Succession: Is Keeping the Business in the Family Necessarily the Best Course?

Whether you should transfer ownership of the family business to your offspring may depend on your needs and the ability of your company, after the transfer, to support two families

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Statistically, family businesses comprise 80-90% of all U.S. companies. Unfortunately, according to the Family Firm Institute, over the next five years nearly 40% of those businesses will be passing to the next generation without effective exit planning in place.

Many owners of closely held family businesses mistakenly believe their companies are not marketable; thus, they assume that their only option is to continue the business in the family. Also, in the minds of some business owners, selling their company to a third party – rather than passing it to one or more family members – is somehow a sign of business failure.

Keep It in the Family? For better or for worse, advisors to family businesses have generally been guided by a single objective: to help resolve challenging family and/or business issues by keeping the business in the family.

Sadly, we know of many cases in which trying to achieve that objective has caused both the family and the business to suffer. Sometimes, as the result of planning, a preferred outcome is to sell the business to a qualified third party and then use the sale proceeds to fund the next chapter in the family's life.

Recent surveys of family businesses reveal that most owners recognize the need for more planning but are too busy with day-to-day operations, are unsure as to how to begin, and/or are afraid to confront their mortality or their long-avoided family issues.

When the situation calls for viable alternatives to keeping the business in the family, business owners should be open to considering those alternatives.

For example, unless the acquiring family member has an independent source of capital to purchase the company from the parents, keeping the business in the family often requires the business to support two families: the family of the founder and the family of the acquiring child or other relative.

There are also issues of price. In many instances, the parents want to help their children by transferring the business at a below-market price, but they are conflicted by the need to maximize the proceeds from the sale in order to secure their financial future.

Planning Steps. Here are some fundamental components of planning for succession or sale.

First, the parents should calculate the amount of assets or income they need to secure their financial independence after they sell or transfer their company. Second, they should pick an exit date. It is essential to pick a target date – even a tentative one – for planning purposes. From there, we can determine the business's current revenue and earnings, and how much it must generate by the planned exit date, in order to satisfy everyone's needs and objectives.

Serious adherence to those steps in the planning process can reveal whether (a) keeping the business in the family, through orderly succession, is a viable option, or (b) selling it to a third party is the more realistic course.

Without this sort of advance planning, many businesses have to be sold at the founder's death in order to pay the estate taxes. That is not something we want any family business owner – or their surviving spouse or children – to face.

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Join us on September 29th, at the Hilton Phoenix/Mesa Hotel for a complimentary "Business Continuity and Exit Planning" seminar from 4:00 – 5:30 PM. For more information, visit www.halaw.com/exit/index