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Select the Right Exit Path - Transferring Ownership to Children

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The purpose of Exit Planning is for you to achieve your financial and lifestyle objectives after you leave your business. One of the fundamental objectives that needs to be decided early in the Exit Planning Process is selecting your successor.

Trends have indicated that the majority of owners of smaller-sized businesses prefer to transfer the business to other family members, an employee or a co-owner. Only a small percent of these owners want to sell to an outside third party. Unfortunately for owners, the people they first identify as their successors often do not end up as the ultimate owners. Much effort is wasted focusing on the wrong successor target or, worse yet, wrongly assuming a child or employee wants to own the company typically doesn't take into account alternative plans.

This and the next few Exit Planning Review™ articles will aim to save you some effort by setting forth the advantages and disadvantages of transferring the business to each category or potential purchaser: family member(s), co-owners, employees and outside third parties. There are pluses and minuses to each choice. Knowing what they are will help you determine which method is most suitable for you. Take time to compare the relative merits and disadvantages of each departure option before making your decision.

Transfer of Ownership to your Children

If you are a typical business owner, there is a 50 percent chance that you want to transfer the business to your children. If you are a typical owner; however, there is a substantial possibility that you will end up transferring the business to someone else because of the difficulties associated with this type of transition. Therefore, it is in your best interest to realize the difficulty of this transaction, as well as prepare the business for the possibility that it will be conveyed to another type of buyer.

Advantages

- Fulfills personal goals of keeping the business and family together.
- Provides financial well-being for younger family members unable to earn comparable income from outside employment.
- Allows you to stay active in business with your children.
- Allows you to control your departure date.
- Enables you to fix value by starting with the question, "How much do I need or want?" rather than being told, "This is how much I am willing to give you." This is especially useful in situations in which the business is worth less than the amount needed to live on – if the business were sold to a third party. When you keep the business in the family, you can sell for what you need to live on even if the business value does not justify that sum of money.

Disadvantages

- Great potential exists to increase family friction, discord and the feeling of unequal treatment among siblings. The normal objective of treating all children equally is difficult to achieve because one child will probably run or own the business at the perceived expense of the others.
- Reaching financial goals is normally diminished not enhanced; although with careful planning and implementation, financial goals can often be achieved while transferring the business to the children.
- Because family is involved, your control may be weakened. You can lose effective control even though you still have voting control – due, of course, to the vagaries of family dynamics.
- The real risk of transferring the business – because of family ties – to someone who can't or won't run it properly, threatens your financial goals and the existence of the business.

Many of the disadvantages can be minimized or avoided through proper planning, but it is important to be knowledgeable of both the advantages and disadvantages associated with the transfer of ownership to children when choosing a successor. In the next Exit Planning Review™ issue, we will look at the second exit path option – sale to other owners or employees.