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THE ESTATE PLANNER'S ROLE IN BUSINESS SUCCESSION PLANNING: A TEN STEP GUIDE

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Regardless of how small or large the size of a family business, succession planning for family enterprises presents a unique set of challenges. Not only can it be a complicated, emotionally-taxing process, but it also carries the potential to detrimentally affect family relationships, which can strain the business itself—often to the breaking point. Even if you manage to craft a plan that appeases the entire family, you will have only solved half of the puzzle. In order to create a successful business succession plan, estate planners must find the answer to two equally important and often conflicting questions: (1) What is fair to all family members? and (2) What is best for the business? The difficulty of striking an effective balance between these two factors is evident in the number of businesses that fail to survive succession; some estimate that as little as 12% of family businesses remain viable into the third generation.[1] Estate planners, therefore, must work to develop the skills necessary to improve the end-result of business succession, especially in light of the fact that the need for this type of planning is set to increase dramatically in the coming years.

Family-run enterprises make up a significant portion of businesses within the United States, and a growing number of the nation's 76 million baby boomers—many of whom own businesses—are approaching retirement age.[2] Because it is clear that many of these business-owners will be looking to plan their exit from the companies they have established, it is important that estate planners prepare for their role in the succession planning process. Preparing for this role, however, can be a daunting task. Unlike other areas of estate planning,

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[1]Family Business Institute, *Succession Planning*, http://www.familybusinessinstitute.com/index.php/Succession-Planning/.

[2]Sarah E. Needleman, *Finally, a Good Time to Sell the Business*, WALL STREET JOURNAL (Oct. 23, 2013), http://online.wsj.com/news/articles/SB10001424052702304682504579153573588055100.

business succession planning has no standard structure or set of forms that attorneys can simply tailor to satisfy the needs of the client. Planning for the succession of a business is fundamentally an exercise in problem solving. Every family is different, every circumstance is different, and there are often no clear answers to conflicts that may arise.

Despite this lack of uniformity, there are specific steps planners can take to help facilitate as smooth a transition as possible. Below is a list of ten steps estate planners should adopt as their standard approach to attaining the perfect balance between pleasing the family and protecting the business.

TEN STEPS TO BETTER SUCCESSION PLANNING

1. Start the Process. The first step is simply getting the planning process started, and estate planners have an inherent advantage in this regard. Many business founders erect substantial psychological barriers to the idea of passing on the ownership and control of their business, but once a relationship is established between a client and an estate planner, the long-term planning discussions can more easily transition into a dialogue of what the client's goals are for the future of his or her business. Indeed, as is commonly encountered in the area of estate planning, clients are often reluctant to contemplate how their world will function without them. Attorneys can help avoid this planning paralysis by acting as the instigator and asking the questions necessary to push the client to face the tough issues.

For clients who desire for their business to continue to grow and thrive long after their departure, estate planners must stress the importance of grooming a successor. Not only is this a long, slow process which in many cases occurs over many years, but it also provides a safety net if the founder unexpectedly passes away. Warren Buffett stresses the importance of pinpointing a successor by requiring all Berkshire-Hathaway business managers to submit a succession plan—and to update it regularly.[3] This practice highlights an important question estate planners should be asking all business-owning clients: Who will take over tomorrow if you become incapacitated tonight?

Early planning, however, is not only useful to plan for the possibility of future calamities; it can also allow clients and their families to reap great reward in the event of future success. When Wal-Mart's Sam Walton, in 1953, transferred 20% of his company to each of his children and kept 20% for himself, he may not have been able to appreciate the amount of time and money he had saved for his family in the future, but he certainly appreciated the concept, stating later on in his autobiography that "[t]he best way to reduce paying estate taxes is to give your assets away before they appreciate."[4]

2. <u>Create an Action List</u>. Because business succession is typically only one aspect of the planning being performed for the client, task prioritization is an important tool for attorneys. With complex projects like succession planning, it is easy for the client to become discouraged, and it is the attorney's responsibility to keep the client engaged in the planning process. Prioritizing projects so that the simpler tasks can be completed first will allow the client to feel he or she is accomplishing something. Creating this kind of momentum can prevent the succession planning project from stalling out.

