Passing on Your Business to Your Children

The following is adapted from our new book, Your Next Adventure: Planning for Life After the Sale of Your Business. The book shows you how to craft a robust transition strategy that considers your business, personal, familial, and community needs. From pre-sale to post-sale, you'll learn how to plan ahead, assemble the right professional advisors, and incorporate your values, legacy, and loved ones into every choice you make.

The sale of your business has a significant impact on you and your spouse emotionally, physically, and financially. Sometimes forgotten is the effect it will have on other members of the family, beyond even your spouse—your children and grandchildren.

When children are involved in the business, they often have a level of expectation that they're going to step in and run the business. It's a family business, after all, and they're in it.

The first question becomes, "Do your kids have the necessary skillset to take the business over and move it forward?" The generation that started the business had the skills, temperament, and ideas necessary to establish the business, grow it, and position it for success. Those aren't always the same skills necessary to take the business to the next level, and while there are similarities, the differences can be significant.

The next question becomes, "Am I, as the business owner-parent, genuinely able to determine whether my children have those skills?" Frequently, children don't have an objective perspective on their own skills, and sometimes parents don't either.

Situations often occur in which a realistic assessment of abilities determines the children aren't prepared. Either the owner-parent recognizes the need to choose another option for the business, or they don't and only realize the mistake after the transition is in progress.

Challenges

The most obvious challenges when you get your children involved in the business conversation about a transition are (a) aligning their expectations with reality and (b) having a good understanding of what the family dynamics are going to be.

Miscommunication and misunderstanding lead to tension. Engage your children in the discussion so everyone involved can share their perspectives and understanding. While their feedback may not ultimately affect the decision you make as an *owner*, for your family's health and harmony, you should become aware of how the children view the business and their expectations around ownership and management.

Making decisions around the future of your business is hard for you and your children. You, as the owner, need to fully engage in addressing the problem and making the decision about who, if anyone, from the next generation has the talent, discipline, and vision to be the next owner and manager of the business. That next generation must then come to grips with your decisions.

By definition, second-, third-, and fourth-generation families tend to demonstrate a strong family cohesion that has allowed that clan and that business to be successful. Even considering occasional fractures in the family cohesion, the clan has enough of a sense of shared value and purpose that they find a way to work through their issues and keep the family and business successful over the generations.

A Successful Intrafamily Transition

If done strategically and thoughtfully, passing the business to the next generation can go fairly smoothly. In one instance, the father of one of our clients, who was the founder of a beverage distribution firm, had six children and built the company into a moderately sized, successful business. The owner-father decided to pass on, or “gift,” 49 percent of the business to the six children and retain the controlling interest for himself. The division was part of his estate plan, with the objective of keeping the business in the family in a way that would avoid future conflict.

He began the process, and every Christmas, he gave the children shares that included a shareholder agreement they were required to sign. None of them were allowed to pass their shares to their children, and their only option was to sell the shares back to the company. Additionally, that option only existed on a limited first-come-first-serve basis because the company wanted to protect its cash flow. None of the children understood why he was handling the gifting this way, and they felt the arrangement limited their options, but they were being given shares of a valuable company regardless.

The owner-father foresaw the challenge with the six children. If each child had two children and the number of descendants doubled, managing the business would become even more complicated, as would future ownership transitions. He wanted to make sure that didn’t happen.

Gradually, four of the children sold their shares back to the company, deciding they preferred the money to involvement with the business. By the time the owner-father finally decided to retire, only two children, plus our client’s husband, owned the company, providing a much smaller ownership group.

As children came into the second and now third generation, each ownership group decided for themselves what the appropriate transition options would be. Not tying the hands of the next generation legally, the shareholder agreements are being changed with each subsequent generation. They feel very strongly that it’s not their responsibility to try and force things on their children for the sake of their grandchildren. The family's dedication to this responsibility has created excellent cohesion across the generations—a genuine success story.

With planning and careful consideration of your children's skillsets, you too can successfully create a family legacy for your business.

For more advice on business transitions, you can find Your Next Adventure on Amazon.

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Together, at Harvest Capital, they help clients attain life goals, as well as financial objectives.