

Getting Out of a Family Business?

“An accountant once told me that the definition of fair market value for tax purposes is the value arrived at in negotiations between a willing tax lawyer and a willing revenue agent, neither of whom has ever bought or sold anything of consequence in his life.” — Paul H. Asofsky

Have you done anything about grooming a successor?

Every business owner, voluntarily or involuntarily, leaves; and few plan for the probabilities of death, disability or retirement, much less for divorce, bankruptcy, or family turmoil. There are many reasons why family-owned businesses fail after the founder steps down, but the lack of a clear blueprint for succession tops the list. If you avoid planning because you do not want to address difficult issues, that only makes the succession problem worse as the chances of a business transitioning effectively through benign neglect or good luck are practically nil. There are basic measures that all owners should implement to set family businesses on a course for survival.

*“At any given time, 40% of U.S. Businesses are facing the transfer of ownership issue.”
“The primary cause for failure ... is lack of planning.” — SBA*

Since most business owners have limited choices, you need to look at the potential options for marketing your business. Are you planning to pass your company on to your heirs, or is it even likely they will follow in your footsteps? If your heirs do not have the talent or inclination, do you have a fall back position? Can you sell your business to other family members, partners, shareholders, key employees, or if you wait too long to start planning will an outside third party step in and take your business off of your family’s hands at a fair price? While many owners have visions of some white knight stepping in and purchasing a going concern for a bundle of cash, the reality is that most sales start close to home and the on-going business generally has to finance its own purchase.

Before you step off the deep end, answer two questions and you will have a good start on transferring the decision making power and the assets that make up your business empire.

- How much longer do you want to work in the business before retiring or moving on?
- What is the annual after-tax income you want during retirement?

When discussing a sale, as an owner, you will want to receive the best possible deal. That means maximizing the amount of money in order to accomplish your personal, financial, and estate planning goals. Since the business is generally your most valuable asset, your financial security depends on preserving value and converting that asset to cash, yet few business owners take proactive steps to enhance value or protect options. *(55% of family business owners, age 61 or older have not named a successor – 2003 American Family Business Survey)*

Waiting until you are ready to leave your business to start a succession plan lessens the likelihood of successful transition, so where do you start? Owners and advisors need to know the current value of the business so that it can be determined if your financial objective can be met at present. With a current appraisal in hand, start building the plan with the following goals:

1. Reduce unnecessary taxes by using a more tax-efficient sale strategy.
2. Protect the value from creditors by avoiding unnecessary risk, consolidate your business operations, and focus on the things you do well.

3. Promote the value of the business by reducing debt, increase cash flow, improve curb appeal of the physical plant, and retain your key employees and management team by building incentives to keep core staff on board during the eventual transition.

In the interim, create a plan and communicate it to your family and employees. This is especially important for sole proprietors because they, more than other business owners, tend to create less structure and keep more of the planning in their heads. At a minimum, you should communicate your plans about what should happen to the business in the event of disability or death. Too few spouses know the inner workings of the family business, so it makes sense for you to:

1. Designate a key employee who can be trusted to keep the business operating successfully, and create a deferred compensation agreement or a stay bonus plan to ensure your employees will hang around to maintain continuity.
2. Keep an updated list of your business advisors (attorney, accountant, banker, financial planner, etc.) that a surviving spouse can use to carry on the business activities. Annually, you need to sit down with your advisors and map out an updated plan that reflects changing priorities and your business environment.
3. Provide a list of possible buyers, after all, who knows the business better than you do? It is likely you have had conversations with competitors or other owners from the same industry; surely, you have an idea about who would be able to take your business forward.

If you are going to have any chance for a successful transition, you need to start unraveling the tangled web that is holding you in place and make the exit strategy work for you. If you do not implement an effective plan, your family will most likely have to liquidate your business and take what offers a “fire sale” will generate. Most business owners would rate a business that fails to make the transition as a disappointment, but the good news is that you have an opportunity to ensure its success. Start now.

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