Succession planning

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1. Introduction

Succession planning is crucial if a family business is going to continue to thrive for more than one generation. If carried out properly, such planning can give the family business a means of dealing with critical strategic decisions for the future. It can also provide a forum to address and manage potential external threats to the family business. Such threats include divorce, individual bankruptcy and taxation.

Succession planning might simply be described as the process by which the transition of ownership and control of a family business from generation to generation is discussed, strategically planned and implemented. That is not to say that it is a 'one time only' debate and plan, or that it is a straightforward process. The opposite is likely to be true: succession planning ought to be a regular and recurrent item of any family's agenda when it comes to considering the family wealth and its source. At its best, it will be flexible enough to cope with unforeseen events in a timely, sensitive, but decisive fashion. That should be the aspiration at least.

The following discussion is divided into three sections.

- Section 2 below addresses the issues and objectives facing families when planning succession.
- Section 3 addresses the means of achieving a smooth transition between generations.
- Section 4 briefly considers potential obstacles to such a transition.

The chapter is written by us as UK solicitors, but its general messages are, we hope, of much broader application and relevance so that they might be helpful in many other jurisdictions too.

2. Succession planning: the objectives and issues facing families

2.1 Initiating appropriate succession planning

The overriding objective of any family when undertaking succession planning is likely to be the desire to ensure the smooth transition of wealth from one generation to the next whilst maintaining family harmony and ensuring that the business survives the transition unscathed. One point that is, in our view, of real importance and should be mentioned at the start is that a succession plan should not be akin to

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a decree from the senior generation. A plan is far more likely to be successful if it is borne out of agreement and discussion with all of those who are to be affected by it. Adopting an authoritarian approach is unlikely to be fruitful in the long term.

There are often hurdles to overcome and difficult debates to be had with family members in agreeing a succession plan; for example, discussing the relinquishment of control and ownership can be a very political and sensitive topic. Reaching agreement between generations (or even the members of the same generation) on such matters is likely to involve significant diplomatic, social and professional skills on the part of those charged with the task in the first place. If it is achieved, however, the rewards for both the family and the related business can be substantial – crisis is avoided, management time is saved, effort is channelled in the same direction and the family's united front provides security and builds loyalty both internally and amongst any employed workforce. If agreement can be reached between generations, the family business is put in a much better position to succeed than would otherwise be the case.

Generally speaking and regardless of the jurisdictions involved, succession planning requires the setting of clear objectives, agreement within the core family group, good communication (the lack of which is potentially a cause of conflict in itself), agreed governance structures, appropriate recognition of risks and timely action. It also needs the discipline to implement planning that some individuals may not instinctively like and, as a result, it should seek to provide a strategy for dealing with and resolving any sticking-points or disputes that might arise from discussions. Ideally, a succession plan should demonstrate willingness on the part of the generations involved to recognise what is of importance to particular family members or generations and to adapt to changes either in family circumstances or the economic, matrimonial or jurisdictional environment.

In many cases the first issue to address is how to encourage the senior generation to turn its attention to succession planning early on. All too often decisions are postponed until it is too late and the family is left to deal with the fallout from the death or mental incapacity of someone with a substantial shareholding and/or operational input. It can be hazardous to wait until the senior generation decides the time is right for retirement. By then, potential future leaders from the family could well have gone elsewhere or never have joined the family business in the first place. If a succession plan is hastily cobbled together under pressure or poorly thought through, it is likely to lead to family disharmony and the resulting resentment of individual family members may, at the very least, destabilise the business and, in the worst case, cause it serious damage. Obstacles to overcome for the senior generation include facing up to mortality and potential incapacity and adapting to the loss of power, control and identity when they are no longer the driving force behind the family business.

Once the senior generation does turn its mind to succession, a number of key issues will emerge. Typically, the following matters will have to be addressed, as discussed below:

- the future of the business;
- the economic benefit sought;
- management versus enjoyment;

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- identifying and preparing successors; and
- individual satisfaction and social responsibility.

