Comprehensive Succession Planning
For the Family Business

The Most Important Asset of the Family Business is the Family

A family business is a wonderful asset within a family. Usually, there is compelling story of a hard working first generation entrepreneur, who through guts, brains and luck created the successful enterprise that is enjoyed by the family today. Whether the business is in the first generation or the seventh generation, family business owners have kept the business a family business because the most important asset of that business is the family. Passing the business along to the next generation is always a source of anxiety, fear and pride for family business owners. So many questions: are my children ready to take over the business? What will happen when I give up control to them? How do I help them to be ready? Should we keep this business in the family or should we sell it? How do we have a smooth transition either way?

Family Business Succession: a Global Phenomenon

These questions are being asked by family business owners around the globe today. In fact, we are in a period of massive business ownership transition. Consider the following facts, reported in the Merrill Lynch/Cap Gemini World Wealth Report 2006:

- High Net Worth Individuals, or HNWIs, those with more than US $1million in financial assets total 8.7 million globally- up 6.5% from 2004; that wealth totals US $33.3 trillion, an 8.5% gain since 2004
- Ultra-High Net Worth Individuals, or UHNWIs, those with wealth over US $30 million, total 85,400, a 10% increase since 2004
- 15% of the world's population is over the age of 56, but 61% of the world's HNW population is over the age of 56, which is 5.3 million individuals
- 83% of these individuals have children
- 92% are projected to transfer their wealth to their immediate family members
- Globally, 37% of these individuals derive their wealth from a family business.
- Regionally, the breakdown is as follows: 26% of North Americans, 50% of Europeans, 48% of Latin Americans, 35% of Asians and 24% of Middle Easterners derive their wealth from a family business

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Best Practices in Succession Planning

As these family business owners consider the fate of their businesses, they are seeking to understand the best practices available for succession planning. There are definitely things that a family can to do insure the best possible succession for the family business.

Start Early

The sooner that business owners think about succession planning, the better off they are. The best time to start is at the birth of the children. The more information you have about the character, capabilities and interests of your children, the better you are able to judge whether or not they will be able to succeed you and keep the business in the family. What does this mean on a practical level?

- Business owners need to be involved parents. Thinking that you are building the business for the family and that this excuses you from the job of parenting is a big mistake. Your children may rebel and hate both you and the business if they never see you and view the business as the “enemy” that takes you away from them. Absentee parenting leads to resentful, rebellious children who have problems with school, drugs, alcohol, etc.
- As an involved parent, really try to get to know your children as individuals. Help them to understand what the business is and involve them in the business in age-appropriate ways that make the children feel proud and have fun. For example, I know a father who brings his ten year old son to business meetings, so he can have a sense of what his Dad does. His father did this for him, and now his son is becoming an interested third generation potential business owner.
- As important as it is to be an involved parent, it is equally important not to be an overly-involved parent.   Do not pressure your children to think that they must be part of the family business if they have absolutely no interest in it. Help them find a path that works for them, and support them to develop their natural passions. You cannot force your children to want to take over your business. I know a top family business where two children are in the company, one is an accomplished artist and one is a highly specialized veterinarian. All are happy and continue to have good relationships with their family.

Cultivate Potential Successors

Let's assume that the family has identified several children who may wish to become potential successors in the business. What are the best practices for cultivating these future leaders?

- Insist that these children complete their education to a college level, and obtain an MBA. It is important that children learn to compete in the outside world where there are objective measurements of excellence. This will build their confidence that they are not inheriting the business just because they are a son or a daughter, but because they are a competent successor.
- Insist on some years of work experience outside the family business. It is extremely valuable for children to come with know-how that is new so that they can expand the range of possibilities for the business; having work experience in another environment will help them to prove to themselves and to the family that they can be reliable and competent employees.
- Once children enter the business, give them appropriate levels of responsibility. Do not give them a corner office on day one. Give them the same level of responsibility you would give another hire of their age and experience level, and let them earn the respect of other employees and senior management by demonstrating what they can add value to the company.

Prepare for Succession in an Orderly Fashion

Let's assume that the children have been working in the family business for a number of years and have been given gradually increasing levels of responsibility based on good performance and real contribution to the company. It is good to start planning for actual succession five to ten years before the event.

- Inform non-family member senior managers of the succession plan. It is important that valuable employees understand what their role will be when the new generation takes over.
- Give ever increasing levels of involvement and responsibility to the successor, and let him or her know what the timetable is.
- Ideally, have a two or three year period when the new generation takes over while the older generation remains involved on an "advisory" capacity, to smooth the transition.

