Video Transcript

Passing on your business within the family

Russell Prior

Good morning and thank you for joining the fifth webinar of our Beyond Business Ownership series. Today's webinar is on the topic of passing on your business within the family. My name is Russell Prior, and I lead the Family Enterprise Succession Service at HSBC Private Banking.

Now, this is the third webinar in our series that takes a detailed look at some of the different exit routes available to business owners. We've looked at selling to private equity, selling to management or employees, but now we turn to the issue of passing on businesses within the family. Over the course of the next 75 minutes, we'll be taking a look at some of the decisions and options available to you.

Now, we have a great panel today and I'm really glad to have joining us for the discussion Andra Ilie, Senior Adviser on Family Governance and Family Offices and Philanthropy at HSBC Private Bank, Peter Golden, Partner at the law firm Fieldfisher and Nick Parkinson, Partner at Grant Thornton. Panellists, thank you very much for joining me for this discussion today.

Now, before we get started, I'd just like to make a couple of things clear, if that's okay. Firstly, that HSBC UK Bank PLC and our panellists have no responsibility for and are not providing legal or tax advice in this webinar. So, please, any views expressed or information provided doesn't constitute legal or tax advice and, please, shouldn't be relied upon as such. And secondly, for our audience this morning, if you'd like to ask questions, please do use the question box at the bottom of your screen and we'll come to them either during the course of the webinar or at the end where we have time for questions.

So, health warnings over, let's turn to today's topic. So, as I said a moment ago, over the last two episodes, we've taken an in-depth look at some of the third- party exit routes. With today's focus on passing on a business within the family, I'd like to ask our panellists, do you see any particular characteristics in either businesses or business families that make a business more likely to be one that's passed on within the family? And Andra, welcome. I'll come to you first with this question, if I may.

Andra Ilie
Thank you very much, Russell, and good morning to our audience. It's a very interesting question. And I suppose first of all, an important point to make here is I think very rarely an entrepreneur will set up a business with a view to building an empire. I mean, it's a nice thought, but I think in reality it starts with a dream, with an idea or perhaps a great commercial opportunity, like in the case of some franchisors, from where it grows organically.

Now for those who are lucky enough and the business does grow and evolve to the point where it is significant and it reaches that point in the cycle where it needs transitioning, the question around the type of transition becomes important, and I know you mentioned that we've covered in our previous webinars some of the main exit routes which are suitable for many entrepreneurs, but I don't think that there are many business owners out there who wouldn't at least consider passing on the business within the family. Of course, unless there is a specific exit motive, say they've reached a particular valuation or they've got an offer they can't refuse, whether they have who to pass it on and that family member or members are the right successors are different questions.

I think a second important distinction to be made here is between newer wealth, so say first generation passing it on to the second generation, and multi-generational wealth because with the latter, there is this almost intrinsic stewardship requirement that comes with that transition. I really like a comment from one of the Hermès family members of the fashion brand that says you don't inherit a family business but you borrow it from your grandchildren, which I think that's true.

Again, in contrast, for the first generation owners and entrepreneurs, I would say whether they do pass it on and they can pass it on is very much linked to their purpose and motivation because both of these aspects, I think, become evolved with time. Maybe when they set up the business, they didn't have a next generation but reaching that point where they've spent a lot of time, effort, financial and emotional capital, they might just consider keeping it in the family.

And I suppose my final point here is from a practical perspective, in terms of some of the common elements that we see within families that are more likely to pass on the business, are things like family members being rather close to one another in the business, families being very deeply rooted within their communities. Again, I've got this example with the owner of a department store in the southwest of England who had received two trade offers and didn't even consider them on the basis that only family could look after the community in which that business has been established and did that well.

Russell Prior
Thank you, Andra. Peter, let me come to you on this question as well. I know you work with a lot of families and family businesses. What's your take on this?

Peter Golden
Good morning everyone and thank you, Russell. I find that we see generally, from a legal perspective, that when clients come to see us to talk about their wills, to talk about, unfortunately, mortality and things like that, that's exactly when they start to think more about who could succeed them and whether they could pass the business on to their family members, to their wives, to their husbands, to their children, to grandchildren. And we do see that it's generally at that point when they start thinking about business succession linked to their wills and how it forms is when they start the planning and it's unfortunate, we all need to sometimes consider our mortality. And it does make sense for business succession to have people in place to make sure that there is not an accidental incident or death, which means that the business is put at risk.

And I think, as Andra said, lots of clients care about their business in the community and what they do and making sure there are people lined up to succeed is very important. So, I see it ties in a lot with will planning, which is the basic level planning which we do as professionals in relation to passing on wealth. And obviously wills cover other assets including properties and other things, but businesses are normally one of the most important things. And there are special tax advantages, which I know we're going to come onto in relation to those, so that's one of the things we see with businesses and how they pass it on.

Russell Prior
Thank you very much. And Nick, let me come to you on this big broad question as well.

Nicholas Parkinson
Good morning, all. So, I think there's a part around are the next gen already involved in the business? Are they around that table in those discussions that you're having? Because if they're not, why aren't they? And perhaps then, by way of that family dynamic, that might make that transferred business more challenging because it probably will take time and if they're not already almost leaders in the day-to-day management of that business, perhaps that might be a difficult step to take.

I think the second point I'd make is around what type of business it is. And Peter alluded to the point about tax relief for example, on transferring a business, and there are some fantastic reliefs that one can use to make that transfer nice and efficient, but if it's quite an investment-orientated business, so we see this a lot with real estate carve outs of family businesses, it actually becomes quite a difficult decision because you either have to realise quite a sizable tax charge, and you're not getting any cash of course for it because you're passing the shares to the next generation, you might have to then just say, well, we'll wait until – using Peter's bit of a morbid point about death – because you get effectively an uplift in the value of those shares on death, or, and I had a client who went down this route with the family, is actually, could we look at pivoting the business?

So, is the second generation going to do the same or something a little different? And in my experience, often they want to maybe put their own stamp on that. And sometimes that change in business could give rise to a more efficient transfer at a later date, so bringing the next gen in day to day in the management, pivoting that business, with a signpost to a later ownership transition that can be done much more efficiently.

