



## Exit Planning

# NAVIGATOR

Exit Planning Strategies for the Entrepreneur



Issue 35

### Has Your Child Earned Ownership Interest In Your Business? A Decision Framework

*Stan Briggs was perplexed and that's why he told his advisor, "My son, Patrick, has worked in the business for the last twelve years. In that time, the business has tripled its revenues and its profits. I've started to think about scaling back my activity and I realize how important it is (for my own retirement income) that Patrick be motivated to continue to grow the company profitably. Since I'd like to have him own the business someday, is there a way to start transferring it to him now? It seems unfair to make him pay for all of the business value since he created so much of it and since he is so important to my financial security. My son, of course, agrees wholeheartedly with this analysis but I'm not so sure that his mother and sister are on the same page. What issues do I need to consider?"*

#### Equal vs. Fair

First, Stan must determine if his son is already paying for the business now through "sweat equity" (lower compensation than he could have earned elsewhere, more working hours and greater risk). If so, any reduction in the purchase price is not a gift, but rather recognition of Patrick's contribution.

Second, are Patrick's efforts adding value to the business? If so, should Patrick have to pay for his efforts by receiving a reduced share of Stan's ultimate estate?

Third, if Patrick's involvement in the business is critical to Stan's retirement, Stan should consider tying his son to the business using "golden handcuffs," such as awarding ownership if Patrick stays to run the business—and the business stays profitable.

Fourth, in many business-owning families, every child is offered the opportunity for involvement in—and ultimately ownership of—the family business. Usually, however, only one child foregoes the allure of the "outside world" to commit to working in the uncertain and illiquid world of a closely-held business. (Not to mention that having **you** for a boss should be worth something!)

Lastly, analyze the transfer issue in light of your own exit objectives. Be certain that any transfer to children will satisfy your exit objectives. Explore with your advisors other issues and concerns that will arise as you begin to transfer ownership to a child. For example, how much money will you need after you leave your business? What, if anything, needs to be done for your key employees or for your other children? Temper and qualify all transfers to children in light of your overarching exit objectives. In short, make certain the transfer of ownership to a child is also a good business and retirement decision.

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## Has Your Child Earned Ownership Interest In Your Business?

(continued)

### Using Advisors

When considering a transfer of your business to a child, don't underestimate the value of using experienced consultants and advisors. Their counsel, experience and input is perhaps never more important than when dealing with your own family. The need for independent, non-emotionally-charged advice is critical. Having worked with other family businesses, these consultants along with your other advisors can offer practical advice.

### Decision Framework

First determine the level of contribution your business active child has made to the value of the business. Second, determine the contribution that child must continue to make to ensure the achievement of your exit objectives. Those determinations can form the basis of what is "fair" with respect to both the business-active child and the other children. Third, use your advisors to help explain, guide and implement the transfer of the business and even act as the "sacrificial lamb" when necessary.

*Subsequent issues of **The Exit Planning Navigator®** discuss all aspects of Exit Planning.*

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