Section 5 Exit

Introduction

This section explores the issues that arise when, for whatever reason, owners of family businesses decide to leave or dispose of the business. You will explore what these reasons may be – including retirement and capital gain – and what the owners' options are.

There are then six topics that look at what happens when the owner wants to pass the business on to the next generation in the family. Areas covered include choosing a successor and dealing with the conflict that can arise between family members.

Topic 10 goes on to look at issues surrounding the appointment of a successor from outside the family.

Sometimes the owner will decide to sell the business. Topics 11 to 13 look at the reasons for doing this, and ways of planning and managing the process.

The final two topics look at aspects of retirement and estate planning, including financial and tax planning.

Learning outcomes

In this section you will be concentrating on the following learning outcomes:

- understand the importance of planning all aspects of exit from the business
- explore issues that arise when the business is transferred within the family
- identify and assess options other than family succession, including transfer to non-family management and selling the business
- analyse the seeds of conflict within family businesses, including your own business
- critically analyse your own situation and devise strategic action plans.

Topic 1: What happens to family businesses?

When you have worked through this topic you should be able to:

- identify reasons why the owner of a family business might choose to leave the business
- list the various options open to family business owners to end their involvement.

Topic 2: Options and plans

When you have worked through this topic you should be able to:

- interpret current research into business owners' preferred exit plans
- explore reasons for business owners preferring certain exit routes over others.

Topic 3: Doing nothing – the ostrich option

When you have worked through this topic you should be able to:

- examine reasons why many family business owners make no plans for the exit
- recognise the possible consequences of making no plans.

Topic 4: Planning for family succession

When you have worked through this topic you should be able to:

- describe why planning for succession is vital to the family business
- assess the role and importance of family involvement and timing in succession planning.

Topic 5: Choosing a successor

When you have worked through this topic you should be able to:

- describe who should be involved in the process of choosing a successor
- list criteria for choosing a successor within the family and explain the need to be objective.

Topic 6: Managing the process of family succession

When you have worked through this topic you should be able to:

- assess the importance and role of training for the chosen family successor
- describe the importance of communication in the process
- summarise the responsibilities of the owner in the process.

Topic 7: Family succession and conflict

When you have worked through this topic you should be able to:

- summarise the anxieties and difficulties each side may have in making decisions about succession
- outline steps for resolving conflict about who should be appointed successor.

Topic 8: Disputes over ownership and control

When you have worked through this topic you should be able to:

- describe the sorts of disputes that can arise in families about ownership and control of the business
- suggest strategies for dealing with these sorts of disputes.

Topic 9: The generation gap – managing change

When you have worked through this topic you should be able to:

- describe the sorts of problems that can arise between generations about how to run the business
- suggest strategies for dealing with these kinds of disagreements.

Topic 10: Non-family succession

When you have worked through this topic you should be able to:

- describe the main issues involved in seeking a successor outside the family
- outline the role of caretaker managers.

Topic 11: Selling the business 1 – motives and concerns

When you have worked through this topic you should be able to:

- summarise the reasons why owners of a family business might choose to sell the business
- describe what concerns owners have about selling the business.

Topic 12: Selling the business 2 – options

When you have worked through this topic you should be able to:

- summarise the various types of sale that family business owners might consider
- describe the benefits and drawbacks of the various options.

Topic 13: Selling the business 3 – planning

When you have worked through this topic you should be able to:

- outline the importance of taking a systematic approach to planning the sale
- describe the issues involved in finding a buyer and valuing the business.

Topic 14: Retirement and estate planning

When you have worked through this topic you should be able to:

- describe ways in which business owners can ensure continuity in the family business
- outline the reasons why having an up-to-date will is vital
- summarise some of the issues of ownership and control that business owners might have.

Topic 15: Tax planning

When you have worked through this topic you should be able to:

- understand the importance of minimising tax liabilities to protect personal and business wealth
- outline steps for minimising inheritance tax
- explain the need for careful planning and, above all, professional advice.

Section 5 Exit

Topic 1 What happens to family businesses?

> '...only 30% of family businesses in the UK reach the second generation, and only 13% survive through the third generation...'
> **'Staying the Course,' a report by London Business School, in association with Stoy Hayward, 1989**

These figures show what a high failure rate there is among all family businesses when it comes to passing on the business to future generations of the family. Of course, not all family businesses are set up with the long-term vision of creating lasting, multi-generational concerns; some will be created purely to serve the founders' needs and will be wound up or sold off when those needs have been met. Yet there is evidence that the high mortality rate among family businesses is partly caused by a failure to plan properly for the time when the founder (owner-manager) of the business decides to retire.

This topic looks at what factors influence the owner's decision to leave, give up control of, or end the business. It then considers what the options are in this situation.

When to stop?

In every business, there are crucial transitional stages – similar to the periods of transition in people's personal lives, discussed in Section 2, Topic 2. One of the most significant phases comes when the person or people running the business decide the time has come to stop. It is significant because the whole future of the business depends not only on what decision is reached, but also on *how* it is reached.

There are many reasons why owner-managers leave the business: reaching retirement age is one of the most compelling reasons, but there are plenty of other factors, such as:

- a good opportunity to sell the business
- ill health
- a change in family circumstance, such as death or divorce
- pressure from partner
- pressure from other family members in the business (especially the next generation)
- loss of interest or wish to move on to another business or personal project
- changes in the business environment.

In some situations, these pressures may combine to persuade an owner-manager to withdraw from the business, as in the example below.

> I was 62 when I had my first minor heart attack. It was a warning, my doctor said. I should 'take things easier'. Easier said than done, with a business to run and 30 people's jobs depending on me. Still, lying in a hospital bed forced me take stock. My wife had been on at me for a while to spend less time on the business – she wants us to buy a house in France and spend more time there nearer her daughter. My two sons are both senior managers in the business and I know I can trust them to take good care of the business – or at least I think I can.
> **Albert, MD of family engineering firm**

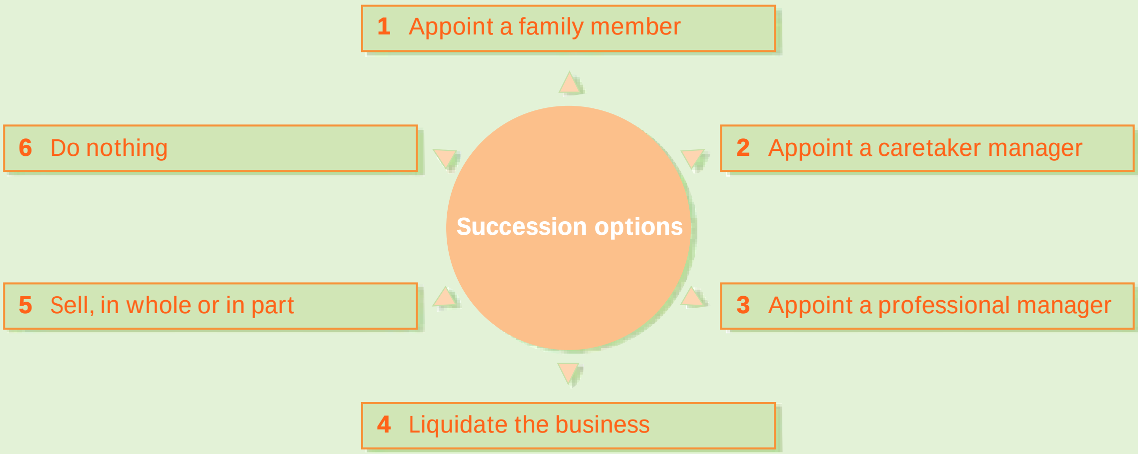
What are the options?

When the owner-manager of the family business decides the time has come to go, the questions are: What next? What are the options?

Activity

In Section 2, Topic 1 you explored the life cycles of family-run businesses. There were case studies of several family businesses. Re-read them now and think about what happened in each case and the different kinds of ending that occurred.

The options available to the owner-manager facing the question of succession are summarised in the diagram below.



