

Business Owner Advisory

Navigating the Exit: Family Business Succession



Family businesses are the backbone of the economy, driving innovation, creating jobs, and fostering long-term value across generations. Yet, despite their importance, many struggle to transition from one generation to the next. Family business succession presents unique challenges that can disrupt or even destroy the very foundation of a business if not managed correctly.

Start Today: Transforming a Business Into a Legacy

Succession planning is not a last-minute process; it requires foresight and strategic preparation. For every family, success means different things to each key stakeholder. A well-structured plan should look to align these interests to ensure a smooth transition, preserve family harmony and sustain long-term business growth.

Without a well-structured succession plan, businesses face the risk of leadership gaps, family conflicts and potentially even failure. The success of a transition depends on careful planning, clear governance and a shared vision that balances business needs with family dynamics.

Succession planning is not just about determining who will take over the family business; it is also about creating an orderly transition that preserves the founder's vision and values. By addressing succession early, family business owners can maintain continuity, mitigate uncertainty and secure their legacy for the future.

While there are three main components of family business succession planning, **management progression, governance and ownership transfer**, it begins by understanding the goals of all the participants.

Special Considerations for Real Estate Families

For families in the real estate industry, succession planning presents unique challenges and opportunities. Real estate businesses often involve significant asset portfolios, long-term leases and complex tax considerations, all of which must be addressed during the transition. Succession planning requires special attention to the nuances of property ownership, management and valuation. Real estate is a unique asset class that often holds sentimental value while also serving as a primary source of income and generational wealth.



Defining Success for All Participants

TYPICAL GOALS

KEY QUESTIONS



FOR THE FOUNDER:

- Ensure the business remains financially strong and continues to grow.
- Pass leadership to a competent successor.
- Achieve personal financial security post-transition.

1. What role (if any) do I want to play after transitioning leadership (e.g., chairman, advisor, completely retired)?
2. How do I ensure fairness among family members, especially those active in the business versus passive shareholders?
3. How do I ensure the business remains viable and continues to grow while also providing for my own personal financial security post-transition?



FOR THE NEXT GENERATION:

- Determine personal career goals (i.e., choosing to be active in the business or being a passive owner).
- Gain the necessary experience and mentorship to lead effectively.
- Clarify ownership versus management responsibilities.

1. Do I (or my siblings) want to take on an active leadership role, or should an external leader be hired?
2. What skills, experience and mentorship do I need to transition into leadership successfully?
3. How will business ownership be structured among family members (e.g., will it be split equally amongst the family or based on individual contributions to the business)?



FOR THE FAMILY (PASSIVE OWNERS):

- Maintain family harmony and avoid disputes.
- Understand the business's strategic direction and valuation.
- Ensure there are appropriate mechanisms that protect family interests and allow for communication with all family members (both active and passive).

1. How will family shareholders be involved in decision-making?
2. What governance structures (e.g., family council, advisory board) should be established?
3. How do we balance reinvesting in the business or distributing dividends to family shareholders?

FOR KEY MANAGEMENT & EMPLOYEES:

- Believe in leadership continuity and business strategy.
- Receive fair compensation and incentives to stay engaged.
- Understand their career path post-succession.

1. Will the succession plan provide continuity and stability for the business?
2. How will my role be impacted by the leadership transition?
3. Are there distinct practices to separate family ownership from day-to-day management decisions?



Management Progression: Developing the Next Generation

A well-prepared leadership team is critical for a seamless transition. Ensuring the next generation is equipped with the necessary skills and experience requires a structured approach.

Assess Current and Future Leadership Needs

Before transitioning leadership, it is essential to evaluate the existing management structure and determine what skills, experience and leadership qualities the next generation will need to successfully lead the business into the future.

Evaluate the existing management structure

- Assess which leadership roles are critical for business continuity.
- Identify whether the next generation is prepared for leadership or if external executives will be needed.

Identify strengths and weaknesses within leadership

- Conduct performance reviews of key managers, including family and nonfamily executives.
- Determine whether the current leadership team has the skills needed for the company's long-term strategy.

Consider external leadership assessments to identify gaps

- Utilize professional leadership assessments or executive coaching evaluations.
- Benchmark against industry standards to identify gaps in strategic thinking, operational management and financial acumen.



FOR EXAMPLE

A family business in manufacturing might find that the next generation has strong operational expertise but lacks financial acumen, requiring formal training in business finance before taking over.

