INTRODUCTION TO PLANNING THE SUCCESSION OR SALE OF A FAMILY BUSINESS

Succession planning

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Introduction

Family-run businesses face unique and complex challenges. One especially important challenge is succession planning. According to research by the Institute for Family Business (IFB), only about a third of family businesses survive to the second generation, and only about one in ten to the third generation, often because they have failed to manage the challenges of organisational change. Go to: http://www.fbn-i.org/ details.

Family businesses are more than just a place of work - there is emotional as well as financial capital tied up in them, and passing on the family legacy can be stressful and fraught with difficulty.

Many family businesses fail to address the issues of succession planning because the challenges are so difficult to face. Entrepreneurs may be unwilling to let go of the reins due to fear of loss of status, or because they do not wish to retire. Equally, it may be hard to choose a suitably qualified successor from the next generation, or because sibling rivalry makes decision making difficult.

This factsheet reviews the issues involved in succession planning or a sale and the options available to a family business. It contains useful hints and tips as well as sources of further information.

Succession issues

Perhaps the first step to take in preventing and dealing with succession issues is to think about:

- What you want for the business and your employees.
- What you want for your relatives.
- What you want for yourself.

In order to make a decision about the future of the business, consideration must be given to your family's objectives for the future. Various questions need to be answered when starting the planning process, which will help to identify which course of action to pursue. For example, you need to consider:

- What is the current ownership structure of the business and how complex is it? If you are a sole trader or a partnership, will this legal format need to be changed to enable the next generation to take over or the business to be sold?

- What are the long-term goals and aspirations for the business - to expand (to go public) or to maintain it as a family enterprise? What finance would be required?

- Is there a need or a desire to achieve value from the business by selling it as a going concern or by realising the assets?

- Who is available to take over the business?

The importance of planning ahead

Despite the challenges, you should plan in advance and allow several years to prepare for the transition to the next generation or for a handover to new owners. Leaving such planning until a sudden crisis arises, such as the illness of the managing director, means that the whole business could be at risk of failure and its value could be lost very quickly.

The planning process should preferably be started at least five years before the transition is expected to take place, to enable the family and employees to be prepared for the changes or the business to be groomed for sale, and for tax planning measures to be taken and pension provision made.

Bystarting this planning process early, you are also making contingency plans that will cover your business against unforeseen events such as divorce, illness, bereavement or the failure of the succession plan.

Various options are available with regard to the future structuring of the business, including:

- Transfer of the business to a younger family member or members.
- Continued family ownership but with professional managers employed to run the business.
- A trade sale.
- A management buy-out.
- Winding-up and closure of the business.

Before deciding on the preferred route, it is important to gather as much objective information as possible and to take professional advice. It will also be necessary to create a structure to manage the change so that ultimately the business can be run without you, and to ensure good communication between all involved parties in the meantime.

Keeping it in the family

Many entrepreneurs would prefer to keep their business in the family in order to retain opportunities for their children and maintain the family heritage and a vehicle for wealth creation. If you want to take this route, you will need to:

Identify the successors

- Is anyone in the family qualified for the role, preferably with outside work experience, skills and qualifications?
- Does the potential successor genuinely want to be involved in the business rather than accepting the role out of a sense of duty?
- Will the potential successor have the skills and personality to fit with the future plans for the business, and will they be supported in the role by other shareholders or family members?

Agree the ownership structure

Should the family retain ownership of the business but employ professional managers to take it forward instead of it being run by family members in future?

- If the business has a sole trader or a partnership structure, it may be necessary to convert it into a limited company so that shares can be issued and divided among the succeeding generation (some receiving shares with voting rights and others without as appropriate, depending on their role in the company) for inheritance purposes.

- Are you really prepared to let go of the reins and allow a junior family member to take control? If not, the transition could be jeopardised.

Consider the management of change

- What kind of training or mentoring plan should be put in place to help the successor and the organisation during the transition phase?

- How much involvement will the current owners have after the transfer?

- How will you manage the change so it is clear to everyone involved with the business who is in charge after the transfer?

- Will the proposed succession plan lead to conflict among family members or other employees who may be jealous?

- What needs to be put in place to help with minimisation of conflict and the development of individual skills in the run-up to the transition? Can you set up a family council or committee to facilitate the changes?

Review financial planning

- Is your pension dependent on you realising capital from the business, and how will you fund your retirement if you don't sell the business?

- Alternatively could the family afford to buy you out if a pension or finance needs to be raised? (It may be possible to fund this through the business by way of staged payments.)

Selling the business as a going concern

This may be the best option if no suitable family member is able to take over; if the priority is to raise money from the business to fund retirement, it may be the favoured choice. A sale could take the form of a management buy-out or an outright trade sale.