2.2 The future of the business

A fundamental consideration will be whether the family wants the business to continue as a family business indefinitely or whether it might, at an appropriate time, be sold. This will often be a difficult and emotional decision and may depend upon a number of other issues. Critically, it should be ascertained whether any of the succeeding generations are interested in taking over the business and, if so, whether they are capable of running the business successfully so that it will flourish for the benefit of the whole family.

If the answer to either of those questions is no, then the family might well consider selling the business sooner rather than later. There is no point in implementing a carefully structured succession plan only for the business to fail under the stewardship of a disinterested or incompetent younger generation. The business is likely to be the principal asset of the family and, if there is nobody willing or able to take over the reins, it is likely to be better for the family as a whole to sell the business whilst it retains its value and to reinvest the proceeds in a manner that can benefit the whole family and future generations.

There are, of course, other intermediate options to consider – it is not only the stark choice of 'retain' or 'sell'. There may be means by which some equity value from the business can be released or distributed in a way that provides income for the retired without compromising family ownership. For example, some of the equity may be held outside the business in a suitably diversified and risk-balanced portfolio. Alternatively, a part sale to investors or a partial flotation might be considered. This option may also hedge against the risk of the family wealth being concentrated solely in the family business. Significant time and thought is, however, required to assess the impact of non-family involvement on the business and on the willingness and desire of any successor generation to work alongside or for non-family members.

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2.3 Economic benefit

The senior generation will have to consider appropriate succession models. This is a potentially contentious area. In a traditional dynastic model, seen often in relation to landed estates, one heir and their descendants will automatically be designated the primary beneficiaries (often as a result of long-established family trusts and the historical traditions of the family itself). In another model, typically found in entrepreneurial family trading businesses, only 'working' members of the family succeed to the business. Alternatively, a much wider family group could be provided for and charitable purposes could benefit from the business's profitability too. (This may be particularly appropriate where the family business has been sold and the proceeds are looked after by professional managers and trustees.) If the last option is favoured, the senior generation will need to decide whether it would be acceptable for the next generation to inherit (and potentially spend) all, or whether they are really 'custodians' who should benefit only from the income with the capital retained for future generations.

In considering succession models, the financial security of the older generation should not be overlooked. In return for passing down control and ownership of the business, consideration must be given to the means of income and support for those ceding it. On the other hand, providing for the older generation needs to be affordable to the business. The appropriate balance will vary from family to family and there are a variety of mechanisms available. Whatever route is chosen, it should be reviewed from time to time.

A further vital question is what does 'the family' mean? What is the family policy in relation to spouses and civil partners, or indeed to second spouses or civil partners, or children brought into the family by marriage but not related by blood? It is quite likely that this question will arise and it is much better if the family make a decision on this in advance and decide what it means in terms of knowledge of, involvement with and the enjoyment of the family business and wealth. Otherwise a reactive decision is more likely to be viewed as subjective and personal by the people affected and this could lead to unnecessary conflict.

2.4 Management versus enjoyment

The big question here is whether those who enjoy the economic fruits of the family wealth or business are also to be entrusted with decision-making powers. For example, should family members working in the business and contributing to its success benefit to a greater extent than others? If additional reward is to be provided to working family members, what form of benefit is appropriate – salary, bonus, share options, pension? These issues are discussed more fully elsewhere, but the issues are pertinent to any succession plan.

The family will also have to consider the nature of the decisions each member and the family as a whole will be making. Will the family have control over broad strategic decisions or will it also participate at an operational level? Will strategic decision making be the preserve of the senior family members only or will all family members be part of the process? Once the younger generations are enfranchised, will each individual have control of his or her proportion of the family wealth, or will they be restricted to the enjoyment of their share with control being entrusted to external professionals, trustees or executive directors?

These are important questions as those making the decisions will effectively determine the fate of the rest of the family. Such issues can have a significant impact on the planned structuring too. For example, different classes of shares in a company might be created to accommodate the family's wishes – some may have voting rights whilst others carry preferential rights to dividends. Many structures are available to provide this sort of flexibility.