Training and Mentoring the Next Generation

Once the leadership gaps are identified, structured training and mentoring programs should be established to prepare the next generation.

Mentorship programs where senior leaders guide and train potential successors

- Pair next-gen leaders with experienced executives for hands-on learning.
- Hold regular one-on-one mentorship meetings focused on business strategy and decision-making.

External experience opportunities for next-gen leaders

- Encourage next-gen leaders to gain experience outside the family business before joining it or taking leadership roles.
- Expose future leaders to different industries to help develop strategic thinking and adaptability.

Executive education and leadership training

- Enroll future leaders in executive MBA programs, leadership courses or specialized training in corporate governance, financial management or strategic planning.
- Have next-gen leaders participation in industry conferences and peer networks to gain external perspectives.

Cross-functional training across different business areas

- Rotate next-gen leaders through various departments (e.g., finance, operations, marketing) so they can build a comprehensive understanding of the business.
- Exposure future leaders to different roles to foster well-rounded leadership capabilities.



FOR EXAMPLE

A second-generation successor in a family retail business might spend time working in procurement, sales and supply chain management before moving into a senior leadership role.

Handing Over the Reins

A structured handover process ensures a smooth transition without disrupting business operations or causing uncertainty among employees and stakeholders.

Establish clear milestones for transferring responsibilities

- Define specific roles and decision-making authority for the next-gen leaders at each phase of the transition.
- Gradually shift major decision-making authority, such as financial approvals, hiring and strategic planning, to future leaders.

Use a phased transition approach to minimize operational risks

- Implement a co-leadership period where both the founder and next-gen leader share responsibilities before the full handover.
- Create contingency plans in case adjustments need to be made during the transition.

Ensure the outgoing leader remains available for guidance while allowing new leaders autonomy

- Have the founder serve in an advisory capacity on the board of directors or as an informal mentor.
- Avoid micromanaging — new leaders need space to make independent decisions while still benefiting from the outgoing leader's institutional knowledge.



FOR EXAMPLE

A founder in the construction industry transitions ownership over five years, first delegating day-to-day operations while retaining strategic oversight, then fully stepping back into an advisory role.

The management progression component ensures continuity, builds leadership confidence and protects the business from disruption. By assessing leadership needs, providing structured training and implementing a phased transition, the business can thrive across generations while maintaining family unity.

Management Progression in Real Estate

Leading a real estate business requires more than theoretical knowledge; it demands structured, real-world exposure across the full operational life cycle. Potential successors should be thoughtfully integrated into day-to-day operations, starting with property-level tasks such as lease administration, vendor oversight, rent collection and budgeting. Over time, they should take on more strategic roles in asset management, capital planning, debt structuring and evaluating acquisitions or development opportunities.

Hands-on property management experience, whether in-house or with third-party firms, is essential for understanding tenant relations, maintenance, compliance and the financial drivers of net operating income and long-term value. Bringing in outside managers during a transition can help maintain continuity while exposing next-gen leaders to professionalized systems and best practices.

For development-oriented families, successors should also gain experience in the entitlement process, permitting and construction oversight. In addition, experience across asset types (e.g., multifamily, office, industrial, retail) could further strengthen their adaptability in an ever-changing industry.

Governance: Establishing Corporate and Family Policies

Governance, both corporate and family, serves as the foundation for communication, decision-making and conflict resolution in a family business succession plan. Effective governance ensures clarity, transparency and accountability among all stakeholders, helping to balance business growth with family dynamics.

In a family business succession plan, corporate governance establishes and formalizes the procedures and oversight mechanisms that guide how the business operates and transitions across generations.

Corporate Governance

Roles and Responsibilities

Clearly defining roles and responsibilities within the family business, including ownership, day-to-day management and advisory positions, helps avoid confusion and potential conflict among family members regarding their involvement and decision-making power.

Distribution Guidelines

Providing periodic guidance on distributions establishes reasonable expectations for all family shareholders while also preserving sufficient capital for reinvestment.

Most pass-through entities (i.e., S corporations, partnerships, LLCs) have a specific policy requiring minimum distributions for income-tax purposes for all shareholders.

Compensation Policies

Compensation must balance fairness with meritocracy, ensuring that family members working in the business are fairly compensated for their respective positions without creating resentment among passive family shareholders.

