

Why Selecting a Successor Early is Key for Protecting Family Wealth

When it comes to family businesses, many entrepreneurs assume their children will want to keep the enterprise within the family. After investing their time, money and sweat equity into the business, entrepreneurs are sometimes surprised to learn their kids aren't interested in taking over the family business. Many business owners never talk to their kids about transitioning their business and they can't understand why someone would reject the offer to run something as wonderful as the business they started.

Business owners are often forced into making quick business transition decisions when they discover the next generation won't be running it. It can be hard to see things go wrong, especially over something that could have been as easy as a short conversation over dinner about whether your kids have an interest in owning your business in the future.

According to the City National Small Business Report¹, 27 percent of all business owners surveyed plan to pass the business onto children or other family members. Similarly, the PwC 2017 Family Business Survey found that among the family-owned businesses anticipating a transition within the next five years, 41 percent plan to pass the business onto the next generation to run, 11 percent plan to pass onto the next generation to own but not run, and 30 percent plan to sell to a third party.

WHEN YOUR KIDS DON'T WANT TO TAKE THE REINS

Successful entrepreneurs are skilled at growing their businesses. However, their focus on the business can mean they don't always have a concrete plan for their family wealth for after they exit the company. According to RBC's Wealth Transfer Report 2017, less than half (39 percent) of business owners have a comprehensive plan in place for the future of their business or their family wealth, and 22 percent of business owners have yet to start even minimal transition planning.

The discussion about the future of the business can be brought up by the owners or their kids, but it's often easier for parents to bring up the topic as part of a strategic conversation. Sometimes parents have always known their kids don't want to go into the business, while other times the kids change their mind after they've worked in the business for a while. Owners need to understand they have a duty of stewardship for their business, particularly if they have employees whose livelihood depends on them.

City National worked with one business owner who assumed his child was following in his footsteps. Once they asked, it turned out that the son didn't want to work there if his father wasn't there. Ultimately, the business was sold so the patriarch could retire. If the kids don't want the business, the default decision by parents is often to sell the business to an outside party or to current employees.

PREPARING A BUSINESS FOR SALE

Preparing a business for sale can take years of planning. Some businesses are so closely tied to the owners' intellectual or physical abilities that they cannot be sold. In other cases, when entrepreneurs who don't develop a succession plan pass away prematurely, the business tends to "wither on the vine."

Sometimes the company has to go on the auction block and the assets get sold for pennies on the dollar. Because most owners invest their money directly back into the business, many family businesses appear to be unprofitable. When transitioning from building the business to getting it ready for sale, it's important to focus on cash flow.

An advisor can help business owners begin separating their personal cash flow for retirement and address how to transition their business. Estate planning and business planning are integrally related. Sometimes parents want to continue owning the business and hire non-family members to run it. The business interest may ultimately be sold or transferred to their kids who can benefit from and oversee as board members.

TEAM APPROACH TO SUCCESSION PLANNING

According to RBC's research, 96 percent of business owners educate themselves on financial matters. However, entrepreneurs are better served by building a team of advisors including an attorney, an accountant, a financial advisor and a wealth planner who can help them understand the decisions they need to make for their family's future as well as the future of their business. An attorney and an accountant are essential to discuss the infrastructure of the business and how it's incorporated, whether the business structure is conducive for a sale, and how to make it attractive to buyers.

Perhaps the most essential role for an advisor is purely as a catalyst for breaking down misconceptions and starting the conversation about future financial and entrepreneurial transitions. It's important to consult with professionals to evaluate your situation before identifying a successor and creating a plan.

To learn more contact your Financial Advisor or CNR Senior Investment Consultant or Portfolio Manager, visit us at CNR.com, or email us at citynationalrochdale@cnr.com.

¹The 2018 City National Small Business Report polled 1,031 business owners, selected from research panels that represent populations of business owners and entrepreneurs from across the United States. We received between 800 and 900 responses per survey question, unless otherwise indicated. The individuals surveyed included men and women whose business revenue is between \$1 and \$20 million annually and who employ up to 250 employees. The survey was fielded online from January through March 2018. Our aim was to help identify the primary challenges and opportunities faced by small to medium-sized business owners across industries in the U.S. by gauging attitudes around finance, technology, labor, competition and long-term goals and strategies for growth. This report is for general information and education only and was compiled from data and sources believed to be reliable. City National Bank does not warrant that it is accurate or complete. Opinions expressed and estimates or projections given are those of the authors as of the date of the report with no obligation to update or notify of inaccuracy or change. This report is not a recommendation or an offer or solicitation to buy or sell any financial instrument. It is not specific investment advice. Readers must make independent decisions based on their own objectives and financial situations. This report may not be reproduced, distributed or further published by any person without the written consent of City National Bank. Please cite source when quoting.

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