# WEALTH: DON'T LEAVE IT TO THE CHILDREN?

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By Donal Griffin

Lawyers are often trusted advisers to family owned businesses but, for various reasons, are not always the first people clients speak to about succession of a family business. More often, they may be asked to document a transaction that is already largely agreed. In some situations, clients become frustrated when the lawyer is seen to be delaying or complicating the transaction by asking sensible questions. As lawyers know from experience, the parties would have been better off asking these questions at an earlier stage.

## Snapshot

- Family business is a large and growing part of the economy, however family business owners often fail to devote sufficient time to planning the succession of their business.
- Many family business owners consider not leaving their children with a large share of their wealth or business, often worrying that their spouse or children could, in the absence of appropriate planning, blow the money.
- Family business advice spans the area of family and commercial advice so lawyers practising in this area need to have a clear costs model.
- Lawyers have not made this area their own. However, neither have accountants and those providing financial advice, yet they are now moving in to this area.

### Family business is growing

Family business is a large and growing part of the economy. Dr Chris Graves from the University of Adelaide states 'family businesses make up approximately 70 per cent of the private sector economy, employ around 55 per cent of the entire private sector workforce and make a significant contribution to the national economy in terms of controlling substantial wealth estimated at $A4.3 trillion. Although many Australian family businesses have successfully become very large, over 90 per cent are small to medium enterprises employing between five and 200 people' (blogs.adelaide.edu.au/business/2014/05/16/families-in-businessthe-heavy-hitters-of-our-economy/).

We suggest that lawyers are selling themselves short by not being front of the client's mind with these succession conversations.

The reasons clients do not speak to their lawyers include:

- A perception that the 'clock will always be turned on';
- A sense that their business' lawyer does not 'do family work'; and
- A sense that their family lawyer does not 'do commercial work'.

Sometimes lawyers are at fault for these perceptions. Family business advice spans the area of family and commercial advice so lawyers practising in this area need to have a clear costs model. Lawyers have not made this area their own. However, neither have accountants and those providing financial advice, yet they are now moving in to this area.

### Common intra-family succession issues

Intra-family succession issues that require proper planning include:

- If a discretionary trust is at the top of the structure owning a business, do each of the children get a role in the decision making at all levels?
- How are decisions to be made? Is a shareholders agreement appropriate?
- What exit options are there, noting the business' need for cashflow and the capacity of family members to buy out a sibling?
- Other threshold issues that busy and successful parents struggle with, including whether they want long serving non-family staff to be governed by inexperienced family members. They may prefer that the business be sold, especially as its value may quickly diminish without the patriarch or matriarch in an executive role; and
- If a business is sold, the parents may be horrified to see the children waiting for their share and not exerting themselves in terms of personal development or career etc.

We have all heard that Bill Gates and Warren Buffett do not plan to leave their children a large share of their wealth. Buffett's line in his letter to the Gates Foundation was that 'I want to give my kids just enough so that they would feel that they could do anything, but not so much that they would feel like doing nothing'. Clients with more modest wealth are now also considering the same strategy. Why? Well, first generation owners of family businesses often have good habits: they usually work very hard in the business and, for cash flow reasons, are conservative, if not modest, in terms of their expenses. They often worry that their spouse or children could, in the absence of appropriate planning, compromise the business and blow the money.

### Importance of long-term planning

The bad habit family business owners often share with their peers is not devoting sufficient time to planning the succession of their business. The 2013 KPMG and Family Business Australia 'Family Business Survey' conducted by the Adelaide Business School found that two-thirds of Australian family businesses plan to pass on the business to the next generation and 43 per cent of this group plan to do so in the next three years. Despite this, around one-third of this group have no (formal or informal) plans in place for this to occur.

In the 2014 PWC Global Family Business Survey, David Smorgon, former director and senior executive of one of Australia's oldest family businesses, Smorgon Consolidated Industries, reflected on his experience, saying:

'[W]e continued to defer discussions on succession because it's such a secretive, difficult and confronting issue. We didn't understand that succession is a process not just an event.'