Many family businesses require an independent assessment of compensation for family management.

Shareholder Agreement

This serves as the legal framework for ownership, voting rights, share transfers and dispute resolution in a family business. As the business evolves, especially during generational transitions, this agreement must be updated to reflect new realities, ownership structures and succession plans.

As part of the shareholder agreement, family businesses should also have buy-sell provisions, which govern what happens when a shareholder wants to exit, dies, becomes disabled or experiences other triggering events.

Creating a Board

As family businesses grow, decision-making complexity increases. A formal governance body, either an advisory board or a board of directors, helps provide strategic oversight and accountability, professionalize management and reporting, and ensure succession planning is handled objectively.

	Advisory Board	Board of Directors
Formality	Informal, no legal authority	Formal, legal authority
Decision Power	Provides guidance only	Can vote on key decisions
Members	External experts, family members	Legally appointed directors
Purpose	Advisory, strategy, mentorship	Fiduciary responsibility, oversight

Family Governance

Alongside corporate governance, family governance is equally as important in maintaining harmony. Family governance refers to the structures and practices that families implement to manage the relationship between the family and their business, providing a framework for communication to promote long-term harmony and sustainability across generations. At its core, it aligns the family's values with the operational and strategic needs of the business. Central to effective family governance is communication, which fosters transparency, trust and cohesion among family members, enabling them to navigate challenges and opportunities together.

Oftentimes, family governance begins with the establishment of a family mission statement as well as a family constitution.

- **A family mission statement** is a declaration of the shared values, vision and purpose that guide a family's involvement in their business and personal lives.
- **A family constitution** is a formal document outlining the rules, policies and processes for governance and decision-making within a family business.

While the family mission statement focuses on the “why” — the family's purpose and values — the family constitution focuses on the “how” — the rules and processes for achieving that purpose. Together, they form the backbone of family governance, ensuring that the family and business can thrive in alignment with shared goals and principles.

Once these major family governance components have been established, the next phase typically includes adoption of several key mechanisms:

- **Family council:** A structured group that represents family shareholders, providing an open forum for discussion, alignment and policy-making regarding business involvement.
- **Regular family meetings:** To ensure ongoing communication, keep family members informed and engaged, and ensure transparency in business decisions and fostering unity.
- **Educational and philanthropic initiatives:** Beyond business leadership, many family enterprises emphasize education and philanthropy as key components of their governance model to develop responsible family stewards and give back to the community.

Strong corporate and family governance provides structure, transparency and dispute resolution mechanisms that endeavor to protect both the business and family relationships. Without governance, succession planning can become disorganized, emotional and conflict ridden, putting the business and family legacy at risk.

Governance in Real Estate

Corporate governance for real estate families must address the dual nature of the business: as an income-producing enterprise and as a repository of family wealth. Formal policies should define how rental income is distributed, how reinvestment decisions are made, and how properties are bought or sold.

Family governance also plays a critical role in fostering alignment around the family's vision for the real estate portfolio. Are the properties meant to generate passive income, or are they part of a larger development strategy? A clear shared vision helps guide decision-making and avoid disputes. Family councils can address competing priorities among members regarding the use of properties for personal versus business purposes. Regular family meetings can help manage expectations around dividend distributions from rental income.

Ownership Transfer: Strategies for a Smooth Transition

Ownership transfer is often the most intricate and sensitive component of succession planning, particularly when multiple next-generation family members are involved. Determining how ownership will be allocated among heirs, some active in the business, others passive, raises complex questions of fairness. At the heart of these decisions lie two primary considerations: who receives economic **value** and who retains decision-making **control**.

Value

Value represents the economic benefit attributable to ownership in a business, encompassing both tangible elements, such as earnings, distributions and compensation, and intangible factors like brand reputation, customer relationships and market position. For family-owned enterprises, value typically reflects each owner's proportional interest in the company's overall worth, but it should be distinguished from management control or decision-making authority, which may be allocated separately.

Regardless of the method of ownership transfer, an objective and well-supported business valuation is essential. Engaging an accredited valuation professional (appraiser) ensures that the transaction is based on a defensible estimate of fair market value. This valuation forms the foundation for equitable transfers and minimizes the risk of disputes, legal issues or unintended tax consequences.

