

Reinvestment and Reinvention: Life after the Sale of the Family Business

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Bond traders have a name for it...reinvestment risk, and it becomes personal at that seemingly joyful moment when good news—such as the maturity of a great bond—results in a big maturity check after years of excellent interest production. This happy satisfaction, however, quickly becomes a darker reality when you realize that there is simply no place in the current market to buy a bond of quality and yield anywhere close to the one you just cashed in. Your money has mysteriously lost its clout. And while there is no shortage of experts to explain the complex phenomena behind declining interest rates, increasing default exposures, or sheer global political volatility as a damper on your money's earning power, it still feels wrong. Now apply that scenario to your position as a family business owner after a liquidity event. The glorious moment has arrived when a buyer assumes the position of risk, reward, and significance in an industry you know and love. Just like the bond holder, you receive a big check. First comes the moment of exhilaration, quickly followed by the cold reality of “now what?”

After the sale is certainly not the time to answer the “now what” question, nor is it the moment when you sign with an investment banker to market the business. Rather, the time to figure out “now what” is when you have the first inkling that the sale, in whole or even in part, is a possibility . . . in many cases, that

time is today. The sale of an asset that holds such a central and complex role within a family as a family business is not simple, nor is it without multiple layers of emotional and motivational issues that simply don't exist in the sale of less identity-related assets. It is reinvestment risk writ large.

Your professional family advisers are certainly more than capable of addressing the technical and daunting issues surrounding the externalities of the sale: taxation, valuation, retained liabilities, continuing employment terms, and so on. It is, however, the interrelationship between those technical (and crucial) issues and the “internalities”(“now what?”), that deserve more attention than they often receive. All involved—you, your family, and the business—will need to be reinvented after the sale, and the time to address the complexities of this is, quite simply, as far in advance as possible. Clearly the business, its balance sheet and its operations, will be “cleaned up” before a buyer appears. All too often, unfortunately, the same is not true for the key constituencies who are defined by the business. . . the owners, managers, and key employees.

One way to approach structuring a plan for both the sale and the “reinvestment risk” it implies is to create a “Reinvention Plan.” By independently addressing three key considerations (discussed in the

following sections) and integrating the conclusions into an analysis, you can create an organic (and often unpredictable) overview of why the sale is being considered and the potential implications for you, your family, and the business.

Considerations for Your Reinvention Plan

What will my/our relationship with the business be after the sale?

There is a frequent misunderstanding that “selling” the family business constitutes a clean break. This is seldom the reality. If the sale is only a portion of the equity, the continuing relationship is self-evident; of equal significance, however, are the less-visible ties to the business after the sale—employment of family members, economic participation through an “earn-out,” representations that constitute continuing liabilities, acting as a creditor for self-financing, and much more. Long before the sale comes to fruition, the family has to resolve the ambiguities these strings entail, including the role reversal of owner to employee, the pain of losing control, the certainty that decisions will be made differently, and the impact on long-time employees and business relationships that may arise in unpredictable ways. While only the most creative mind can conjure up the realities of this part of the ownership’s forced “reinvention,” conversations with professionals and others who have been through similar experiences can be of enormous help. It is at this point that the family owners can and should identify the “non-negotiables” and build these into the planning from here on out.

What might constitute a “non-negotiable”? It could be job security for key employees (“They are like family to us”) or an unwillingness to put the family at economic risk after a shift of control (“I can’t

guarantee future sales when I am not guiding the process”). Non-negotiables may also be far more personal, such as ensuring that the business’ name and quality or participation in industry groups or community activities will be maintained. In short, some non-negotiables go to the very values and legacy as well as the identity of the patriarch and the family. Early identification of and preparation for the implementation of non-negotiables is the first key to successful reinvention.

Estate and Tax Planning: Unintended Consequences

It goes without saying that there are few moments in a family’s economic life that have greater impact than the sale of the family business. Proper planning may (should?) have anticipated the sale by years, or even decades. The legal ownership of the business may be a complex maze of trusts, family partnerships, or shared ownership with descendants, all the products of sound tax and estate planning. The good news is that the fruit of tax and estate planning is picked at the moment of sale, as value is shifted between generations in great gulps with minimal transfer tax or concern. Too often, though, the consequences of great planning catch the family unaware—cash is a very different asset to manage than a minority interest in the family business. The individuals, trustees, and general partners suddenly have to reinvent themselves, often from passive to active management. Of greater possible concern is that the increased liquidity will alter the relationship between fiduciaries and beneficiaries, between siblings, and even between parents and children, often in unpredictable ways. Foresight in family preparation and training assumes huge significance overnight. Reinvention is crucial, but preparation for reinvention starts decades earlier.

