

All in the family

How to successfully transfer corporate ownership to family members **Interviewed by Jerry Roche**

Ideally, the moment you take the reins of a business, you should already know how you are going to exit. Within three to five years prior to your exit, you should be well into your exit-planning process.

According to Joel J. Guth, an advisor in Smith Barney's Citigroup Family Office, the five most common ways owners exit their businesses are to transfer to family members, sell to key employees, sell to co-owners, sell to a third party or file an IPO.

In this and the next several issues of *Smart Business*, Guth will discuss each option in more detail, noting the advantages and disadvantages of each. This month, the topic is transferring ownership of your company to a family member.

When is it appropriate to transfer a company to a family member?

For a successful transfer, three conditions must exist.

One, a family member must have a desire to own and run the business, rather than the owner forcing the business on his/her family. You need to have a very open discussion with the family member and understand if the business is his/her true passion.

Two, the family member must have the needed skill sets to own and run the business. This is very difficult for many owners to determine, especially if they are evaluating their children. We often encourage the owner to discuss his/her child's strengths and weaknesses with key employees inside the business as well as with outside professional advisors. You need a very impartial appraisal of your successor.

The third condition is the right family dynamics need to exist. If the owner has multiple family members in the business, he/she will need to be able to pick a successor without destroying the family relationship. If you have three children working in the business, how will the two not picked to be CEO react when they are informed they will work for their sibling? Many times the family dynamics are the hardest part of the succession plan.

What are the advantages of selling the company to a family member?



Joel J. Guth
Advisor, Citigroup Family Office
Smith Barney

First of all, you are transferring ownership of the company to a known entity. You can help ensure continuation of the business's culture and mission.

The second advantage is that it allows the owner to remain involved in the business. If your child takes over, you can probably still come to the office every day. (Whether that's good or bad for the business is a separate discussion.)

The third advantage is that you're providing wealth and income for your children and maybe even future generations if the transition is successful.

What are the disadvantages?

One is that you are probably going to have very little cash up front. Very few children have the means to write a big check up front to buy the company. Many times, families are using a loan from mom and dad to fund the purchase of the business. The children then use the proceeds from the business to pay back the loan. In this scenario, the risk is that the owner's financial well-being is still tied to the success or failure of the business. If the business hits hard times, mom and dad could still be very much impacted financially.

Another disadvantage is that the business

may still require substantial involvement from the owner. The children may still look to mom or dad to make the decisions. This reluctance to assume control may have long-term effects on the management of the business. Key employees may decide they do not respect the new CEO and continue to approach mom and dad with issues.

As discussed above, transferring control to one or more children may cause resentment and jealousy among the family. Everyone has a different opinion of fair and equal. You can execute a successful transfer of ownership and control, yet it may still damage or destroy family relationships.

A final disadvantage is some owners realize they can reap more cash (and experience less risk) through a sale to a third party. This is especially true as deal terms become more favorable to sellers.

How does an owner go about transferring company ownership to a family member?

The first step is to get an official valuation of the business. If your goal is to sell it to a third party, you want the highest possible valuation. If your goal is to transfer the business to your children, you may be looking for the lowest defensible valuation.

Normally, parents begin to gift shares of the company to the son or daughter. Depending on the size of the gift, the gifts may be tax free. Or, if your child has the money or the ability to get a loan, he/she may purchase the stock outright. Many times the worst scenario is to leave the company to your offspring at death.

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JOEL J. GUTH is a registered representative of Smith Barney, a division of Citigroup Global Markets Inc. Reach him at (866) 464-2750.

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