SUCCESSION PLANNING AND THE FAMILY BUSINESS

Family businesses face a unique set of challenges, but with proper and advanced planning, it is possible to turn many of the hurdles into advantages.

KEY POINTS

1. Don't use revenue-sharing or commission-splitting arrangements, or any form of eat-what-you-kill compensation if the goal is to build a single, strong, and enduring family business model.

2. Plan on developing and retaining a team of successors to support your business from the first generation to the next, with each team member fulfilling specific roles crucial to long-term business success.

3. Have the family business valued early and often, and share the results with family members so that they understand not only what the equity value is, but how it has grown and developed over time.

Family business succession is the process of transitioning management and ownership to the next generation of family members. It is possible that a succession plan will be triggered by the sudden death, disability, or retirement of the founder, but most formal plans are process-driven rather than event-driven. Implementation of a successful plan is often first centered on a gradual transition of key management duties, and later includes a gradual transition of ownership to a team of successors over a 5 to 20 year time frame.

Creating a business of enduring and transferable value is the starting premise of the Succession Management Program (SMP); however, it is important to understand that the succession planning process is about far more than just whom to leave the business to and when. As an SMP client, it can safely be assumed that a seven-figure business, in terms of equity value, is at the center of this discussion and that most owners don't want to give it away. A highly-regulated financial advisory business has serious obligations to fulfill and a demanding client base, many of whom are much older than the next generation advisors and family members. So how do you successfully build a multi-generational family business and create a legacy in this industry? Here are some of the most important considerations:

It's About Talent First and Foremost. Building an enduring and valuable family business in a highly regulated industry may take more talent than the founder(s) has sons, daughters, or relatives to call upon. As such, an important part of building a family business may include the consideration of non-family member talent as ownership prospects. This doesn't have to terminate the "family" element of the business; adding the necessary skill sets around the namesake family member(s) often makes for a stronger, more competitive business. In fact, at some point, it is often inevitable. Consider reframing the goal to building a "family-like business," rewarding the skills of both related and unrelated professionals over the course of a formal plan.

Opportunity versus Entitlement. Successful family businesses must ensure that future generations clearly understand what the family business can do for them, and what the obligations and risks of ownership are in return. (The owners should share these later points with non-owner siblings as well, to assure that all interests are aligned.) Ownership should not be treated as a "birthday present" and given away, at least not in totality. Create an ownership track early in the business's lifecycle and make the ability to become an owner a part of its culture. Make sure that compensation to family members and non-family members is paid at competitive levels, a function best accomplished by annually benchmarking the business against peers, and sharing these benchmarks with managers and key staff members. Finally, implement the transition plan gradually, being careful to transfer ownership (think shares of stock or an ownership interest in an LLC) incrementally as the founder's time in the office is reduced, not vice versa – absentee ownership in the independent financial services industry can have serious, adverse effects.

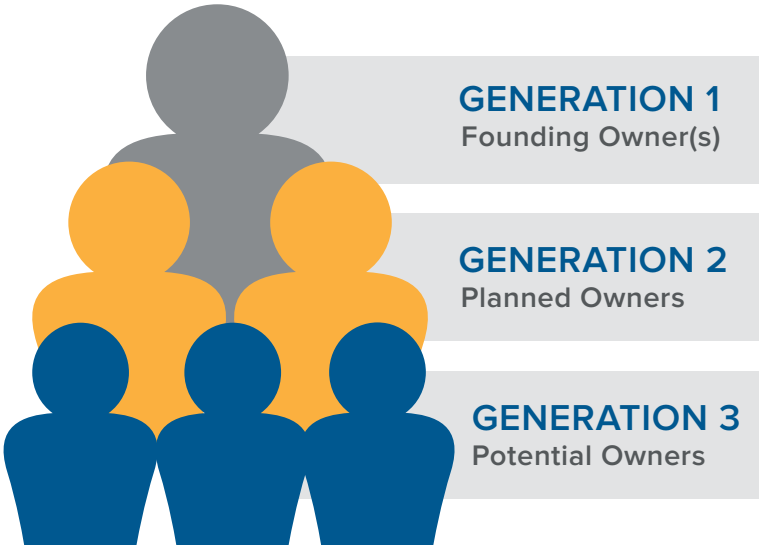
Wanted: Leaders and Builders. A common mistake is to conclude that a given family member isn't an entrepreneur like the founder(s) of the business. The issue is that the founders often look for younger versions of themselves – an obvious chance to repeat a process that worked so well the first time. But in many cases, this is the wrong approach. Building on top of a seven-figure business value requires a very different skill set than starting a business from scratch. An established business can present an investment opportunity for succeeding generations of advisors that comes with a paycheck and a mentor, and does not require one person to do it all.

Building a business, certainly a multi-generational family business, usually benefits from a team of owners who each bring a unique skill set and cumulatively guide the business to a higher level of production and expertise.

The Business Has to Grow. Growth of the business is imperative, which ties into the talent and team-building concepts addressed above. Without top line revenue growth and competitive profit margins, the business will die on its own, or be overtaken by competitors eventually. Sustained and steady growth in revenue, clients, assets, and even skills from one generation to the next, will be part of the ongoing process, along with the responsibility of gradually shifting the growth from the founding generation to the succeeding generation. In the financial services industry, this is more than just common sense. Since most internal successors and family members don't have sufficient cash reserves to buy into the ownership level, it is the succession plan that is tasked with answering the key question: "Where does the money come from?" In short, the best answer is future business growth over many years and preferably from two or more next generation advisors/investors.

Sell First - Then Grant. If the goal is to give stock or ownership to a son, daughter, or relative as part of an estate plan or tax-planning strategy, do so as part of a comprehensive, long-term succession plan. It is a common practice in the Succession Management Program to provide strategies that involve a sale of stock augmented by a granting strategy over time as the advisor/investor proves his or her commitment to the process. Remember that this is a business with demanding clients, and regardless of how easy it may be to acquire or receive it as a family member, its management and leadership has to be able to compete for those same clients every day with owners of other financial services businesses that have had to pay for and earn every last client and nickel of revenue.

Addressing Value and Valuation Issues. For most founders, their financial services business is their single largest, most valuable asset, and it represents a lifetime of work. The starting point for a family business succession plan is a formal, third-party valuation. This is a critical step — and learning tool — for both sides of the transaction, and even for non-owner siblings. Do not make the mistake of performing the first and only valuation on the eve of retirement; instead, create a library of annual valuation results to monitor the business's growth over time. Put history and evidence on your side by starting this process early and sharing these results with managers, key staff, and family members.



Start the Planning Process Early. Financial advisors, with books of all sizes, generally are starting the planning process too late. Selling to a third-party doesn't take a lot of advanced planning to generate good results, but retooling a practice to do the things most financial advisors need a business to do for their families and clients takes time and expertise. For the best results and widest array of planning options, advisors who want to build a family business should begin to establish a formal, written succession plan by age 50 to 55. It is likely that the process will still work later in life, but the range of solutions and the opportunities to make course corrections as the plan unfolds will be fewer and more challenging.

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