Four Strategies for Family Business Succession Planning

The Great Wealth Transfer: Strategies for Succession, Legacy and Wealth Generation

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As Americans enter the "Great Wealth Transfer," with an estimated $84 trillion or more expected to pass to younger generations over the next two decades, family business owners face critical decisions regarding business succession and continuity. This advisory outlines four principal strategies for family business succession planning: intergenerational succession planning, minority investment, insider sales and third-party sales. Each approach presents distinct legal, financial and operational considerations, underscoring the importance of early, tailored planning to preserve legacy, generate wealth and ensure business continuity. A trusted legal advisor can assist in evaluating these structures and recommend a path forward that most closely aligns with the family business owner's goals.

This is the first advisory in a series examining the impact of the "Great Wealth Transfer" on business and succession planning for family business owners, including detailed business and legal considerations in selling a family business, lessons learned from the "private equity playbook" designed to maximize the business's exit valuation and how wealth transfer and other estate planning techniques can further optimize the business strategies set forth in this series. For more, subscribe to our series and receive our extensive guide, *The Great Wealth Transfer: Strategies for Succession, Legacy and Wealth Generation*, coming later this year. The guide will expand on the topics covered in the series and provide additional context, explanations and cost-benefit analyses for each topic.



1. Intergenerational Succession Planning

For businesses with a capable and interested next generation (G2), intergenerational succession (i.e., the transfer or sale of the business to the next generation) offers a pathway to preserve family legacy. Successful transitions require early engagement with G2, alignment of family and business goals and robust governance structures. Establishing shared goals and implementing strong governance practices form the foundation of a successful transition. Key legal instruments, such as stockholder agreements and bylaws for corporations or operating agreements for limited liability companies, should address, among other things, mechanisms for appointing and removing officers and directors, major decision-making rights and protective provisions, transfer restrictions, voting rights, parameters for capital contributions and distributions and dispute-resolution mechanisms. These agreements may also address the treatment of G2 members, including buyout provisions, put rights, or changes to voting rights, who are not involved in the business, who commit "bad acts," or who require early liquidity, ensuring clarity regarding economic and decision-making rights. These provisions protect both active and inactive equity holders.

Education and leadership development for G2 are essential, including training in business operations, financial literacy, organizational leadership and strategic decision-making. Early and ongoing conversations among family members help resolve key considerations and prepare G2 for effective leadership. Where G2 is uninterested or unavailable, hybrid approaches, such as partial transitions combined with minority investments, may balance family continuity with access to outside capital and expertise.

2. Minority Investment

Selling a minority stake in the business to financial investors or strategic partners can provide liquidity and growth capital while allowing owners to retain involvement at a strategic level. This phased approach enables a gradual transition and a potential "second bite at the apple" in a future liquidity event, if or when a full sale occurs later. Minority investments allow owners to take some chips off the table while bringing in capital and support for growth opportunities. Over time, owners can gradually step back, handing daily operations over to seasoned professionals or a prepared G2 team, while maintaining involvement at the board or strategic level. However, minority investments from third parties often entail increased financial reporting, operational transparency and governance requirements, which may add complexity and incremental costs. Investors may require a seat at the table for strategic decision-making, and their involvement can influence or shift company culture. This means that thoughtful alignment with a minority investor is crucial to preserving core values and operational cohesion.

3. Sale to Insiders

Selling the business to management or employees preserves company culture and institutional knowledge. Selling to management (i.e., a management buyout, or "MBO") is often faster, more discreet, and more confidential than a third-party sale and provides continuity since the management team is already familiar with the business. However, MBOs may require the business to take on significant debt to finance the acquisition and can create conflicts of interest between the business and the management team in their new role as owners. Similar to an MBO, a family business owner may elect to sell to employees, including via an Employee Stock Ownership Plan (ESOP). In an ESOP transaction, an Employee Stock Ownership Trust acquires some or all of the selling business owner's equity, and over time, equity is allocated to employees. ESOPs, when structured correctly under applicable law, may provide attractive tax benefits and align employees with the business's financial outlook. However, ESOP transactions are inherently complex and come with higher transaction costs compared to standard M&A deals. In all cases, transparency, communication and trust are key to successful insider transitions.

4. Full Sale to a Third Party

Selling to external buyers, including strategic acquirers, financial acquirers or search fund-backed entrepreneurs (i.e., ETA operators), can maximize financial returns, particularly in competitive or high-growth industries. Strategic acquirers are often competitors or companies in related industries and may offer meaningful synergies, deal premiums and a purchase price paid in full at closing. Strategic buyers tend to acquire businesses with a long-term view, allowing for a quicker, cleaner exit for the owner, but may implement changes that affect company culture, management, and the business's identity and legacy. Financial acquirers, such as private equity firms or family offices, focus the post-closing period on growth and returns with the goal of selling the business again within an approximately 3- to 5-year timeframe. However, their offers may be formula-driven (and thus lower) and likely include deferred consideration, earnouts, or seller notes, which may be less attractive than cash offers from strategic buyers. They may also require the selling owner or key executives to remain involved post-closing. ETA operators, who are increasingly active in lower mid-market transactions, are often former consultants or entrepreneurs seeking to buy and run a business. They are more likely to preserve the existing team, culture and legacy, and deal terms can be highly flexible, though they may have a more limited operational track record and may not offer the same economic premiums as robust strategic or financial buyers. Nevertheless, for owners seeking a values-aligned exit with flexibility and continuity, ETA operators can present a compelling option.

The Importance of Advance Planning

Transitioning a family business is both a financial and emotional undertaking. Early, thoughtful planning enables owners to clarify objectives, engage stakeholders, and avoid rushed decisions in

the face of unforeseen events. The ongoing "Great Wealth Transfer" presents both challenges and opportunities for family business owners. Careful evaluation of succession and transition options, supported by sophisticated legal and strategic advice, is essential to achieving long-term goals and preserving family and business legacy.

Katten is here to help you plan in the near term and execute for the long term when it comes to navigating important commercial and legal considerations for your family business, including wealth transfer and business succession. Click here to subscribe and receive the rest of our series and our extensive guide, The Great Wealth Transfer: Strategies for Succession, Legacy and Wealth Generation, coming later this year. This article was written by Michael L. Sherlock, a corporate and family office lawyer in Katten's Chicago office. Julia Brook and Emily Kay Watson, M&A and private equity lawyers in Katten's Chicago office, and Mitchel C. Pahl, an employee benefits and executive compensation lawyer in Katten's New York office, also contributed to this article. Please reach out to the authors or your existing Katten team with any questions.

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