CeFEO Centre for Family Enterprise and Ownership

Tecnológico de Monterrey | Escuela de Graduados en Administración

Ownership transfer in family businesses prompted by tax reform

Marcela Ramírez-Pasillas

The transfer of Ownership Conference in Private Businesses

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Introduction

- Swedish government promoted an important tax reform.

- The aim: to stimulate and increase the volume of successful ownership transfers of businesses.

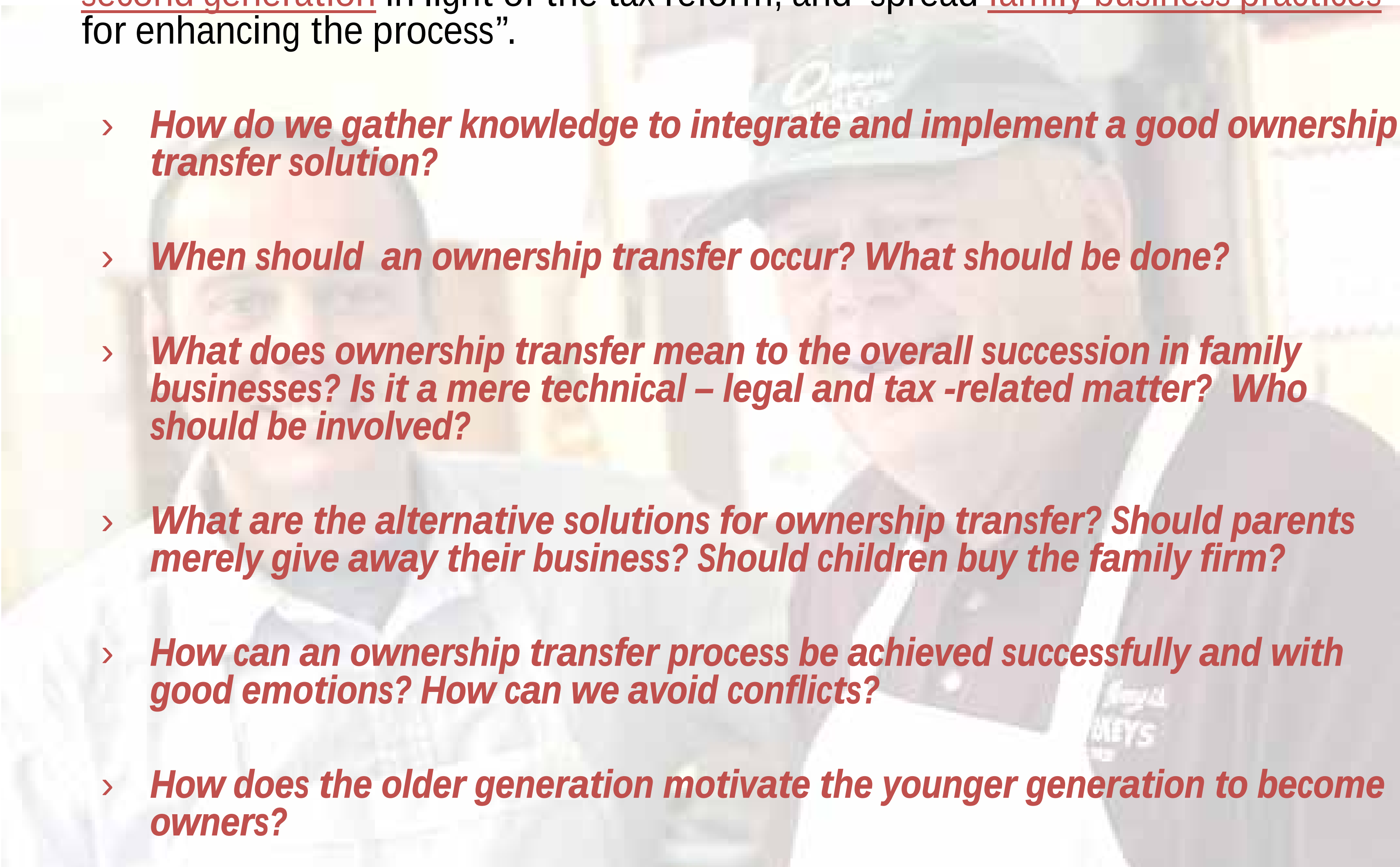
- Ownership transfer = *Process by which a company's ownership is conveyed from present owners to their children or to employees, external entrepreneurs or companies*.