This is an extremely personal area and advisers who are not seen to be sensitive to the needs of the first and second generations can quickly find that they have lost the confidence of one or both of those groups.

Failure could be:

- That the business leaves the family;
- The business is not sold before it becomes run down;
- Long serving employees leave because they do not respect the next generation;
- The next generation fight about the business; or
- The next generation squanders the wealth or the wealth aggravates younger or weaker family members' personal problems (addictions, failed relationships or enterprises).

One thought leader in this field is Alan Crosbie who points out in his book *Don't Leave it to the Children*, that while parents often over-estimate the business skills of their children, the contrary can also be the case. The point is that parents rarely get it right.

Even if children have the skills, they may not have the inclination to follow a course set by a parent. Many of these children have had an expensive education and move in wealthy circles. The thought of spending an hour each way to travel to work in an industrial estate in an unfashionable part of town may not appeal to them. Without honest discussions within the family, expectations and entitlements can be mismanaged with terrible consequences for the family and the business.

Where one child only is earmarked for a leadership role in a business (as usually happens in a farming business) that can exacerbate sibling rivalry. The problems of course multiply if there is a step-parent or children from a second family. The conflicts of interest are often such that families may not blend successfully.

Business founders are totally involved with their businesses and spend much time on them, often at the expense of building relationships with their children, making decisions about their business. The thought of others making those decisions can be hard for them to face. Crosbie points out that most people do not establish businesses and, of those that do, some like Henry Ford use their position to develop a legend about themselves while others like Bill Hewlett and David Packard of Hewlett Packard focus on their responsibilities to employees, customers, suppliers and the welfare of society at large.

Crosbie points out that while the founders often wanted to establish a business, the fact that it becomes a 'family business' is usually an accident. We do not always choose to go into business with our children or siblings. As with most things that happen by accident, we need a lot of work (including monitoring and planning) or luck for them to sustain in a way that is acceptable to us.

### Managing succession through effective communication

Businesses can succeed to next generations as has happened in the case of the Barcelona based winemakers Codorniu which, at the time of publication of Crosbie's book, had 144 shareholders, after 14 generations, all of whom were family members. Closer to home, we have seen the success of the Coopers brewing family.

There are lessons to be learned from families who have managed succession well and from those who have not been as successful such as the Vanderbilts. Like many things, you often (but not always) get out of it what you invest. Planning and communication however increase the chances of being in the former group. More and more, we play the role of facilitators and need to be able to understand the individual motivations of each player.

Successful families spend a lot of time getting their governance structure right. If there is a trust at the top of a structure, care needs to be taken as to who makes different types of decisions over various generations.

Just as important is the need to get the culture right. This may involve discussions which bring agreed values or principles out of the uncertainty of family mythology. These could include education about managing what may be the largest lump sum they will ever receive and philanthropic considerations. There needs to be a discussion about 'hygiene' or minimum standards of behaviour and an informal dispute resolution process if there is a perceived failure to meet these standards. There needs to be agreement about what access to capital people who do not work in the business will get in order to pursue rewarding lives.

No-one likes surprises in this area and expectations have to be managed. It is not easy and if the decision of a founder is ultimately not to leave a business (or substantial wealth) to the children, plan B needs as much consideration as plan A.

Lawyers may earn the personal respect of their clients by having a succession plan for their business. By articulating this with trusted clients, they may convince clients that not only are solutions available in this area, but the lawyer can provide them for fees set out in a scope of work that includes inter-generational advice.

The impact of this could be positive for the family as a whole and far-reaching.

Lawyers can work with facilitators from other professions to fill in the gaps of their offering. Done properly, the whole should be more than the sum of the constituent parts.

Alan Crosbie will be presenting on this topic with other leading speakers at the Legacy Law Conference in the UK during the Rugby World Cup in October 2015.

**legacylawconferences.com**

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