G J Barnett & Associates
Accounting, Taxation & Business Advice

GJB's guide to family business succession planning

It's inevitable you'll leave your business someday – are you prepared?

Whether you decide to sell up, retire or leave due to health reasons, it is important that you prepare[i] yourself for that eventuality:

Decide on who should be a successor
When choosing a successor from your family, think about what is best for the future of the business. Do not let emotions cloud your judgement and be aware of the potential problems when choosing a family successor. Choosing just one may cause conflict if others are interested in taking over, but if you appoint more than one successor there may be no clear leader and constant disputes.

Evaluate your situation by ensuring your successor has both the necessary skills and passion to take over the business – children should earn their right to be at the helm of a business, rather than having it handed to them on a silver platter. A board of non-family members or an adviser may help provide an objective opinion.

Multi-generational family businesses often succeed when the decision to remain in business together is made by the children themselves, rather than the parents. Parents should continuously include their children in the decision-making process about succession and leave them to make their own decisions about their future prospects at a more appropriate time.

Train the successor
Owners of family businesses often make the fatal mistake of bequeathing the business to their children or siblings without much prior notice or previous training. Succession planning is a process, not a one-off incident – start teaching your heir about the business's operations and finances because it takes years to get up-to-speed with everything.

Identify areas of expertise that are fundamental to your business and determine if your successor fits the bill. Conduct regular appraisals, give performance feedback and assign higher-level projects to prepare them for what lies ahead.

Transfer of knowledge is critical to succession planning. Successors need to:

- learn about business through formal education and working outside the business
- learn about the family business, in particular the family network and network management skills, and
- learn to lead the family business by codifying knowledge and learning the tacit knowledge, training in operational and financial management, and thinking strategically in the business.

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Work on a succession plan
A complete succession plan has to incorporate the core values of your business and should:

- answer questions about who will be in charge, how much of a stake they will acquire and at what cost
- include a shareholder's agreement
- include an estate plan
- include a timeline for the transfer of power
- be known to all parties
- include a valuation of the business - such valuations require professional skills, given the intertwined nature of the business, the family, and the unique family factors that drive value
- include a financial security plan for the founder, and
- be in written form.

Also think about financial and legal issues such as:

- are you planning to gift or sell the business to your family?
- do you need to set up a trust as part of the succession?
- would you prefer to receive a regular dividend from the business or a lump sum?
- are there any legal or industry requirements to meet in relation to ownership of important positions?
- if you sell your business to a family member, are you giving them a loan or are they acquiring a loan from a financial institution to pay for the business?

Identify risks and common goals, potential conflicts and enlist the services of this office if necessary. Also consider if you need to transfer both ownership and management, if ownership will be equal among family members and if the management team should include non-family members.

You may have to continually revisit your plan, review and update it to reflect changes in business value, market conditions, your own health as well as the abilities and passion of the successor you intend to pass it on to. Regularly review your plans with family to ensure they are aware of, and happy with the development of the business.

Show your faith
If you do not instil confidence in the proposed successor and demonstrate to employees that you trust this person to take over your business and keep it thriving, your business is not likely to succeed in the aftermath of your departure. Ensure everyone knows who your worthy choice of a successor is and how excited you are for them to develop the business into a new frontier. Do not belittle the successor or force them to mimic your management style or business values.

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Consider external options
If there is no one suitable within your business or family, consider looking externally too. There is no benefit in having an uninterested daughter or an incapable son at the helm. Look for candidates that have strong talents, skills that will complement the business, and a resourceful and enthusiastic approach towards work. If you end up selling or passing on your business to an outsider, you may be able to negotiate a provisional consulting and training period where you remain in the business to ensure a smooth transition.

The sooner a succession plan is put together, the better, but this is by no means an exhaustive list of all the factors you need to consider. Consult GJB on 02 9686 3130 for professional advice before selling or passing on your business to your successor.

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[i] A recent nationwide survey revealed that more than 40% of family businesses are looking to transfer their wealth and operations to other hands in the next five years. Are the owners of those family businesses thinking about succession planning?

Findings from the survey suggest not. In an overwhelming majority, 93% of the survey's respondents intend to transfer their business wealth within the family, but only 39% of respondents have a complete succession plan that nominates a chief executive successor. Other research shows that more than 65% of family businesses fail in the hands of the second generation and another 20% fail when the business passes to the third generation.

The most common causes of business failure are:

- lack of management skills, and inadequate consideration and planning for the ownership transition
- failure of parents to "let go"
- the problem of the "insider and the outsider" which relates to a failure of the head of the business to share knowledge and decision-making with all relevant parties
- the "disconnected shareholder" – that is, a dissatisfied family member who is not part of the decision-making hierarchy but constantly undermines authority and management, and
- "fighting over the spoils" when family members look critically at what one is receiving from the business and comparing it to what another receives.

These worrying indicators, compounded by a baby boomer generation fast approaching retirement, have prompted us to prepare this to-do checklist for family businesses considering succession

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planning in the next few years.

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