3. <u>Form a Planning Team</u>. Business succession planning is too complex to be successfully accomplished with just the client and the estate planner. Rather, it requires a team of advisors. Critical to the team is someone who has a long-standing relationship with the family. Whether their CPA, lawyer, financial advisor, or respected family friend, this role

[3] Warren Buffett, Memo (July 26, 2010), http://www.berkshirehathaway.com/letters/2010ltr.pdf.
[4] Zachary R. Mider, BLOOMBERG.COM, *How Wal-Mart's Waltons Maintain Their Billionaire Fortune* (Sept. 11, 2013), http://www.bloomberg.com/news/2013-09-12/how-wal-mart-s-waltons-maintain-their-billionaire-fortune-taxes.html.

should be filled by someone whom the family trusts and who maintains a high degree of credibility. The profession of this person will vary from family to family, but the purpose of his presence remains the same: to provide a voice of reason that emanates from an intimate knowledge of the family dynamic and inner workings of the business.

In some cases, it may be beneficial to add an outside consultant who can assist with the psychological aspects of the succession planning process. Client meetings can often become emotionally-charged, especially if family members are present, and the presence of someone skilled in confronting behavioral issues can help create an atmosphere that is much more conducive to productivity. But regardless of whether an outside consultant is used, there must be someone on the planning team who can serve as the "quarterback"—coordinating all the pieces and ensuring continued progress. Even a task as simple as using time at the end of a meeting to establish goals and schedule the next meeting time can make a significant difference in the efficiency of the planning process.

4. **<u>Manage Expectations</u>.** Providing clients with a realistic picture of the ultimate outcome and the difficulty of the planning process can help prevent dissatisfaction and frustration. Estate planners must stress to the client that, when it comes to business succession, there is no perfect solution. It will likely be impossible to achieve perfect equality between children and no one will receive everything they want. It is also important to alert clients to the typical time frame. Business succession planning is a process that evolves over time and necessarily includes multiple meetings.

5. **<u>Identify the Issues</u>.** Creating an effective solution will be impossible until all the problems have been identified. Ascertaining key stakeholders and conducting individual interviews can help provide a clear picture of the concerns and desires of those involved. It is important to include the founder's spouse, key employees, children, and even the children's spouses. Although in-laws might not have a direct involvement, they will have opinions, and those opinions can often greatly influence the planning process.

6. <u>Define the Desired Outcome</u>. Undoubtedly, the desired outcome for the succession of any business is a plan that can be deemed successful by as many of those involved as possible. But how is success defined in this area of planning? Because so much of succession planning is determined on a case-by-case basis and because no two succession plans will likely be identical, estate planners should remain flexible in their idea of what success will mean for each family. There are, however, a few factors that are common within many effective succession plans:

- The business is managed by people who have the right skill set.
- The business generates cash flow for all of its owners.
- There is an exit strategy in place for those who decide they would like to exit the business.
- The business is only a reasonable portion of each owner's overall financial picture.

If the above factors are unattainable or if the family dynamic is too dysfunctional, an outcome that leads to a *sale* of the business may be the best chance for success. Even though some business owners wish to stipulate that the business should never be sold, it is important to remember that even the Rockefellers sold Rock Center. But, regardless whether the desired outcome is a smooth transition to the next generation or a sale, if the planner, the client, and the family all have an accurate understanding of where the planning is headed, the road to get there will be considerably less bumpy.

7. <u>Search for a Solution</u>. Because every family is different, searching for a solution should not be about utilizing a cookie-cutter approach, but rather should entail evaluating a toolbox of planning options. Estate planners have to find the right fit for their client, and in this regard, succession planning is much more of an art than a science. For example, some families may operate companies with assets that can be easily divided and distributed, while others may require more complex—and creative—planning.

