PRIME

February 2021

The family business: Ensuring a smooth transition when it's time

Gina M. Barry, Esq.

Unfortunately, most business owners fail to plan for the continued operation of their business should they become incapacitated or die. Currently, only 30 percent of family-run companies succeed into the second generation, and only 15 percent survive into the third generation.

More often than not, the family business is doomed by a failure to plan.

No plan = failure

Contemplating one's mortality is not a pleasant activity. Most believe they have plenty of time to plan. Some business owners identify so closely with their business that they simply cannot comprehend the idea of their business being operated by anyone other than themselves. When a business owner becomes incapacitated or passes away without a plan in place, the business always falters and often fails.

Timing is important

The most successful business succession plan includes a number of steps that are carried out over time. The generally recommended time to plan for business succession is between the ages of 55 and 65. Some succession consultants recommend a 3 to 5-year plan, while others advocate a 5 to 10-year plan. Adequate planning time allows a business owner to test potential successors in different roles and to evaluate their maturity, commitment, business acumen, and leadership abilities. Further, once a successor is chosen, adequate planning time allows the successor to gain expertise so that the business does not falter when the former business owner leaves the business.

Choosing a successor

More often than not, the head of a family-owned operation chooses a child as successor. Commonly, more than one child is competent to step into the parent's shoes, which makes the selection process even more difficult. When a family member is not available, a key employee often fits the bill. Typically, these employees have already displayed the abilities necessary for operating the business.

Preparing for the break

The business owner should begin by determining when they want to step away from the business and for how long they want to remain active in the company and in what capacity. Next, the business owner should discuss their ideas about the future with their family, senior management team, and key employees. Thereafter, the business owner should begin revising their business plan in conjunction with the successor, thereby allowing them to include any future new products, plans for expansion, growth or new investment, and a candid assessment of the company's current environment and competitive positioning.

Financial considerations

The business owner should also develop a financial strategy for turning over the business. Perhaps the most significant activity associated with succession planning, a financial strategy protects the company, the family, and the employees against a monetary burden that could doom the entire process to failure. For example, if a business owner intends to leave the business to their children, they must consider any estate taxes their estate may face upon their passing that may require the liquidation of the business, despite best intentions.

Regardless of who "inherits" the business, it is critical to obtain an accurate valuation of the business. Such a valuation encompasses tangible assets, such as real estate, buildings, machinery, and equipment, as well as intangible assets, such as employee loyalty, manufacturing processes, customer base and business reputation, patents on products, and new technologies. As there are many different factors that affect the value of a business, employing a professional valuation company is recommended.

The family business: Ensuring a smooth transition when it's time

Gina M. Barry, Esq.

Making the transfer

Once the business has been valued, it is necessary to determine the method of transferring the business. Some of the options for transferring a business include: (1) gifting; (2) the use of a trust; (3) buy-sell agreements; and (4) life insurance funded plans. One factor that will strongly influence this decision is the successor. Surely, there would be a difference in the plan that gives the business to children or family members and the plan that requires a third party to buy out the business owner's interest. When transferring to a child or related party, the business owner may gift some of the business's value whereas when transferring to an independent third party, the business owner would most likely want to be paid the full fair market value of the business.

As various plans may be established and the specifics of the business must be considered, each different plan must be reviewed on its own merits. The process of choosing a succession plan involves numerous factors, and there are many pitfalls along the way; therefore, it is best to allow as much time as possible to plan and make the transition. By doing so, the business owner can ensure the vitality of their business for many years to come.

Gina M. Barry is a Partner with the law firm of Bacon Wilson, P.C. She is a member of the National Association of Elder Law Attorneys, the Estate Planning Council, and the Western Massachusetts Elder Care Professionals Association. She concentrates her practice in the areas of Estate and Asset Protection Planning, Probate Administration and Litigation, Guardianships, Conservatorships and Residential Real Estate. Gina may be reached at (413) 781-0560 or GBarry@BaconWilson.com.