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cutting through complexity

Family Business Story

Case Study 1
After the funerals: estate planning for the family business

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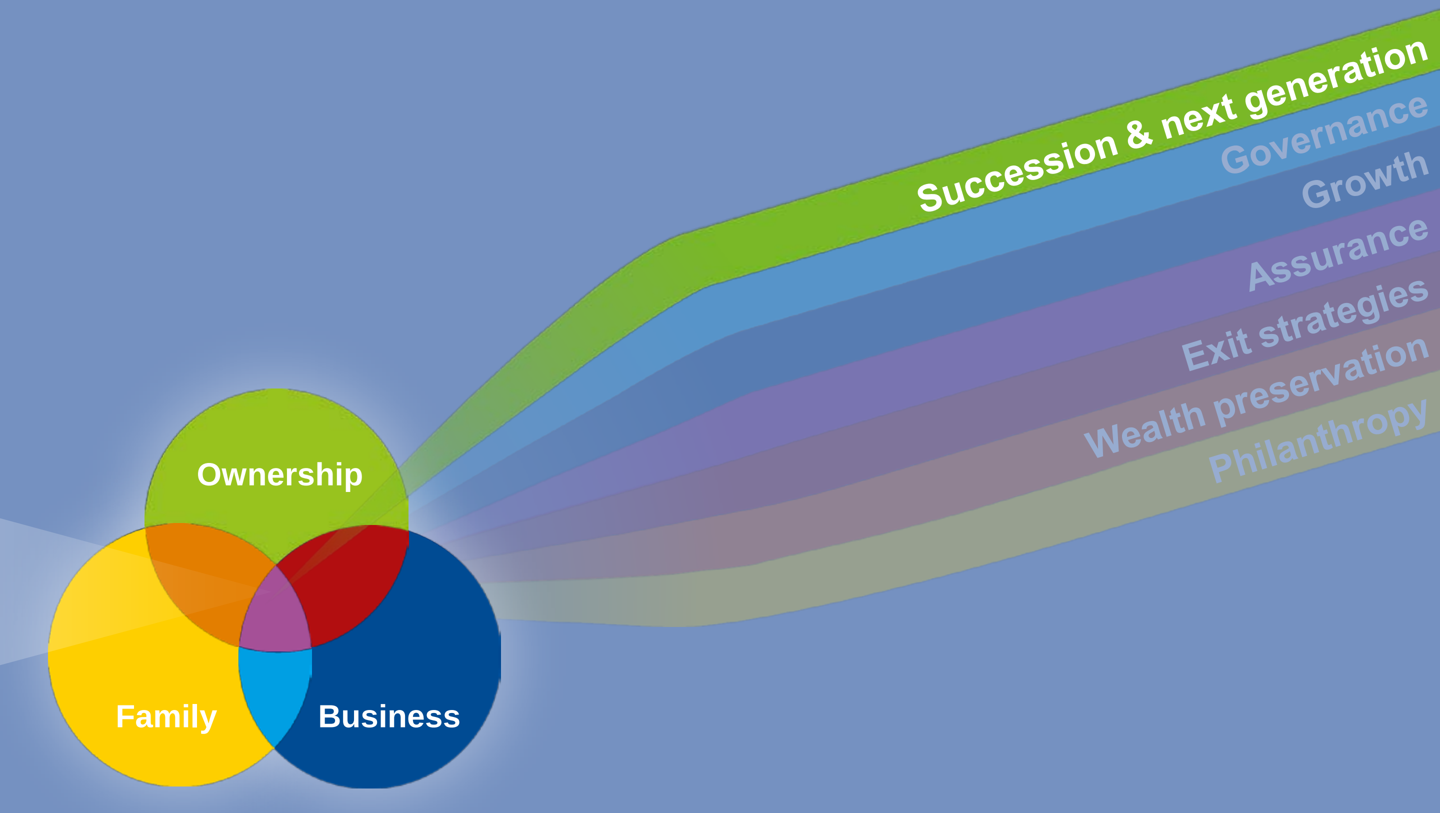
Part 2:
Key learning points

Case Study 1



Part 2: Key learning points

Ownership succession planning

1.Thinking of succession ahead of time does not cause one's death. But it can avoid a lot of conflicts.

It is important to take the time to look at the different solutions other business families have found ("benchmarking"), to initiate communication in the family, to consider several options, to decide without pressure and to start preparing.

2.There is rarely a "perfect solution" – there should be a solution that suits a given family.

A frequent question is: "should I leave the shares to the ones who manage the business, and give compensation to others in the form of real estate or other assets?"

