



How to Talk to Your Family About Succession Planning

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A survey conducted by the Family Firm Institute indicated that the majority of small business owners want their business to transfer to the next generation. However, 70 percent of family businesses do not survive into the second generation, and 90 percent do not survive into the third generation.

No secret recipe guarantees your business will last for generations to come. Communication with family members about your business goals, philosophy, and succession plans with family members is critical.

Business succession planning consists of two separate, but related parts: ownership succession and management succession. Management succession requires the succeeding family member (or members) to become increasingly involved with the day to day operations of the business. Ideally, this process would occur gradually, with the succeeding member taking on an increasing amount of responsibility over time.

Management succession should begin before ownership succession for several reasons. First, the management capabilities of the succeeding generation may be unknown. Accordingly, it is wise for the older generation to maintain ownership (and ultimate control) over the business until it is clear that the member of the succeeding generation will be a successful manager. Second, the promise of future ownership incentivizes the successive generation to earn their ownership interest and to manage the business in accordance with the older generations' directives. Finally, waiting to begin ownership succession allows the older generation to match ownership with management responsibilities. This is particularly helpful where multiple children are involved in the business and one clearly performs the bulk of the management duties.

Throughout the management and ownership succession process, it is important to communicate your business values and succession planning goals to the successive generations. If you are unsure about

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how to frame this discussion, the following is a list of important discussion points:

- **Legacy of Family Ownership:** Successful family businesses have a sense of pride in family ownership. Founders of the older generation view this legacy as a business asset that has grown large enough to provide for their family for subsequent generations. Successive generations view the business's legacy as maintaining the successful business built by the founders.
- **Opportunity not Entitlement:** It is important that the legacy of the family business does not create a sense of entitlement in subsequent generations. You should be careful to say that the business is an opportunity, and the opportunity for ownership will only come with actions in accordance with the family business philosophy.
- **Compatibility and Compensation:** It is ill-advised to expect your children and grandchildren to all be cut from the same mold. Still, it is also important to ensure that your successor's personality is compatible with the business and your business philosophy. If you have multiple children and only one that is compatible with and active in the business, you may be encountered with an estate planning issue as well. It is important to emphasize that the business is the source of the family's wealth and that active participants deserve to be compensated accordingly for preserving that wealth. Here, what is *fair* may not also be *equal*.
- **Access to Information:** Subsequent generations will not blindly succeed the management and ownership of your business. Your family members should be given access to an increasing amount of information that is consistent with their age, maturity, and interest in the business. Family business meetings and family council meetings are not only good opportunities to provide your children with information about the business, but are also good opportunities to teach them your business philosophy.

The best way to start talking about succession planning issues is to formalize business relationships in writing. Employment agreements can be used as a tool to formalize the management succession process and gradually transfer management duties to the successive generation in a clear, well-defined manner. Similarly, shareholder agreements or operating agreements provide a clear ownership succession structure and ensure ownership of the business remains in the family.

Engaging a skilled succession planning attorney is also a good idea if your family struggles with communication or the discussion of business issues. The topic of business succession includes both emotional issues and business issues. The rationality of business issues may sometimes be best presented by a succession planning attorney that does not have the emotional connection with the younger generation. Finally, a good succession planning attorney will oversee the succession process to accomplish your succession planning goals in the most tax efficient manner.

If you have any questions about this article, or if you would like more information on the succession planning process, please contact please contact Mike Zahrt at 616.726.2223 or at mzahrt@fosterswift.com or any one of our business succession planning attorneys.