Owners Must Undertake The Seven Step Exit Planning Process

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There is a "recipe" for creating a successful intergenerational transfer. It isn’t the only recipe that works, but because it depends on six carefully chosen ingredients, its chances for successful completion are greater than others.

If any of the following six ingredients is compromised, or worse still, missing, the result will change.

Ingredient 1: Parents must undertake their own Seven Step Exit Planning Process.

Ingredient 2: The one child active in the business becomes the *sole* successor owner.

Ingredient 3: The business transition plan is fair to *all* children.

Ingredient 4: Parents have achieved financial security (independent of the future cash flow of the business) *before* business ownership and control is transferred to the business-active child.

Ingredient 5: The business-active child has demonstrated the capacity, ability, and willingness to run the business for a significant time period (at least three years) before the parents transfer control and ownership.

Ingredient 6: There is a back-up plan.

Just as baking bread at sea level is not the same as baking at high altitude, this is not a "one size fits all" recipe. Regardless of altitude, bakers use flour, yeast and water but quantities, temperature and cooking time vary. So too, the recipe here may need to be adjusted to your specific circumstances.

All business sales or transfers are challenging but owners wishing to transfer their businesses to children often find themselves in the middle of their own Desert Storm: your spouse, children (and their spouses) all have opinions about how you should exit—and they are not afraid to share them!

If you find yourself in this position, we have one suggestion: get off the roller coaster. Undertake the process that all savvy owners use to plan a successful exit: The Seven Step Exit Planning Process. In your case, the Process will enable you to craft your exit and take into account the concerns of all family members. Believe it or not, this Process can integrate all points of view into a single, unified strategy. It organizes your priorities and can be easily modified (as illustrated in red below) to reflect additional considerations unique to family business transfers.

Here is that process:

Step One: Establish *Parents'* Objectives.

Step Two: Determine Company's Value and Cash Flow. *Evaluate Business Active Child's contribution to both.*

Step Three: Increase Business Value (through Incentive Planning for Key Employee Group *and/or Business Active Child*)

Step Four: N/A (Sale to Third Party)

Step Five: Transfer to Insider: *Design Sale/Gift of Business Interest to Business Active Child*

Step Six: Business Continuity Planning (*in case either parents or Business Active Child dies*)

Step Seven: Wealth Preservation Planning (*Estate and Gift Planning to level the playing field for all children*)

Let's look at each Step in more detail.

Step One

You may have a number of Exit Objectives but you should establish, at the outset, at least these three:

- How you (and your spouse) define Financial Independence;
- How you and your spouse define "fairness" regarding distribution of family wealth (including the business) among children;
- When you (and your spouse if active in the business) want to leave the business and transfer control according to a timeframe you set.

Step Two

In addition to knowing what you want, you must know what you have (the value of your company) before you can plan your exit. In the transfer of a family business, not only must business value be determined but the business active child's (BAC's) contributions must be considered. Often parents reduce business value by the amount of the BAC's past contributions so that he or she does not pay for his or her contributions to value. Also, a current value can be used as a base so that any future growth in value (if not due to the active parent's efforts) is typically attributed to the BAC. Again, the purpose of this is to keep the BAC from paying for his or her own "sweat equity."

Step Three

Once you know what you want (Step One) and what you have (Step Two) you must think about how you can motivate key employees (including the BAC) to increase the value of the company and remain with the company through the transition.

Step Four

Step Four is a transfer to an outside third party so it does not apply to family business transfers.

Step Five

In this Step, you design the transfer ownership to your business active child (and possibly some key employees). This is often accomplished through a combination of gifting and sale, depending on your financial needs and other wishes.

Step Six

It is critical to make contingency plans for what will happen in the business active parent dies before the transfer can be completed. For example, should the business active child receive the business via a buy-sell agreement or bequest at death? Should ownership first transfer to the surviving spouse before an ultimate transfer to the BAC?

Step Seven

All owners undertake Wealth Preservation Planning but this Step is absolutely critical in the transfer of family companies. It is through estate and gift planning that parents provide for their non-business active children. The considerations in this Step involve a balancing of the fairness issues that arise in every family transfer.

This is just a brief overview of the first ingredient in a successful family transfer. If you would like to discuss this first ingredient or family transfers in greater detail, please contact us.

appreciate your interest.

Any examples provided are hypothetical and for illustrative purposes only. Examples include fictitious names and do not represent any particular person or entity.