For that family, which was again very real-estate heavy, that way it's not just from an efficient transfer, but the second generation were a lot more excited because they had the freedom to take that business forward now they were looking to take it forward.

Russell Prior
Thank you, no, thank you. Some good points and I'd like to just probe some of those a little bit more, if that's okay, starting perhaps with some of the attitudes that are held within the senior generation. So, perhaps I could pose that question really. What are some of the key concerns that you see from the senior generation of family business owners when they come to think about this? And do you see, I guess, a difference between transfers of newer wealth or businesses, say, generations one to two versus more established wealth and family business transitions later down the generations, perhaps into third and fourth? Andra, let me, let me come to you again first on this question.

Andra Ilie
Thank you, Russell. I guess, as with any big decisions, I suppose both the senior and the younger generation, so let's not forget about them, will have a number of concerns. And whilst they will all be very personal, I do think there are some broad themes that we see frequently, and I'm only going to touch upon a couple of them because I know we'll discuss some of them later on in the webinar.

So, the first one, and perhaps the one that we see most frequently, is the fear that the younger generation won't do as good of a job as the generation that established a business in the first place. We know that many business owners regard their business as an extension of their identity. It's almost like another family member. I keep using this example with a business owner who once told me that their business is just another one of their children, perhaps the most predictable and trustworthy one.

Now, to me, that flagged a really interesting point. It does ultimately come down to trust, I think. Do you trust your next generations to do the right thing, even if what looks right to them may not look right to you? And again, another important point to make here is remember that the chances of them being just as worried and concerned as you still apply, and really interesting case here is I had a client whose next generation's mission was effectively to turn the father's network of bottling factories into a more sustainable operation. He faced quite significant reluctance to begin with, but in the end, he was allowed to experiment with his ideas, in the father's words, with one of the plants. So, he's just introduced some very small changes, like he shifted to LED lighting, he used some solar-power enabled machines, and sought some suppliers of recycled plastic. And over two and a half years, he was able to prove to his father that that plant did better than some of the other ones operationally, so then they started rolling that on. So again, perhaps an extreme example, but again, it worked so that proof of concept works.

The second thing that I wanted to touch upon is what does the senior generation do once they pass on the business? Also linked to that is how do they maintain their lifestyle? Because Nick just mentioned they're passing it on, they're not selling, so how are they going to fund their lifestyle without that salary? It’s a very real issue and how you facilitate that personal transition post the business transition, I think, is a really interesting one. And again, it comes down to having those discussions and thought processes early on, preparing as much as you can for what would effectively be a new stage in that senior generation's lives.

I know it's much easier said than done, but you do need to start somewhere and there are routes, and there are things that you can do post-transition and to still be involved and have that sense of purpose and belongingness, so things like non-executive roles, which also could be paid, so that could help with both aspects, mentorship to a younger generation, or for the more numerous families that have a family council, perhaps a role with that could help.

Russell Prior

Thank you, Andra, thanks. Some great points there and as you say, we'll dig into one or two of those emotional aspects further on. But Peter, let me come back to you as well on this question about some of the concerns. And I guess, from a legal perspective, you are very often the one that has to draft this into the legal documents. What do you see as some of the challenges from the senior generation accepting transition?

Peter Golden
Thank you, Russell. And I completely agree with what Andra said. What, to build upon that, a lot of the elder generation, senior generation, when they come to see me, from a legal perspective, they are very much worried about what's going to happen with the next generation. And most of them do raise the concept of is the business going to dissipate by me passing it on? So, the third generation curse, which some people talk about is always quoted out by certain people. So, the entrepreneur who builds at generation one passes it on to generation two who secure it and keep it. But then by the time it gets to generation three, it's effectively being spent, and so by generation four, there's nothing left. Third generation curse, which lots of clients want to avoid.

I mean, there was the comparison which was made, I think it was the 1900s, or just before the 1900s, and then the same again just before the 2000s. And I think only one or two families lasted that hundred-year period, which, it's a long period, but that's only three generations, one would say. And so, you could just see that if people don't consider succession properly, they really can struggle in that sense. And so, the senior generation worry about that a lot. And therefore, we see a lot of clients thinking about how they would structure it, how they would make sure that generation two and generation three are encouraged to embrace it. Whether they're the right people to lead it, do it, are all questions which we're covering today, but putting some kind of format and some structure around that – and I know we're going to come on to some of the different structures and some of the things we do – but that's where, normally, as professionals, we're there to help.

There's the tax side which, briefly, Nicholas and I have both touched upon, which is a key driver, but as well, it's the control aspect, the legal structure which goes around the succession planning. Just gifting it down is not always necessarily the right thing to do. Maybe back in the early 1900s that's what they did, but we're seeing more and more families thinking about how to do this, and this is what's bothering the senior generation a lot.

And I just take one of Andra's points, and increase it a little bit, is that, thinking about how they take wealth from the business after they've stepped down, is something which is very important and certain structures do allow that. Andra's touched on a few of them. There are a few more. It does make sense to consider all their options, and this is where we find that the business owners who start realising they need to see what tools there are which they can employ, it really does benefit them in the long run.

Russell Prior
Thank you. Again, really helpful points and I want to pick out one of those. Nick, turning to you next, we've talked about succession, but succession is not a single thing. There's a difference between management succession, running the business, and ownership succession. And actually, sometimes these things can all be packaged together. But that's not always the case. So, Nick, how important is it to separate out the issue of who's going to take over the running of the business from… where is the ownership of the business going to pass to?

Nicholas Parkinson
Thanks, Russell. So, rarely do I actually see the management of the family mirror the family ownership. Typically, there'll be one or two members from the family that are going to take the business forward but often their role is almost effectively to look after that business on behalf of the wider family. And you can have those structured very differently, and an ownership structure which can encompass all the family is often probably quite a passive structure. They don't need to be that involved in the business, particularly if you set up certain structures that Peter will probably allude to, like trusts, that may own certain shareholdings within the business. So, they can be quite passive in the background and that actually can work quite well because working with family members has its own challenges. My father worked in a business with his brother and to say their bickering was a little unprofessional at times is probably an understatement.

