Wealth — don't leave it to the children?

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Lawyers are often trusted advisers to family owned businesses but, for various reasons, are not always the first people clients speak to about succession of a family business. More usually, they may be asked to document a transaction that is already agreed. In some situations, clients become frustrated when the lawyer is seen to be delaying or complicating the transaction by asking sensible questions. As lawyers know from experience, the parties would have been better off asking these questions at an earlier stage.

Family business is a large and growing part of the economy.[1] Dr Chris Graves from the University of Adelaide states:[2]

> family businesses make up approximately 70 percent of the private sector economy, employ around 55 percent of the entire private sector workforce and make a significant contribution to the national economy in terms of controlling substantial wealth estimated at $A4.3 trillion. Although many Australian family businesses have successfully become very large, over 90 percent are small to medium enterprises employing between five and 200 people.

Issues relating to an intra-family succession which need proper planning include:

- if a discretionary trust is at the top of the structure owning a business, do each of the children get a role in the decision making at all levels?
- how are decisions to be made? Is a shareholders agreement appropriate?
- what exit options are there, noting the business' need for cashflow and the capacity of family members to buy out a sibling?
- there are other threshold issues that busy and successful parents struggle with including whether they want long serving non-family staff to be governed by inexperienced family members. They may prefer that the business be sold, especially as its value may quickly diminish without the patriarch or matriarch in an executive role; and
- if a business is sold, the parents may be horrified to see the children waiting for their share and not exerting themselves in terms of career etc.

We have all heard that Bill Gates and Warren Buffett do not plan to leave their children a large share of their wealth. Buffett's line in his letter to the Gates Foundation was that "I want to give my kids just enough so that they would feel that they could do anything, but not so much that they would feel like doing nothing".

Well, first generation owners of family businesses often have good habits: they usually work very hard in the business and, for cash flow reasons, are conservative, if not modest, in terms of their expenses. They often worry that their spouse or children could, in the absence of appropriate planning, blow the money.

The bad habit family business owners often share with their peers is not devoting sufficient time to planning the succession of their business. The *2013 KPMG Family Business Australia National Family Business Survey*[3] which the Adelaide Business School was commissioned to do found that two-thirds of Australian family businesses plan to pass on the business to the next generation and 43% of this group plan to do so in the next three years. Despite this, around one-third of this group have no (formal or informal) plans in place for this to occur.

In the PWC commissioned Family Business Survey 2014,[4] 24% of business owners said that they will pass the business on to the next generation rather than sell it (38% said they would sell the business — interestingly as recently as the PwC 2012 Survey, 38% said that they would pass it on to the next generation). Again, whatever the plan, there is a lack of planning.

Failure in terms of succession could be:

- that the business leaves the family;
- the business is not sold before it becomes run down;
- long serving employees leave because they do not respect the next generation;
- the next generation fight about the business; and
- the next generation squanders the wealth or the wealth aggravates younger or weaker family members' personal problems (addictions, failed relationships or enterprises).

Alan Crosbie has written a book called "Don't Leave it to the Children". Crosbie points out that parents often over-estimate the business skills of their children. The contrary can also be the case. The point is that parents rarely get it right.

Even if children have the skills, they may not have the inclination to follow a course set by a parent. Many of these children have had expensive educations and move in wealthy circles. The thought of spending an hour each way to travel to work in an industrial estate in an unfashionable part of town may not appeal to them. Without honest discussions within the family, expectations and entitlements can be mismanaged with terrible consequences for the family *and* the business.

Where one child only is earmarked for a leadership role in a business (as usually happens in a farming business) that can exacerbate sibling rivalry. The problems of course multiply if there is a step-parent or children from a second family. In our experience, the conflicts of interest are such that families do not usually blend successfully.

Business founders are totally involved with their business and spend much time, at the expense of building relationships with their children, making decisions about their business. The thought of others making those decisions can be hard for them to face. Crosbie points out that most people do not establish businesses and, of those that do, some like Henry Ford use their position to develop a legend about themselves while others like Bill Hewlett and David Packard of Hewlett Packard focus on their responsibilities to employees, customers, suppliers and the welfare of society at large.

Crosbie points out that while the founders often wanted to establish a business, the fact that it becomes a "family business" is usually an accident. We do not always choose to go into business with our children or siblings. As with most things that happen by accident, we need a lot of work (including monitoring and planning) or luck for them to sustain in a way that is acceptable to us.

Businesses can succeed to next generations as has happened in the case of the Barcelona based winemakers Codorniu which, at the time of publication of Crosbie's book, had 144 shareholders, after 14 generations, all of whom were family members. Closer to home, we have seen the success of the Coopers brewing family and others.

There are lessons to be learned from families who have managed succession well and from those who have not been as successful such as the Vanderbilts. Like many things, you often (but not always) get out of it what you invest. Planning and communication however increase the chances of being in the former group. More and more, we play the role of facilitators and need to be able to understand the individual motivations of each of the players.

Concerns of creators of wealth often include:

- keeping family united;
- sustaining business and financial enterprises;
- sustaining their standing in the community;
- preserving well-being and livelihood of children and grandchildren;
- cultivating human capital for the next generation; and
- ensuring the next generation have a connection with and experience of sharing in the legacy.

Successful families spend a lot of time getting their governance structure right. If there is a trust at the top of a structure, care needs to be taken as to who makes different types of decisions over various generations.

Just as important is the need to get the culture right. This may involve discussions which bring agreed values or principles out of the uncertainty of family mythology. These could include education about managing what may be the largest lump sum they will ever receive and philanthropic considerations. There needs to be a discussion about "hygiene" or minimum standards of behaviour and an informal dispute resolution process if there is a perceived failure to meet these standards. There needs to be agreement about what access to capital people who do not work in the business will get in order to pursue rewarding lives.

In our experience, no-one likes surprises in this area and expectations have to be managed. It is not easy and if the decision of a founder is ultimately not to leave a business (or substantial wealth) to the children, plan B needs as much consideration as plan A.

Some thoughts on how to run family meetings include:

- get the prior agreement of all of the elders — no hostages within this group should be taken as their support for discussions needs to be real and tangible;
- have a clear purpose and goal for the meeting — the first meeting should not be to solve all succession issues but perhaps focus on what people have in common;
- consider asking an experienced third party to hold private interviews prior to setting the agenda;
- have a steering committee generate agenda;
- include a letter of invitation from the elders;
- consider using an outside facilitator;
- establish ground rules and set the tone for a positive dialogue;
- have a clear action plan with named "owners" and "delivery dates"; and
- report back to all parties.

Lawyers can work with facilitators from other professions to fill in the gaps of their offering. Done properly, the whole should be more than the sum of the constituent parts.

Alan Crosbie will be presenting on this topic with other leading speakers at the Legacy Law Conference in the UK during the Rugby World Cup in October 2015. You can register or get more information at www.legacylawconferences.com.

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Footnotes

1. Campden FB, Harland C, *AN INSIDER REVIEWS*, March 2006, www.campdenfb.com.
2. The University of Adelaide, Graves C, *Families in Business … the heavy hitters of our economy*, May 2014, blogs.adelaide.edu.au.
3. KPMG, Family Business Australia, *Performers: resilient, adaptable, sustainable — Family Business Survey 2013*, www.business.adelaide.edu.au.
4. PWC, *Building for success today and tomorrow — Family Business Survey 2014*, www.pwc.com.au.