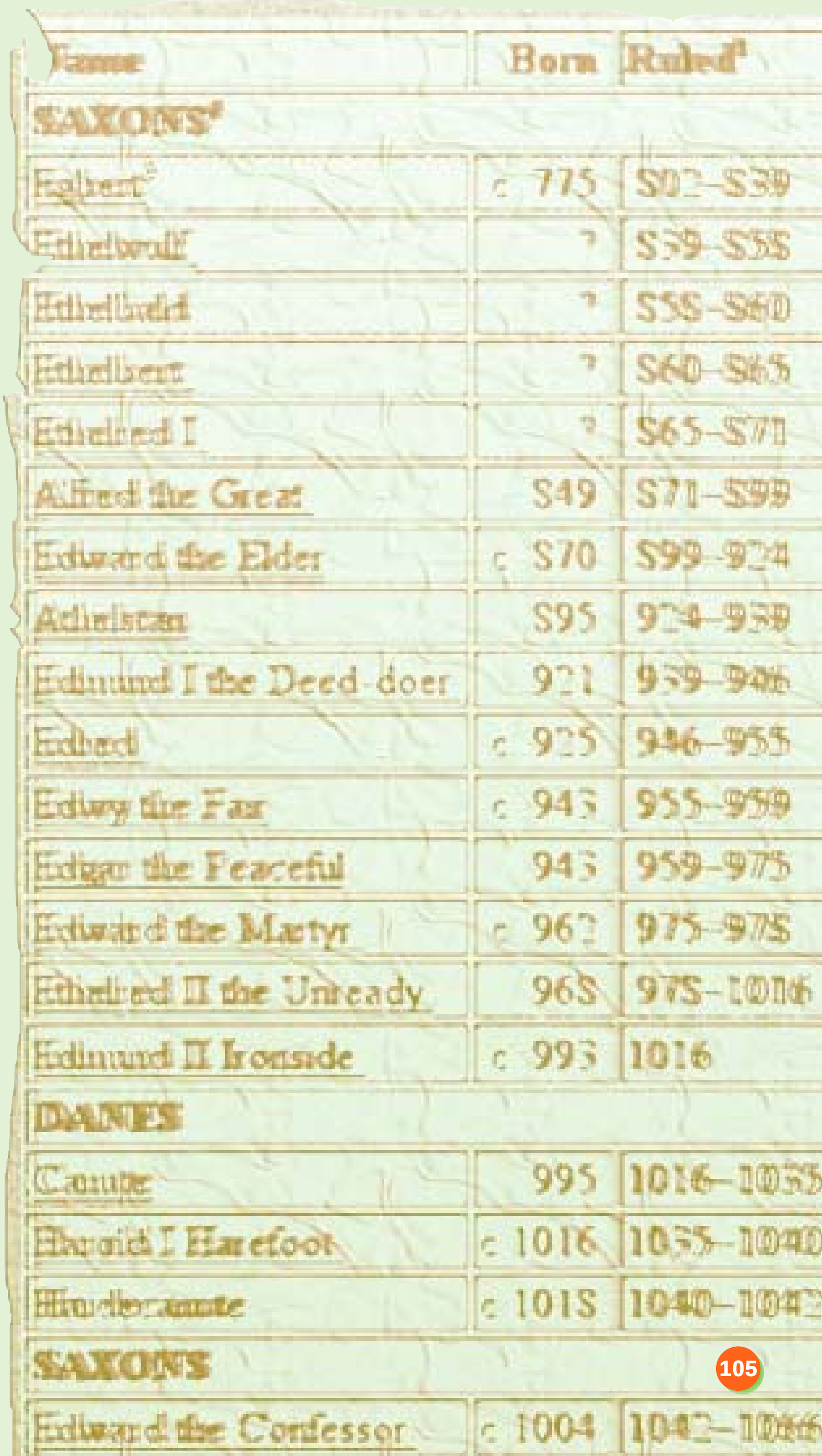
Source: Leach and Bogod (1999), p. 162

Options 1, 2 and 3 all involve keeping the business intact and handing it over to a successor, whether that is within the family (option 1), or to a manager or management team from outside (option 3). Option 2 is a hybrid of the two, whereby a non-family manager takes over the running of the business, while a successor from within the family is groomed to take over at a suitable point. In all three cases, the family can retain control of the business, for example by retaining ownership or a majority shareholding.

Option 4, liquidating the business, essentially means ceasing trading and bringing the business to an end. It involves selling off the company's assets, laying off any employees and paying any outstanding debts. This option can be costly – in terms of liquidator's and other fees – and the receipts from sales of assets are likely to be at a price far below their value to the business.

Option 5, selling the business in whole or in part, is a way of getting the best value if there is no obvious successor to take over the running of the business.

The final option – making no plans for succession – is the one most likely to store up trouble for the future, for when the time comes for the owner to bow out, the most likely result is confusion (at best) and chaos (at worst). Amazingly, however, it is by far the most popular option amongst family business owners-managers. You will examine why in Topic 3.



Name	Born	Ruled[1]
SAXONS[2]		
Egbert[3]	c. 775	802–839
Ethelwulf	?	839–858
Ethelbald	?	858–860
Ethelbert	?	860–865
Ethelred I	?	865–871
Alfred the Great	849	871–899
Edward the Elder	c. 870	899–924
Athelstan	895	924–939
Edmund I the Deed-doer	921	939–946
Edred	c. 923	946–955
Edwy the Fair	c. 943	955–959
Edgar the Peaceful	943	959–975
Edward the Martyr	c. 962	975–978
Ethelred II the Unready	968	978–1016
Edmund II Ironside	c. 993	1016
DANES		
Canute	995	1016–1035
Harold I Harefoot	c. 1016	1035–1040
Hardecanute	c. 1018	1040–1042
SAXONS		
Edward the Confessor	c. 1004	1042–1066

Section 5 Exit

Topic 2 Options and plans

Topic 1 identified the various options available to the owner-managers of family businesses seeking to leave the business. In this topic you will explore the available options more closely, in particular looking at the results of research into what owner-managers' exit plans typically are. We looked at this situation in Section 2, Topic 7, in relation to values and culture. Here we will look in more detail at different ways of leaving the business.

What owners want

The following table shows the results of research referred to earlier by 3i European Enterprise Centre. Owner/managers were asked to describe what their exit plans were.

Table 1: owner-managers' exit plans (3i EEC)

Plan	Britain	Overall
Transfer within the family	32	46
Sale to trade buyer	45	40
Sale to existing management	23	14
Total	100	100

The results of a survey of UK family businesses by Manchester Business School/Sand Aire were fairly similar. (Note: the options available are not mutually exclusive, hence the percentage column totals over 100 per cent.)

Table 2: owner-managers' exit plans (MBS/Sand Aire)

Plan	%
Lifetime transfers to family	43%
Sale to third party	35%
Setting up trusts	27%
Management buy out/in	16%
Minority family business owners selling out	15%
Employee share ownership plan (ESOP)	13%
Flotation	73%

Activity

Look at the figures shown in the two tables above.

- What conclusions can you draw from these figures about the plans of family business owners?
- Do any of the findings surprise you?

The first obvious conclusion is that not all family-run businesses see bequeathing the business as the most obvious or attractive option – or indeed as a realistic one. Selling the business, either to a trade buyer or to existing management, is the more likely option for UK businesses, with only one-third of owners intending to pass on the business within the family.

Interestingly, the 3i European Enterprise Centre found that intentions differed depending on the route by which people came to own the business. For those who started the business themselves, 44% favoured transfer within the family (across Europe), but this figure rose to 59% among those who had inherited the business. In other words, where there was already a dynastic succession, there was a greater desire to maintain the family succession.

When ownership came by means of a management buy-in or buy-out, the percentages favouring family transfer fell to 38% and 16% respectively.

Activity

Why do you think the owner of a second- or third-generation family business might be keen to pass on the family business to the next generation?

And why is it that owners who acquireda family business through a management buy-in or buy-out would be more ready to sell the business on?

To answer the first question, read the words of one person musing on her position as the inheritor of the family business.

Where the owner of the family business has acquired it through a management buy-in or buy-out, there is perhaps less sentimental attachment to the business, as it was originally the result of another person's or another family's entrepreneurship.

The family firm had already been going for 50 years when I inherited it as the third generation of Levines to run it. The business and the family are completely intertwined. It's hard to imagine one without the other, so I can't conceive of, say, selling the firm. I also feel a strong sense of responsibility for my children and grandchildren – the business isn't mine, I'm the custodian of the family inheritance.
Charlotte Lucas, Managing Director, James Levine Ltd

Check Point

What are your favoured options for the future of your business when you come to pass it on?

Tick the appropriate box, depending on how strongly you would favour each option:

	Strongly Favour	Favour	Neutral	Disfavour	Strongly Disfavour
Transfer within the family	○	○	○	○	○
Appoint caretaker manager	○	○	○	○	○
Appoint professional manager	○	○	○	○	○
Sale to trade buyer	○	○	○	○	○
Sale to existing management	○	○	○	○	○
Winding up the business	○	○	○	○	○
Do nothing …	○	○	○	○	○

Summarise your thoughts about your favoured options in Action plan 5 in Section 6.

Topic 3 Doing nothing – the ostrich option

As you discovered in Topic 1, doing nothing about planning for the future is the most usual option by far among the owners of family businesses. It is obviously not the most sensible option but, for various reasons, burying your head in the sand is the choice most family business owners make – and for that reason this topic is subtitled 'the ostrich option'. It explores some of the reasons why this might be so.

Reasons for doing nothing

The reasons why owners choose to do nothing are many and complex. The following diagram summarises some of the types of pressure than can lead to inactivity.