I've got a client who's unfortunately spent years trying to split a business from her brother because they couldn't see eye to eye on the day-to-day management of that side of things. It would have helped probably if the first generation took more of a role and less of washing their hands of the situation perhaps. But again, going back to those kinds of passive structures, so like trust for example, you can have very different businesses for different kinds of family members, which can work quite well, and they work independently but with the same ownership structure.

But the other point I'd probably mention is are management taking an equal share in ownership in the business compared to those that are more passive? Perhaps, perhaps not. And that's a consideration that's best thought of as early as possible, because it's often quite difficult to transition greater equity to management at a later point as an afterthought. I'm a tax person, there's lots more tax concerns and challenges there.

Russell Prior
I wanted to – Andra, I'm going to come to you on this question in a moment but Nick, I just want to pick up on that. You've touched on that really interesting question when we're looking at management versus ownership and do family businesses get that right in terms of the balance between the management reward, the people who are driving the business, versus the ownership reward that they get for being the owners of the business? What's your practical experience about the balance of that? And is it struck correctly?

Nicholas Parkinson
It's not always struck correctly, Russell, but every family dynamic is different. I think there's a cultural side to the family dynamic. Some people are more stewards of the business, whereas others see it more almost as a kind of meritocracy and if I'm doing more, then I should be entitled to more. So, there's no one size fits all with that. But those that don't get the family together at the table to have that discussion at the outset, and don't get everyone bought in to whatever that proposal is, probably are going to have more and more experience of harder challenges at a later point because ultimately, this is a family business, but you've got certain people taking a driving seat, and I've talked already about a couple of situations where it doesn't always work, so yeah, it's not easy.

Russell Prior
Thank you. No, thanks for that. Andra, let me just come quickly to you then on this issue of management succession and ownership succession, are they packaged up? I know when we talk to families about this, we do separate these two ideas. But what's your take on this? I think we have a frozen screen there at the moment. Let me just move on., on the assumption it's Andra and not me that's frozen. I think that's okay because I've seen Nick smile.

So, let's move on then to the next part. I guess as an extension of this idea around succession, we see, and I've experienced a lot, when family-owned businesses are getting into the third, fourth or even subsequent generation transitions, it becomes apparent that an injection of external management or business leadership is needed. What do you see? I'd like to explore really what we see as some of the challenges that this brings for families and actually for external management as well. Peter, let me come to you first on this. What do you think either makes this work well or can help deal with some of the challenges that come from that sudden switch of bringing in external management, particularly for the first time?

Peter Golden
Thank you, Russell. I think it's something which all businesses normally think about at some stage, whether it's early or late. And normally the entrepreneur, the generation one who set up

the business, they will run it and they'll be effectively running it all themselves. But they can't do everything, and therefore, thinking about external management is something which is key, either they build their own team internally, but they manage it all themselves, but it gets to a stage where they need to consider bringing in external management. And Nicholas actually touched upon it, the remuneration and the aligned goals of the management with the ownership is a really difficult one we find and that's probably, I would say, one of the main challenges for the family and the external management is how you do that.

I mean, the family want to and need to incentivise external management to come in and perform well. And it's not just normally necessarily the concept of a salary. When you're dealing with some of these very high-powered, very successful external management people who are coming into a family business, they want their interests aligned as well and they want to look at that.

And there are legal structures and legal formalities which can be put around this. I'm not so much talking about the trust, which I know we're going to come on to more, I'm thinking about ownership structures like EBTs, employee benefit trusts, employee ownership trusts, share incentive schemes where you can give growth shares, hurdle shares. I'm sure lots of people have heard all of these words being thrown around. The reason they're thrown around is because these are the kind of tools which can be used to really incentivise external management and align the interests of management with families.

I mean, there are tax issues and you've got to pay very serious care to what works for what business and how it works, but it does really make sense to think about how you incentivise the management. And from a management perspective, we've got to look at their perspective as well. They don't necessarily want to come in, do a two-year job and then move on. They may want to grow with the business. They may want to grow certain different streams and certain different elements of a business. I mean, businesses expand, and I thought Andra's example of the son in relation to one of the factories is a really good one. You see that a lot with external management having ideas which are different from the family. They bring certain experience and expertise from other businesses they've worked in and other people they've learned from. So, trying to wed them together is a really difficult but could be a really generative idea.

And so, it really does mean that people need to really take care and do it well, and those that plan properly, I find, do normally reap the rewards.

Russell Prior

A phrase we use a lot when talking about ownership transition, thank you. Thank you, Peter. Nick, let me come to you on this question of bringing in external management. What works, what doesn't, what are some of the challenges?

Nicholas Parkinson
Yes, Russell. So, whilst we're on the subject of family succession, often there's a point or a juncture at a later date where it might not be a full exit the family are looking for. It might be partial liquidity event, looking to get cash off the table effectively, and the instances where I've seen external management being brought in for a prospective liquidity event has almost always been really successful because the family are typically experts in that business, in making it the success that it's been. What they're not necessarily an expert in is maximising certain operational aspects or building external profile for a PE house or someone to maybe come in on that business.

So, there's really great examples in that space that I've seen with a lot of family businesses. The point I'd probably touch on – it's a bit more nuanced – is around culture and a culture in a family business is often not what one would always encounter in, say, professional services, large listed businesses. So, you're bringing in often external management that have been in those types of environments, coming into a family-owned business that has its own way, and a very successful way but perhaps slightly different way and environment of working, and parties need to be aware that that can well happen.

There needs to be some self-awareness in the family perhaps, of what unique nuance is there for how their family runs that business, and how easy is it for someone from external management to come in and transition into that type of culture? It can be difficult. I've seen, unfortunately, a lot of instances where management hasn't worked out because, to be honest, they don't enjoy it. It's quite a different environment. So, being really open and transparent as to what each are looking for, not just in the KPRs, but how one works and how one wants to work together, I think, is really, really important because if you don't have management coming in, challenging the status quo, then really what have you brought them in for?