Control

Control refers to the ability to make decisions on the company's strategic direction, operations and governance. This generally includes the power to appoint or remove leadership, set performance objectives, approve budgets and determine the allocation of profits, whether through reinvestment or distribution. Control is typically exercised through voting rights as well as through defined governance such as board seats and composition, and it does not always correspond proportionally to ownership interests.

In a family business, value and control represent distinct but interrelated aspects of ownership, economic benefit versus decision-making authority. A successful transition depends on clearly defining and, where appropriate, separating these elements. Doing so allows families to craft governance structures that reflect both business needs and family dynamics, ensuring continuity, accountability and harmony across generations.

Separation of Value and Control

Common strategies in family business succession include recapitalizing the company's equity into **voting** and **nonvoting shares**, allowing for a more tailored allocation of rights.

This separation can take several forms:

Ownership Without Control: A family member may inherit or receive equity in the business, entitling them to distributions or future appreciation, but may hold no voting rights or operational authority.

Control Without Ownership: A nonfamily executive may be appointed to lead and manage the business, exercising day-to-day control and strategic oversight, despite holding no equity interest in the company.

Methods of Ownership Transfer

There are several methods to transfer ownership, each with its own strategies and considerations.

Gifting Ownership

This method involves transferring business interests without receiving payment in return. It is frequently used for estate planning purposes and generally utilizes the annual gift exclusion and/or the lifetime gift tax exemption to efficiently transfer business interests to family members.

- **Direct:** Ownership interests are transferred directly to individual family members. This approach is often chosen when the current owners want to provide the next generation with immediate ownership and decision-making authority and are comfortable relinquishing some or all control right away.
- **Indirect (via trust structures):** Rather than transferring shares outright, some business owners prefer gifting ownership through trusts. This provides greater long-term control over business interests and can provide asset protection benefits.

Selling Ownership

Ownership can also be transferred through a structured sale to a family member or members. This approach ensures that the next generation has a financial commitment to the business while also providing liquidity to the current owner.

- **Outright:** Involves immediate transfer of ownership in exchange for a lump-sum payment. Best suited for successors who have access to capital, either personally or through third-party financing.
- **Seller-Financed:** Also known as an installment sale, this method allows successors to purchase ownership over time by making direct payments to the selling owner. It offers financial flexibility for the buyer and can be an ideal structure when the next generation has the operational ability to run the business but not the immediate funds. However, the selling owner must assess the risk of default if business cash flow falters.

Commonly utilized trust structures:

- **Grantor Retained Annuity Trust (GRAT)**
Allows a business owner to transfer ownership while freezing the value of the gift for tax purposes. Any future appreciation of the business passes to heirs with minimal gift tax. However, if the grantor dies during the trust term, the assets may revert to the taxable estate.
- **Generation-Skipping Trust (GST)**
Transfers ownership to grandchildren or future generations, skipping over children to minimize estate taxes and preserve family wealth across multiple generations.
- **Intentionally Defective Grantor Trust (IDGT)¹**
Moves business ownership outside of the taxable estate while the grantor retains responsibility for income taxes on the trust's earnings. Often structured as an installment sale, whereby the transferring owner receives payments over time while the business grows outside of their taxable estate.
- **Spousal Lifetime Access Trust (SLAT)**
Enables a business owner to transfer ownership to future generations while still offering income access to a spouse during their lifetime. While assets are removed from the taxable estate, access is lost if the beneficiary spouse dies first or in the event of divorce.

1. Before transferring business ownership to the IDGT, the transferring owner typically would make a small "seed gift" to the trust, usually around 10% of the value of the business interest, to demonstrate the trust's ability to pay for the asset.

Earning Ownership

Ownership can also be received as compensation, providing a powerful incentive for performance and long-term commitment. This approach helps ensure that equity is earned through demonstrated contribution rather than granted solely through inheritance or expectation. By linking ownership to value creation, this strategy supports leadership development and aligns incentives with the ongoing success of the company. Earning ownership is particularly effective when family successors are actively engaged in the business but not yet in a financial position to purchase equity outright. It also enables the current generation to observe and assess the next generation's readiness before transferring meaningful control to them.

- **Performance-Based Vesting:** Ownership is granted incrementally based on the achievement of specific business goals, such as revenue growth, profitability targets, operational improvements, or individual milestones like completing leadership development or bringing in new clients.
- **Time-Based Vesting:** Transfers ownership gradually over a set period, rewarding loyalty and long-term service while providing a clear, structured path toward increased equity participation.