Practical obstacles
- No obvious successor
- No obvious buyer

Psychological blocks
- Ego
- Fear of mortality
- Fear of loss of identity
- Fear of retirement
- Jealousy

Reasons for doing mothing

Outside pressures
- Partner may fear change
- Family unsure about readiness to take over
- Employees 'can't imagine business without you'

Management style
- Owner tied up in operational planning
- Strategic planning tends to be done 'on the hoof'

Psychological blocks

Some of the most powerful factors at work here are psychological ones – to do with the owner-manager's personality and fears. They include the following:

- **ego, and fear of loss of identity** – Successful entrepreneurs are often assertive people with a high opinion of their worth, and pride in their achievements. Giving up control of the business means giving up the very thing that has helped them define themselves.
- **fear of mortality** – Giving up the business is a strong reminder to owner-managers that they are dispensable; moreover that this ending may be the prelude to that more final ending, when their life is entered into the great balance sheet in the sky... and their contribution to the business will be no more than a memory.
- **fear of retirement** – The prospect of retirement creates anxieties for many people in all types of employment, but a particular problem for the owners of family businesses is lack of preparation and outside interests. The family business often absorbs so much time and energy that owners pay little attention to life beyond it and do not built up the interests that could be developed in retirement.
- **jealousy** – Linked to the question of ego is the refusal to accept that anyone, not even close relatives, could possibly run the business effectively without them. They may feel resentment and jealousy towards potential successors. In some cases, 'retired' owner-managers have been know to engineer crises in order to stage a dramatic return to rescue the business.

Practical problems

There are problems of a practical nature which it may be hard to deal with. For example, there may be no obvious successor – either within the family or within the existing management. If the business has flourished because of the owners' specialist knowledge or understanding of a niche market, they are then faced with the prospect of finding and training up a successor – this can appear extremely daunting, especially given the need to run the business whilst simultaneously devoting time to the task of training.

Similarly, if the owner-managers want to sell the business, there may be no obvious buyer and the owners may not be sure how to go about finding one.

Management style

One of the key themes of this section is the need for systematic planning and for that planning to start early. By their nature, many entrepreneurs are more concerned with 'doing' than 'planning'. Indeed, they are often proud of the flexibility they can show in responding to changing circumstances and changes in the market-place.

The danger is that by being immersed in operational management, strategic planning gets done 'on the hoof', if at all. But, while markets may change and fashions come and go, the need for succession planning is a certainty.

Other people's fears

Owner/managers may experience pressure from people outside the business to stay on in their leadership role.

- **Spouses/partners** – Retirement of the owner/manager may present a challenge to partners and spouses – retirement can put quite a strain on marriages and partnerships, as people have to adjust to spending much more time together.
- **Successors** – Those earmarked as successors or potential successors may be unsure about their readiness to take over. They may be nervous of having to bear comparisons with their predecessor. They many not be sure that they even want the task.
- **Employees** – Employee loyalty is one of the hallmarks of the successful family business and this often translates into personal loyalty towards the founder or owner of the business. Staff, especially senior staff who have worked closely with the owner, may not be able to imagine the business without them. They may be suspicious of changes imposed by a management team, especially if that includes representatives of a younger generation with 'new-fangled' ideas.

Check Point

Are you guilty of taking the ostrich approach to succession planning? If you died tonight, who would take over the business tomorrow?

Have you prepared them for this? ○ Yes ○ No

What factors might lead you to delay making plans for the future of the business? Consider the four areas covered in this topic and note any thoughts here.

- psychological blocks
- practical problems
- management style
- other people's fears.

Summarise your ideas in Action plan 5.

Section 5 Exit

Topic 4 Planning for family succession

Passing the business down to the next generation of the family is only one of the options available to the owner-manager of the family business. How important an option it is depends to a large extent on the values and goals of the business founder and the family. For many family businesses, the values of tradition and continuity are paramount – the whole business is regarded as a key family asset and an expression of the family's identity. In this situation, getting the issue of succession right is vital.

The importance of succession planning

Succession planning means preparing to pass control to others, in order to ensure that the business does well in the future.
It involves:
- identifying and training successor(s)
- assessing all aspects of business in the light of transition – ownership, management, structure
- gradually relinquishing control.

Issues of succession must be faced early. Failure to prepare may be catastrophic for the company and the family alike, as you will see in some of the case studies later in this section. However, the evidence is that preparation, when it comes, is usually too little, too late …

'Of those planning to retire within the next 1 to 5 years, 40% have not identified a successor and 18% have not made the family aware of their future plans.'
Source: Bournemouth University Business School (1999)

Happy families or battleships?

How smooth the transition is from one generation to the next depends on two factors: how early planning starts and the level of involvement of the family. The Stoy Family Business Centre, in its *Toolkit for the Family Business*, analyses the effect of these factors as making a choice about what sort of 'game' you want to play… The options are Battleships, Risk, Bingo or Happy Families!

1 **Battleships** – The owner wants the business to remain in the family (i.e. high family involvement), but has failed to plan how to pass on the business.
2 **Happy families** – Again, the owner wants the business to stay in the family and has started planning in good time.
3 **Risk** – The owner is not bothered about keeping the business within the family, looking instead to sell it or hand over control (but not necessarily ownership) to a management team; however, the owner again fails to plan early.
4 **Bingo** – The owner is not looking to keep the business in the family, but has started planning other arrangements in good time.

Activity

Match up the following descriptions of family firms to the type of business 'game' being played.

1 **Bill Waddell** ran the Waddell fleet of refrigerated lorries for 20 years, with the help of his brother and sister-in-law. Sadly, Bill was accidentally knocked over when one of his lorries reversed over him. Bill's brother wants to retire and Bill's widow wants nothing more to do with the business. They are looking to try and sell the business as a going concern. Failing that, they will liquidate.

2 **Justright Carpets Ltd** is in its second generation. Philip Jenkins is the current owner-manager. His sons Kevin and Phil, both expert fitters in their time, now spend most of their time in the firm's two shops. Philip Jenkins hankers after a change of lifestyle and suddenly decides he wants to spend the rest of his life on the Costa del Sol. He wants his sons to buy him out. Somewhat stunned by his sudden decision, they are searching for ways to finance the buy-out, but frictions over the price of the shares and the timing of the sale is souring family relations.

3 **Jane Brown** and **Stella Walker** set up the first all-woman estate agency in their town 14 years ago, when in their 40s. The sisters are now planning their retirement. About five years ago they discussed what to do in this situation, and after much family discussion, it was agreed that Jane's daughters Selene and Hera would take over the business. After university, both daughters joined the family firm and went through professional training. Dates have been set for first Jane, and then Stella, to withdraw from the business.

4 **Cinzia Parati** runs a family business making and selling elaborate wedding and communion dresses. She and her husband now have four shops and have recently been approached by a nationally known firm to sell the business. Cinzia has taken various steps to make the balance sheet look as attractive as possible. She has already made a number of pension investments and set up various trusts to minimise the tax implications of the sale of the business.

Although you will have realised that this is intended as a humorous analysis, it contains a great deal of accuracy. You should have identified the following games…

- Waddells – Risk
- Justright Carpets – Battleships
- Brown and Walker – Happy Families
- Cinzia Parati – Bingo

Check Point

Note your answers to these questions before turning to the Action plan to consider any changes you may wish to make.

- What sort of game *are* you playing:
  - ◯ Battleships
  - ◯ Risk
  - ◯ Bingo
  - ◯ Happy Families?
- What sort of game *should* you be playing?

Section 5 Exit

Topic 5 Choosing a successor

This topic follows on from Topic 4 in looking at the issues involved when there is a strong desire for the family business to be passed on within the family. This topic considers the questions of who should make the decisions about succession and on what basis those decisions should be made.

Who should decide?

In family firms it is usually the outgoing owner-manager who has most influence in decisions about who will become the next guardian of the family firm.

Activity

What are the arguments for and against the existing owner-manager of the family firm making the choice of successor?

You probably noted that the advantages of the current owner-manager making the decision are that they are likely to have the clearest idea about the needs of the business and the demands of the role. They may have seen the potential successors 'in action', by supervising them in their current work for the firm.

There are also clear drawbacks, however. The decision may be made according to objective criteria, but very often will be made on subjective grounds, for example:

- choosing the eldest or favourite child regardless of ability or experience
- deliberately steering control of the business away from the direct line, e.g. putting one of their siblings or a nephew/niece in charge, as a way of thwarting their own children's ambitions or a perceived challenge to their parental authority
- choosing someone in their own image – who will carry on the business in exactly the same way as before
- choosing someone they know they will be able to control 'from beyond the grave', perhaps the most loyal or most easily influenced child.

Sir John Harvey-Jones described this as the 'laying-on of hands system' – like the pope, the family owner vests his authority in the chosen successor in a kind of sacred ritual.

Other experts have also questioned whether this approach is the most suitable. Harry Levinson explains the psychological contradictions inherent in successful entrepreneurs choosing their own successor. On the one hand, entrepreneurs want the business to thrive after they have left; on the other, they are desperate to believe that they are indispensable to the business they have created or moulded. So, while striving to make a wise choice about whom to choose, they unconsciously want to prove that no one can succeed them.

