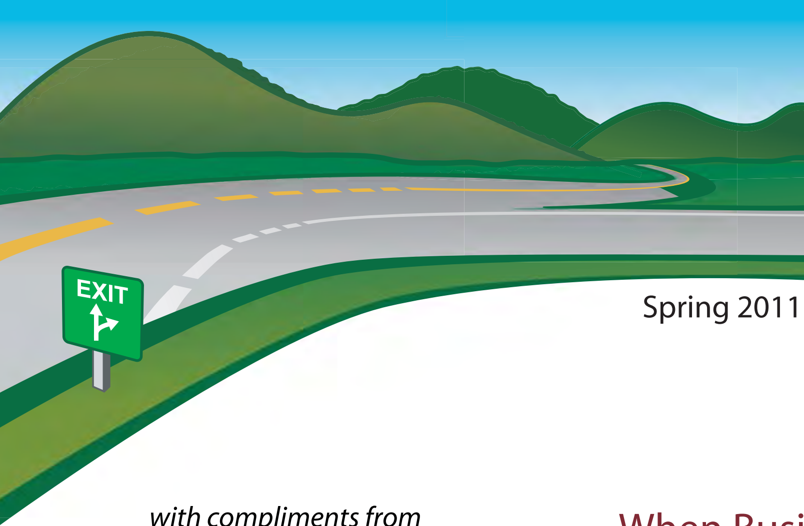



# Changing Lanes

*Transition planning for entrepreneurs and family businesses*

Spring 2011

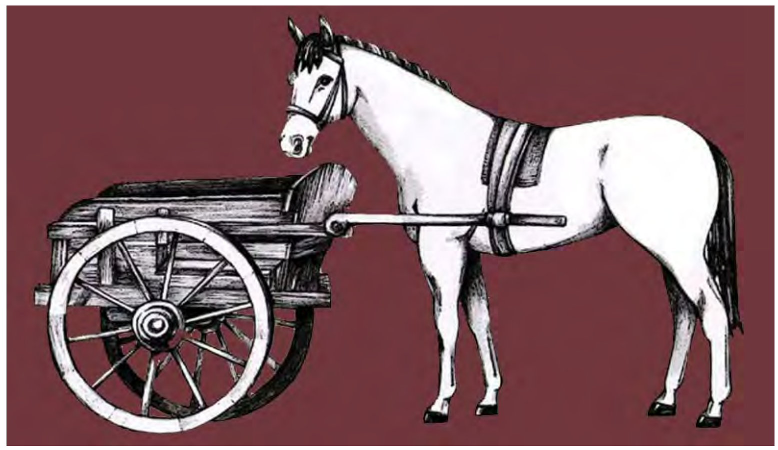
*with compliments from*

Frank C. Allen, CLU, CHFC, CFP

The Frank Allen Financial Group Inc.

*We build Financial Bridges for your Business and your Life*

## When Business Owners Put the Cart Before the Horse



Carl Harrington was devastated when he was forced out of his ownership of Carmichael Manufacturing by his cousin Michael. Carl felt they had a reasonably good partnership and would never in a million years have thought that Mike would oust him from the family business their grandfather had founded over 70 years ago. How could this have happened?



Jim T[illegible]e never d[illegible]ussed h[illegible]houg[illegible] ideas [illegible]futu[illegible] plans with a[illegible] of his family and [illegible]he died [illegible]lenly [illegible]e wa[illegible] clear [illegible]der[illegible]ed leader a[illegible]ng the equal he[illegible] His [illegible]fe str[illegible] to [illegible] the [illegible]ness[illegible]hing [illegible]hile the kid[illegible] among th[illegible]selve[illegible] abou[illegible] the [illegible]t d[illegible]tion for the b[illegible]ness.

[illegible]e Goldbe[illegible]s[illegible]set o[illegible] the a[illegible] sa[illegible]s flying as hi[illegible]ildren vie f[illegible]utonomy. He can't understand what went wrong. He always took such care to reward his children equally in order to avoid any competition.

Ryan Holt is peeved that his siblings disagree with his renovation plans for the car dealership. These upgrades are essential to the continuity of the franchise agreement and ultimately his business. He desperately needs their support.

