Pass It On

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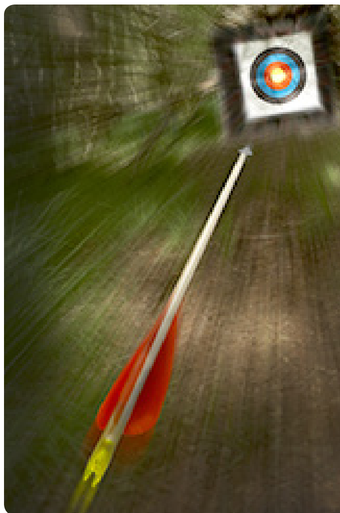
Planning to Keep Families in Business

Since 1947

An Arrow Goes Where You Aim It—So Will Your Company

By Don See, CLU

ONE OF THE JOYS OF MY STAGE IN LIFE AND career is that I have a talented, energetic, creative young person taking the reins on our company marketing–my daughter Misty. She is bombarded with invitations to various networking groups in San Diego, where the objective is to meet as many people as possible who just might be prospects at some point in the future. That's a good strategy for establishing our brand and expanding awareness of who we are and what Pass It On, Inc. is about.



When it comes to an effective means of growing our business, the best method is to become a planning resource for a community of professionals who counsel business owners. That includes attorneys, CPAs, bankers and business coaches/mentors. By targeting the folks that our prospective clients already trust, we increase the chances of meeting people who actually need what we do and who are in a position to do something about it.

There's a parallel to this consideration when you begin to think about an exit strategy for your company. You can sell or gift ownership in your company to the people you choose, and hope they don't "network it" to other people due to inadequate planning. It is better to target the appropriate people for ownership under the most likely circumstances than it is to let fate determine who gets "networked into your company ownership."

How does this happen? Whenever a portion of your company ownership ends up in the wrong hands as the accidental result of a poorly-designed business or estate plan. With proper planning, business owners can offer stock for sale to employees to reward them, to encourage them, and to evidence their importance to the future of the company. Stock or partnership shares are often transferred to children for estate planning reasons. These transfers usually produce a good result, but there are situations where stock gets transferred without due diligence given to the outcome.

Some examples of these potentially disastrous situations follow:

- Your key employee decides to leave for another opportunity and you never got around to signing that shareholder's agreement or designating the price and terms by which you would recapture the stock.
- Your daughter ends up in an unfriendly divorce, and your stock gets distributed in the settlement. Subsequently you see your company shares transferred to her ex-husband's new family, who have no interest in you or your company other than how much you'll pay to get them back.
- Your partner takes a hard turn on his new Harley just days before he was going to buy that helmet. His ex-wife

is a friend of yours, but his current, recent wife is only interested in the income you'll provide her.

What are the practical problems created by these scenarios?

1. Stockholders can demand to see your financial records and review your compensation, and can even question the means and amount of your compensation as CEO of the company.
2. In a company with a small number of share-holders, a line of credit may require signatures and personal guarantees from all shareholders.
3. SBA loans are generally limited to companies where the shareholders and executives are the same people.
4. When you decide to retire and sell the company, 1% shareholders can defeat the sale if they decide the price is inadequate . . . or if they simply want to cause trouble.

Your company will go where you point it, even if you don't know where you're aiming!

How do you prevent an unplanned shareholder? Here are a few simple precautions to reduce the risk of having a stranger as a partner:

Don't sell or gift business interests without clear, thoughtful advice.

Your attorney, accountant, and succession planner can help you assess the relative risks and implications of such transfers. You should consider the legal ramifications, the financial implications and the potential problems related to employer/employee or family dynamics.

Always insist that an up-to-date shareholder agreement is signed, valued and understood prior to making any transfer.

The most important provisions of this agreement will deal with a clear "recapture strategy" for the stock, particularly in the event of death, disability or the voluntary termination of the employee. Different stock values and payment methods may be appropriate for each event.

Family buyout plans can eliminate the most difficult outcome—major conflict among heirs.

Where a family-owned company has some children or grandchildren who work in the company and some who do not, serious consideration should be given to a funded, guaranteed buyout plan between the employed children and their majority-owner parents. It is often better to provide children who work in a family company the ability to buy their parents' interest at their eventual demise rather than forcing them to work for siblings who may not share their understanding of the financial realities of running a business.

Review your stock protection plan every couple years—if you have one.

If you don't, give us a call and we'll help you get one. ■

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Misty Meschter and Don See of Pass It On, Inc. (est. 1947) work with a national clientele designing and funding succession plans for privately held companies.

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