Another significant issue to consider is how to pass down the stock of a corporation. In other words, who gets to elect the Board of Directors? In families where some family members are more involved in the business than others, this question can create serious friction. As estate planners, it may be necessary to create different classes of stock, design trusts to own the stock, and profile the qualifications for future board members (including some outside board members who bring an objective, non-emotional viewpoint). Ultimately, to ensure the success of the business, the board of directors must be able to function as a rational body.

Whether children should receive a managing role in the daily operations of the business can also become a delicate subject. Despite the best of intentions, some children are simply not sufficiently qualified to take on an influential position. Richard Rainwater has opined on this precise issue, as chronicled in the book *Money Masters of Our Time*:

> What has always struck me as odd is that if you look at corporations, even corporations that begin as family businesses, the way they promote people is based on skill, not bloodlines. But most families continue to make the decisions on who will manage the fortune based on bloodlines.[5]

Hiring someone to objectively review the business to evaluate the skills and qualifications of all of its employees can provide a safe way to approach the discussion of who should receive leading roles in the operation of the business.

[5] JOHN TRAIN, MONEY MASTERS OF OUR TIME (HarperCollins Publishers, Inc. 2003).

If there are children in the family who will not be involved in the business, it is important that a plan is created for them to receive sufficient cash flow. But because this may not align with the best interests of the business, other tools—such as life insurance—can be used to resolve the issue. Establishing an irrevocable life insurance trust ("ILIT") may not solve all planning problems, but it can help create liquidity and equalize inheritance between children.

The timing of a transfer of the business can also serve as a planning tool. With some families, it may be wise to transfer the business before the client passes away, which allows the client to help in the process and provide support and guidance for the family throughout the transition. Through careful drafting, it is possible for the founder to move assets into a trust of which he or she is a trustee, thereby keeping the client in the driver's seat of the business. Estate planners must, however, consider the potential consequences of this scenario because it may not always be in the best interest of the family or the business.

Resolving potential estate tax liability issues is also a substantial part of a successful succession plan. Using estate freeze techniques and ILITS (as discussed above) can serve as effective tools for dealing with estate tax, but regardless of how the issue is addressed, estate planners should not forget that determining exactly how the check will be written to pay for the tax is a key piece of the planning puzzle.

8. <u>Get Buy-In from the Key Stakeholders</u>. There is no question that having the support of the client is vital to the planning process, but estate planners should not underestimate the significance of getting buy-in from the key stakeholders. While the feasibility and wisdom of conducting family meetings will depend on the dynamic and characteristics of each family, it is undeniable that finding a way to gain the support of the family will not only make the planning process smoother, but will also increase the likelihood that the plan will ultimately be successful.

Once a family member makes a mental commitment to finding a solution, he or she will be much less likely to stand in the way of arriving at that solution. This concept is well-founded in the field of psychology. Dr. Robert B. Cialdini stated in his book *Influence: The Psychology of Persuasion*, "Once a stand is taken, there is a natural tendency to behave in ways that are stubbornly consistent with that stand."[6]

9. **Address the Challenges.** Although the entire process of succession planning is challenging, there are certain obstacles that are common to all types of clients. Over time, planners will, no doubt, develop their own strategies to combat frequently encountered challenges, but there are two problems that are so common in succession planning all estate planners should be prepared for their inevitable occurrence: (1) reluctance to begin the planning process; and (2) family conflict. Below is a discussion of ways the planner can effectively confront these two issues.

a. Reluctance to Begin Planning.

Rarely does a family begin their planning early enough. As already mentioned, a business founder often harbors fear over what may transpire if he steps down from his role in the business. Some clients worry that their lives will be empty and boring or that they will no longer be welcome at the office. Others express concern about whether their family can remain functional and trusting of each other and whether the business itself can continue to thrive without them at the helm. These are legitimate fears, but they are fears that can be relieved through careful planning. For example, a very popular option is for the business founder to open a family office to be responsible for philanthropy and investing in things outside of the family

[6] ROBERT B. CIALDINI, PH.D., INFLUENCE: THE PSYCHOLOGY OF PERSUASION 67 (HarperCollins Publishers, Inc. 1993) (2006).

business. This provides a transitional environment for founders so that they do not feel as though their skills are no longer useful.

