

777 Main Street, Suite 550
Fort Worth, Texas 76102
Phone: (817) 334-0066



THE BLUM FIRM, P.C.

www.theblumfirm.com

300 Crescent Court, Suite 1350
Dallas, Texas 75201
Phone: (214) 751-2130

303 Colorado St., Suite 2550
Austin, Texas 78701
Phone: (512) 579-4060

2800 Post Oak Blvd., Suite 4100-17
Houston, Texas 77056
Phone: (713) 489-7727

BUSINESS SUCCESSION PLANNING: TIPS WHEN KEEPING IT IN THE FAMILY

Marvin E. Blum, JD/CPA

October 2022

Every family is different. There's no single succession plan that will work for all families. Searching for a solution involves evaluating a toolbox of planning options to find what works best.

When developing a business succession plan to pass a business down to family members, there are 6 key components of a good plan.

First, you need to decide the timing.

When will the change in control of the business happen? It's often best to transfer control while the founder is alive so that he can participate in the process and influence the stakeholders. The founder is the "glue" that keeps everyone together and makes the process a smoother transition.

Second, it's time to start training the successor.

To groom a successor, the founder needs to shift from being quarterback to coach. The process of having a successor "ride around in the truck" with the founder may take many years, so it's important to start early.

While the successor is being groomed, offer him or her a role as an observer at board meetings. Expose the successor to the process. I work with one family business that invites family members to observe board meetings beginning at age 14. They call this the "junior board." The founder wants the children to understand what the family business does before the children enter college or decide on career paths because it may affect what the child decides to study in college and the child's choice of a career path.

Third, who will manage the business? Who will be on the Board of Directors?

The business needs to run like a business and not like a family. You may have to come to grips with the fact that some children aren't qualified to run the business. (Management is a separate concept from ownership of the company.)

The Board of Directors needs to include someone with hands-on experience in the business world, perhaps with training in management. Who will elect the Directors? If you have only one class of stock and you leave it in equal shares outright to children (some active and some not), this is a recipe for friction. Instead, consider different classes of stock (such as voting and nonvoting or common and preferred).

Also consider leaving the stock in trust with a carefully selected trustee. The trustee needs to be either an objective party or someone who'll do what's best for the well-being of the business. When designing the trust, consider naming an independent (or special) trustee with powers to remove and replace the trustee and powers to make certain amendments if unforeseen events arise.

Fourth, a good succession plan needs to provide a cash flow for all family members who will own the business.

If a family business is passed to children in equal shares and only some of the children work in the business, the other children may not receive a cash flow from the business. The non-active children may push for the business to be sold so they can see a cash flow.

Are there assets that you can divide up and distribute out to the owners? For example, does the company own real estate that can be separated out from the operating business and put in a separate entity, then enter into a long-term lease? This could provide a cash flow for those not employed in the business.

Life insurance can provide a cash flow for the children who will not receive a salary from the business.

Fifth, provide an exit strategy for an owner wishing to sell his share.

Explore buy/sell arrangements (ideally funded with life insurance). Buy/sell arrangements are especially effective in family businesses where family members active in the business can buy out those not in the business. The non-active sibling sells and gets cash. The active sibling buys and gets control.

Sixth, starting when the kids are young, develop a culture of stewardship, as opposed to ownership.

Train heirs to protect the business like a tree. Live off the fruit of your labor, but don't disturb the branches. Preserve the tree so it will continue bearing fruit for future generations. As Hobby Lobby founder David Green asserts: "No one owns the tree." Each generation is merely a steward for the next.