At the forefront of these issues lies the need to consider equity in succession. Different families will have different ideas about what constitutes 'equity', but it does not necessarily amount to financial equality amongst all members of a given generation (or the family more widely). For some families, equity might be achieved by those who participate more actively being the ones having a greater share in ownership or profit. For other families, equity might be achieved intra-generationally by creating structures whereby members within each generation are

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treated in a similar fashion. For others again, it may be important to achieve intergenerational equity whereby the interests of successor generations are balanced against the interests of more senior generations. Whichever way the particular family views equity, the succession plan should strive to achieve it. This is essential in avoiding or ameliorating future conflict.

Communication between those in the family who make decisions and those who merely enjoy the benefits of the family wealth is also vital if future conflict is to be avoided. It may, for example, be necessary to ensure that a process is put in place whereby the managers and decision takers can report to and, if appropriate, be held to account by non-decision takers. Following on from this, and in relation to all of the above questions and issues, the family will have to ensure that there are robust structures in place to manage conflict.

In any structure, it is also of paramount importance for family members to understand the nature of their rights and responsibilities. This can involve recognition of the fact that a given family member could be connected with the business in a number of different capacities. For instance, a family member could be a company director, employee, trustee, beneficiary and individual shareholder, all at the same time. Failure to recognise and take account of these different roles can lead to conflicts of interest, and families must remember that some roles require individuals to accept potential personal liability as well as fiduciary obligations to others.

2.5 Identifying and preparing successors

Careful consideration should be given to which of the next generation is most suited to take over. In this respect successful succession planning often takes place over a long period. There should be processes in place to educate and inform family members from a young age of the nature and workings of the business and, if appropriate, to integrate them into the business. To this end, the family should ensure that the career development of family members who are keen to participate in the business is a key priority.

Younger family members should be encouraged to obtain work experience and develop skills that will be useful to the family business. That experience need not all be obtained within the family business. Many families regard it as a virtue to have obtained experience in other businesses, not just to develop relevant skills and to prove themselves in an impartial environment, but also to experience practices and techniques that might differ from those in the family business and which, if brought later to the family business by that member, might refresh and reinvigorate it in a way that would not be possible if they simply joined the family business straightaway.

Alternatively, if younger family members work in the family business from an early age, it gives them the opportunity to 'work their way up from the bottom' and to experience different areas of the business, getting to know the employees better than they might coming in later at a higher level. This can generate greater loyalty in the family member and ideally towards them from the other employees. It can also provide an excellent opportunity to assess their performance and potential. If

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any family members who had hoped to take a certain role within the business 'come up short', early recognition may provide time for both the member and business to look at other options.

From the point of view of non-family members working in the business, the work experience may go some way to ensuring that family members participating in the business are not simply perceived as attaining any given position or status as a result of nepotism. Where conflict or resentment is detected, the family would have more time to avoid and resolve difficulties.

Clearly, the senior generation will also need to consider (possibly, and preferably, having first discussed matters with those who will be affected) when and how the succeeding generation should become fully informed about the family business and associated wealth.

2.6 Individual satisfaction and social responsibility

The family ought to try to evaluate how and the extent to which family members will obtain satisfaction from their different roles. Some family members will be key decision makers or managers who bring particular strengths to either the business itself or the family group and therefore have self-evident roles. Others may be less well suited to or have no real interest in those areas. Consideration could be given to finding them specific roles, perhaps in reaching out to other family businesses, taking charge of the social responsibility agenda for the operating entities or becoming involved with the philanthropy programme for the family as a whole. Encouraging involvement and avoiding isolation is likely to result in a more positive family environment and any succession plan should deal with such issues accordingly.

The family must also consider the needs of any non-family employees of the business and, indeed, the business's overall ethical profile. People do not necessarily feel entirely comfortable or fulfilled by just helping a very wealthy family become even wealthier, so a good philanthropic programme can help motivate the workforce and, of course, it can give the business a better profile, resulting in more appeal to its customers and a competitive edge. Whilst it may not seem like it at first glance, this is all connected with succession planning since any successor generations will need (and want) to understand the rationale and justification for historic decisions relating to the family business it is taking over. Such things help to mould the identity of the family business too and can create greater family and non-family loyalty to it.

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