Fears of a dysfunctional family or a failing business may be more complicated issues to address, but in doing so, estate planners cannot be blind to the fact that, in some instances, selling the business may be the best solution. If the family members are wholly incapable of trusting each other or working together, it will be impossible for the business to survive after the patriarch—or matriarch—is gone. The estate planner must be willing to explain to the client that a sale may be in the best interest of everyone involved and should be strongly considered.

b. Avoiding Family Conflict.

Family members often maintain conflicting goals and visions for what the future of the family business should look like, and it is not uncommon for families to be composed of drastically different personalities. It is, therefore, generally impossible to create a succession plan that pleases everyone and avoids any kind of friction or conflict. Family members are going to disagree, but there is a tool estate planners can use to diminish the likelihood and intensity of conflict during the planning process: ensuring that no family member feels that his or her interests and well-being have been ignored. Accordingly, planners should strive to convince the key stakeholders that their voice is being heard.

As previously discussed, this can be accomplished through individual interviews with each family member, but it is also important for the estate planner to create an agenda for family meetings so as to cultivate a productive atmosphere where family members feel invested in the conversation. Because people will generally support what they helped create, estate planners should focus on the commonalities and values that all family members share in order to establish the mindset that the family is working together for a solution. The planner, however, should not ignore the fact that each family member maintains a unique set of aspirations and concerns. Rather, the planner should strive to acknowledge and understand the motivations of each individual because "appealing to *interest* is likely to work better as a matter of human persuasion than appeal to anything else."[7] Indeed, avoiding family conflict is often best achieved when each family member believes the succession plan is in his or her own best interest.

10. **Implement the Solution.** This step may seem relatively straightforward, but it is important that the client and family understand that implementation of the plan may be a multi-year process. Training a successor is a key responsibility of the founder, and it is one that can greatly increase the probability of the business's continued success. This idea is well established in the publicly traded corporate world, where grooming a replacement is often a substantial part of a CEO's job description. In the South, this concept is sometimes referred to as "riding in the truck" with the patriarch of the business. The fateful story of a successful Texas businessman depicts how the wisdom behind this strategy can help safeguard a business from the unexpected.

As the founder of an oil and gas company in Texas, Steve (name changed for privacy) had worked hard to build up his business and understood the importance of grooming a successor to replace him one day. Steve identified one of his sons-in-law as the best fit for the company's next leader, moved him out of an insurance career, and spent 5 years mentoring him. When Steve died unexpectedly in a plane crash, the son-in-law was trained and ready to continue his father-in-law's legacy. Steve's prudence in planning for the future provided a safety net for his business during a time of unanticipated transition.

Even if selling the business is the best option for the client, estate planners should not fail to point out that selling a business can sometimes take several years, and the way in which it is

[7] Lecture by Charles T. Munger to the students of Professor William Lazier at Stanford Law School, *Outstanding Investor Digest* (March 13, 1998) *in* PETER BEVELIN, SEEKING WISDOM: FROM DARWIN TO MUNGER 264 (PCA Publications L.L.C. 2003) (2007).

carried out can have a profound effect upon the value of the business. Regardless of when the client would like to ultimately exit the company, the process of preparing a business for a sale should be started long before the sale occurs. The stability of the economy and of the client's industry in particular are unknown variables. Business owners should position their company to be ready for purchase so that when the time comes to sell, they can maximize the sales price and minimize the tax cost.

LEARN FROM OTHER FAMILIES

Estate planners are an integral part of succession planning, and in reality, they must perform many different roles in order for the process to run smoothly. Instigator, mediator, visionary, strategist, and implementation consultant are just a few of the above described responsibilities of a planner. In addition to these duties, however, estate planners should also be *observers*, striving to learn from the mistakes and successes of other families. Studying other succession plans can not only provide examples of creative planning but can also reveal unforeseen pitfalls. Consider, for instance, the succession stories of the Feil and Pritzker families.