For all these reasons, experts recommend that decisions about succession should be made in conjunction with people other than the current owners. A strong independent board of directors or an experienced non-executive director can be invaluable in giving objective advice (see Section 4, Topic 9). Professional advisers are another source of help. Even family members not involved in the business could be consulted, although this latter course may hold similar dangers to the ones discussed above.

Who is the best successor?

There are complex issues at play when it comes to choosing a successor, as the first part of this topic highlighted. It is essential for the success of the business that rational decisions are made. One way of ensuring this happens is by drawing up a set of objective criteria to judge who would be most suitable. In this sense, it is no different from the selection criteria that should be used to fill any vacant position in any business.

Among the questions to be considered are the following:

- What are the candidate's values and goals?
- Is the candidate committed to the company's mission statement?
- What skills does the candidate have that qualifies them for the role?
- Does the candidate have the skills necessary to direct the company:
  - – strategic planning skills
  - – budgeting and financial skills
  - – communication skills
  - – marketing skills
  - – leadership skills?
- What experience does the candidate have within the company and outside it?
- What training would be necessary to fill any skills gaps?

In a recent survey by Bournemouth University, family business managers were asked about their succession plans. Those questioned identified two areas where they had concerns about the abilities of possible successors: lack of relevant business and people management skills. A number of other skills gaps were also identified, with the highest skill gap related to accounting, followed closely by strategic skills and marketing.

A revealing statistic from the survey shows up the lack of objectivity many family businesspeople have when it comes to choosing a successor. A huge 85% of owners who had identified a successor considered that the family member chosen had the skills needed to take over the business. However, when questioned more closely about what those skills were, 75% of respondents were unable to answer whether or not the successor they had identified had specific skills.

The conclusion seems to be that owners-managers of family businesses are concerned that their successors should have relevant skills and abilities, but are willing to suspend their concerns when it comes to family members. All of this serves to stress the importance of using objective criteria when choosing a successor.

Check Point

Who are the candidates for succession to your family business? For each candidate, think about the questions below. Then, in Action plan 5, note down any priorities for action that your answers uncover. (Complete this check point only if family succession is a likely option for the future of your business.)

	Candidate 1	Candidate 2	Candidate 3
What are the candidate's values and goals?			
Is the candidate committed to the company's mission statement?			
What skills does the candidate have that qualifies them for the role?			
Does the candidate have the skills necessary to direct the company:			
– strategic planning skills			
– budgeting and financial skills			
– communication skills			
– marketing skills			
– leadership skills?			
What experience does the candidate have within the company and outside it?			
What training would be necessary to fill any skills gaps?			

Section 5 Exit

Topic 6 Managing the process of family succession

In Topic 5 you examined how important it is to get the process right when making decisions about family succession: this includes getting help and advice, where appropriate, and applying objective criteria for choosing the most appropriate family member.

‘The world’s oldest operating family-owned business is Hoshi Ryokan in Japan, which has been entertaining guests in its 100 rooms since 717 AD (46 generations). Designed by Garyo Hoshi, it was built near a spring believed to have miraculous healing powers.’
Source: Guinness Book of World Records/CBS Inc.

This topic looks at other elements in the process of planning for family succession: training your successor, communication and planning your own future.

Training your successor

When considering candidates for the post of successor, you may well find that a clear favourite emerges, but that they don’t meet all the criteria set, in terms of skills or experience. This is not an insurmountable obstacle. Provided the successor has the required abilities and potential to develop, a programme of training can be set up to prepare them for the role.

‘Nearly two thirds of all identified successors have worked for businesses other than the family-owned business. Of these, nearly half have worked for other businesses for a substantial number of years.’
Source: Bournemouth University Business School (1999)

It may be important not to force the pace, but to nurture the successor’s involvement in the company, so that the transition is a gradual process. This will be important for all parties involved.

- It gives the successor the opportunity to grow into the role, and scope to try out their own ideas.
- Staff and others working for the business have time to get to know the successor and get used to working with them.
- Customers of the business, too, have a chance to get used to dealing with the new face of management, working alongside the old familiar face.

Communication

As well as starting to plan in good time, you should be consulting with other people from the earliest stages. In particular, you will need to communicate your ideas to your family. There may be formal mechanisms to do this, e.g. through family meetings or by following guidelines laid down in a family constitution, if one exists.

I was only in my late twenties when my father raised the possibility of my taking over from him and running the firm he’d set up. I was surprised he spoke about it then – I know it was something he hankered after, but he’d always been careful not to ‘name’ this hope. Instead, he let me get on with my own life. Anyway, he was barely 50 and I couldn’t see what the rush was – he wouldn’t be retiring for at least 10 years. But when we sat down together and worked through what the job involved, what skills I might need and how long it would take to prepare for the role, 10 yeas suddenly didn’t seem that long at all!
Christopher, son of managing director

Above all, don’t make assumptions about what other people want. For example, don’t assume that the person you have earmarked as the family business’s future leader actually wants the job … you will explore the dangers of doing this in the next topic.

Talking to non-family members may also be crucial, especially if they are able to offer an unbiased perspective on your plans.

Take a back seat

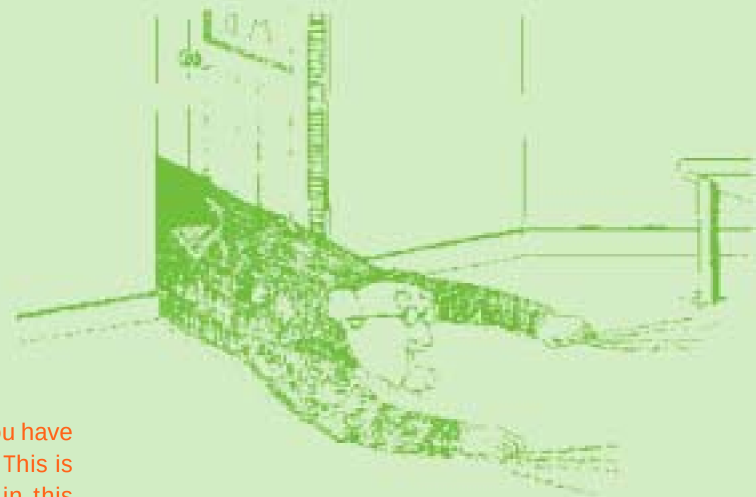
As you have seen, choosing and grooming a successor requires careful planning – and time – but another side of the process is planning your own exit from the company. It can be incredibly difficult to let go of the reins, especially if you are giving up control of a business you yourself founded. There is evidence, though, that by delaying their departure (often into their 70s or 80s), the owners of many family firms actually cause their beloved business great harm – sometimes even inflicting terminal damage.

Retirement: key steps

- Be ready to give up your control.
- Set a date for retiring.
- Go when you say you will!
- Don't interfere from 'beyond the grave'.

The key is to give the successor the independence to run the business, not to feel constantly in their predecessor's shadow. There may a vital role for the outgoing founder, e.g. in strategic planning, new product development or in a promotions role, but this should be negotiated and not assumed.

Another part of retirement planning is ensuring that you have a financial base that is independent of the business. This is discussed in more detail in Section 3, Topic 6, and in this Section, Topic 11. Setting up this secure base is again a long-term project – one that should be started as early as possible.



'Of course, I could always stay on … in a purely advisory capacity…'
Source: Leach and Bogod (1991)

Check Point

(Complete this check point only if family succession is a likely option for the future of your business.)

Reading through this topic, identify priorities for action in the three areas covered. Make brief notes here before summariising your thoughts in Action plan 5.

- training your successor

- communication

- planning your retirement.

Section 5 Exit

Topic 7 Family succession and conflict

In the past few years, there have been some spectacular family business implosions, caused by conflict over succession. As ever, the United States provides the biggest and best examples …

- In Washington, D.C., the Haft family blew itself up fighting over control of its $1 billion empire of drugstores, bookstores and real estate after the father changed his mind about the succession plan for his eldest son.
- In Dallas, the Simmons family, which made billions in pharmacies and mining, went to war over multimillion-dollar trust funds Harold Simmons set up for his four daughters, ostensibly so they wouldn't have to work in the family business.
- In New York, the Pressman family, founders of the clothing store Barney's, were recently humiliated when their years-long effort to expand the chain and pass on the business to the next generation ended with favourite sons Bob and Gene Pressman being expelled from the company.