All four of these family squabbles are representative of the cart being put before the horse. They are the product of the well-intentioned business, ownership and tax management strategies that are frequently implemented without adequate forethought and discussion around the potential side-effects.

This issue of Changing Lanes looks at how to ensure you don't fall into the same trap, but instead take the time to fully understand the implications of all common business tactics before adopting them as your family and business policies. You will discover how to begin your transition plan by first defining what is important for you, your family and your business.

### *Inside....*

## What Went Wrong

There is no doubt that the financial, legal and management professionals who advise entrepreneurs and privately-owned businesses are highly-qualified, extremely protective of their clients and adept at saving them money.

The part that is often missing is the discussion about what is right for the family.

Carl and his cousin [illegible] had a sho[illegible]n clause f[illegible] an exit strategy. Micha[illegible] a silent partne[illegible] involve[illegible] the management of th[illegible]mpany, wasn[illegible]ap[illegible] with th[illegible] Car[illegible] was running the busine[illegible]d act[illegible]ted [illegible] shot[illegible] [illegible] Unfortunately, Carl wasn't [illegible]e t[illegible] an[illegible] in[illegible] and had to acced[illegible] pa[illegible]o Micha[illegible] only [illegible]s Carl's life thrown into a tailspin, the action severely destroyed relationships between the two branches of the family.

While Jim Thorne was able to take advantage of tax savings through gifting considerable share value to his three children, he also created an "accidental partnership" among siblings who had no idea that they would end up in business together. Unfortunately, this accidental partnership didn't come with any leadership or decision-making instructions.

Abe Goldberg is alive and well, and actively managing his tax liability. His four children all receive equal bonuses and directors' fees even though only two of them have a management role in the company. Now the kids are fighting over who works harder and deserves more compensation than the others!

F[illegible]truly th[illegible]ght he was [illegible]t thing when he l[illegible] the [illegible]dea[illegible]ship to the [illegible]nly one of his children i[illegible]ested [illegible]ki[illegible]ver. To be fa[illegible] the others, he gave them e[illegible]-thi[illegible] share of [illegible]property and outside i[illegible]stments. He [illegible]n't foresee [illegible]n's need to approach the o[illegible]r siblings to [illegible] for a re-inve[illegible]ent in the property when the "franchisor" [illegible] of the building! Nor did he foresee the strained relations that would result from his "fair and equitable" estate plan.

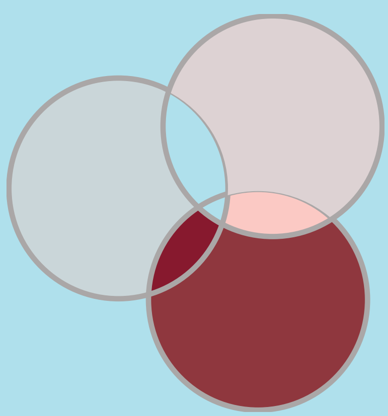
Without realizing it, the advisors to these business owners actually created policies with outcomes that the families didn't expect or fully understand – policies, for example, that ultimately dictated the terms for compensation and the future ownership and leadership of their clients' business.



## The Future-Focused Approach

Be it strategies to enhance your profitability or minimize taxes, or advice to ensure you don't put all your eggs in one basket, each member of your advisory team is adept at developing creative, and sometimes complicated, systems to protect you both financially and legally.

But when planning a future for your family and business, it is so important that you first consider the interdependence of the three key areas of your privately-owned business: the ownership, the day-to-day operation of the business AND the family or personal relationships. The overlap between family and business is clearly depicted in the 3-Circle Model (adapted from the concept by Tagiuri and Davis). The diagram shows how it is impossible to make changes in one area without those actions impacting the other two circles. As each circle has very different objectives it is imperative that you explore how each proposed financial or legal solution might impact all three areas before putting it into action. This also helps to ensure a much-needed balance in the three circles.



Had the "what ifs" of the tactics suggested to Messrs Harrington, Thorne, Goldberg and Holt been explored thoroughly, these business owners might well have chosen a different strategy, or at the very least consciously accepted the liabilities that came with each solution.