- Many family businesses are owned and run by people born in the 1940s. Family members owning these businesses will transfer their ownership to the next generation in the near future.

Family businesses and families that avoid, delay or postpone the transfer of ownership are likely to be affected significantly.

Objetive

"To understand the process of ownership transfer in family businesses from first to second generation in light of the tax reform, and spread family business practices for enhancing the process".



- ***How do we gather knowledge to integrate and implement a good ownership transfer solution?***
- ***When should an ownership transfer occur? What should be done?***
- ***What does ownership transfer mean to the overall succession in family businesses? Is it a mere technical – legal and tax -related matter? Who should be involved?***
- ***What are the alternative solutions for ownership transfer? Should parents merely give away their business? Should children buy the family firm?***
- ***How can an ownership transfer process be achieved successfully and with good emotions? How can we avoid conflicts?***
- ***How does the older generation motivate the younger generation to become owners?***

Succession in family firms

- Succession in integrated by 2 processes: leadership & ownership transfers.

- *Ownership transfer is important because:*
  1. Family needs to guarantee the business survival across generations.

  2. It is often associated to a larger number of family members that are economically dependent of.

  3. *F*amily-business owners rely upon the firm for all or part of their income. Thus, retirement plans go in hand.

  4. Family members are emotionally bonded to the family business.

Ownership situation of family businesses in Sweden

- 1 of every 4 owners in the country was between 55-64 years in 2007.

These owners will retire &/or change their activities, & transfer ownership within the firm in the near future!

- Children involved in family businesses often become shareholders late in their adult life.

- Many business owners lack knowledge and awareness of the importance of the ownership transfer process.

Research methodology

This report relies on a study based on:

- **A pilot study**
  - 30 telephone interviews with family business owners.
  - All with ownership transfer experiences.
  - The selected companies have a good diversity in terms of size, age and industry.

- **An in-depth study**
  - Five in-depth case studies of ownership transfer processes in family businesses.
  - All representing succession from first to second generation.

    Case 1, logistic service, 3 family members involved.
    Case 2, metal tools company, 4 family members involved.
    Case 3, catering & event organizer, 5 family members involved.
    Case 4, construction & transportation company, 4 family members .
    Case 5, green house and garden centre, 4 family members involved.

Overview of pilot study findings

- 27 companies had initiated or had concluded their ownership transfer process = 10 different solutions.

- Ownership transfer process was carried out before abolition of taxes (9 cases), after the abolition of gift & inheritance abolition (12 cases) and ofter the abolition of wealth taxes (6 cases).

- Solution combined transferring ownership by:

1) Gift during timelife, gift by death, sale during lifetime.

   - Gift during timelife was the most important component (17 cases).
   - Gift by death (2 cases).
   - Sale the company during timelife; market price (3 cases) & non-market price (2 cases).
   - Sale stakes of ownership during timelife ; market price (1 cases) and/or non-market price (3 cases).

2) Operation among: family (23 cases), external buyers (3 cases), employee (1 case).