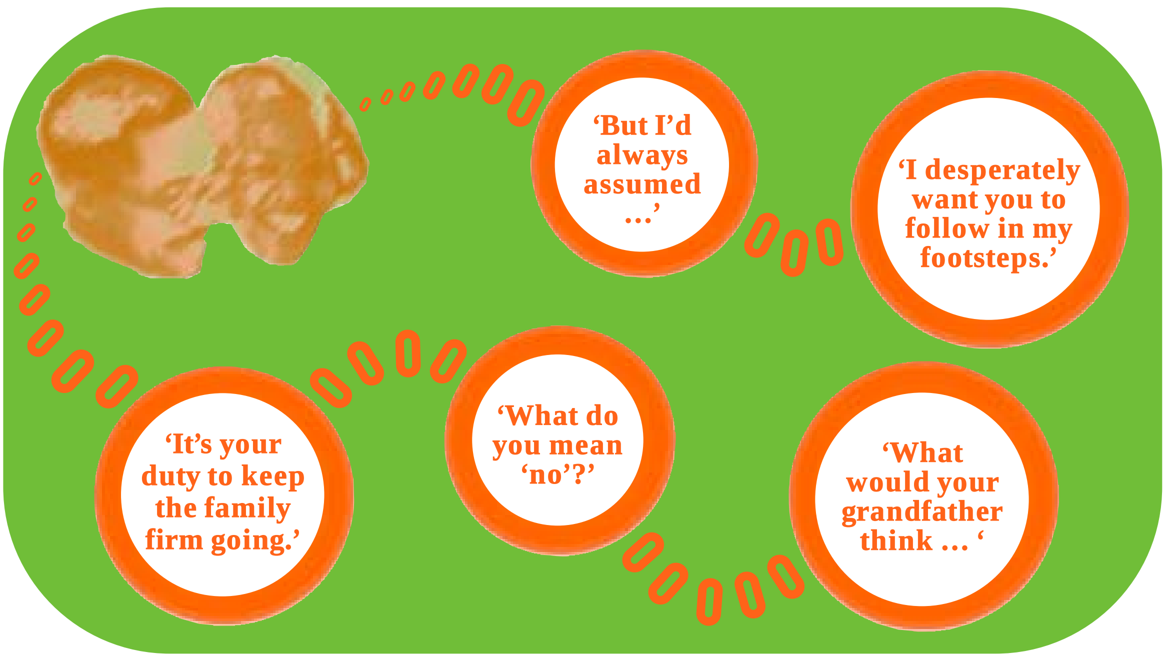
When large sums of money are involved, the fallout from the blast can be earth-shaking, but the tremors in even the smallest company can be big enough to rock the business to its foundations. This topic looks at some of the difficulties and conflicts that can occur in trying to make plans for succession.

When the chosen successor says 'no'

'Nearly 50% of family businesses surveyed had not yet identified a successor … less than half of all successors who had been identified had indicated a willingness to be involved in the business.'
Bournemouth University Business School (1999)

So far in this section, you have worked on the assumption that the chosen successor actually wants the role (and responsibility) of running the family business. But the question has to be asked whether the successor actually has the will to assume the mantle. The family business can provide a rewarding career for children reaching working age, but the world offers a vast array of opportunities and, when it comes to it, there may simply be more rewarding opportunities outside the family firm.

This question raises all sorts of difficult spectres: feelings of duty clashing with individual wishes, ensuing guilt, anxieties about responsibility, unspoken assumptions about family members' roles. Here are some typical responses from children and other family members faced with decisions about taking on management roles in the family firm.



The important thing is for both sides to communicate. By naming fears and anxieties, it becomes possible to deal with them. Leaving them unspoken is a guarantee of simmering discontent that is likely to boil over into a crisis at the worst possible time.

For the disappointed parent, it can be hard to swallow the disappointment of seeing the chosen successor reject their 'golden future', but their right to say 'no' has to be accepted and alternative options considered.

When it's hard to choose

A different scenario arises when there are *too many* candidates for the job!

It is always hard to face up to having to favour one child over another, and the fear of creating inter-sibling conflict is a real one. The key thing is to handle the process as fairly and reasonably as possible. As ever, good communication is vital. The key steps are:

- discussing the issue of succession with all those concerned as early as possible
- making your intentions known as early as possible. That will help to avoid misunderstandings later on
- not jumping to conclusions – the eldest son may only have said he wanted to succeed you because that is what he thought you wanted. He may be happy to pass the burden on to his younger brother. And the middle son may not really want the job either…
- making sure you speak to all the children about their ambitions
- involving an objective third party – e.g. business advisor, a non-executive director or trusted non-family manager.

> I've got three children working in the business, all of whom would like to take over from me when I retire. My eldest son assumes he will inherit the mantle, but really it's my middle son who is the best qualified and has the best temperament. I'm scared to say anything in case all hell breaks loose.
> **Shirley, owner/manager/mother**

This last point is the key. Even if the other processes listed above are gone through, there may still be too much left unsaid. It is important to get to people's real motives and desires, not those which are 'acceptable'.

Section 5 Exit

Topic 8 Disputes over ownership and control

Topic 7 looked at the conflict that can arise when different generations have different ideas about who should succeed in the family business. Succession plans can also raise other issues that cause difficulties between family members: ownership and control are two of these. This topic looks at these issues.

Disputes over ownership and control

Disputes over inheritance provide a plentiful supply of family conflicts. Ownership and control of the family business can be particularly troublesome areas.

Activity

What are the issues in the three case studies that follow?

What suggestions can you give for resolving these problems?

1) My father was keen that both my brother and I should be involved in the family timber business and left us each a 50% shareholding. The trouble is that we seem to have completely different ideas about where the company should be going. I want to invest and expand the business; Tim seems most interested in getting as much out of it as possible – we are always arguing about dividends. I think Tim would be happiest to see the business sold off.

2) My father is now 74 and still won't relinquish control of our motor retail business. He is living in a different era – when AA patrolmen would salute you as you drove by! He is now becoming a liability and I'm having to cover up his mistakes. The motor industry is a much harder world than he's used to and it's time he handed over control to the younger generation. He just can't accept that he isn't needed in the business.

3) My mother has withdrawn from the business and now I'm charge of the boutiques, but she absolutely refuses to give up any shares and remains the sole shareholder. She won't tell me what her plans are. I'm worried that she will leave my brother and sister shares in the business, even though they are not involved and I've been running things for years.

Compare your analysis of these situations with the following:

1 Many business founders and owners are scrupulous about being 'fair' to their children when it comes to bequeathing interest in the business. Here, the father, by taking an equitable approach, has actually put the whole future of the business in jeopardy.

The issue here is one of planning and communication. The father should have discussed with his sons what they wanted out of the business: their aspirations, values and goals. The mismatch between his sons' ideas would quickly have become apparent. The father could then have separated out ownership and control, e.g. by giving one son control, while giving the other an equal share of ownership. This could have been done by creating different classes of share, one having full voting rights, while the other being subject to voting restrictions or carrying no voting rights at all.

2 Here, the problem is of the older generation refusing to give up control and jeopardising the future of the business by doing so. For the children in this situation it is frustrating but they are probably also wary of being too harsh with their father. If their father refuses to take gentle hints, it may be a good idea to enlist the help of someone independent whom their father respects and trusts, e.g. a friend or business associate. Encouraging activities and interests outside the business would also be a good idea, but it's not always easy to persuade a life-long entrepreneur that he would be happier hitting a golf ball around the park …

3 This scenario again highlights the potential for conflict when communications are poor. By not discussing her wishes, the mother is running the risk of alienating the very person on whom her business depends, and causing conflict between her children. She may be worrying about how to treat her children 'fairly' while recognising the part played by the child active in the business. The cause of this dilemma may be the assumption that fairness means equality of treatment, but (as in scenario 1) there are ways of being fair without treating people in exactly the same way.

As in scenario 1, bequeathing shares with different voting rights could be a good solution. Another option is to take out a life insurance policy in favour of named beneficiaries that can be used to provide cash for the heirs who are not active in the business. The amount of money they receive under the policy can be made roughly equivalent to the value of the shares bequeathed to other children.

The three examples above involve disputes about 'shares' in the company. In some ways these kinds of disputes are easier to resolve when the business is a company. With a partnership, the partnership agreement will probably lay down what is or is not possible in a retirement from the firm (see Section 3, Topic 3). Sometimes the articles and memorandum of a limited company will do the same about different classes of share.

'I have one daughter with no business sense and a lovely temperament and one daughter with excellent business sense and a poisonous temperament! The business may go to the latter as inheritance but the former will also be left something of equal value.'

Source: Bournemouth University Business School (1999)

Check Point

Make brief notes brief and then summarise your ideas in Action plan 5. (Complete this check point only if family succession is a likely option for the future of your business.)

- What potential areas of conflict can your foresee arising when it comes to passing on your family business?

- What action can you take now to prevent this happening?

- Who needs to be involved?

Section 5 Exit

Topic 9 The generation gap – managing change

Any period of transition – such as when a family business passes from one pair of hands to another – involves change. The question then arises of whether successors will want to carry on in the tradition of the founder/current owner, or will want to run the business differently. This can also lead to disagreement and conflict. This topic explores these questions.

Accepting change

Activity

What are the issues in the two case studies that follow?

What suggestions can you give for resolving these problems?

1 Gary Rayburn set up a typesetting business in the 1970s after working for a printing company for over 20 years. Having invested heavily in equipment, he has seen a lot of it made redundant by the advent of desktop publishing and other technological development. His daughter, Lorraine, works in the business and is the appointed heir to it. She is keen to change the direction of the company and focus on more design work, especially website design, while reluctantly maintaining the more traditional typesetting machinery for the existing, although shrinking, customer base. Gary is extremely nervous about the whole thing, and his method of dealing with the tension is to refuse to discuss it. Lorraine is threatening to leave and set up on her own.