## The Family Business Philosophy

We recommend you begin your transition plan by defining your Family Business Philosophy. As discussed in a previous edition of Changing Lanes, your philosophy is simply defined as *what is important to you* in each of the three circles and the overlap between them.

In defining what is important, reflect on what you want for today, and then envision how you would like each area to be 100 years from now.

In the Family circle, examine your philosophy around financial independence for family members, the importance of supporting them in achieving their personal visions, and your desire to keep the family connected. And consider [illegible] this philosophy will deliver a legacy for future generations.

Moving to the Ownership area, explore what is important around the management and continuity of the family wealth, both today and in generations to come, and then define what might be required to provide clear entrance, exit and re-investment guidelines.

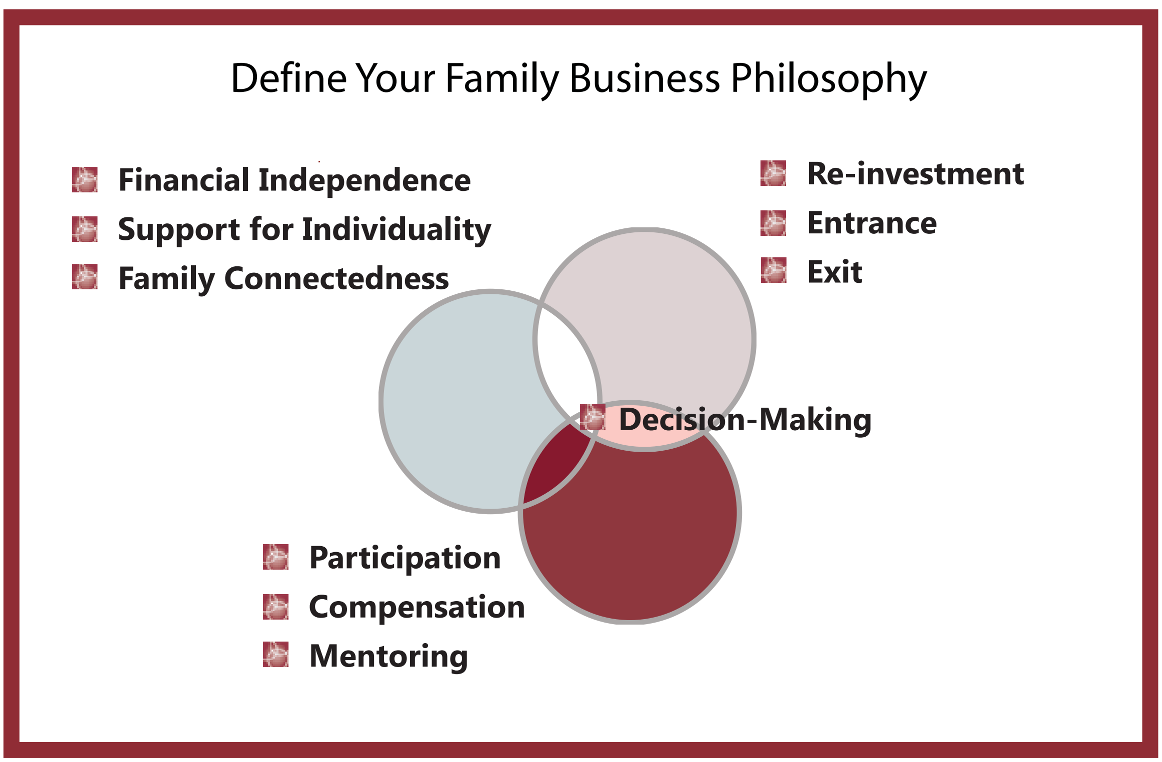
For the Management circle, review your principles for conducting business and use them to clarify the rules of engagement for both the nuclear and extended family. This introspection will be the foundation of the Family Participation Plan that is a key step in the process for safely transferring the business and family wealth to the next generation.

Finally, in the overlap area, define your philosophy around how decisions will be made in family, ownership and business situations. The decision-making process may differ for each area or you may adopt one overreaching methodology.

This exploration and subsequent understanding around who you are is the first step in what we call the "Wealth Transfer Process" and should engage both the current and succeeding generations. It is equally important to share this philosophy with your professional advisors so they can design financial and legal solutions that help rather than hinder family cohesiveness.