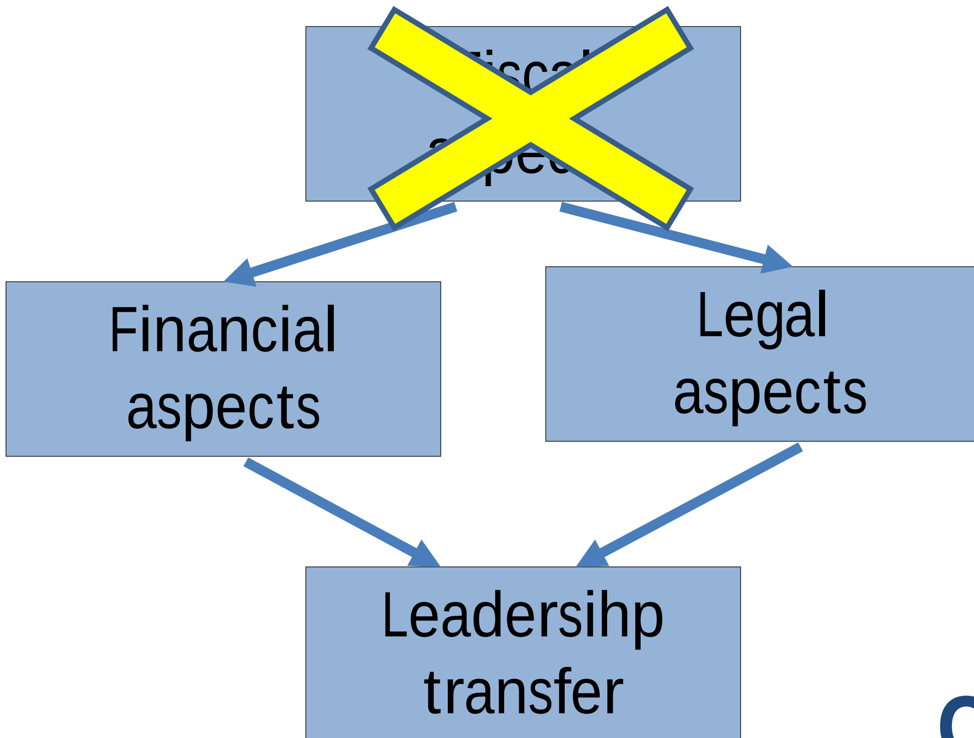
3) Voting shares (A-aktier) were more commonly used than non-voting shares (B-Aktier).

KEY FINDINGS – Key lessons

Has *the tax reform enhanced ownership transfers?*

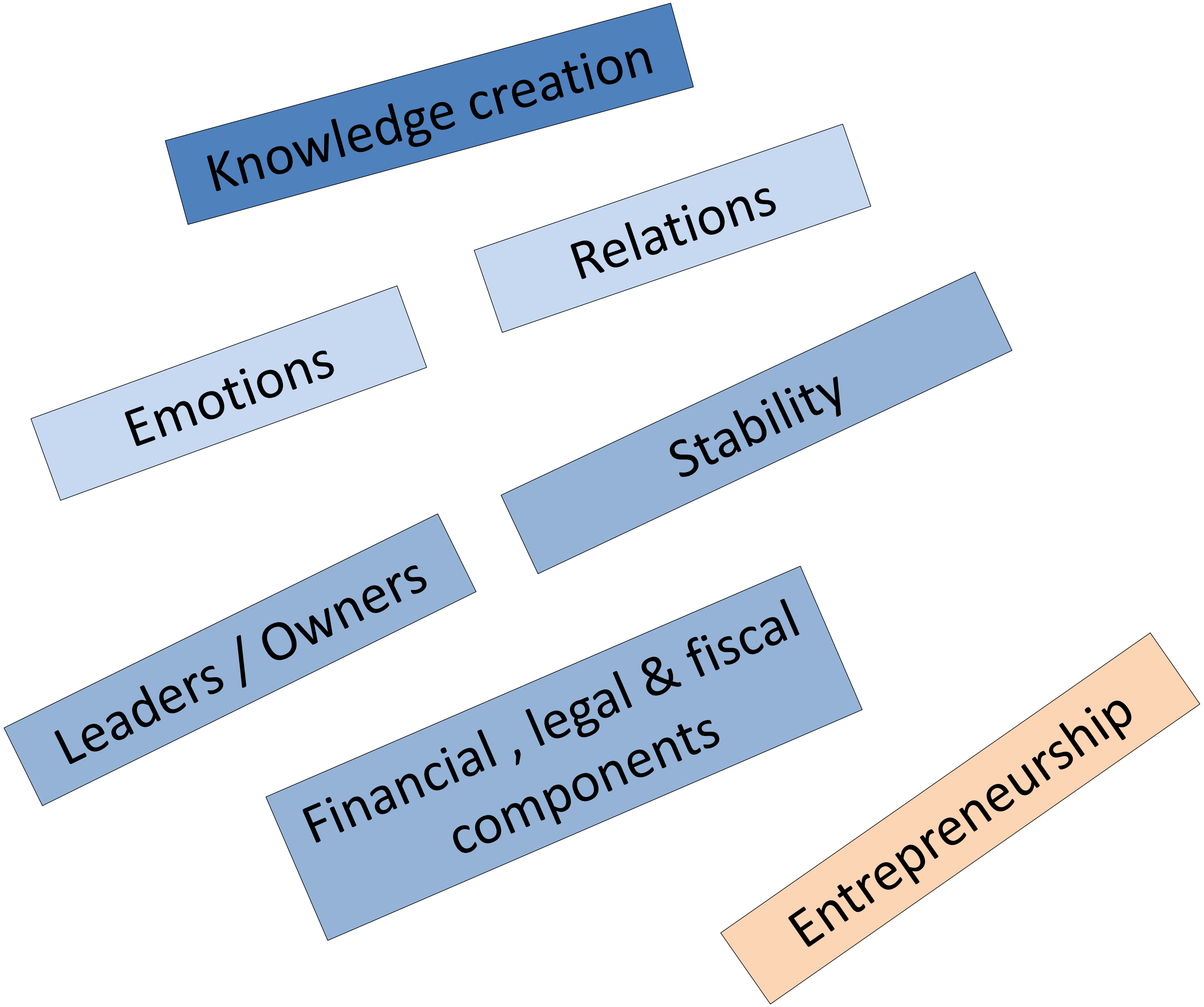
- The study shows that:
  - The abolition of gift, inheritance and wealth taxes motivates family businesses to work more focused with their transfer.
  - This situation is particularly so in the cases in which companies had already started discussing ownership with their consultants before the abolition of taxes was made.
  - The abolition of taxes stimulates families to go through an ownership transfer, partly because they can increase their wealth with significantly less tax consequences.