And a number of families… We've talked about trust with the next generation. Ultimately, they're going to have to trust the management for what they've brought them in for, and they need to be prepared for that type of critique. So, having strong characters from management prepared to challenge, family willing to compromise on what's probably been their tried-and-tested technique and winning formula for a long time. So, then maybe them building that, what that objective for management should be for the next hundred days, to the next year, to the next liquidity event and really been bought into that, not just on the KPRs but on the culture side of things as well.

Russell Prior
Thank you. Thank you both. Look, I think two really important points that you're highlighting there, one is that cultural fit. Absolutely right. I've heard so many times external management – notwithstanding the fact they go into and they know they're going into a family-owned business – still being surprised by that cultural shift. I think that is huge. And then I think, Peter, your point about alignment of incentives is a crucial one. I've got a question already come through on that, which we'll pick up in the Q&A.

I'd like to just explore another angle here, which is what happens when, within a family, within the next generation of family, actually you've got a lot of family members who are keen? I think we've touched on items already here where perhaps there's one or two who are going to lead the family, the management of the business forward. But what happens when actually there's multiple members of the next generation willing and wanting to get involved? How do you see business owners managing these tensions, again, either in management succession or in ownership succession? Peter, let me come to you first on this one.

Peter Golden
Thank you, Russell. It's a difficult one and I can see that. I mean, in a sense, it's great if you've got lots of family members who are interested in being part of the family business and being involved in running it and going forward. I mean, it's worth thinking about ownership compared to management, because you could still be an owner and not necessarily have to be a director, be on the ground day to day and do that kind of role, but balanced with some of them wanting to do that. And it's great when you've got multiple generations and multiple family members who do want to do that.

And we do see that some of the families really are interested in keeping it a family business. You see some of the really old family businesses, some of the banking families, where you do see family members from random different generations who, when you're looking at the branch, are really quite distant from other families. They still come into that business. They may or may not have the surname, but they are part of the family.

So, we see with a lot of the structures, effectively we will have branches, so trust branches, sub-trusts amongst them, so that they can effectively evolve within a family council, family constitution role as to what requirements are on the family members for them to be involved with the business. So, most family constitutions and guidelines for trustees as to how they should involve the next generation, or the future generations, not just… When you're just dealing with one or two generations, it’s easy. You can ask the parents, you can ask the family members, but when you're dealing with generation four or five and six, it gets too wide, and so you need a bit more structure around that.

So, we normally see people putting in family constitutions specifying things like the requirement for education up to degree level, work experience, and actual employment in other businesses becomes more important, so the family members can take different experiences and bring them back to the family business. It's not just about growing up in the family business, which is a good thing in itself, but sometimes there's a value to having external family members who've worked in other businesses, other parts of the industry to bring that all back together to the family business.

And so, we see that as a key thing, where the elder generation and the family council need to consider that. When it’s just generation one, that's all being done by one person, potentially maybe a husband and wife. Generation two, there's siblings, there's more people, but you do need to have a group who makes the decisions of how do we bring people on? I'll go back to Andra's point right at the beginning. No one intends to build an empire but when you get to that stage, you need to consider having different people at different stages. And it does again require a lot of planning and a lot of consideration.

Russell Prior
Thank you. And it's a really good point. There’s a family I've worked with where they were into the fifth generation and they'd actually outsourced to non-family members the selection process for family members coming into the business because they wanted to completely take away that sense that there was any family involvement in those decisions, which I thought was both sound but brave in the context of what they were doing. Andra, let me come to you on this question as well. What do you see in some of the work that we do at the bank?

Andra Ilie
Thank you, Russell, and apologies for my technical glitch. It happens. So, I guess my take here is I would completely echo Peter's points around the constitution and the importance of that. And again, that doesn't have to be an onerous document. It can be something very simple with some very brief rules. But I wanted to pick up on the point around culture because I think that's a very important parameter. And in some parts of the world there is just an expectation that ownership will be passed on to the firstborn son, so that's the primogeniture model. You do also have cultures like the Middle East where again, there's very, very clear rules around

ownership transition based on local succession laws. And then you also have places like Asia where they might go to extended family to ensure that the business is passed on to a male heir.

Now, what we do see in the West is many families that base their decision around ownership and management transition around meritocracy, so I know Nicholas made that point before. And where you have multiple siblings, again, what we see is families with very strong governance frameworks, where there is clarity around roles, responsibilities, things like who can be an owner in the business, who can become a manager in the business. And even just more basic, who can get a job in the family business are the ones who tend to be more successful. Roles are really, really important. And again, what's also important is establishing them very early on, so perhaps at that stage where you don't have a lot of family members and you can de-personalise that conflict perhaps.

So again, simple things like having a shared view as a family on who is family, is it just blood only? Is it spouses? Is it adopted children? Who has that right to ownership, again, and who can be a manager? And again, I liked your example, Russell, and I had another one of my own with, again, quite an extreme case where the business owner decided that only one of his three children could become the CEO of the business once they've proven themselves by running three different geographies of the family business, but in Europe, and then the one with the best results after a period of three years could interview for the job alongside external candidates.

So again, just to see the length and the extent to which some business owners go just to make sure they get it right. And a lot of business owners use meritocracy for ownership as well, things like unless you can pass certain tests – so to Peter's point – and have certain degrees, maybe you've worked in the family business or in a similar business outside of the family for a number of years, you can't own shares, simple as that. But again, whichever one works for you, having those rules and communicating them widely can help.

And I guess finally, from an ownership perspective, as those families evolve, you get many more individuals involved in mechanisms like ownership consolidation, I think we see very frequently. So, we see the use of family branches and again, structures like trusts that both Nicholas and Peter have mentioned can work. But we do see provisions like a maximum number of shareholders that can own, for example, in a corporate vehicle, that can be owned by the family, because a very fragmented ownership is really not helpful in a lot of situations and can sometimes hinder decision-making. And again, it just comes down to having that clarity of purpose in what you're looking to achieve and who can have certain roles.

And I suppose sadly, sometimes you may just want to seek alternative routes, be it for ownership or management.

Russell Prior
Thank you. And I think that point about ownership consolidation is an interesting one. I think we’ll all have seen cases where it doesn't take many generations for there to be suddenly 50, 60, 70 plus shareholders in a family business. Nick, do you have a view on this question about how do you manage some of those challenges when the families get so large?

