



# Succession Planning in an Age of Longevity and Liquidity

Owning a family business presents its own unique challenges, especially when it comes to succession planning. However, recent trends and new structures now offer some alternatives which may provide the ideal solution to passing on your assets to the next generation.

## Insight

Family businesses are no longer automatically sold when the founder retires, as many factors are now influencing when and how such businesses achieve longevity and equity for future generations.

## Recommended action

If you own a family business, ensure you have conversations with family members to clarify objectives and put structures in place to achieve fairness and longevity in the event of succession.

**There is a thought-provoking line in Nassim Taleb's book, *The Black Swan*, which says, "Reading the newspaper makes you dumb."**

This is a reference to the common occurrence that, when we read a persuasive article and opinion by an 'expert', we are likely to be influenced by those views and perhaps act on them. Whereas, in fact, we should consider any opinions in the context of the current and predicted future environment, with as many facts and as much evidence as possible at our disposal.

And so it has been with the many predictions, some even based on apparent rigorous research, that many family businesses would be sold as ageing baby boomers wanted to retire, necessitating a liquidity event to enable assets to be equitably distributed to their children. Whilst there have been some such sales, the avalanche has not eventuated, and at the risk of potentially placing ourselves in the position of those so-called experts, we venture to suggest that, based on our assessment of the current and future business environment, it will not come.

We believe this to be the case for two reasons.

## Longevity

The first is **longevity**. Business founders don't feel the pressure to retire by the age of 65. They don't have a clear exit mapped out by that age, nor have they divided the assets between their various offspring by that age. Hence, the time available to plan and execute an effective succession is extended. However, if that were the only reason, it would simply delay the sale of the family business for a few years, rather than for a much longer time, as we are currently experiencing.

## Financing and Structuring Alternatives

The second and more profound reason is the increased **variety of financing and structuring alternatives** available to family businesses to provide an equitable division of the assets amongst the heirs. This can achieve an acceptable result without the sale of the business to an outsider, which is also often the most desirable outcome for family business owners.

If the additional time is used effectively, it is now not uncommon to see family businesses implement an appropriate inheritance plan and an appropriate business management succession plan, without the need to sell the business.

Once there is an understanding of the business objectives, the basic components available to achieve such structuring include:

- **Separation of the business into core and non-core assets.** Such non-key assets might include real estate that can be sold and leased back. This can provide cash for those family members not inheriting a share of the operating business. Alternatively, the non-key assets can be left to those family members to own. There might be parts of the operating business which could also be sold, again to either a third party or to other family members.
- **Superannuation funds.** Significant funds can be accumulated within superannuation so that balances can be left to those not inheriting the business. Whilst superannuation is the most effective way to do this, portfolios of non-operating assets can also be accumulated in other vehicles, such as Trusts.

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- **Alternative financial structures.** Within the business itself, there might be financial structures including leasing, mezzanine finance and equity or quasi-equity type arrangements that can be used effectively to provide assets other than ordinary shares in the operating business to some family members.

We have seen many variations of these approaches in recent years, which are utilised to achieve a level of equity amongst offspring and siblings, where some obtain control of the operating business and others receive other assets. There are, of course, always legal and tax issues to be handled, but these should not act as an impediment to achieving the family's objectives. The key, therefore, is to determine the business and family objectives. Our strong recommendation is to spend as much time as necessary discussing and agreeing with relevant family members their aims and wishes.

## Case Study: The Family Farm

Family agricultural businesses are a good example of the issues confronting succession planning today. Such businesses are often asset rich and cash poor. Liquidity is difficult as agricultural businesses are often debt-laden for tax minimisation and business growth purposes, which makes value realisation problematic for exiting owners wanting to retire. Leverage against agricultural land is also limited, reducing the appeal for new owners. Increasing land prices are also not in line with cash returns on agricultural businesses, meaning that owners often have unrealistic expectations of sale value.

As with other family businesses, the key is to start succession planning discussions with family members early to ensure that opinions and expectations are aired and understood by all. We also need new liquidity into agriculture and new ideas on the ownership model, to make succession planning less problematic.

## Conclusion

In structuring a succession plan for transferring family wealth, it is vital to recognise that relationships between family members will change over time with the introduction of partners, next generation children and the changing financial positions of family members. It is therefore important to regularly review objectives and plans to ensure everyone's needs and expectations are being met, now and in the future.



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