The Exit Strategies Newsletter

Family Business Exits and Transfers Pitfalls to Avoid – Part I

Amongst the millions of privately-held businesses in the United States, a large percentage are 'family' businesses. This means that there is more than one generation of a family working in the business. As you, the exiting owner, begin to consider how you and the company will live without the business as it transitions to your children, there are a few key areas where you should focus your attention. This newsletters lists five (5) of the pitfalls that you should avoid when planning your family business succession.

It is helpful to begin with a few statistics illustrating how often family businesses are trapped within these pitfalls. Namely, less than one-third of family-owned businesses survive the transition from the first generation of ownership to the second - and only 13 percent of family businesses remain in the family over 60 years.

Why such challenging longevity statistics? It could be in part to the added challenges that come with running a family owned business or, quite possibly, the many hurdles that can come with succession of that business. Given the importance of the business to the families involved – including your family members, the employees, the management team and your community, it is worthwhile to review this list of pitfalls and incorporate these ideas and plans for greater success in your overall exit planning. The five (5) pitfalls are as follows:

I. Transferring when the parents are not financially ready

Being a parent, you want the best for your children. Some business-owner parents who have children that are ready, willing and able to take over their business sometimes put their children's needs above their own and rush into succession. For parents who are not financially stable to transfer a business, this premature move could be devastating to their retirement planning and financial security (not to mention what could happen to the business). There are also some business owners who may feel financially ready but have retirement plans that require significant funding, which may draw from the business, impeding possible growth. Waiting until you, the owner, are

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financially prepared for a transition is of utmost importance to your retirement and the success of the business.

II. Transferring before the parents are mentally ready

Waiting to transition until you are financially ready is one thing – but understanding when you are mentally ready is another story. Before a business owner transfers ownership, they need to assess how mentally prepared they are for an exit.

Remember that exiting a business that has been built by years of hard work and dedication can be a difficult emotional hurdle.

How involved are you in the day to day operations of the business? What will you do with your time when you are no longer running the business? These answers will become the key to understanding whether or not you are ready to move forward into the next stage of your life.

III. Transferring to children who do not know how to run a business

It goes without saying that many family members have been involved, in one way or another, in the family business their whole lives. But being involved and being in charge are two very different things. Many small business owners forget to realize that the new owners, most often their children, must possess or obtain very critical skills and experience to successfully run the business they are taking over. If key skills and responsibilities are missing from the background of a successor, then a part of your succession planning needs to be developed with the goal of training and developing that successor into a better and more qualified manager and leader. Alternatively, you may also be looking to hire, groom, and/or train support personnel to compliment the future successor's weaknesses.

IV. Not taking advantage of gifting opportunities

There are a number of lifetime gifting strategies that can be implemented by the business owner to minimize, or possibly eliminate, estate taxes. For parents who plan to transfer the business by lifetime gifts or at their death, gift and estate taxes will apply based on the value of the assets transferred. To transfer the most assets at the least tax cost, it is important to use all of the discounts that are available. Experienced appraisers, attorneys and accountants can help maximize these discounts for tax purposes. There are a number of strategies for handling this type of wealth transition and a majority of them can and should be included in your written exit and succession plan.

V. Failing to Document the Terms of the Agreement in Writing

Many business owners assume that when dealing with family members there is no real need for a formal agreement, while others find it a difficult subject to broach, so many times there is no written agreement for the business transfer. The

reality is that there is less of a chance of running into future problems if family business owners clearly define the nature of their relationship in writing. In the unfortunate event of litigation, more often than not, the family members will find themselves arguing over the terms of their oral agreements. With as many recollections of "the agreement" as there are family members involved. The opportunity is ripe for more confusion, frustration, anger and further division within the family.

Concluding Thoughts

These five (5) pitfalls should be addressed and avoided when building a plan for your exit and your family business transition. Careful planning can lead to more successful outcomes when you navigate these pitfalls and continually build, update and refine the plans for your family business succession.

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