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All In the Family

Multi-generational businesses require a fair amount of due diligence when it comes to succession and estate planning.

By Maura Keller

For many second- or third-generation family members, the idea of running a family business might sound like a walk in the park – the chance to create your own position, lifetime job security, and dear old mom or dad as your boss. It can offer a wealth of opportunities and challenges, not to mention the opportunity to continue the family legacy. Of course proper succession and estate planning, especially in the multi-generational business mindset found within the automotive recycling industry, takes proper planning and due diligence for the transition to go smoothly.

In the Know

Succession planning and estate planning should go hand-in-hand to achieve the most advantageous results. There are many strategies available to preserve assets and minimize tax burdens with the right planning. Proper estate planning is very important in order to build, maintain and preserve assets for your family and to provide for the security and support of family members in the event of your incapacity or death.

Your succession and estate plans will provide exactly where your property will go after your death. If you are married, it will determine how your spouse will be provided for. If you have minor children, it will name the persons who will be responsible for their care and custody. If your children are too young to handle the assets they inherit, your estate plan will designate the persons to manage your property and use it to educate and support your children until they reach a suitable age to receive their inheritances outright.

It will also permit you to designate the purposes for, and the ages at which your children will receive the assets you leave to them, including how business assets are transferred to adult children or grandchildren.

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DR. PETER ROLAND

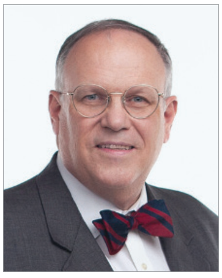
Dr. Peter Roland is a CPA and wealth manager who, with his firm Canon Capital Management Group, has been working with business owners and their families to grow the unique value of business wealth for over 30 years.

"Ideally the thought of a succession plan should be part of the startup business plan as it can help guide the direction of building the business with an end goal even though that goal may be many years in the future," Roland says. For many business owners who have not thought about business succession, the best time to begin is as soon as possible. Automotive recyclers need to consider estate planning and succession planning together as your business may be the most valuable asset you have.

"Note that in a broad sense estate planning does not just involve what happens at death, but it can include what happens during your life as well," Roland says. For example, what would happen to your business if you may have an unexpected accident and become incapacitated for a short, or even long, time. The value of some businesses can decrease very quickly without the owner or operator involved.

Roland says proper succession planning can establish tax-saving opportunities with both the income tax and estate/inheritance taxes that prevent the government from getting an oversized portion of the value you have created in your business.

"There are two important perspectives on your business in terms of succession and value: The first is operational and addresses who will run your business to keep the value building if you do not; and the second is how will you monetize the asset or business value you have created for you and your family," Roland says.



MATTHEW ERSKINE

As the fourth generation at Erskine & Erskine, Matthew Erskine understands the nuances of succession and estate planning for family businesses. He is an acknowledged expert in the field, whose insights run in a regular Forbes.com column, as well as a frequent guest on such media outlets as Bloomberg and Reuters. According to Erskine, the best time to begin thinking about succession planning is before you create the business.

"When you start with a plan in place, even if it is a one page plan, it avoids a host of problems that come about because of assumptions and ambiguities when these decisions are pushed off 'until I have the time,'" Erskine says. "The second best time to think about succession planning is right now – even if this is a lousy time to take time off and think about strategies, and you can only do something basic. Something is better than nothing."

Steps To Take

SHERYL LINCK

Sheryl Linck, senior vice president at the Trust Company of Tennessee, offers family businesses investment management, business advisory services, and financial planning, agrees that, though not everyone has this luxury, the best time for business owners to start transition planning is when they start the business.

"The most successful plans occur over the course of many years and are an integral part of the business strategy. If this has not been the case and a business owner is contemplating a transition, they should plan on a three- to five-year timeline," Linck says. "Of course, you can transition out of your business in a matter of months, but preparing an ownership transition on your own terms takes time. Planning not only establishes security for your loved ones, but also creates a legacy impact for the business you built."

Linck points out that a key step is understanding your goals with succession planning. To whom do you intend to transition the business, such as family, key employees or a third party? If it is an internal transfer, are the employees ready and capable of assuming ownership? Also, what is your transition timeline?

It's also important to make a realistic evaluation of where the business is now and where it needs to be for a successful transition. As Roland explains, this involves thinking about what is important to you and your life.

"So many business owners have a business that is essentially a job for themselves where they have freedom to work that job as they wish. The potential problem with this is that when that owner stops working, the business may come to a halt and income stops flowing," Roland says. "An alternative to that scenario is to picture your business as a machine that you want to run itself with no assistance from you, then you have true freedom in your life and have built a valuable asset. The closer you can get to having a self-running business 'machine,' the more successful you will be. Of course, you can always work in the business if you want to; the point being that the goal is that you do not have to work in the business to have it be profitable and continue to grow."

Erskine says one of the key steps in succession and estate planning is to have an articulated "common goal" that all the stakeholders in the business, both in the family and outside of the family, can agree to. This can be as basic as "make money now and make money in the future" or "sustain family ownership now and into the future."

"The reason why you need this first is because during the discussion stakeholders will have their own objectives in the process and if those objectives do not move you towards your common goal, then you can set that objective aside as not relating to the common goal the stakeholder has already agreed to," Erskine says.

