Avoiding an Inevitable Family Feud

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By:

Roman A. Basi

Roman A. Basi, President of The Center is an Attorney, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning and Real Estate.

and

Marcus S. Renwick

Marcus Renwick is an attorney and the Director of Research and Publications with the firm.

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Introduction

If you are a parent, do you remember watching your children squabble over who should get to watch their show on TV, or whose toy it was, or even who got to ride in the front seat of the car on a trip to the grocery store? Have you ever seen your children or nieces or nephews destroy something in the process of fighting over it? If you are a parent, aunt or uncle of course you do! That what kids do…fight like crazy over absolutely every matter imaginable. Now imagine them fighting over a potentially million dollar asset. Kind of terrifying.

If you own a family or closely-held business, this kind of battle could be in their future. There are thousands of family businesses in this country and each and every one of them can cause an incurable rift within the family when passed on. If you have a family business, quite simply, you need a business succession plan in order to avoid a family feud.

BACKGROUND

There are different types of exit strategies to choose from. Most entrepreneurs who start businesses set their ultimate goal as selling an initial public offering on NASDAQ. While this is a respectable and admirable goal, for most it is not likely to happen. Most exits from business involve a sale or some other succession from of the business. It is important to make a reasonable goal when creating an exit plan. This does not mean an IPO is unreasonable for everyone, but the business owner should think about possible alternatives to their primary goal or their intended exit. The alternatives include:

1) Sale of a Business – A business is sold to an individual, group of individuals, or an entity. Doing this, the business owner receives cash or an equivalent for the business. However, it can be difficult to find a ready, willing, and able buyer to purchase the business.

2) Acquisition – Similar to the “Sale of a Business” exit, but usually involves an outright purchase by another company. You receive cash right away, but you must find a ready, willing, and able buyer that wants to acquire your business and add to their business.

3) Merger – In this type of exit, the business joins with an existing company. As with a sale of a business, you get cash, stock, or a cash equivalent, but you join in with new

partners and may suffer a partial or complete loss of control of your business. In addition, you may end up with stock in another company. A Buy-Sell Agreement is used for the future exit strategy

GETTING STARTED

Since we can’t predict the future, it is important for the business owner to adopt a “what if” mentality when thinking of exit plans. It is very simple logic. To follow it, ask “What if” or “What should I do if” and then name or state a scenario. Examples: What should I do if my business rapidly expands in the next five years? What if the economy enters a depression? While the form or wording of the thought is not important, this kind of thinking allows the business owner to cover a wide range of contingencies and plan accordingly.

Although it may be useful to list many contingencies, you cannot plan for every contingency that arises. It is imperative to select the most important scenarios from the many considered. Create a plan describing the actions and policies to be followed in the event any contingency comes to pass.

Every exit plan should take into account different factors such as the industry, competition, the owner’s resources and goals, and any other relevant intangibles. The best plans take into account all of the person’s goals.

THE HOMEWORK

The homework consists of reviewing any existing agreements you have with partners, shareholders, and others who are involved in the organization. The agreement may consist of articles of incorporation, by-laws, and buy/sell agreements. The exit plan must conform to the existing agreements or it could defeat the plan. If you don’t have any existing agreements between shareholders and partners, now may be the best time to create one in conformity with the plan you want to follow. REMEMBER, A BUY/SELL AGREEMENT IS THE MOST IMPORTANT LEGAL DOCUMENT A BUSINESS CAN HAVE THAT COVERS EXIT STRATEGIES.

WRITING THE PLAN

After doing the homework, the rest of the plan should be written. The plan does not necessarily have to be complicated or even well written to be effective when the scenarios arise. The most effective plans are the plans that are most thoroughly thought out, so it pays to think at this stage.

The Goal - It is important to define a goal. Obviously the main goal in any exit plan is to achieve the best results. These results may include reviewing the biggest monetary gain, the smoothest transition into the next generation, paying the least taxes, or creating a retirement plan.

The People - Next it is important to choose the players to be involved in the exit plan. Decide what partners or key people will handle what you would like them to do. When the time comes, the people named may not be willing to do the task, so be wary of this situation and always keep your plan up to date and current.

The Valuation - Valuation of the company is also very important. It is important to identify a company or professional that has expertise in this specialized area. A poor valuation can lead to selling the business for a price short of what it should be. An entire lifetime of hard work and sacrifice should not be devalued by means of a poor quality valuation; it would not be fair to you or those around you. A valuation of a company should take place every year, because the results and value-added drivers of operation are important to the overall value of the business.

Due Diligence - Potential due diligence issues need to be addressed. Due diligence is the process of ensuring the accuracy and completeness of assertions. It is best to address the issues now rather than wait until the exit. Items such as obsolete inventory, family members on the payroll, and real estate all need to be dealt with and thought of before the business is put it for sale. An issue in due diligence can result in a deal breaker when your exit plan is put in action.

CONCLUSION

Being proactive in business will pay off. It especially pays when you are dealing with an exit strategy. Dealing with the issues that come up now can eliminate lost opportunity, headaches, and problems that may not be able to be solved when the exit occurs.

Therefore, it is important to have an exit plan at all stages of a business. If you like, please contact the professionals at the Center for further assistance in your business and tax needs. The professionals at the Center specialize in exit strategies for private companies. Financial, legal, and tax advice is provided in developing such exit strategies.