CASE STUDY

Family, Fair and Equal a Potential Problem

The following case study is based on a true story. It highlights the importance for parents in family owned businesses to clarify and articulate their business exit and succession objectives to their children. Even if the parents believe that they are being fair that does not guarantee that all family members will be aligned. Parents need to prepare a plan to transition the family business years in advance. They should consult with an experienced team of advisors, like our NAVIX Consultants.

Key Lessons:

- **Family owned businesses face distinct challenges in transition.** Parents must communicate their objectives to their children as early as possible—ideally years before any transition will occur. As time passes, opportunities are eliminated.

- **Children often make different contributions to the family business because they have differing skills, abilities, and levels of motivation.** Children also often differ in their needs for support and financial assistance.

- **Estate documents often call for equal distribution of assets amongst siblings.** Facilitating equalization can be complicated when the concentration of wealth is in business and there's a lack of liquidity. It's hard to leave the business to one child and to divide the estate when all the assets are in the business.

- **Parents should decide what fair means to them and their children.** Does fair mean equal?

- **Family owned businesses need to work with advisors who are experienced in helping clients achieve successful exits.**

Family, Fair and Equal a Potential Problem

Dennis and Mary founded their manufacturing company serving military markets in the early 1980's. Over time, each of their four children worked for the company. Dennis and Mary wanted to give their children equal opportunity to run the business. They gave each child 5% ownership in 1995. The company was successful overall, but they hit a real financial challenge in the late 90's caused by a local flood. They were forced to file bankruptcy and reorganize. Given the stress of the times, all the children but one, Will the youngest son, left the business. Will earned the role of President in 2005 and acts in that capacity today. The other children achieved different levels of success in their endeavors.

Dennis was always generous to his other children given some of their financial instability. On several occasions, Will approached his father about estate and succession planning. Dennis repeatedly rebuffed these attempts, always insisting that everything was taken care of in his estate planning documents. "Will you are going to get the business."

Will's frustration grew over time as he saw the fruits of his labor enriching his siblings through gifts and financial support from Dennis. Through bonuses, Dennis paid for the other sibling's children's private school. Additionally, the other siblings all drove company cars despite their total lack of business involvement. They viewed the business as the golden goose laying golden eggs. Over time, great resentment grew between Will and his siblings.

In May of 2012, Will finally convinced his parents to revisit their exit and estate plan. Dennis engaged our firm to help them design and implement their exit plan. Less than a month into our work, Mary died unexpectedly of undiagnosed cancer. Several weeks later, Dennis suffered a massive heart attack. He was alive, but in bad shape. He was in no condition to address family and business matters.

It quickly became apparent that everything was not taken care of in the estate planning documents. The assets were divided equally among the four children. There were no provisions for the business to go to Will. He was entitled to a fourth of the assets. If something happened to Dennis, the other three siblings agreed that they would sell the business and all the real estate. There were not any other appreciable assets. At age 55 and after 30 years working with his parents, Will would be without a job and without a reward for his sweat equity. It was even worse as Will had never enjoyed Dennis' gifts and financial support. He was just going to get the business.

Sure everything was divided equally, but was it fair?

After countless and heated debates our team helped the siblings plow through their financial situation, history, and emotions to facilitate an agreement. We constructed numerous models to help them reach an agreeable and equalized estate distribution. Will would buy his father's and siblings' business interests for a somewhat low, but justifiable price. In exchange, the siblings would receive ownership of the company's real estate, and Will would sign a long-term lease with them at reasonable but high rent rates. The siblings received a steady income stream from the rental income. Will received the business. We encouraged Will to bias the structure towards rental payments as they were tax-deductible to the business. Will felt he was overpaying in the total arrangement, but with his siblings it was three against one. He felt he had no other career options.

Once all the siblings were in agreement, our firm presented a unified solution to then, a sick Dennis on behalf of the children. He agreed with the proposal, we drafted the documents, and executed the deal late 2012.

Will entered 2013 relieved to have a clear plan and be in control of the business. But as 2013 proceeded, sequestration and the government shutdown became a reality. Sales to the US military plummeted.

As a consequence, Will missed rental payments to his siblings and is now in risk of losing ownership of the business. Will may be in an even worse spot than before.

NAVIX® is a proprietary process that helps business owners plan for and achieve successful exits.

NAVIX® helps owners of closely held businesses plan for and execute successful exits: achieving financial freedom, creating a sustainable legacy, and exiting on their own terms.

NAVIX® was designed out of experience seeing business owners struggle to achieve financial freedom, create a sustainable business legacy, and exit on their own terms. NAVIX® is a dual track process, that prepares both the business and its owner(s) for exit. NAVIX® is not just about planning; we also help clients execute the strategies and tactics needed to achieve a successful exit.

To learn about the NAVIX® program, please visit

navixconsultants.com