Exiting the Family Business

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EXITING THE FAMILY BUSINESS

- Passing the family business from generation to generation is a challenge.
- Goals and objectives change.
- Financial concerns, industry changes, capital requirements, staffing and succession issues are all complicated.

EXITING THE FAMILY BUSINESS

- Selling the entire business or a client's interest in the family business is one of the most important events in his life.
- It is a culmination of his life's work and a change in identity.
- It is stressful, risky and very, very emotional.

EXITING THE FAMILY BUSINESS

- Exit can be a complete sale or an intra family sale to other family members.

- A family business owner considers exit because they need to, want to or are required to.

EXITING THE FAMILY BUSINESS

- The need to sell a family business may come from a need for liquidity, asset diversification or need for increased income.
- The need to sell a family business is typically one of lifestyle.

EXITING THE FAMILY BUSINESS

- A client may want to sell the business because he has lost interest, is not well, there is no one left to carry on, or because this is a good time to maximize its economic value and he would like to be the person in charge of the liquidity event.

EXITING THE FAMILY BUSINESS

- Exiting the family business may be required to pay estate taxes or to fairly distribute an estate among business and non business owners.

- It may be required if a key stakeholder becomes disabled or dies suddenly, with no clear successor.

- It may be required if an adverse action such as litigation or divorce mandates another owner.

IMPORTANT QUESTIONS TO ASK

1. Do you want to continue to work in the business?
2. When do you want to stop working?
3. What is the annual after tax income you need if you are not working?
4. How important is it to you that your business be maintained after sale?

IMPORTANT QUESTIONS TO ASK

- Is your business one asset? Or can it be bifurcated – example, splitting off real estate from operating company?
- If so are you exiting from entire enterprise or just operations?

IMPORTANT QUESTIONS TO ASKS

- Do you know who would sell or transfer it to now?
- Outsiders? Family Sale? Employees? Combination?
- If you are not selling it all how important is it to retain control?

IMPORTANT QUESTIONS TO ASK

- Is the exit only to be when you die?
- What steps have you taken to insure that taxation is handled and that the assets pass to the right people?
- Is the tax burden aligned with the asset ownership?

IMPORTANT QUESTIONS TO ASK

- What is your business (or your interest in the business) worth?
- How was that value determined?
- Is it substantiated?
- Is there a possible premium buyer out there (a competitor who could increase market share through acquisition)?

IMPORTANT QUESTIONS TO ASK

- Is your corporate/business house in order?
- Are all governing documents in place and signed? (By-laws, operating agreements).
- Are minutes current?

4 Ways to Exit

1. Outright sale (of entire or partial interest).
2. Sale pursuant to a buy-sell agreement.
3. Gift of business interest.
4. Gift/Sale Transaction.

IMPORTANT TO PLAN NOW

- Advance planning allows client to:
  - Pay less tax.
  - Increase the business value (if desired) with techniques such as key employee non-compete retention packages, removing assets the client wishes to retain, remove excess cash.
  - Position the business for sale.

A First Step

- Put a “disaster plan” in place- if you died tomorrow who would be in charge?
- What should they do?
- Who should they go to?
- What would be the terms the exit should happen on? What would be a fair value?
- Who should they stay away from?

CASE EXAMPLE

Succession Planning:

A Father dying before his time with sons not trained enough to take over the business – the tough family discussion and solution that involved life insurance and pre-planning.

CASE EXAMPLE

- Generation 2/sibling succession of operating business. Sibling cancer diagnosis and succession planning. Financial protection for spouse.

CASE EXAMPLE

– Owner with family (second spouse and children); no family successor to run complicated business; independent advisors in charge of post mortem sale.

CASE EXAMPLE

- Uncle owns majority interest of operating company and minority interest in limited partnership that owns underlying land.
- Preplanning for succession to Generation 2 nieces and nephews.

CASE EXAMPLE

- Leader of Gen 2 decides outright sale of significant family enterprise. Gen 2 has lost interest and there is no one on the horizon interested.

CASE EXAMPLE

- Father is in total control of entire significant empire. Doles money to children as needed. At death empire will be held in trust –nothing outright.
- Focus on unlocking liquidity for Gen 2
- Focus on Gen 2 planning while father is alive as each is now 60 years old and will have significant net worth at his death.

CASE EXAMPLE

- Family dispute. Father gave stock to son and daughter. Daughter is now estranged.
- Liquidity event now needed for daughter who is hostile stockholder.
- Valuation is key.
- No corporate records in place.
- Strategies to avoid litigation on exit; you can't litigate love (so why are you trying)

CASE EXAMPLE

- Brother and sister co-own business they started together- neither gets along with other's spouse.
- Avoid litigation
- Focus on contracts, buyout insurance and choice of fiduciaries to execute.
- Insure spouse has assets outside of business that will support spouse.

CASE EXAMPLE

- Father died leaving estate and business in trust for each of 2 children; one in jail. Other child is trustee of both.
- Substance abuse, mental illness, competence issues.
- Should a business be in trust? What are exit alternatives? Who should be fiduciary?
- Strategies to unlock liquidity between them.

CASE EXAMPLE

- Father started business. Would never give up control or dividends. Died without plan.
- Mother made the tough decisions- named CEO and negotiated terms of transaction between 2 children in business – while she was alive.

CASE EXAMPLE

- Father retired yet continues to own controlling stock. Son is CEO and is angry because as value has increased- “he, not father improved the value” and now he will have to buy his “own appreciation back” from his siblings.
- Strategies to freeze value and alleviate disagreements.

CLOSING THOUGHTS

- Exiting the family business has many tricky issues- technical, family, emotional and financial.
- Interests compete and change.
- The time to plan an exit is far advance of the exit. Plan, revise and revise.