While there are numerous strategies for transferring ownership, each must be carefully tailored to a family's unique circumstances, and success depends on aligning financial, business and family considerations. Ownership transfer is often the final step in a well-designed family business succession plan, serving as the culmination of thoughtful planning to ensure both continuity of the enterprise and fulfillment of generational objectives.

Ownership Transfer in Real Estate

Real estate businesses require meticulous planning ahead of transferring ownership due to the additional complexities involved.

Managing debt obligations is a nuanced aspect of real estate ownership transfer. Properties are often encumbered by mortgages, and the transfer of ownership, whether at the property or entity level, can trigger legal and financial implications that must be addressed in advance. Most loan agreements include due-on-sale or change-in-control provisions, meaning that a transfer could accelerate the debt or require lender consent. Legal counsel must carefully review loan documents to assess whether the planned transfer structure will breach any covenants, and if so, whether waivers or refinancing arrangements are needed.

Valuing real estate portfolios requires specific expertise due to the diversity of assets involved (e.g., residential, commercial, industrial). Each property must be appraised individually, assessing its unique characteristics, including location, condition, income generation, and highest and best use. When properties are held within an entity, appraisers must apply a tiered valuation methodology that not only aggregates individual property values but also factors in entity-level considerations (e.g., management control, transfer restrictions, minority interests and marketability discounts).

Entity structures such as limited liability companies (LLCs) and family limited partnerships (FLPs) remain effective tools for consolidating real estate assets, centralizing management and facilitating systematic ownership transfers while maintaining control. These entities also enable flexible management of debt allocation and responsibilities among family members.

Key Team Members

Business succession planning often requires a team of key professionals to advise and assist in specific areas. In addition to their trusted financial advisor, a business owner should assemble the right professional team for a well-rounded and successful business succession plan, including (but not limited to):

Business Attorney

Ensures the legal structure of the succession plan is sound, drafts necessary agreements (e.g., operating agreements, shareholder agreements, etc.) and ensures compliance with relevant laws.

Estate Planning Attorney

Ensures the owner's personal estate plan aligns with the business succession strategy, and specializes in drafting wills, trusts and asset protection strategies.

Certified Public Accountant (CPA)

Provides financial analysis and develops tax planning strategies to help minimize tax liabilities associated with a transition.

Business Valuation Expert

Determines the fair market value of the business, which is necessary for transferring ownership.

Insurance Advisor (if applicable)

Helps with insurance needs to protect the business and facilitate buyout funding if needed.

Finalizing the Succession Plan: An Actionable Road Map

Implementing a succession plan requires a structured approach.



Initiate Discussions: Open conversations between all stakeholders to align expectations.



Assess Leadership Potential: Identify successors and develop tailored training plans.



Establish Governance Structures: Formulate and communicate policies for transparency and accountability.



Plan for Ownership Transfer: Select the best transfer method(s) based on family and business needs.



Set a Timeline: Develop a clear transition road map with measurable milestones.



Evaluate and Adjust: Continuously monitor the plan's effectiveness and adapt as needed.

Ensuring a Lasting Legacy

For a family business succession plan to be truly effective, it must proactively address and integrate the varying definitions of success across stakeholders. Setting milestones early in the planning process allows for adjustments along the way as the business and/or family circumstances evolve.

Establishing a succession plan is a chance to solidify a family's legacy while ensuring the opportunity for continued growth. A well-structured plan preserves the founder's (or current generation's) vision, fosters the next generation's leadership and secures the business's financial future while also balancing the personal needs of the family.

Implementing a family business succession plan may seem daunting, but with the right approach, it's entirely achievable. The key is to start early, involve all stakeholders and seek professional advice as needed. By focusing on management progression, governance and ownership transfer, family businesses can create a road map for success that honors their legacy while embracing the future.

Now is the time to take action. Start the conversation, define your goals and begin building the framework for your family business's future. After all, success in succession is the ultimate measure of a family business's legacy.

Keep in mind that while some families maintain businesses for many generations, many more may decide that the best path forward for the business and its stakeholders is to exit via another pathway, such as a sale transaction or an employee stock ownership plan (ESOP).

To learn more, contact your Financial Advisor. You can also visit us at www.cnr.com, or email us at citynationalrochdale@cnr.com.

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