Nicholas Parkinson
Yes, Russell. I'm conscious I’ve given examples of when it's not worked, but I think, if anything, they’re probably, hopefully useful examples because you learn, people on the call can learn from them and not go into those scenarios again. It’s about protecting the wealth and where you encounter challenges, family dynamics or business, there is a risk of dissipating the family wealth but try as you might, whether you've got a constitution in place, whether you’ve got a certain family dynamic, things may get to a point where, unfortunately, it's not working and you might need to split the business. They might be two very – and I talked about a couple of siblings, had very different directions as to where they want to take the business, and they’ll probably be very successful in those businesses, but wasn't one collaborative approach, and the answer in some cases might be splitting out the business or the direction that the next generation, the following generation, may want to take.

But it doesn't mean – we talked about it earlier – it doesn't mean that ownership needs to be completely separate. Perhaps, but it doesn't always have to be the case. And I've got family dynamics where the next generation are given freedom to go into certain things like FinTech, et cetera, which the first generation haven't got the foggiest about, I don’t think, but they trust them and they're happy to take that forward, but they want them to go into that business looking after other family members that are not party to that whatsoever. But the businesses are completely split. So, there's ways and means to work through problems with family dynamics.

Russell Prior
Look, I think that’s absolutely right, and thank you. You highlight some really great points, because I think there are some great examples of families tackling this in different ways. I think sometimes when we talk about exit mechanisms, it’s perceived to be a very negative thing. But sometimes, for some of the reasons you've given, it's actually a very positive thing, investing, co-investing in new opportunities that certain next gen family members want to take advantage

of, or see an opportunity to build wealth in, is again another mechanism. I think there's some really interesting points you're alluding to there.

So, look, I think we're at that point where it's probably right that we turn to the issue of what are some of the routes by which ownership of a family business is passed on. And I guess I'd like to explore now some of the tax and legal perspectives. So, what – and Peter, I'll come to you first, if that's okay – what do you think is some of the key, from a legal perspective, some of the key options, practicalities around passing on ownership to another generation? What are some of the mechanisms you're seeing that are used for this?

Peter Golden
Thank you, Russell. I mean, I think control, which we mentioned before, but now's the time to dive into it. Control is one of the key elements, I think, in relation to how you pass on the assets. I mean, not necessarily does the older generation retain control, but how do they deal with passing control as well as ownership and value effectively? So, the simple gift of shares down a generation is something which, I think, historically happened. Sometimes – I go back to, unfortunately, my point about mortality – is that sometimes it's under the will, so sometimes they literally say, the shares will pass to my children when I die. And until then, they'll be the owner for effectively the rest of their life. And there's basic and perfectly decent planning using wills and those kind of structures.

But then you end up with potential risks of challenge of the next generation and others not having the ownership and therefore, the thought of gifts comes in. But again, giving away your shares means that you're giving away control. And they may want to retain some kind of income, some kind of influence. Also, it could be detrimental to the business doing so. So, what we end up looking at are things like trusts, things like partnerships, splitting the shares into voting and non-voting of a business, how you can wrap them all together. What people see as operating business and what goes above that is where you start thinking, I've historically, you normally have business owners who own the business 100 per cent themselves, but the succession plan normally means vehicles and trusts and structures, maybe more because of holding companies at the level above. And all of these have sort of tax implications. And I think Nick is going to cover these in more detail, but it's worth thinking about how you structure from a control perspective to be able to benefit multiple generations, potentially.

That's where trusts come in and other structures because making a gift to a family member, albeit maybe a good idea, you don't know what they would do with the business once you pass it on. And that's again why people sometimes use non-voting shares. The fact you can pass on a bit of the value, but you're not giving them the full control of their shareholding of the business so that they don't do something which the older generation, and potentially the family – and I go back to what the family council may or may not want – is to allow a large number of shareholders or to pass outside to the family, because if you give control, theoretically, they could pass that onto someone you don't want them to, outside of the family. They could sell it to someone. So, we see those kinds of tighter controls coming in, not deemed to try and restrict the business running, but who actually ends up being the owner and how it passes down.

So, I must say – and I'm biassed, I'm a trust lawyer – I do see a lot of trust structures coming into place, sometimes on death, sometimes during lifetime. For business owners, there are some very good reliefs, which Nicholas has already touched upon.

Russell Prior
Thank you, Peter. Nick, let me come to you then on some of the issues here perhaps from a tax perspective that might be relevant.

Nicholas Parkinson
Well, let's start with the positive. If you've got a trading business, you should be able to transfer those shares to the next generation without any tax payable. Ultimately, you're not getting any cash for that, but it's a trading business and there's a lot of reliefs available to enable people to transition those shares to that next generation. But, my big but is if you don't do the right forms and the right elections, perhaps it's not going to be quite as tax efficient. I cycle ahead and seen some less favourable stories when, again, this may be a liquidity event, a buyer's coming in and reviewing shareholdings, the right forms haven't been completed. It can create some challenges on a later liquidity event.

So, there's got to be care there, but the positive is it should be able to be undertaken really tax efficiently. The point I'd probably bring up, and Andra talked about it earlier, is the generation may be looking at the succession, but how are they going to finance their lifestyle? And ultimately, they've built up this wealth, do they want to access some of that? Do they want to take some of that reward away for their retirement? So, there might be some cash within the business, or effectively there's going to be cash going forward that we could look at as part of that succession strategy, effectively buying out that generation from the business, and one has to take great care when one does that, because under certain routes, that could be seen as a dividend, taxable at nearly 40%, but if there is that right succession strategy and the controlling interest is being taken over by a new generation, the departing person or generation, they might be able to still maintain a minority interest, perhaps 5% each, something like that. But for the tax authorities, HMRC, to be happy that this is a commercial driver around succession, they do need to probably see that controlling interest being taken over.