Has *the tax reform enhanced ownership transfers?*



Ownership transfer is not only about tax plannig!

Has *the tax reform enhanced ownership transfers?*



Even if there are no gift, inheritance and wealth taxes, it is important that family businesses prepare, plan choose & realize a good ownership solution.

Knowledge creation

How do we gather knowledge to integrate and implement a good ownership transfer solution?

- Family businesses often do not have all the necessary knowledge to accomplish a transfer successfully.

- Successful ownership transfer processes =
  - Family members actively engage in finding and creating a base of specialized knowledge.
  - Ask among their acquaintances for recommendations on alternative advisors .
  - Get stories on successful cases and failure cases from their personal networks
  - Discuss different aspects of the ownership transfer process.

Emotional associations to ownership transfer

How can an ownership transfer process achieve good emotions and relationships?

- An ownership transfer process is process embedded in emotional associations to ownership.
  - The emotional associations are the feelings that awake engagement or disengagement in the ownership.
- Both new and former owners emphasize the importance of open dialogue, harmonious relations and respect to differences.

Can we avoid conflicts?

- No, conflicts can occur at all time.
- But, clear ownership goals, open dialogue and respect to differences help families sustain harmonious relations during the transfer process

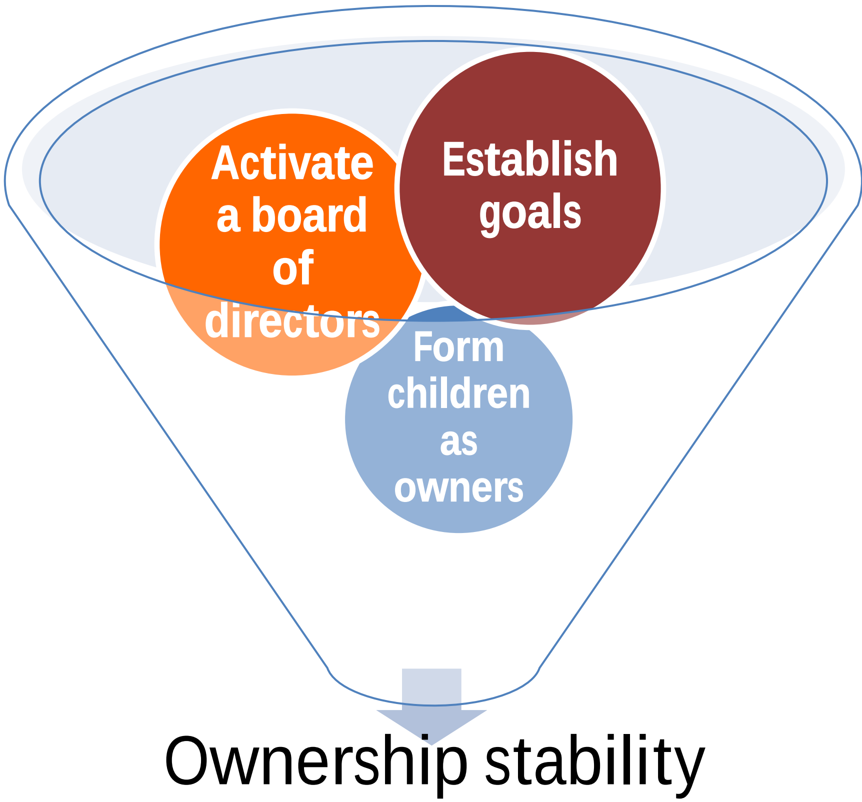
How does the older generation motivate the younger generation to become owners?

- Next generation members need to see opportunities for career development that are connected to their areas of interest and specialization.
- Next generation members need to identify with and feel proud of the family and family business.

Ownership stability

When does an ownership transfer should be done in order to create stability?

- There is no easy answer to this question:
  - how can companies create ownership stability when carrying out their succession?
- Ownership stability is generated by gradually transferring ownership within the family business:
  - Older generation shows trust in the capacity of next generation.
  - Older generations also let go of their identity as "*owners of the entire company*" progressively.



Financial ownership

What does financial ownership mean to the overall succession in family businesses? Is it a mere technical – legal and tax related matter? Who shall be owner?

Ownership transfer solution

- Ownership structure, tax regulations, gifts, owners involved and strategy renewal.
- Family businesses often establish a holding company, which fosters the creation of a platform for investing money and spreading dividends. The transaction creates a financial base for compensating older generations and non-active family members.

Group of owners

- New owners infuse new energy, new skills and new ideas to the group of owners.
- Think on synergies, personal chemistry, backgrounds and perspectives among family members.

Gifts

- Used as a sign of increased legitimacy:
- Children demonstrate commitment and skills that the parents hope for.
- Rewards = when they work for a period as CEO, functional director, recognized by workers or when improve the company's products/process

Fairness

Every successful ownership transfer that involves more than one owner has the challenge of creating fairness among family members.

Should parents merely give away their business?

- Not necessarily.
- Company valuation in order to determine a price, compensation & stakes of ownership.
- Owners establish a market– or non-market price for their company in relation to the valuation.

Should children buy the family firm?

- Parents need to discuss openly the company's finances; children have the right to take an informed decision about their ownership.
- The ownership solution should create financial resources for financing the payment of the compensation to the parents.
- This financial resources are connected to a renewal strategy.
- This strategy has to produce enough profits to pay compensations over time.
- If children focus on the renewal strategy, they will thereof consolidate the survival of the company, across generations.

Concluding remarks

- Tax reform fostered processes of ownership transfer within family businesses.
- Ownership transfer is a gradual process, 3 to 12 years.
- After the transfer, group of owners is integrated by old and next generation owners who jointly renew the corporate strategy.
- The process of ownership transfer is a multi-faceted process – ***knowledge creation, emotional associations, ownership stability, financial ownership, and fairness***.
- Lack of specialized knowledge in ownership transfer is probably the most common reason why this process is delayed or carried out in an unsuccessful manner.
- Policymakers can consider supporting family businesses to have their children become business owners in good time (i.e. earlier).
- If the owners succeed with the process, they can be proud to have created a business that will survive across generations.

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Thank you!

Comments & questions are most welcome

Marcela – mrpasillas@itesm.mx

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