Structuring the Family Business to Assist in Succession

The business owners can do a great deal to help create an orderly succession by thinking carefully about the ownership structure of the company. Of course specific structuring advice depends on the country where the business is operated and the tax and estate planning rules of the jurisdictions where the company operates and where the family lives. Given that caveat, some general suggestions apply:

- The business owners should have up to date wills and estate plans at all times, and should have comprehensive instructions on what to do should there be an unexpected death or incapacity due to illness such as stroke or dementia. I know of several large private companies where the untimely death of the founder resulted in years of chaos, since he had no will and preferred to keep all information about the business in his head.
- Business owners in tax-paying jurisdictions should work with estate planning advisors upon the birth of children to gift shares to the next generation as early as possible. This will allow the value of the business to grow without the family facing a huge gift tax if interests are given to children at a later date.
- Business owners should think very carefully about voting rights in the company, and come up with a plan that feels comfortable. I know of a situation where there are five children with shares in a very large company, and their father now has dementia and can no longer make decisions. It has been very painful for the family members to be able to legally take control and make decisions due to the structure of voting shares.
- Business owners should plan for possible shareholder dissention by creating buyback plans, where some family members can get out of the family business by selling their shares back to the company. Paradoxically, people are usually more willing to stay in situations where they know that they can exit at any time in a fair way.

Deciding to Sell the Family Business

The business owners may have planned to keep the business in the family. They may have carefully cultivated some terrific successors. However, things have changed in their industry in the last twenty to thirty years, and suddenly the business receives a very attractive offer to sell. What should the family business do?

- Unless the company is very experienced in mergers and acquisitions, immediately obtain expert opinion by hiring an excellent investment bank to help with the valuation of the company and negotiation of the deal
- Involve family decision makers throughout the process
- Ideally, work with estate planners prior to the acquisition decision to make sure that all corporate structures are in place to maximize family interests prior to the sale

Understand that there are often differences of opinion within the family whether to sell the business or not. Some children, who were groomed to run the business, may feel excited about a large exit price for the company but may feel robbed of a livelihood they have prepared for over a number of years. Others may push for a sale when the time is not right due to personal financial constraints. Hopefully the family can make a good decision, guided by outside experts on appropriate valuation, that will be in the best interest of all family members.

The Role of the Family Office in Succession Planning

As the company grows, the family may want to consider creating a family office. A family office is a private operation that handles the cash flow, tax, estate planning and investment needs of the family. The family office can be structured as part of the overall tax and estate plan, for example as a Limited Liability Company or a Family Limited Partnership. Typically, young family businesses reinvest the bulk of their cash flows into the company. As the company grows and begins to throw off excess cash, a family office can be created to handle financial matters that do not relate to the operating business. Families often create family offices if they have over $100 million in excess liquidity. When families have liquidity in excess of $15 million, they can consider using the services of a multi-family office.

For large families with many operating companies, the family office can oversee the investment of excess cash from a number of businesses, create a comprehensive consolidated investment strategy and reporting capability and can help coordinate the educational development of young successors. A family office often helps the family to create a family governance structure, or a way to make decisions as a group. This is particularly helpful when the family has grown beyond the first generation, and there are now multiple decision makers.

The Role of the Family Office After the Sale of the Operating Company

If the family decides to sell their primary operating business, this is often the time that they consider setting up a family office to manage the proceeds of the sale. The sale of the primary operating company is a time of significant change in the identity and purpose of the family. It is important to take time to reflect on what has happened and to figure out what will happen next. After the sale of the family business, the family grapples with the following types of questions:

- How do we invest going forward? Will each shareholder work separately, or do we want to pool our assets and invest as a group?
- Do we want to purchase other operating businesses, or do we want to invest strictly in liquid assets?

- How do we train our children to be productive members of society when we don't have a business to run anymore? How will we spend our time?

Often family business owners who are very successful in creating and selling an operating business immediately want to directly manage the liquid wealth created by the exit. Unfortunately, the skills they built up for years as a business operator are not directly applicable to the management of huge sums in the capital markets. Families should seriously consider either creating a family office or joining a family office to help them with this new phase of their development.

Family offices can help the family create an appropriate asset allocation for their new liquidity, select money managers and monitor the performance of these managers. Family offices work with top brokerage firms and private banks, but most importantly they represent only the interests of the family, and can help them navigate the investment world as successfully as they navigated the industry that created their wealth. They can also help them preserve this wealth for future generations, and help them develop best practices to raise well adjusted successors. Many of these young inheritors like to start new businesses, and the family can then enjoy a new cycle of growing a family business.

About Pepper International, LLC

Carol Pepper is CEO, President and Founder of Pepper International LLC, a multi-family office located in New York City. The company manages the tax, investment, estate planning and multi-generational issues of wealth families from around the globe. The company also provides consulting services to large global families who wish to create their own family office. Carol is a board member of ESAFON, the European Strategic Advisor and Family Office Network, and organization serving wealthy European Families. Carol graduated cum laude from Bryn Mawr College in 1984 and from Columbia Business School in 1989. Please visit the company website for more information at www.pepperinternational.com.