The Feil Family. Businesses that produce minimal cash flow tend to create serious family conflict in the long-run, especially when not all of the owners are involved in the business. When there is limited cash on hand to distribute to the owners, those outside of the business typically become frustrated, which is exactly what happened with the Feil family.

Louis Feil created a real estate dynasty worth around $7 billion. Before he passed away, Louis groomed his son, Jeffrey, to take over the family business, and upon Louis' death, the ownership of the business was divided equally among Jeffrey and his three sisters—with Jeffrey in charge.[8] Jeffrey has decided to hold back money for the business and only distributes around $300,000 a year to each sister. The sisters are currently suing their brother, alleging that he is starving them out so that he can buy them out at a discounted price. One sister has a terminal illness and has expressed her concern that her family will be unable to pay their estate tax. No matter how valuable the family business, when that business represents the entire net worth of the family and not all family members have control over it, conflict is likely to occur.

Unless there is some way to create cash flow for all the business owners, it is generally preferable in these situations to sell the business. Clients may be optimistic that their children will be able to work together peacefully, but this dream does not always become a reality. As Jeffrey Feil admitted, "The binding of the book became loose when my father died . . . The pages fell out after my mother died."[9] Although the Feil family represents the worst of what can happen with succession planning, estate planners should keep these types of conflicts in mind so as to prevent them from happening with their own clients.

The Pritzker Family. The Pritzker family, owners of Hyatt Hotels and Royal Caribbean Cruise Line, presents a perfect example of how different personalities can make it impossible for family members to work together in the family business. Before Tom Pritzker's father, Jay, passed away, he told Tom that he suspected family tensions would eventually cause a breakup of the multi-billion dollar enterprise.[10] Shortly after Tom took over the business following his father's death, he received a letter from his two brothers and some cousins informing him that they had hired lawyers and they wanted to know everything that was going on within the Pritzker

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[8] Sarah Rose & Peter Grant, WALL STREET JOURNAL, *Real-Estate Family Wars With Itself: Feil Siblings Grapple With Empire Created By Their Father* (Sept. 2, 2013).
[9] *Id.*
[10] Anupreeta Das, WALL STREET JOURNAL, *Inside the Breakup of the Pritzker Empire: Decadelong Restructuring Wrenched Apart Wealthy, Philanthropic Family* (Nov. 26, 2013), http://online.wsj.com/news/articles/SB10001424052702304281004579220162619539146.

empire.[11] Rather than enter a long battle with the family, Tom managed to reorganize the business for the collective interest of the family. Although the division of the enterprise took close to a decade, the Pritzker heirs now control their own fortunes, and they are each pursuing their own—markedly different—professional careers. Penny Pritzker is the U.S. Secretary of Commerce and her cousin, GiGi, is a movie producer. As one commentator stated, "The Pritzker saga writes large the problem of maintaining a unified family business down the generations. Siblings can make great business partners, but family unity frays when you get to cousins."[12]

From multi-billion dollar family empires to mom-and-pop family business, the basic tensions remain the same. Achieving what is fair for the family member and ensuring the business is successful are two factors which often weigh heavily against each other—and sometimes, one must give way or neither goal will be accomplished. Sometimes, however, there is a delicate balance that can be attained, and it is the estate planner's responsibility to find that balance. Although the solutions will vary case-by-case, the ten steps laid out above will equip estate planners with a process to follow in order to create an effective business succession for all types of family businesses.

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[11] *Id.*
[12] Peter J. Reilly, FORBES.COM, *Pritzker Trust Dodges Illinois State Income Tax*(Jan. 2, 2014), http://www.forbes.com/sites/peterjreilly/2014/01/02/pritzker-trust-dodges-illinois-state-income-tax/.