It may also be the case that the business needs investment to survive and protect all its employees. In that case you could look for a private buyer who has the funds to make it grow.

If it is felt that a sale is the best course of action, it may be helpful to employ a broker to find a buyer. However:

- The best candidates to buy the business are probably the people you've had the closest working relationships with over the years, so be sure to cultivate them - important suppliers or customers may be interested in buying your business or a direct competitor might want to buy you out.
- Read the trade and financial press to find out who is making acquisitions in your sector and what sort of prices are being paid. You will probably know the marketplace already but you may discover an investor looking to move from a related sector who can see synergy in selling your products or services to their customers or vice versa.
- Non-family members working within the business may consider a

management buy-out, but if that's the plan you need to make sure they will be able to raise the backing.

- If you sell more than 50% of your shareholding, you will lose control of the business and you may find it difficult to stay involved if you don't have the final say. If you wish to keep a minority stake in the business, you should be aware that your options of selling this stake in the future may be very limited.

Preparing for a sale

If the sale of your business is your preferred option, it will be necessary to prepare the business for sale over several years so that it will be a more attractive proposition to a buyer and allow you to achieve maximum value from the sale.

The business may not necessarily be attractive to a buyer at all; if it is very dependent on the owner's personal knowledge and networks it may be unsaleable as a going concern.

In general when preparing for sale:

- Aim to have a record of increasing profits to show potential buyers.
- Make sure accounts are up to date and that you comply with health and safety legislation.
- Try to expand your range of customers. A business that relies on a single big customer is difficult to sell.
- Consult your accountant about your capital gains tax position as you

may be eligible for Entrepreneurs Relief which can minimise your liability while you will also need to be aware of the dates for payment of any tax which falls due.

- Discuss succession issues with other members of the family who will continue working in the business.
- Farm tenancies can contain rights of succession. Land and property owned by individuals but used in the business may create problems when there is a change of ownership.
- Review customer, supplier and employee contracts and be aware of employment law regulations regarding transfer of undertakings - particularly note the requirements of the Transfer of Undertakings (Protection of Employment) Regulations 2006, some of which apply to both the transferor and transferee.
- Consider whether there are any assets (such as a property) that you would like to exclude from a sale.
- Get professional support - advisers will help you get the best price, deal with taxation issues and negotiate a smooth sale.

Valuing a business

Most small business owners have a sentimental attachment to their business that has no value in the open market. If you have several offers for your business you can certainly afford to be choosy, but for some owner-managers the opportunity to sell is something that will only come along once in a lifetime.

This makes it very difficult to know what the right price is, but knowing the market will help with this assessment but your own professional advisers will be able to advise you as to the value that a prospective buyer's professional advisers are likely to place on your business based on its profits and prospects.

You should draw up a sales memorandum providing a brief summary of the business profile. This should include financial details, ownership information and reasons for the sale.

Money is one of the most common reasons for conflict and all family members will want to know what the business is worth, even if their role is passive rather than active. It will also be crucial in tax planning.

Closing the business

If it is not possible to sell the business as a going concern it may be more appropriate to close it down and realise the underlying assets. Tangible assets and equipment may be saleable, as well as intangible ones such as customer lists and intellectual property.

In addition it may be possible for next generation family members to take just a part of the business forward and continue to run that as a new venture, so retaining some continuity of employment and family heritage.

Financial considerations

Capital gains tax or inheritance tax may be incurred on the transfer or sale of a business. Professional advice should be obtained as to possible liability depending on individual circumstances, because both rules and tax relief change frequently.

Hints and tips

- Plan ahead. Select a year for exit or retirement and manage your business with a focus on that date.
- It's important to set a realistic price and set aside plenty of time for the sale to go through.
- Develop something a buyer will really want - a new market or product or service.
- Make sure your employees share your objectives. If they feel their futures are threatened they may become demotivated and the business will lose value.
- Be fair to your other staff and put sentiment aside when dealing with family members.
- Consider your tax position. You may be entitled to business property relief on shares you give to family members.
- Even if you are selling to a relative you're on good terms with, each party should obtain independent legal advice. If both are properly represented, there's less chance of resentment if the deal doesn't work out and it is important that both parties understand all the current and future legal, emotional and financial implications of the contract they will be entering into.

Small Business Resources

Add value to your brand by generating catch business and product names like Amazon, Google, Coca Cola, Yahoo, Blackberry and many more using the same business name generator used by top business and product naming companies: http://www.businessnameidea.com

Generate more leads, cash flow and profits for your business and pay only based on results. This web site connects small businesses with top traffic web sites like Google, Facebook, Youtube to generate constant flow of traffic and leads: http://www.intelwebsolutions.com

Information and tools for small business to help entrepreneurs develop and market their business and ideas: http://www.2-small-business.com