Why you go to the tax authorities in advance is certainty. What you want to know is, before I transact with my family, I want to know what the tax is going to be on this, otherwise maybe I won't do it. So, you can go to the Revenue for some of the key tax principles to check. I'm not going be subject to income tax on this cash, I'm going to be subject to certain CGT on the cash I'm taking out, but perhaps not on the shares that I'm receiving in return for other shares, because you probably have a new company that the next gen will use to buy the second generation out. There might still be a bit of stamp duty. Cost of that? Half a per cent or so. One would take that as a wider commercial view, and that can work really well. Andra's point about how I'm going to finance myself going forward in a tax-efficient way, and I'm transitioning that ownership to the next generation.

The one point I'll finish on is it's all well and good taking out 10 million cash out of the business tax efficiently, but what are you going to do with that cash and who is it for? Because you've gone from owning shares in a trading business, and there's no inheritance tax probably on death, to earning 10 million, say, in cash and the IHT exposure is 40% of that on death. So, there's a really important discussion to be had as to what the purpose of that cash is for, when did one need it, and challenging as to is that the right route, or are there further steps that might be needed whether that cash is housed somewhere else? Or maybe it's not all cash, it's maybe some kind of preference share owed back, which has certain inheritance tax reliefs. But the important point is there's mechanisms to look at tax efficiently, financing that generation when they're looking to exit. It's not simple, but you can get a lot of certainty by approaching the Revenue with that as well.

Russell Prior
Brilliant. Thanks. Thanks, Nick. Some really great points there about how you get organised. And I think it's probably a good point for us now, if you don't mind, I'm going to turn to the Q&A. We've had some really great questions coming in from our audience. I think I can group a few of them, so let me try and do that. So, the first one, a couple sort of linked to this, the first one, though, I want to pose is to do with whether or not we've seen any changes in the way family businesses are organising themselves since COVID. I know when we were going through COVID, we got a lot of work on this during that whole period around the way family businesses were organising themselves.

But since COVID, are you seeing more or accelerated family business successions, more diversification, focus on growth perhaps, or efficiency-driven profitability or, indeed, perhaps, linking into some of that, what you were saying, Nick, about the tax issues, building wealth outside the business to reduce dependency, notwithstanding the risks associated with that?

I’m going to come to each of the three of you on this because I suspect you'll have some interesting perspectives on this. Andra, let me come to you, to you first. Are you seeing any, any sort of shift or changes in the way family businesses are thinking about these things post-COVID?

Andra Ilie

Thank you, Russell. There are a few notable areas there, and I think one of them is actually a couple of cases where the senior generation had stepped back, had transitioned to the next generation, but during COVID, they almost stepped back into the business to be that support and bring their experience to the table and help that next generation through. In terms of acceleration, again, yes, we've seen some cases around where the next gen were brought in a bit earlier, but again, that's very much business-dependent and family-dependent. So only where the next gens were pretty much ready already, if I can say that, that’s when we saw them being brought in.

And for the diversification piece, I guess that's an interesting one because we've seen all sorts of, well, we've seen various ways of diversification. So, we've seen things like vertical integration, so we've seen business owners almost buying their supply chain throughout COVID. And we've also seen others perhaps pivoting into businesses that were a bit more COVID-proof. But again, all of this was done with the power of both generations almost, from my perspective, from what I've been seeing.

Russell Prior

Thank you. Peter, let me come to you on this. Have you seen any changes in approach from family businesses since COVID and issues that have arisen through COVID?

Peter Golden

I completely agree with Andra. There have been definite changes where people have considered their businesses. I mean, from my perspective, we've seen so many people, so many business owners, looking at their succession effectively during COVID when people had a lot more time to think about these things, one would say, and unfortunately, there was mortality all over the world. We saw everyone reconsidering their wills, reconsidering, is my succession plan up to date? Is my structure up to date? And so, it's, in my view, kicked off a whole other layer of this thinking.

And I agree with Andra that some people decided to speed up a bit of the transition. Some people actually put some structure around the transition where they hadn’t thought about it, they'd spent years just concentrating 100 per cent on their business. And we see this a lot with business owners, who really concentrate, really go very well at their business and succession and exit, and all those things are very much in the distance and not something they were spending any time on. Suddenly it came to the forefront because either they were doing very well or either not so good, but they're also thinking about, well, if something happens to me, or if I'm stuck in a place, I can't access my normal travelling around the world, running the business, how do I do that? And I need more people to be able to do that, to take certain geographical jurisdictions.

So, it's created a lot of really interesting discussions and a lot of changes. I mean, I think we're still seeing it, still seeing that runoff where people, maybe coming out of COVID in the sense that obviously it's a while ago since all the lockdowns in the UK and things like that, but people are now getting to a stage where we've come through it, we've done well. Now, what happens if this happens again? What happens if there's another change in business?

And therefore, succession planning is something they're all looking at. And it's very interesting, from a professional perspective, to see how families are really approaching it in a good way. And it's something I think lots of people are doing.

Russell Prior
No, I would agree. Thank you. Nick, what are you seeing on this front?

Nicholas Parkinson
Yeah, perhaps I think for certain individuals, maybe it's been an increased sense of mortality in the last few years, but not always the case. I look at it, family businesses are incredibly entrepreneurial, and what they are therefore is very opportunistic. And through COVID, there's fantastic new opportunities about new ways of working, and therefore new business lines that, particularly, I would say, second generation through tech are looking at exploring.

And then the other point I'd probably add is my view is, post-COVID, with the remote working that we're now all enjoying, we can be a lot more internationally mobile with how we run businesses. And that might mean that family members here, there and everywhere may take an increasing part in running that business or expanding elsewhere. So that does seem to be really prevalent in a lot of family discussion.

Russell Prior
Thank you. Had a couple of questions, good questions actually, coming in on the issue of bringing in external management. I'll just break them up a little bit, having said I was going to

consolidate them, but I'll just break them up a little bit. First one is on the issue of external hiring. What specifically can you do to attract and retain the right talent? Maybe, Nick, Peter, I'll come to you on this. What are you seeing are the ways in which business owners do this?

Peter Golden
Happy to jump in on this one, Russell.

Russell Prior
Thanks.