2 Matt Somerset set up his shop-fitting company as a young man, over 40 years ago. It now turns over nearly £750,000 per year, and his two children, Caroline and Joe, are both involved. Caroline worked outside the business, taking an MBA before joining as finance manager. She wants to strengthen the strategic planning and marketing side of the business. Joe's speciality is human resources and he is well aware of Matt's autocratic approach to staff management – and of the rapid turnover of staff the company has had.

Matt often gets frustrated with his children, pouring scorn on their cautious approach and emphasis on 'boring paperwork'. Being used to working very long hours, including weekends, he has also occasionally questioned his children's commitment to the firm. This has led to one or two rows, as the children's riposte is that they aren't going to put the business first and their family second in the way their father did.

In both these case studies, there are issues about differences of approach between generations:

1 Gary has spent years building up his business and is naturally concerned about handing it over to someone with very different ideas about the business's future. Lorraine, meanwhile, has very clear ideas about where she wants the business to go. Her determination is intimidating to her father who responds by refusing to discuss the problem.

For the business to prosper, Gary and Lorraine must resolve their differences soon, so that both can feel comfortable working in the business. There are responsibilities on both parties to compromise.

- Gary has to respect his daughter's business sense, skills and experience.
- He has to realise that she has the best interests of the business at heart and that the future of the business lies with her ability to respond to changes in the market.
- Lorraine should respect her father's emotional (and financial) stake in the business.

2 In this instance, the children are in some ways more conservative than their father, who built up a business by being creative, taking risks and trusting his instincts. With their business school training, they are taking a more measured approach – which is what they are comfortable with. The children have an altogether different management style – one based on consensus rather than domination. For a business in its second generation, this is often a more appropriate style as the driving force of the founder disappears from the scene.

There are also generational differences about attitudes to work. Caroline and Joe, having grown up in a family business, know only too well what a toll it can take on the family and are determined not to miss out on family life. By stating this openly, they are also implicitly questioning their father's approach to his family and work. This factor may influence the decisions they take about whether to expand the business or keep it at its existing size. It is not surprising that this causes friction.

In both these situations, communication is, once again, the key. Matt, Caroline and Joe need to have an honest discussion about their personal goals and their vision of the business. This would include aspects such as attitude to risk and financial goals. Again, involving a third party as a mediator could be a very good idea.

Managing the transition

Managing the transition from one owner to another depends to a large extent on being able to manage the anxiety generated during this process. Transition often involves dismantling the structures and relationships that have held business and family together, and building them up again in a different way. Simply accepting that this anxiety exists and accepting the need for change are often the first positive steps towards new stages of development.

Check Point

(Complete this Check Point only if family succession is a likely option for the future of your business.)

Make notes in response to the following questions before summarising any ideas for action in Action plan 5.

- What potential areas of conflict can your foresee arising because of generational differences?

- What action can you take now to prevent this happening?

- Who needs to be involved?

- Are there people outside the business whom you all know and trust, who might be able to help?

Section 5 Exit

Topic 10 Non-family succession

The diagram in Topic 1 identified the various options open to the owners of family businesses as they face the question of their exit from the firm. Two of the options involved appointing managers from outside the family, either as a permanent measure or in the role of 'caretaker'.

Topic 8 in Section 4 looked at issues relating to introducing non-family managers to the business. This topic revisits the subject, but with a focus on issues arising when the non-family manager is taking on the role of successor.

Appointing non-family managers

Although many family owners cherish the hope of passing on their prized business to the next generation, this is not a practical reality for the majority of them. In the UK, family succession is only a realistic plan for around 35 to 40% of businesses. Even then, not all of them will bring their plans to fruition. Furthermore, family size declines with prosperity, so it will be even less of an option in the future.

When faced with no obvious family successor, and yet wishing to keep ownership of the business within the family, the retiring owner's best option may be a non-family manager. The family can retain control of the business, for example by retaining a majority shareholding.

The main issues in this situation include ones of understanding roles, mutual trust, communication and reward, as the following table shows.

Issue	Family members	Non-family managers:
Roles and responsibilities	need to understand the limits of their involvement in the business	need to understand the scope of their role and where the boundaries lie
Trust	have to have confidence in the ability of managers to take good care of their major asset	need to feel confident that the family will allow them the independence to manage
Communication	should agree systems whereby they will be kept informed about the progress of the business	need to know that there are clear channels of communication open to the family
Reward	need to consider whether they are prepared to give the manager a controlled capital involvement.	have to have incentives to remain and be clear about the possibility of acquiring a share of ownership.

For businesses that reach the third generation or beyond, the route of appointing outside managers may be the only solution to succession problems as, by this point, the ownership of the company may be shared by a wide spread of relatives, all with different views about how their stake in the firm should be preserved. In this situation, it is even more vital that the issues above are discussed openly and agreements are reached, in order for managers to feel secure about the scope of their role and the support they will receive.

The question of reward has to be seriously considered. Since share options are increasingly common in quoted companies, it could be difficult to tempt high-quality managers into the business without the prospect of share ownership. However, for many families this is a very difficult prospect to face up to.

As businesses move into later generations, the family's involvement may become more and more distant, even to the point where it gives up its stake in the company, which by this time is run by an established hierarchy of professional managers and owned by an array of individual and institutional shareholders.

An era ended recently with the retirement of Sir Dominic Cadbury from the board of Cadbury's, leaving no member of the founding family on the board for the first time since the company was founded back in 1824 … Sainsbury's and Moss Bros are among other well-known companies to have lost their boardroom links.
Source:
www.newbusiness.co.uk/

The traffic isn't all one way, however – the family can make a comeback!

[In] the latest segment of Ford Motor's corporate soap opera, family scion William C. Ford Jr. ousted tenacious Chief Executive Jacques Nasser and took Nasser's title for himself … the first time a Ford family member has run the namesake business since 1980, when Ford's late uncle, Henry Ford II, stepped down as chairman.
www.forbes.com/2001/10/30/1031ford.html

Caretaker managers

The role of non-family managers acting as caretakers is rather different from that of the long-term professional manager discussed above. A caretaker or 'bridge' is someone appointed to tide the business over during an interregnum – a period between the exit of one family manager and the appointment of the next.

A caretaker is usually needed when potential successors are not ready to take over for whatever reason:

- they are too young or inexperienced
- they are committed to other business activities and need time to manage the change over to their new role
- they are not confident about taking over the role and want to 'shadow' the caretaker manager for a time.

The caretaker's relationship with the owning family will be rather different from that of a permanent professional manager, as the caretaker is by definition a short-term appointment, although there may be a role for them after the chosen family successor takes over, e.g. acting as an advisor or mentor.

Issues of communication will be particularly important, as both sides will constantly need to review progress towards the eventual hand-back of control to the family.

Section 5 Exit

Topic 11 Selling the business 1 – motives and concerns

What happens if there is no likelihood of family succession and the prospect of continued ownership under professional management doesn't appeal? Selling the family business may be the most attractive option. This topic looks at reasons for selling the business and at some of the concerns owners have when considering taking this step.

Reasons for selling

Being unable to appoint a family successor is just one reason for selling – and in the UK is by no means the most influential. The following table lists reasons for selling the business given by owners of family businesses in the UK.

Table 1: Reasons for selling the business (UK figures)

Plan	%*
Realise capital gain/received a good offer	81
New management needed to develop business	33
Not able to pass on within the family	26
Need for more finance in the company	23
Illness	5

***Respondents ticked more than one box and therefore columns sum to over 100%.**

Source: Burns and Whitehouse (1996)

Activity

What are the main inferences you can draw from these figures about owners' motives for selling the family business?

Do any of the figures surprise you?

As this table shows, the factors influencing the decision to sell are varied. The financial motive is evidently a very strong factor in the UK – stronger than in the other European countries surveyed, where the average was only 68%, with Germany registering a surprisingly low 22%. In fact, the inability to pass the business on is cited by only 26% – fairly similar to two other commercial reasons: the need for new management to develop the business and the need for more finance. These figures would suggest that when it comes to making the decision to sell, most family managers take a fairly hard-headed view of the situation.

Concerns over selling

Burns and Whitehouse, in their research, questioned family business owners about their concerns over selling the business. The results, for UK business owners, are shown in the bar chart opposite.

In the questionnaire, owners were asked to rate the importance of their concerns on a scale ranging from +10 = very important to –10 = not at all important.

Given the strength of the desire to realise capital gain shown in Table 1, it is not surprising that getting a high price rates as the most important concern, although staff welfare and the new owner's ability to maintain the company are not far behind. Many of the people employed in the business may be friends, as well as colleagues, and many owners feel conscious of not wanting to betray the trust and loyalty that staff often give in large helpings to family firms.

