Business succession planning: the key to success

Insights - 29/01/2014

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The transition of a family business from the founder to the next generation is always a critical time, and likely to be particularly so in the ever more competitive markets that we see in modern times. Many cultures have long recognised that this can all too often be the beginning of the demise of the family business, and even reflect this in proverbs such as "from rags to riches to rags in three generations" (in the West) and "wealth will not survive the third generation" (in China).

What can entrepreneurs do to help their businesses avoid this fate?

Formal governance structures

One question for advisors and their business-owning clients is whether a formal governance structure might help in the management of the business, particularly in the succession from one generation to the next. For example, the founder may establish a family council, with rules to govern who should be involved in running the company, to facilitate joint and informed decision making and accountability, and to provide a mechanism to resolve conflict.

In some cases, however, there will be too much internal conflict (particularly after the founder's death) for this to work, and in others the family members may not be interested (or talented) enough to run the business.

Succession: absolute or controlled?

Another question for advisers to discuss with their clients is whether succession to the business should be absolute or controlled. For example, where the founder transfers his shares to the next generation either equally or subject to a factor such as involvement in the business, this is absolute succession. Where the founder establishes a business succession trust the succession is controlled.

One problem with absolute succession is that if the business is left to only one child where the founder has more than one this could be perceived as unfair, but if left to more than one it leads to fragmentation of ownership, which could ultimately destroy the business. Another concern with absolute succession is that the next generation might decide to sell the business, which may well not be what the founder wants.

Business succession trusts

A traditional approach of common law jurisdictions, where an individual wants his wealth to be managed for the benefit of his family, and succession controlled to some extent, might be to set up a trust.

However, a traditional trust has its limitations in the context of a family business. Where the trust fund includes shares in a family company, the trustee will ordinarily need to maintain some involvement in the operation of that company. This is unlikely to be what the founder of the company (the settlor of the trust) will want - he will want to run the business himself during his lifetime (perhaps with input from the family or chosen directors), and he may want his family, or other chosen people, to run it after his death, without interference from the trustee.

The BVI VISTA trust

The offshore world has responded to this problem with a variety of innovations. One solution that is designed for these circumstances is the BVI VISTA trust. In a BVI VISTA trust the trustee can hold the family business for the benefit of the family, but does not get involved in managing the business.

The BVI VISTA trust may establish a family council to facilitate joint family decisions on matters such as distributions of trust funds to family beneficiaries, and may also contain rules which govern succession to the office of director of the company, and which regulate the business activities of the company.

Cayman STAR trusts

A Cayman STAR trust can be established either for beneficiaries, or for any purposes (whether charitable or non-charitable) or for both. A Cayman STAR trust can therefore be established where the purpose is to retain and maintain a family company for the benefit of the family, and where the beneficiaries are family members. The existing company directors can be left to run the company free from interference from the trustee.

Reserved powers trusts

Many offshore jurisdictions, including the BVI, Cayman, Jersey and Guernsey, expressly allow settlor reserved powers trusts where a settlor may retain and exercise as he wishes specific powers, such as an investment power. This would also allow the founder of a company to transfer the company to a trust for the benefit of his family, but to continue to run the company without the involvement of the trustee. The settlor could also pass on this power after his death.

Private trust companies

Where the settlor does not want to use a professional trustee as trustee, another option permitted for certain types of trust in many jurisdictions including the BVI, Cayman Jersey and Guernsey, is to use a private trust company as trustee.

The private trust company will be established by the family, and can include family members and chosen advisers on its board. It thus facilitates direct involvement of the family and its advisers in decision making.

Flexibility is key

All the structures discussed allow flexibility and involvement of the family beyond that which would be offered by a traditional trust structure. Whatever structure is chosen, circumstances will change, and conflict may increase after the founder's death. A successful structure needs to have the flexibility to respond to the unforeseen and all the structures discussed above do allow such flexibility.

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Meet the Author

Marcus Leese

Partner

Guernsey

Hong Kong

E: marcus.leese@ogier.com

T: +44 1481 737152

Key Contacts

Anthony Partridge

Partner

Cayman Islands

E: anthony.partridge@ogier.com

T: +1 345 815 1810

Giorgio Subiotto

Partner

Cayman Islands

E: giorgio.subiotto@ogier.com

T: +1 345 815 1872

Skip Hashimoto

Managing Director

Tokyo

E: skip.hashimoto@ogier.com

T: + 81 3 6402 5635

Sophie Zhong □□□

Head of Business Development, Shanghai □□□□□□—□□

Shanghai

E: sophie.zhong@ogier.com

T: +86 21 5116 9188

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