To review a sample Family Business Philsophy or discuss whether or not your existing wealth transfer strategies support your current philosophy, just give us a call.





# Changing Lanes

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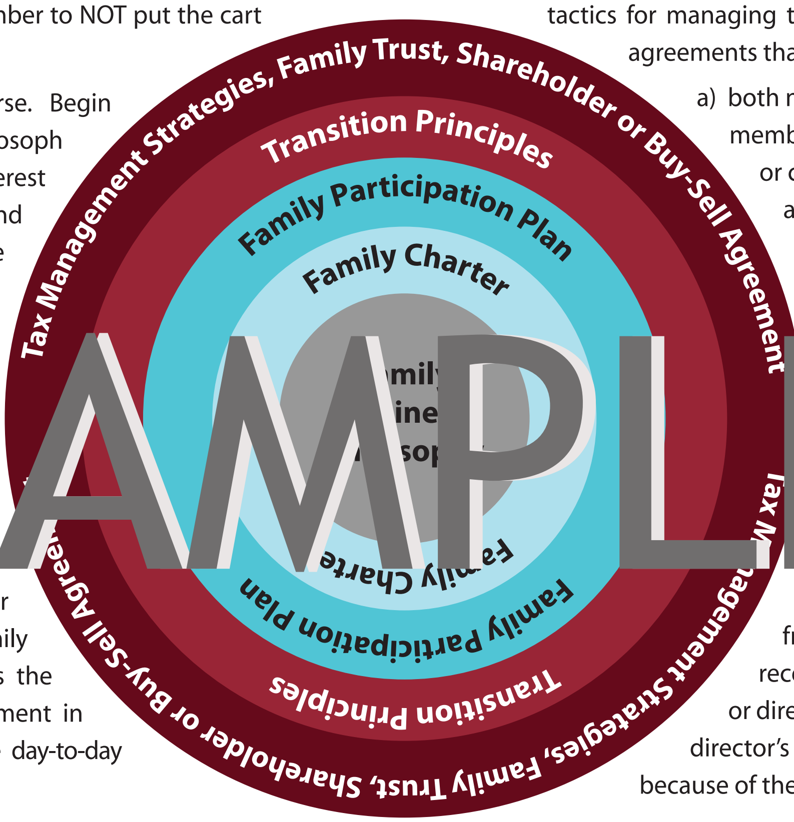
## The Wealth Transfer Process

When planning the eventual transfer of wealth from one generation to the next, remember to NOT put the cart before the horse.

You should lead with the horse. Begin with a Family Business Philosoph that defines a common interest among the stakeholders and clarifies a purpose for the wealth and how it will be managed, preserved or distributed.

Step two is to document your family policy so it can be quickly and easily referenced by advisors and family members. The Family Charter contains your family philosophy and the Family Participation Plan documents the guidelines for family involvement in both the ownership and the day-to-day operations.






From your Family Participation Plan, we then help you define the ***Transition Principles*** ~ the key elements of your Family Business Philosophy that will ultimately determine the strategies that best provide for a smooth transition of wealth and authority to the next generation. These principles are the foundation for policies that stipulate how a family member can enter or exit ownership, how shareholders realize a return on their investment, how decisions are to be made, and how family employees will be compensated for the work they perform.

> ***Bringing up the rear is the cart containing the appropriate tactics for managing tax liabilities and developing agreements.***

Bringing up the rear is the cart containing the appropriate tactics for managing tax liabilities and developing agreements that ensure:

a) both nuclear and extended family members are clear about who can or cannot become shareholders and accidental partnerships are avoided;

b) there are harmonious ways to exit the business;

c) the exit process is linked to the entrance process;

d) the compensation for working in the business is appropriate for the role and separate and distinct from the compensation received for being a shareholder or director – as opposed to salaries, director's fees or bonuses disbursed because of the need to minimize taxes.

The key objective of our approach to enabling the transfer of wealth is to ensure that family unity does not take a back seat to tax savings. At the end of the day, your family needs to have the confidence that the process to transition the business will not only enable the continuity of the wealth engine but will also preserve family relationships.

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