By Robert M. Barnes

3 options for family-owned business continuity plans

Out of roughly 20 million family businesses in the U.S., 30 percent make it to the next generation, 12 percent make it to the third generation, and only 3 percent make it beyond that. Experts cite three primary reasons for these low percentages: family conflict, estate taxes, and failure to design a proper succession or continuity plan. A well thought-out written plan that provides for liquidity when needed can dramatically shift the odds in favor of multi-generational survival.

It's not easy to get business owners to adjust their focus from running their business to planning for its future. Advisors can help them by asking questions to identify their desires and the best course of action.

Business owners have three options for what happens when they leave the business. They can sell, gift, or liquidate the business. Let's examine these three options.

Sell

Your clients will want to get fair value for selling their business. They will also need to be clear about their own role in the transition and/or financing of the sale, and whether they want to provide for children or key employees. Ask the following questions.

1. How will you determine a fair market value?

- What does your accountant say?
- What have similar businesses sold for in the past?
- Should you hire a professional valuation firm?

2. How will you find a buyer?

- Would a competitor be interested?
- Should you hire an investment banker to match you with a buyer?
- Will networking or trade associations lead you to a buyer?

3. How involved will you be in the transition of your business?

- Are you willing to stay on for a while after you are no longer the boss?

- What type of economic environment will you and your former employees be in?
- What happens if there is conflict during the transition?

4. How can your buyer retain key employees or your children who work in the business?

- How can you retain key people to stay during and after the transition?
- Is it possible a key employee or child could purchase your company?

5. Do you want to play any role in the financing of the sale?

- Should you finance the sale, even if you sell to one of your children?
- What happens if the business takes a dip and the buyer has trouble making payments?
- What happens if your buyer drives the business under?

Gift

If your clients intend to gift the business, they should share the plan with all of their children, as well as with key employees. Gifting business assets to non-employee children can create conflict among siblings. It may even cause a permanent divide. The advisor should suggest a family meeting to discuss the transition. True, family business transition meetings can be a challenge. As uncomfortable as they can be, it is worse for family members to confront the plan after the transition starts.

Clients should also make sure that their business plan aligns with their estate plan and provides the liquidity they need. If the business continuity plan will be addressed via gifting, you must make sure it is in sync with the estate plan. This situation calls for different questions from when clients sell a business.

1. Do your children have the ability to run your company?

- If not, how will you groom them?
- What are their strengths and weaknesses, and is there outside training that can help?
- Do you have a management team that can help?
- How can the business retain key people during the transition?
- How will you provide for children who don't work in the business?

2. Do you intend to gift the business after your passing or during your lifetime? If during your lifetime:

- Will you maintain control?
- Will you have enough income and liquidity during the rest of your life?

Liquidate

Not every business can continue indefinitely. This is especially true for service businesses.

To decide whether to liquidate, start by asking:

- What is unique about the business?
- If the business were to close, where would the customers go?
- Does anyone in the family have the ability and willingness to take over?
- Do any employees have the ability and willingness to take over?
- Would a competitor consider buying it for more than liquidation value?

Many business owners believe that their business will be worth a lot when they retire. But that isn't always true. If it's not an easily transferrable business, it's especially important that the owner save for retirement.

Role of insurance in the plan

No matter which of the three solutions the owner pursues, it is important for continuity that the business owner (and perhaps key employees) be properly protected with insurance in the event of the death or disability of the active owner.

Some continuity plans will fail without proper protection. If an owner is selling the business and staying on for a transition, the coverage could be important during those crucial transition months or years. If the owner is gifting it to family members at death, insurance coverage could help equalize the estate or pay estate taxes. For the business that plans to liquidate, it will be vital for that owner to protect the family as long as the business is operating, much like a recipient of a regular paycheck would do. For this business, income will likely diminish or disappear in the event of a death or disability.

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It is important to discuss whether coverage should be owned by the company or the owner individually. Sometimes it makes sense to have some of both. If you decide to have life insurance owned by the business, make sure you comply with the employer-owned life insurance (EOLI) laws to keep the death benefit income tax free – and contact your insurance consultant for information on EOLI laws.

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