How to Keep the Business in the Family (or Not)
By Denice A. Gierach
June 2010

Denice A. Gierach,
Owner and founder,
The Gierach Law Firm

It has been said that it takes a generation to make a business and two generations thereafter to lose it. Usually, the entrepreneur creates the product or service and sells it, creating a great business model over his or her lifetime. Then, upon the entrepreneur's death, the family fights over who should be in charge and what distributions should be given to the family not directly involved in the business. No one is really "minding the store" as no one stands to directly gain from the extraordinary efforts of maintaining and growing the business, creating a higher stock value. Consequently, after the family disputes and the distributions to the next generation of family members who are not involved in the business, the business diminishes. The competitors to the business visit the customers of the business and lure away the key employees. As a result, the business is sold to an outside third party at a fraction of what it was worth in the entrepreneur's lifetime.

Sound farfetched? Not really. This is the reality of the circumstances when the entrepreneur fails to do any succession planning. Many times the entrepreneur has a family member involved in the business, but many other children or other family members not involved in the business. If the entrepreneur just leaves the executor or the trustee in charge, in the case of a more standard estate plan, the family member who works in the business now reports to the executor or trustee, who may have no experience in the family business. The family member who is involved in the business finds that he or she must work harder than they did before, absorbing some of the entrepreneur's job, getting paid the same amount, not having any stock in the company, and having the fruits of his or her labor being paid out to the other family members not involved in the business.

A better route is to do succession planning--starting now. Even when the entrepreneur is relatively young, he or she still needs a plan as to how to leave the business. For instance, if the entrepreneur is incapacitated and cannot work or dies, obviously there needs to be a plan as to how the business continues and how the value of the business can be realized through a sale to provide funds for the entrepreneur's family. For this purpose, the plan may be as simple as to train employees to do certain facets of the entrepreneur's job and leave a list of potential buyers of the firm, in case the unthinkable happens.

If the entrepreneur has children involved in the business and children that are not involved in the business, the entrepreneur will have to decide over time which child has the capability to manage the business and how the children can eventually buy the entrepreneur out. The entrepreneur will include provisions in his or her will or trust to give the business to the children who work in the business and to provide alterative assets to the children who do not work in the business.

As with many entrepreneurs, the business may be the largest asset, so the entrepreneur may have to seek some life insurance to equalize the value between the children who are receiving stock in the company and those who are not. This dichotomy resolves the issue of children not working in the business expecting the same amount of distribution from the business as those working in the business. Since those working in the business are receiving stock in the business and those not working in the business are receiving other assets or proceeds of life insurance, the children not involved in the business will not have the rights to any income from the business, only from their share of the other assets allocated to them.

If the entrepreneur does not have any family working in the business, he or she may consider taking on a "junior partner" who can grow into the job and who may have the monetary strength to buy the entrepreneur's interest in the business out at the time he or she retires or dies. It is important in that circumstance to use a shareholder agreement with the appropriate buy-sell provisions in it, coupled with an employment agreement to protect both the entrepreneur (and his or her family) and the junior partner.

Your succession plan needs to be reviewed from time to time, as circumstances change. Sometimes the family members leave the business to explore other opportunities. Sometimes the junior partners leave as well, due to family considerations, or to change industries.

If the entrepreneur wishes to protect the value of the business to benefit his or her family, it is important for the entrepreneur to have a succession plan and keep it up to date.

Denice Gierach is a lawyer and owner of The Gierach Law Firm in Naperville. She is a certified public accountant and has a master's degree in management. She may be reached at her website at www.GierachLawFirm.com or 630-756-1160.