Peter Golden
I mean, I think what we're seeing, it goes back to the incentivisation and we're seeing a lot of offers of, effectively, some kind of carry, some kind of incentive structure, where effectively the goals are aligned and the external management become, their remuneration structure is linked to the success of the business so that they feel if they come in and they do a good job, that actually they will be rewarded properly. And the ability of family-run businesses to do that is a really good thing. I mean, I know a lot of us work in very big firms, it's very different for a family-owned business where they really do have the flexibility to bring in the talent to really take their business to the next generation, to the next level. And it may not necessarily be the next generation who can do that, or they need to do it in conjunction with other people.

So, we're seeing a lot of packages put together where there are – and I to go back to the hurdle shares I mentioned – growth shares where it's showing that if the business is worth 20 now, 30 million now, but the aim is to get to 100, if you put a hurdle rate and you say to management, look, we think we can get to 50 or 60 million in the next couple of years because of the route we're on, but we want you to take it to the next level. So, you'll start a ratchet between the 60 and the 100 million mark, you're really giving that external management team a real reason to expand and do that.

Now, obviously, you want to link it to making sure that no undue risks are taken, and it's really, really interesting discussions we're seeing about how you involve the right people at the right level.

Russell Prior
And Nick, your, your thoughts on this?

Nicholas Parkinson

Yeah, I won't add too much, I think Peter's covered that very well, but the point, I think, is that some kind of equity, it's not just their salary. They want some kind of skin in the game typically, but not necessarily always. And don't forget about network. I always find clients know all their competitors, very friendly often with those, and perhaps someone's already been through that phase a few years back, and perhaps they brought in management that have gone through that and that did very well for them, and perhaps therefore they could be a great fit to bring in on your next stage of the journey. So don't be afraid to maybe look at the network.

Russell Prior
Thank you. Sorry, problem with the mute button there. The other question on this is something we, I think, reflect on something we raised earlier, but as perhaps families are less involved in the day-to-day running of the business, because they put in place good external management, how do they stay on top of what management is doing? And actually, over time, particularly as time passes, can they do that? And the question that, I think, has come in here is what does the panel think about the use of independent non-executive directors on boards to assist in this part of the process? And if you do use them, what payment or incentive structures should you use for them to ensure that they stay independent in their role? Does anybody want to volunteer for that one?

Nicholas Parkinson
I think one point that I might mention on that, Russell, and again, this is only from experience with clients that are actually non-exec directors now, they're not often really motivated by the financial reward anymore. What they're motivated by about how they can make a difference, and so really bring them on board as to what you're looking to achieve and how that mirrors what they're looking to do for their next new role. In my experience with some of those clients, that's actually what really motivates them. And therefore, the reward side of the thing is, well, pay me some kind of arm's length deal, what have you. But actually, the real successful ones, for some of the non-executive directors that are coming in and imparting their wisdom, is they want to make a difference more than anything.

Russell Prior
Yeah, I think that's a very fair comment, Nicholas. And again, I've seen some examples where it's actually, I think, a really good discussion and a resistance to moving towards rewarding non-execs based on the performance of the company, actually steering clear of that to ensure that their reward mechanisms reflect what they're there for is, I think, that's something I've certainly seen used in that case.

Peter, Andra, was there anything you wanted to add in response to that? Andra, yeah.

Andra Ilie
Yeah, just a couple of points. So, I guess I've seen non-executive directors also being used for educational purposes. So, they were mentoring the next generation, which was an interesting one. And the second one, I just wanted to comment on the part of the question linked to reporting. So, how are they doing? How do they report to the family members? And again, here, I guess, for families that have family councils, there tends to be some reporting elements where they will go into some of the family council meetings and talk about their view on life and the business, and where they don't have a family council, again, there is some sort of an agreement around the non-execs reporting directly into the family, bring on their takeaway on the business, again, independently to the family.

Russell Prior
Thank you. That's interesting you should raise that topic, Andra, because I've got a question, funnily enough, relating to elements of family constitutions, and I'll come to that after this next one which had come in, which was really picking up on some of the issues that I think we talked about. But I guess the question here is when is the right stage to involve the next generation? I think we've alluded to some of the issues around first generation. Peter, I think your point about if succession starts with wills, then that's a bit later on in life. But do you have any views, panel, on when is the right time to involve the next generation? Peter, yeah.

Peter Golden
Thanks, Russell. I mean, I personally think that with the experience I've seen with my clients, the sooner the better really. I'm not saying that you want an 18 year old next generation to start going to work in the family business – not to say they couldn't if they didn't want to – but getting them involved, even from a high-level perspective so they understand this, is a great education piece, I think. And so, getting them to understand it doesn't mean they need to join the family business, be part of it and do it through their whole life. But knowing it's there, knowing how the generation above and the family council and others are thinking about it, the sooner the better, really, I'm seeing.

So, a lot of the constitutions which I draft, they normally do say that once a child, once the next, once anyone in the family hits the age of 18, they're brought into the fold in terms of knowledge, being told about the family, being told about the history, being told about this is the business. And some families, especially when it's the generation four or five, there's a lot of diversity there. It's not just one business, it's multiple things. And so, bringing them early, from a knowledge perspective, is great. Some of them may not work or ever in the family business, but some may at 25, 30, once they've done other things. It's to see so they can open up and see what it is, so I think the earlier the better on that perspective.

Russell Prior
Thank you. Andra.

Andra Ilie
I completely agree with Peter's points. I think the earlier the better. And I think normalising that topic at a very early age, and I have quite a lot of families that tend to just talk to their kids over a Sunday lunch, or just take them on a retreat when the family talks about all business-related things in an independent context and just bring their kids, but again, when they're 18,19, that might happen. And I do actually see them getting involved in the family business really early on, perhaps by shadowing, by coming in a few days a week, or where there are structures and there are trustees, for example, where the business is held, perhaps shadowing the trustees. That's another one that I've been seeing.

But my point here is putting them in those situations and giving them those opportunities to figure out for themselves whether there is a space for them in the business, whether it is something that they want, I think, is absolutely vital so just giving them that option, because, I go back to what I was saying for the first question, Russell, which is, realistically, if you built a business that is sustainable enough, good enough, why would you not at least consider passing it on, given how much you've invested?

