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THE 2011 SUCCESSION PLANNING DILEMMA

Current uncertainty is prompting some business owners to take action ahead of the Budget. While owners should not feel pressured into making decisions for tax reasons, those who are looking at succession between now and the end of the year would do well to consider the important communication and governance issues identified by **Niall Glynn** in this short article.

A business owner considering succession is confronted with a myriad of personal, commercial, financial and legal issues that merit consideration. These include examining the value of the business, considering issues around management transition, ensuring the business has an appropriate strategy so there is continuity through any transition, making provision for the owner and his/her spouse in retirement, wealth management issues, examining the overall corporate structure of the business, ownership configurations and ownership percentages in passing on the business, in addition to how all these elements fit into the business owner's will or estate plan.

There may also be the need to look at the implications for shareholder agreements and, of course, the complication of dealing with differing family personalities and the associated emotions that may arise in managing family expectations.

With so many factors to consider, it is not surprising that many business owners choose to delay making a decision until circumstances force their hand. However, having a clear plan to guide the business and the business owner's family through the process is the best way to achieve a smooth transition. It is better to be proactive rather than reactive since this will ensure that adequate time and resources are given to considering all the important issues for each individual family business.

IMMEDIATE ISSUE

Over the next number of months many business owners, in light of future potential tax changes, will be advised as to the need to take some action now. In the upcoming Budget, changes are anticipated to the rates of Capital Acquisitions Tax (CAT), Capital Gains Tax (CGT), and possibly to the tax reliefs available when passing a business on to family members. It is our view that, given the important contribution of domestic businesses to the overall economy, we would expect, at one level, little change to the various reliefs, although there can be no absolute certainty on this issue.

BASIC CONSIDERATIONS

Within this short timeframe, if a business owner is planning for succession, some issues will assume more importance than others. While time will not permit consideration of every issue that might be addressed in an all-encompassing plan, business owners should focus on the following:

- The preparedness of the next generation to operate the business. An unprepared successor running the business could spell disaster in the future.
- Taking time to deal with family issues. Not communicating with other stakeholders, particularly family members, can result in issues being left unresolved which, in the future, could again spell disaster for the business. In-fighting in a family business usually leads to decline, eventual discontinuance and/or sale.
- Even where family issues have been adequately discussed there is always potential for issues to arise in the future. Failing to have appropriate governance structures from the outset which enable these matters to be managed in the best way possible can also lead to potential future disaster.

> "COMMUNICATION IS THE KEY TO ACHIEVING A SUCCESSFUL OUTCOME."

SUITABILITY OF THE NEXT GENERATION

Where succession is planned over a number of years, the business owner will usually take time to assess its future management candidates. Children's suitability to run the business is considered in advance of any ownership transition. If there is one obvious, suitably qualified family member ready to take over, then the decision is easily made.

However, if more than one child is involved in the business, having to choose between children is difficult for any parent. An outside perspective can assist the business owner in arriving at the right conclusion.

Business owners making decisions in advance of the Budget may consider transferring shares to family members, while retaining the management role themselves. Although unusual, transition of some element of ownership, while maintaining appropriate controls, may facilitate claiming tax reliefs before they potentially change while also providing an opportunity to establish an appropriate talent development and management succession plan. Having such a plan will enable you to:

- ➤ consider appropriate training for family and non-family management;
- ➤ provide for an assessment process; and
- ➤ enable you to define key leadership positions, identify candidates and match them against future potential roles.

These issues can then feed into the selection process. You may even consider a non-family member as the most suitable candidate either in the short term until family members develop further or in the long term if no suitable family candidate materialises.

FAMILY

The emotional interplay of many of the decisions required in a succession situation is usually the factor that makes those decisions the most difficult to make. Good communication is the key to achieving a successful outcome. Inadequate or poor communication is often the source of many family disputes and if decisions are being made over a short timeframe we caution business owners to make the commitment to regular and frequent communication to and between all family members to minimise the potential for friction over what some may perceive to be a 'quick' decision. The following considerations should form part of your communications plan:

- ➤ Managing family expectations which is best achieved through clear and open communication.
- ➤ Discussion with key stakeholders. which helps the business owner gain a greater awareness of stakeholders' perceptions and wishes for the business.
- ➤ Seeking consensus. A decree from the business owner as to how they wish the business to transition is rarely as successful as an approach involving the next generation in the decision-making process where they can offer their views and feel their views have been given consideration.
- ➤ Futureproofing decisions. Involving stakeholders in the decision-making process helps secure their 'buy-in' to the decisions that will shape their lives.
- ➤ Dispute resolution. All family businesses face the challenge of resolving the different needs and expectations of family members. Having a dispute resolution process in place will help resolve these differences while maintaining good family relationships.

In a large-scale family business the communication process may involve establishing a family council with a family constitution to govern the relationship the family has with the business.

GOVERNANCE

In providing a framework for addressing future potential sources of conflict, governance issues need to be addressed at the ownership and management levels. In the context of ownership transition, this can be facilitated through shareholders' agreements and managing the relative percentages and classes of shares that transition to each family member. In some instances it may be advantageous to have a separate class of voting shares. For tax purposes, it may be beneficial for owners to consider transferring non-voting shares to family members now while retaining control though the voting shares. Similarly, certain shareholdings may be held in trust, particularly voting shares, so they are warehoused and passed to family members in the future, depending on how their performance and progression within the business develops.

A shareholders' agreement will facilitate management of important issues, including transferability of shares, share buyouts, how voting may be used in certain circumstances and, where appropriate, it can provide for a dividend or distribution policy. Agreements in respect of shares can also provide for buyback arrangements should shares ever transition to an unwelcome in-law or spouse. Where parents are divesting themselves of shares, they may wish to preserve a formal oversight role for themselves. In these circumstances, the business's Memorandum and Articles of Association may be altered to provide for life directorship.

At a management level, where a number of family members are involved, it may be appropriate to obtain an outside perspective at board level. In some instances, non-executive directors can facilitate and offer guidance to family in managing conflicted family relationships which, without an outside influence, may quickly result in board meetings denigrating into family disputes. As with all structuring in this area, there is no one size fits all and appropriate advice should be sought.

DECISION TIME 2011?

The issues highlighted are in reality a 'band aid' approach for those looking to make a quick decision over the next few months. Above all else, family businesses should not feel pressurised into making a decision now for tax reasons – succession decisions made with one primary objective in mind are rarely successful. Businesses have only one chance to get this right – if in doubt, the best approach is always the more carefully considered structured one. If that cannot be facilitated immediately then investing that time in the coming years is far more important than any short-term tax saving.

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