The next step is to define the objectives that move you towards the common goal. These are usually more concrete, such as "increase the younger generation in the management of the company over the next five years" or "acquire one of our competitors in 2025."

"Next, you must look at the strategy that is best way to achieve each objective so, for example, if the goal is to sustain family ownership and the objective is to avoid paying estate taxes at the death of the current owners of the company, a strategy could be to make gifts of stock in the company to family members," Erskine says. "These strategies need to be necessary, sufficient, aligned and feasible in achieving the objective. Finally, you need a tactic. If the strategy is what you are going to do, the tactic is how you are going to do it."

It also is important to consider your state rules and regulations in your succession planning because every state can be different, and your automotive recycling business may be operating in multiple states. These rules and regulations may be unique to your business and must be considered in your overall succession planning. An experienced attorney or estate professional will help keep you compliant.

So what happens if a business owner wants to pass along the business to employees rather than family members? As Roland explains, many times it is your key employees that can run the business, but you want to keep the business value in the family.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Planning not only establishes security for your loved ones, but also creates a legacy impact for the business you built. –SHERYL LINCK

"There are alternatives that can reward and motivate key employees while allowing your family members who are either part of the business or separate from the business to retain business value," Roland says. "It is important to write different contingencies into your plan and not leave the decisions up to someone's interpretation of a verbal agreement."

Erskine adds that one strategy is to establish an Employee Stock Ownership Plan, which has many tax advantages for the owner but is highly regulated and therefore complicated to run in compliance with the rules.

Though transition through ESOP has a reputation as being expensive and difficult, in the right cases, it can be a great option.

"There can be ongoing tax benefits for the owner and the company. They also reward employees and preserve the legacy of the company for the community," Linck says. "The timeline can happen all at once or over time, so it's on the owner's terms how quickly the transition will take place."

Another strategy is a Purpose Trust (also called an Employee Ownership Trust), which is a perpetual trust the purpose of which is to sustain the ownership of the company for the benefit of current and future employees. "Purpose Trust as more commonly used in the EU and the UK but they are being used here," Erskine says.

Business owners can also consider an installment sale where the owner becomes the bank for buyers who may not have the financial wherewithal to purchase the company outright.

"It does put the owner at risk, so this may not be the most advantageous path," Linck says. "However, if you have a long enough lead time, employees can be bonused ownership over time and then use that equity to qualify for full or partial bank financing."

Mistakes To Avoid

Many business owners do not consider how to handle non-business-active children. That's why Linck suggests there needs to be a plan for how everyone will be treated and also an understanding of the difference between the concepts of "fair and equal."

"Another mistake is not locking in the value, meaning that the company is managed as a lifestyle business. If that's the case, the owners are the business, so the value of the business itself hasn't really been unlocked because once they're gone, the value is greatly diminished," Linck says. "It's important to institutionalize the organization with clear policies and procedures, trained staff, leadership development and diversification across vendors and clients so there is an explicit true value to the company as opposed being dependent on the owner."

Failing to do business continuity planning is another mistake Linck sees. That's the proverbial "hit by the bus" scenario. If something were to happen to the owner or senior leader in the company, what happens the next day? How does the company operate?

"People also forget their silent partner: Uncle Sam. Many business owners fail to realize how much of a role taxes will play, and that's one of the reasons you want to do succession and estate planning well in advance of a transition," Linck says.

Another big mistake that Roland sees many business owners make is neglecting to consider succession planning because they feel that nobody can run the business as well as themselves. While it may be true, this way of thinking can stifle the growth of the business because the owner does not delegate tasks or formalize systems.

"In one of my businesses, I had a rule that if a subordinate employee could perform a task at 2/3 of your capacity, then you should consider delegating that task and with your freed up time work to move that employee to 100% (or more) of what you could do," Roland says. "The impact of this type of philosophy was that we created a learning and teaching culture where the whole organization experienced growth and improvement."

Another common mistake Erskine sees business owners make is not informing the stakeholders what it is that they plan for the succession, usually because the owner does not even know. "The second most common is to delay too long in setting up and implementing the succession plan," he says.

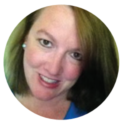
Resources Aplenty

It is common that several individuals should be involved in your succession and estate plan. For example, your accountant knows the business financial information; an attorney knows legal aspects; a financial planner may know how everything fits together in your personal financial plan. Then there are the human aspects of interpersonal relationships between you and your family business members or employees.

"There also may be other individuals that can bring in unique expertise for your business, for example to value the business or market it for sale. You may want to consider someone who can collaborate and integrate with all the different parties required to accomplish your goals," Roland says.

Linck advises business owners to find professionals who specialize in exit and succession planning and can view the process through multiple lenses. It is imperative the entire team be working toward a common set of goals; a specific timeline and the progress be monitored. Most owners have a day job and may not have the time to devote to being involved in all the intricacies of the process.

"Business transitions can be a very emotional process. Owners initially may be hesitant to hand over the reins," Linck says. "However, if you partner with a seasoned and trustworthy planning professional, they can help you through the details and plan what is next."



Based in Minneapolis, Minnesota, Maura Keller is a seasoned writer, editor, and published author, with more than 20 years of experience. She frequently writes for various regional and national publications.