The Dangers of Transferring to Children Without Planning

After building a successful business, many business owners decide that they want to transfer their ownership to their children. Too often, those owners assume that a transfer to children will go smoothly and simply, requiring little more than informing their kids of the date they'll be taking the reins. Owners who make this assumption commonly realize that without planning, they can harm their businesses, their business exits, and their long-term relationships with their families.

Without proper Exit Planning, ownership transfers to children can produce negative consequences in three areas of your life.

1. Money

It's likely that your children don't have the capital to purchase their shares of ownership outright. This means that when transferring to a child, you'll likely need to accept a promissory note and rely on your child to maintain or grow the company to receive your business' full sale value. If something goes wrong, such as your child not having the ability to run the company as successfully as you did, you may receive less than what you expected from the transfer of your ownership interest. Since the goal of an Exit Plan is to position you to exit with financial security, transferring ownership to a child without a thoughtful plan can threaten that goal.

Another common money-related problem concerns how you'll parse your assets between your business-active children and non-business-active children. Transferring ownership shares to non-business-active children can lead to two problems.

First, it can create resentment among any business-active children, because those children have worked hard to build the business, only to watch a sibling who did nothing to build the business get a share of their hard work. Second, it can make non-business-active children feel forced to do something they have no interest in doing to receive their share. In both cases, your company's cash flow can be affected, potentially harming your ability to exit your business with financial security.

2. Time

Ownership transfers to children usually require owners to wait longer before receiving full sale value. This means that your finances may be exposed to general business risk for longer. If the company or economy experiences a downturn, you might need to wait longer than you had anticipated to receive the full sale price, which can affect your post-exit plans.

Another time factor that many owners overlook relates to how much time they'll need to spend training their children or refereeing squabbles between them. If your children aren't ready to run the business without your help, you may find yourself doing more work for longer, which can prevent you from doing other things you want or need to do to achieve your exit goals. Additionally, if you need to mediate fights between children—whether it's related to who should do what within the business, or asset allocation between business-active children and non-business-active children—you may end up spending more time cleaning up messes or, worse, end up having to take the reins back to prevent your children from doing permanent damage.

3. Values

Although many owners assume that their children will run the business similarly to how they ran it, this isn't always the case. If a child decides to run your business differently than you, it can create discord or amplify existing friction among your family members. This can cascade into problems that affect the money you receive and the time you spend in the business.

Differing values can also create hard feelings among in-laws, who might feel that you aren't treating their interests fairly. In the worst scenarios, in-laws can use access to grandchildren as bargaining chips to get what they think they deserve out of your ownership transfer.

Business owners often fail to identify the consequences of a poorly coordinated ownership transfer to children until it's too late. If you're considering transferring your ownership to your children but aren't sure whether you've addressed these potential problems, contact us today.

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