It is perhaps surprising that the independence of the business and maintaining existing methods and ideals are rated so low – perhaps once they make the decision to sell, owners are able to take an unsentimental and realistic assessment of the future.

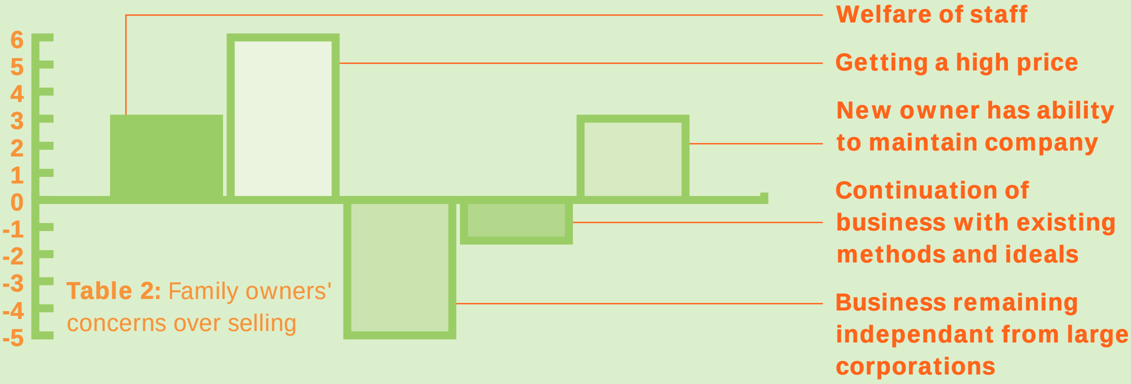


Table 2: Family owners' concerns over selling

Failure or success?

Nevertheless, for many owners of family businesses, the idea of selling, especially for those who have cherished thoughts of family succession, is a bitter pill to swallow. Many regard the inability to pass on the concern to the family as a failure, when it should be regarded as success – a different form of success from securing succession, but a success nonetheless. It should provide for the family's future through capital gains and remains an achievement to be proud of.

Accepting the need to sell is, however, the vital first step, as the process of selling requires the same level of planning and commitment as any other aspect of running the business. In fact, selling the business can actually prove a liberating experience. For example, where owners have sold the business but stayed on in an executive role, their business decisions often improve, because they no longer face the conflicts of family or emotional issues.

Check Point

Think about the following questions before summarising your ideas in Action plan 5.

- Have outsiders ever approached your firm with a view to buying it?

- Have you ever considered, or would you ever consider, selling the family business?

- If so, what would be your motives for doing so? Which of the factors in Table 1 would apply to you?

- What would your concerns be in selling the business? How would you rate the five factors shown in the bar chart? Give each one a rating on the scale from –10 to +10.

- What other concerns would you have?

Section 5 Exit

Topic 12 Selling the business 2 – options

Aside from a full or partial liquidation (discussed briefly in Topic 1), there are several options that the owner of a family business can weigh up when deciding to sell:

- a trade sale
- management buy-out
- family management buy-out
- stock market flotation
- employee share ownership plans (ESOPs).

Each of these has advantages and disadvantages – not least in taxation implications. This topic looks in particular at the first three. Going public, through a stock market flotation, is an option that only the largest family businesses can contemplate, while ESOPs are complex and specialised affairs – both of these require expert business and legal advice, and are beyond the scope of this book.

Trade sale

This means selling the company, lock, stock and barrel, to a buyer already operating in the same general business sector. This appeals to many family business owners, as they have a certain reassurance that the business is going into experienced hands – although there may be questions of rivalry and pride to consider.

There are some tax advantages to selling the business as a going concern:

- gains on the disposal, normally subject to capital gains tax, can be deferred if the sale is to a company in exchange for shares, rather than tax
- VAT is not payable, subject to certain conditions
- unused trading losses can be preserved
- taper relief for business assets is available (this replaces retirement relief, phased out in April 2003)
- reinvestment relief is also available.

VAT

Management buy-out

If the family business has reached the stage where non-family managers provide much of the management expertise, then selling the business to them may be a logical step forward. This has obvious advantages to all sides.

- It preserves the business more or less intact and in the hands of skilled and experienced managers who understand it.
- It gives added incentive to managers.
- It minimises disruption in the handover.
- The personal relationship that exists between family and non-family managers can be maintained, if necessary.
- Conversely, it might also resolve any conflicts that had arisen between them.

Table 1 opposite shows the results of Burns and Whitehouse's research into why family owners in the UK would prefer to sell to existing management.

The most obvious hurdle with management buy-outs is whether the management team can raise the capital needed to buy the business. Indeed, this is one of the main reasons for owners not wanting to sell to an existing management team (see Table 2). Other reasons expressed by owners are lack of skills and experience, and the obvious attractions of a higher offer.

Another drawback with management buy-outs is that the quest for capital to buy the company may prove a big distraction from the day-to-day concerns of running the business. As they are busy drawing up plans, meeting with possible investors, etc., the business and its value may suffer.

Table 1: Reasons for wanting to sell to existing management (UK figures)

Reason	%*
Best for continuity and independence of company	50
Have most appropriate skills and experience	42
Personal relationships with management require it	17
Unable to pass on in family	13
Realise capital gain/best offer for the company	8

Table 2: Reasons for not wanting to sell to existing management (UK figures)

Reason	%*
Do not have access to enough finance	51
Likelihood of higher price from external buyer	50
Do not have appropriate skills or experience	43
Personal reasons	2

*Respondents ticked more than one box and therefore columns sum to over 100%.

Source: Burns and Whitehouse (1996)

Family management buy-out

It may be that the current owner-manager wants to maximise personal wealth (for retirement), while other family members (e.g. next generation) still want to be involved. One possible solution is for the family members to combine with non-family members in a family management buy-out.

This has the advantage of releasing money to the retiring owner, who can also make the most of reliefs against capital gains tax which would not be available if the owner simply passed the business on to the family. At the same, the family ethos of the company can continue in the presence of family members in the management team. Having a balance between family and non-family management can prove a powerful asset.

Check Point

Consider the following questions.

- If selling the family business is one possible option available to you, which of the routes discussed in this topic would be appropriate?
- What would be the reasons for and against each possibility in your particular case?

	Reasons for	Reasons against
• a trade sale		
• management buy-out		
• family management buy-out		
• stock market flotation		
• employee share ownership plans (ESOPs).		

Section 5 Exit

Topic 13 Selling the business 3 – planning

This topic looks at some of the practical steps that need to be taken when the business owners decide to sell up. This includes the need for careful planning and a clear-sighted approach, as well as practical issues of finding a buyer and valuing the business.

Finding a buyer

If the business is to be sold, you first need a buyer. In some of the situations discussed, e.g. management buy-outs, buyers readily present themselves. In other cases, e.g. a trade sale, a purchaser has to be found. This can be a long and delicate process, and cannot be rushed, no matter how urgently the vendor wants to dispose of the business.

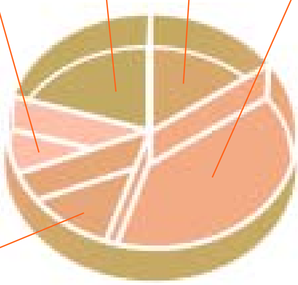
In many cases, the sale will be precipitated by the arrival on the scene of a buyer, who makes an offer the family owner cannot turn down. According to a recent UK survey, almost 90% of family company respondents indicated that they had received an approach within the last six to seven years.

Valuing the business

Having agreed a sale in principle, the next critical step is to put a value on the business. There is no one objective way of arriving at a valuation. Various methods are available and different companies will choose the most suitable method, depending on factors such as:

- what will give them the best valuation
- what the prevailing market conditions are
- comparison with other companies
- how they can minimise tax liabilities.

The Burns and Whitehouse study found that in the UK, the multiple of profits method was the most highly favoured at 39%.



Perhaps not surprisingly, 21% didn't know what method they favoured. After all, selling the business is a one-off task and most owners will approach it with trepidation and little previous experience. This underlines the importance of having specialist advisers to call on throughout the whole process.

In terms of pitching the valuation, vendors will seek to present as favourable a picture as possible to the purchaser, without penalising themselves through increased tax liabilities. On the other hand, purchasers will be looking for weaknesses with which to beat down the price. They will – with good reason – make thorough investigations into the business, its assets, its management styles, its financial controls, its use of information technology. Vendors have to steel themselves for a fairly thorough going-over and should not be surprised or offended by this.

Tackling the sale: practical guidelines

Whatever form your sale takes, it is vital to keep on top of the whole process and feel that you are in control. The following checklist contains a few practical guidelines for approaching this task.

