on the business.

31. Family business conflicts are more about emotions and control issues, and not disagreements based on facts.[30]

32. Owner must address who will <u>own</u> versus who will <u>control</u> the family business – not necessarily same person(s).

33. Owner must decide what is more important – the business or the family**.**

34. There should be separation between ownership and control for legal purposes.

35. The less the children are tied together the less there is reason and ability for disputes.

36. The owner's goals for the business must be consistent with the owner's estate plan and documents.[31]

37. Owner's Goals:[32]

a) Retain control;

b) Retain income to continue lifestyle of owner and spouse;

c) Satisfy estate planning objectives (perhaps treat children equally);

d) Provide for continuity of business;

e) Concern for the employees of the entity (provide for "key" employees);

f) Concern for the community in which business located;

g) Charitable desires;

h) Dynasty desires;

i) Reduce transfer taxes;

j) Provide for liquidity for estate taxes; and

k) Reduce income taxes.

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[1] Charles D. Fox IV, *Keeping it in the Family: Business Succession Planning*, SS039 A.L.I.-A.B.A.2009, 2013 (2011).

[2] *Id*. at 2011.

[3] *Id*. at 2012.

[4] *Id*.

[5] *Id*. at 2011-12.

[6] Michael D. Allen, *Motivating the Business Owner to Act*, SFA2 A.L.I.-A.B.A. 1, at 7 (2001).

[7] *Id*. at 8.

[8] Fox, *supra* note 1, at 2015.

[9] *Id.* at 2013.

[10] *Id.* at 2013-14.

[11] *Id*. at 2014.

[12] *Id*. (citing Margot Gibb-Clark, *Family Firms Learn to Share Power*, Toronto Globe & Mail, June 25, 1999).

[13] Fox, *supra* note 1, at 2016-17.

[14] *Id.* at 2019-20.

[15] *Id.* at 2020.

[16] Edward F. Koren, *Non-Tax Aspects of Family Business Succession Planning*, MAR-06 EST. & PERS. FIN. PLAN. UPDATE ART (Mar. 2006).

[17] Gerald LeVan, *Keeping the Family in the Business: Estate Planning May Not Be Enough,* PROB. & PROP., vol. 2 at 28-31 (1988).

[18] Fox, *supra* note 1, at 2020.

[19] Koren, *supra* note 16.

[20] *Id.*

[21] Kay B. Abramowitz, *Enhancing Trust and Communication in Family and Business Succession Planning*, *in* FAM. BUS. AND SUCCESSION PLANNING, 2011 WL 4454155, at 1 (2011).

[22] *Id*.

[23] *Id.* at 2.

[24] *Id.* at 7.

[25] Louis A. Mezzullo, *Business Succession Planning*, ST022 A.L.I.-A.B.A. 1131, 1133 (2011).

[26] *Id.* at 1134.

[27] *Id.* at 1135.

[28] *Id.*

[29] *Id.*

[30] Mezzullo, *supra* note 25, at 1134.

[31] *Id.* at 1135.

[32] *Id.* at 1136-37.