Option: Unequal distribution of shares **Give shares to those who manage the business and other assets to those who are not involved**	**Option: Equal distribution of shares** **Give equal shares to all, regardless of whether or not they work in the business**
✚ Ownership power linked to leadership power: easy decision-making process for business leaders ✚ Financial reward of personal efforts ✚ Those who do not work in the business do not bear the risks - Need other assets or debt to compensate the family members who do not receive shares; this can deprive the company of cash that is needed to be used for compensation - Risk of feelings of unfairness: what happens if the value of the assets/family business evolves in a dramatically different manner? - What happens if the "most talented" person is born in a non-owning branch of the family? Some branches may feel "left out" in the future	✚ Easy allocation of assets. No need for other assets or debts ✚ Shared ownership can strengthen family ties, providing the right governance is in place (see below) ✚ Larger talent pool in future generations ✚ No ill feelings if the value of the different assets evolve differently - A need for a shareholders' pact: ensuring shares are not sold outside the family, establishing a valuation process, anticipating conflict resolution (e.g. arbitrage). - Shared ownership can destroy the family if not properly organised: the need for communication, family policies and conflict resolution mechanisms. - Reflection needed on remuneration of business leaders and shareholders

Part 2: Key learning points

Each solution has its advantages and disadvantages. It is a matter of family culture and involvement of those who will live with the new distribution of ownership. The consequences of a choice will span over generations.

3. More options exist and are often overlooked.
In some cases, children buy their parents' shares, which reflects their commitment and provides the parents with financial security for their retirement.

- Splitting the business to allocate different units to family members; this option is close to the unequal distribution of shares (children are given different assets, ownership and management are linked)
- "Family buy-out" - where a number of family members buy the shares of others.

4. No surprise! If the will is different from what the children expect, it can create a lot of turmoil... and it will be too late to change it.

5. Fair Process: the process is at least as important as the result. In fact, the process can lead to better decisions and better motivation. The essence of Fair Process is to engage those concerned (in this case, Thomas' children) and to discuss different options with them. Each individual situation should be taken into account. Once the decision is taken, it has to be clearly communicated and followed. The five principles of Fair Process in family businesses are :

- Communication and voice (listening to those concerned)
- Clarity
- Consistency
- Changeability (when circumstances have changed – but this needs to be communicated!)
- Commitment to fairness (authenticity: "I mean what say and do")

(Source : Van der Heyden, Blondel, Carlock, INSEAD)

6. The earlier the better: starting to think about succession early (in one's fifties) is easier because the emotional implications are still sufficiently far away. Also, succession can take many years, because it means that the successors have to find their role, and it can entail the evolution of the whole governance system. Last but not least, anticipated donations can avoid heavy taxes.

7. Check the legal and fiscal environment: depending on the country, the law may impose a certain distribution of the inheritance to the children and spouse, with a limited amount of free allocation. Also, taxes can put at stake the whole succession scheme if not addressed in time. In some jurisdictions, there is the possibility (and a fiscal advantage) to make anticipated donations of shares without their dividend or voting rights; however it should be noted that this postpones full empowerment of the next generation. Technical advice is crucial, but tax considerations should not impede following a "Fair Process". and having the right governance.

Ownership succession planning

What decision did Thomas make?

From all the different possibilities, the Sages family found this approach to be the best for them. Each family will find its own path.

Thomas' trusted advisor confirmed that 20% of Thomas' inheritance would go to his wife (e.g. 11% of equity). He also had the freedom to distribute a small amount of his estate to whomever he decided (some of his children, a charity, anyone else); and the rest had to be split equally amongst his children. The advisor also recommended that Thomas ask his children how they saw the future of the family business. Thomas took the time to meet each of them individually and check their motivations. Each of them expressed the wish to become or stay a shareholder in order to be able to pass on some shares to the next generation. Thomas decided to split his shares equally between his four children. He discussed with his wife Martina who intended to do the same with her own shares (but only to her three children).

He called a meeting with them and his advisor.

% of shares	Thomas	Martina	Louis	Charles	Caroline	David Jr	Timothy	Managers
Today	55%	10%	0%	5%	5%	10%	5%	10%
Thomas' succession		*11%*	*11%*	*11%*	*11%*		*11%*	
After Thomas' succession	**0%**	**21%**	**11%**	**16%**	**16%**	10%	**16%**	10%
Martina's succession				*7%*	*7%*		*7%*	
After both successions	0%	**0%**	11%	**23%**	**23%**	10%	**23%**	10%

Part 2: Key learning points

Louis and Charles were happy with the amounts they were to inherit provided their children would be considered for employment. Timothy did not like the idea that his sister and her husband would ultimately own one third of the business. After some discussions, David Jr agreed to sell 3% of his shares to Timothy.

% of shares	Thomas	Martina	Louis	Charles	Caroline	David Jr	Timothy	Managers
After the 3% sale	0%	0%	11%	23%	23%	**7%**	**26%**	10%

This arrangement would ultimately allow Timothy to have a veto right for key decisions (at least 25% of shares in their country), like Caroline and David together.