Close attention to the legal and human changes that would result from a sale will reveal surprising constraints on reinvention. The sooner the analysis is conducted, the more time there is to address these changes and prepare to manage the potential conflicts and altered relationships. Simply said, the legalities of tax and estate planning have created built-in consequences that can present unpleasant surprises at sale time. Forewarned is forearmed.

The second key to Reinvention Planning is clearly identifying the constraints on reinvention and using the time before the sale to address the most negative of anticipated consequences. Even where there is little time to train younger family members, change trusts, or complete the restructuring of ownership entities, opportunities remain for facilitating thoughtful family reinvention post-sale. The identity and qualification of trustees, revision of partnership agreements, revision of estate planning documents can all have enormous significance in the smooth (or tumultuous) transition often entailed by the sale of the family's business. There is no substitute for life-long training of younger generations for the benefits and responsibilities of wealth, but the legal entities in place can provide time and a forum for that training even after the sale has occurred. Foresight, again, is the essential element in successful Reinvention Planning.

Reinvention and Identity

The final element in successful Reinvention Planning is the most personal. The family business occupies a unique role in defining its owners as much as the owners define the business. Those who have led the business, grown it, and identified (and been identified) with it are about to face a radical personal reinvention with significant consequences that are

frequently underestimated or even ignored. For many families, the business represents the locus of identity, prestige, and community and its loss can lead to a form of emotional vertigo. Reinvention in this area is of particular importance since it goes to the core of the family and how its members learn to feel productive, valuable, and valued. Even families that have experienced conflict or resentment in the business can be surprised at the disorientation that results from the loss of the forum for acting out family contribution or competition. Even when internal stresses in the family business are a driving force for the sale, the loss of the business leaves an enormous hole, one that is often filled with unresolved issues and rivalries that threaten the future of the family as a unit.

It is important, even in these highly turbulent circumstances (as well as in happier family situations) that the true heart of reinvention must be addressed: What is next for the family *as a family*? Without a plan to redirect the family energy and commitment previously lavished on the business, the reinvestment risk of the bond trader becomes an exaggerated reinvention risk to the family. Without the business, what provides the heart of cohesion for the family or is the sale of the business a first step in the atomization of the family? The Reinvention Plan is, at its core, the roadmap of how to replace the business with a legacy that will provide the soul of a successful and mutually supportive family. Without some shared family values and a vehicle to embody them—for example, philanthropy, serial entrepreneurship, or family investment—the seemingly happy event of the sale can jeopardize the continuity of the family *as a family*. Reinvestment risk becomes very real.

Organizing the Process of Reinvention

All families are different, and no two families will reinvent themselves in the same way after a defining event like the sale of a family business. Nonetheless, the key to successful reinvention lies in foresight and intentionality, identifying and approaching the sale as both an opportunity and a risk. Family councils, structured conversations among generations, detailed reviews of investment and legal constraints, and fearless willingness to articulate “non-negotiables” early on can help provide a forum to exercise both foresight and intentionality. The discipline to prepare far in advance for a transition as daunting as the sale of the business is, fortunately, a valuable exercise, even if the sale never happens. Rarely will the family have a better opportunity to assess the role, both positive and negative, of the family business in family dynamics than when addressing the possibility of selling it. Similarly, the exercise informs the family about the all-too-often mechanical approach to creating trusts and tax saving vehicles that will become independent vehicles after a sale. Finally, the discussion identifies issues that often go unexplored. Do the children want to succeed to either ownership or management?

Are key employees properly included in the discussion of the future? Is the unexamined assumption that retaining earnings for growth appropriate or necessary?

The result of early and imaginative Reinvention Planning may well be that a sale would have unintended consequences of greater cost than the family is willing to bear. Conversely, do the “non-negotiables” represent too great a constraint on the salability of the business and require a difficult revisit? Sometimes non-negotiables, when weighed against their cost, become more negotiable.

The participants in the reinvention conversation may include lawyers, accountants, board members, investment bankers, appraisers, family mediators, or any number of other professionals. Ultimately, however, only the family can assess the reinvention process for itself and generations not yet ready to participate in the conversation. Foresight powers reinvention and intentionality is the discipline of reinvention. Only the family is the repository of its legacy—the ultimate beneficiary of reinvention.

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