Checklist: Tackling the sale

- **Plan early**, as it is impossible to specify a date for the sale of your business. You never know when a buyer may appear on your doorstep.
- **Use specialist help** – advisers will have far more experience of selling a business than you. Negotiations are often better handled by someone outside the business.
- **Get financial advice** on the options you are considering. Sorting out the tax implications can be very complicated and professional advice is essential.
- Make sure that you feel in **control** of the process. Ask to have strategies explained to you in the fullest possible terms.
- Know what your **priorities** are – decide which aspects of the sale are non-negotiable and which you will be willing to compromise on.
- **Be prepared to say 'no'** if you are unhappy or unclear about what is going on. Don't be afraid to use your subjective judgement to identify whether the outcome is what you want.
- **Keep running the business** – avoid 'deal fever'. The sale should be second on your agenda; your first priority should be to run the business as if it is going to be in your family for generations to come.

Check Point

If you are considering selling your family business, now or in the future, think about:

- what your priorities would be for the sale
- which aspects of the sale would be non-negotiable
- which areas you would be willing to compromise on.

When you have given some thought to these matters, turn to Action plan 5 to summarise your ideas.

	Priorities for selling the businesss	Non-negotiable	Negotiable	How
1				
2				
3				
4				
5				
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Section 5 Exit

Topic 14 Retirement and estate planning

Retirement and estate planning is not something to leave to the last minute – because you never know when the last minute is going to come. It is, rather, a continuing process, which must be started in good time, in order to plan for retirement and for the transfer of assets to the next generation.

Key issues to deal with when considering retirement and estate planning are:

- ensuring continuity within the business, e.g. by minimising the financial effect of the owner's departure
- transferring control with or without ownership
- transferring assets while minimising tax liabilities on retirement, sale or death.

The next topic looks at some of the issues surrounding tax liabilities, while this topic explores the others.

Ensuring continuity

Preserving financial stability during the period of transition is one aspect to ensuring continuity. Tax planning (see Topic 15) is part of this, but so too is preparation of personal finance. All too often, owners planning their retirement or exit from the business realise that the only way to ensure their own security is by extracting as much money as they can from the business – which becomes their personal and only nest-egg. This can have a serious and negative effect on the business.

If the owner is careful to build up investments outside the business, then that increases their options in other areas of retirement planning. For example, it will free them up to consider different options for transferring shares rather than depending on selling them.

Owners of family businesses can also help to ensure continuity by planning for their death, especially sudden death. This unpleasant circumstance can hit the business hard, but even more so if arrangements for dealing with this situation have been neglected. Arranging life insurance cover is one strategy (see Section 4, Topic 12). Another essential step is to ensure that the owner's wishes are expressed clearly in a will.

'Nearly a quarter of owners of family businesses have not drawn up a will which gives a clear picture as to future ownership.'
Bournemouth University Business School (1999)

Making a will

Topic 3 sketched the image of the 'ostrich' approach to succession planning – owners who bury their head in the sand and refuse to plan for the future. Making a will is one of those vital actions that are too often overlooked. Granted, it requires some careful thought, a little practical effort and a bit of expense, but the benefits can be enormous.

Activity

Read the following case study. What could Dean John have done to avoid the messy demise of his successful company?

Dean John was the owner of John's Sports Ltd and had developed a tennis shoe that gave the wearer excellent ankle support and good grip on the court, while preventing skidding and foot injuries. Dean brought his son, Jason, into the business. His daughter, Tracey, was married and worked part time on the promotions side. The business prospered when his shoe was taken up by a high-profile tennis star.

Dean's first wife had died and he had remarried Dawn, his secretary and 20 years his junior. One day while watching the Ladies' Final at Wimbledon, Dean had a heart attack after getting excited during a particularly long rally, and expired. It was discovered that Dean had not updated his will for over 15 years. His 51% shareholding in the business all went to his second wife Dawn, who had no interest in keeping it going and demanded her one-half interest in the business in cash. Estate taxes were also due. Jason and Tracey had no choice but to arrange a quick, messy sale of the business at a bargain price.

This messy ending was unnecessary. Dean John could have avoided this problem by:

- updating and clarifying his will, making it clear about what he wanted to happen to his shareholding in the business
- putting his second wife's share into a trust or dividing his shareholding up to give his children the majority shareholding
- drawing up a prenuptial agreement with his second wife before marrying her
- above all, taking advice on options available to him.

Transferring control and ownership

Many business owners wrestle long and hard with questions about transferring control of the business on their exit, either with or without ownership. One common situation is where owners decide to retain an ownership interest, while giving up management control. This situation can create tensions and is discussed in Topic 10.

Other difficulties arise when owners, in an effort to be fair, divide their ownership of the business among various family members, regardless of how active they are in the business, or conversely, transfer all the ownership to one person, in an effort to preserve a strong element of leadership. These problems are discussed in Topic 8, along with various solutions, such as isolating ownership and voting rights.

The key point to remember is that there are many options available in these situations – options which are too often overlooked. Getting advice on what the options are, and the pros and cons of each, will ease the path to a smooth exit from the family business.

Farewell

Check Point

How well formed are your plans for retirement? In particular, how will you manage to:

- ensure continuity within the business

- transfer control with or without ownership?

Have you made a will? Is it up to date?

Note down any action this checkpoint prompts you to consider, in Action plan 5.

Section 5 Exit

Topic 15 Tax planning

Disposing of the business has tax implications. It is important to minimise their impact of and so this topic looks at some of the main forms of taxation liability that family business owners have to consider.

This is not intended as a detailed tax guide, but raises issues that you should include in discussions with professional advisers.

Inheritance tax

Inheritance tax (IHT) is the tax 'your estate' pays when you die, although it can also be charged on certain lifetime gifts. If your estate is over a certain amount (£242,000 in 2001/02), it bears inheritance tax at 40% on the excess.

It may seem unfair that we are pursued by the taxman even after death, but, unlike many other taxes, there are many steps you can take to reduce the IHT burden. Indeed, IHT is sometimes called a 'voluntary tax' by accountants, simply because so much of it is avoidable.

Steps you can take include:

- **make a will now** and keep it up to date (see Topic 14)
- **review the value of your assets** – do this every few years or so to take account of growth
- **consider gifts** – use your Lifetime gifts allowances to cut the size of your estate
- **set up trusts** – often a good way of protecting assets and minimising tax liabilities
- **take out life insurance** – this could cover any eventual tax bill
- **take proper professional advice** – essential for setting up trusts and writing a will – a badly written will is almost as bad as no will at all.

A gift of shares to children is exempt from IHT provided you survive for seven years after the gift. If you should die before seven years are up, a tax charge may arise, depending on the length of time since the gift.

Taper relief

If tax is payable on gifts made within seven years of death, 'taper relief' might be available. This is a reduction in the tax due at the full death rate for gifts made between three and seven years before death, as shown in the table opposite:

Years between gift and death	% of death rate tax payable
0–3	100%
3–4	80%
4–5	60%
5–6	40%
6–7	20%

Business property relief

This is a special kind of relief from IHT that has been available since 1996. It exempts from IHT transfers of business property made during the owner's lifetime, including transfers of shares in unquoted trading companies. The owner must have owned the business property for two years before the transfer and certain sorts of company are excluded from the relief (e.g. those dealing in securities, stocks and shares, or land and buildings, or those making or holding investments).

Capital gains tax

Capital gains tax (CGT) arises on the disposal of an asset, so selling the business attracts a CGT liability.

As with IHT, there is relief available which can reduce the CGT bill. Up to 2003, this included retirement relief available to vendors over 50 planning to retire. The loss of retirement relief has been offset by increases in taper relief, which reduces the amount of a gain subject to CGT, based on the length of time the asset has been held since 5 April 1998.

No CGT is payable on death. The beneficiaries of a deceased person's estate are treated as if they had acquired the assets of the deceased at their market value. For an older shareholder considering tax implications, it might make sense to retain shares until death in order to enjoy the CGT exemption, but such a course of action would depend on how the owner stood with regard to inheritance tax.

Gifts to spouses

Normally, gifts made to a spouse during your lifetime or on death are exempt from tax. This can be a useful way of avoiding tax liabilities, but can store up a higher tax liability for the surviving spouse, who may then bequeath an increased tax burden on their combined wealth when the surviving partner dies. For this reason, it may be important for both partners to use the exemptions and reliefs available during their lifetimes.

Charitable giving

Charitable giving can be part of an outgoing owner's will or estate plan. This has the dual advantages of benefiting a chosen charity, while also providing owners and heirs with income during their lifetimes.

One effective strategy is to make a deferred gift using a charitable remainder trust. The donor transfers cash or appreciated assets to a trust, which provides payments for the lifetime of the donor over a term of years. At the time designated by the donor, funds remaining in the trust are transferred to the charity. Charitable remainder trusts can be designed to provide variable or fixed payments while offering donors several tax and payment benefits.

The bare essentials

All in all, working out tax implications of retiring and dying is extremely complicated. The key points are:

- get professional advice
- review the situation regularly.

Check Point

Note your answers to these questions before summarising your plans in Action plan 5.

- How well formed are your plans for minimising tax on your exit from the business or on your death?
- What are the key elements of your strategy?
- What tax liabilities would arise if you were to die tomorrow?
- Do you have an up-to-date will which accurately expresses your wishes?
- If you are unable to answer these questions, you should seek professional advice immediately!