And my final point would be some families, what they tend to do is they tend to get their next gens involved in different areas of the family, so perhaps philanthropy, so they might get their next gens to experiment almost in a safe environment with that side of the family's wealth, just to, again, build that knowledge and those skills that could then later on be applied to the business.

Russell Prior
Thank you. And Nick, let me come to you on this as well, for your perspective.

Nicholas Parkinson
Do you want to choose when the next generation gets involved, or is it going to be enforced and you're no longer around? And unfortunately, I've had a couple of instances where, unfortunately, first generation are no longer with us, unexpectedly so, and they haven't really imparted all of that wisdom fully to the next generation. So, to the extent that you can choose that, I suppose always the question, why not now? What's stopping you doing this now? And

therefore, how can we resolve those challenges that are stopping? Is it control, what Peter's talked about, how you can deal with that? Is it cash flow? We've talked about how you can maybe finance yourself.

So, there's always ways and means, but what are the stumbling blocks that mean why not now? It might be that they don't want to be involved and you don't think that they're ready for it, and hence it's a different conversation and there's different routes.

Russell Prior
Very good, thank you. This next question, I suspect, comes from somebody who we might classify as being in the next generation. I don't know whether it's got something to do with the series Succession having finished, but the question is, if you're in the next generation, is there anything you can do, or what would the panel suggest can be done, to help the senior generation to exit gracefully? Does anybody want to take that one? Nick, thank you.
Nicholas Parkinson
I think one thing I'd say, give them a purpose. I had a client who exited, went past his business of 20 plus years, 'Nick, I've lost my purpose in life'. He went meditating for a couple of weeks to try and find that. They can't go from 100 miles an hour to zero. Find a role. They've got so much expertise and wisdom and real insight that can add further value, but what role could they take on that would excite them, that helps you and the business, but you're now taking that lead and taking that forward? And I think that's a dynamic, I think, that hopefully can really breed success.

Russell Prior
Thank you. I've got one last question before we close today. So, forgive me, Peter and Andra, not coming to you on that last one, but I think what the question's alluding to here is the panel has hinted at various elements that we might, or I might, describe as being contained within a family constitution. We've heard mention of family council and other such things. What's the view on whether… Or what role can a family constitution play in helping families with the family business succession? Andra, I know this is something we work on a lot at the bank, so maybe I'll come to you first on this one, if that's okay. And then, Peter, I'll perhaps come to you after that.

Andra Ilie
All right. Thank you, Russell. I think there is just so much, perhaps, noise around family constitutions and family charters and what they mean and whether they need to be extensive documents. And I guess, in practical terms, they don't. They can be as long or as short as the family wants them to be. And all they are is, think of them as the business plan for your

business. Your family constitution is your business plan for the family and for the way your family interacts with the wealth.

Now, the rules that you include in there, again, are only as valuable as the stakeholders and the people that are involved within it, which is why I would say, it's really important to make sure all the voices are heard when drafting this document. Now, in the UK, a family constitution is not a legally-binding document. I'm sure Peter will talk much more about that, but there are certain elements of the family constitution that can actually be embedded within a legal agreement. So, things like pre-emption, rights of shares so if you do not want those shares to be sold outside of the family, just make provisions that they get sold back to the business or they have to be offered first family business to family members.

So, I cannot stress how important having even a very simple set of rules written down, shared with everybody and agreed with everybody, and also the, the second point to it is just make sure you have some sort of mechanisms of meeting up with the family, seeing if they're still fit for purpose, seeing if all generations are still represented and whether it still works because it's a dynamic document that evolves with the family.

Russell Prior
Thank you, Andra. Thank you. Peter? Your reflection on this?

Peter Golden
Yeah, and I completely agree with Andra. I mean, family constitutions don't need to be complicated documents and actually letters of wishes, things like that, where you set up a trust to hold certain shares, we always say the Settlor needs to write a letter of wishes. It doesn't need to be the Settlor sometimes, sometimes it’s the main beneficiary. Each generation would be asked to write a letter of wishes and a letter of wishes is just a smaller version of a family constitution, really. It goes back to Andra's point. It's a roadmap. It's an intention. And you want to have that, especially when you're dealing with third-party trustees who need to understand what is going on, if there's an untimely death or you're dealing with minors, how to deal with them, how to bring them on.

So, the hardwiring and the letter of wishes and the hardwiring that into trust structures, into voting shares, into pre-emption rights, into legal agreements, it’s all very important to do. But you don't have to do, it's not a massive exercise. You can do it piecemeal. And we, on lots of our clients, you start small. It's always worth doing the small things, and it doesn't require a huge effort to get things in much better shape. And then, yes, there is more you can do and for some of the bigger families, yes, there's a lot, lot more you can do. And though Succession, being the TV series, has shown how things can go very, very wrong. Great TV for making it, but all of our clients would fight tooth and nail to avoid all of those issues. And they can be overcome very easily, and it just requires that planning and start thinking about it. Even small things now can really help.

Russell Prior
Thank you, Peter. Maybe that's the sequel to Succession, dealing with it easily. Look, panellists, thank you for a really great discussion this morning. Before I close, I would just like to come to you with something we do on these webinars, is how would you distil our conversation for an hour and 10 minutes down to one simple closing statement? So, maximum 30 seconds. Nick, I'm going to come to you first, if that's okay. How would you summarise?

Nicholas Parkinson
There are options, Russell, if one gets involved earlier and gets the next generations involved in those discussions. But don't be afraid that actually sometimes it might need a bit more of a nuclear option if the family dynamic doesn't work but make that then work for the family in the right ownership structure.

Russell Prior
Thank you very much. Thank you. Peter?

Peter Golden
I think planning is the key thing. I think, thinking about things and putting it down, even if it's not a legal format, is really something which is essential. Once you start putting it down, once you start planning it, I think things follow. And I think the thought process of involving the generation and how you want things to plan out. Once you put down just a little bit in writing, potentially, you can really start building upon it and start doing things which will really pay dividends in the future.

Russell Prior
Thank you Peter. And Andra?

Andra Ilie
I would say just talk about it, be open and honest about what comes next for your business and for yourself. You may want to pass it on to your children, but do they want it? Are they ready? Are they comfortable? Perhaps could they get some help from external management? Does it have to be both management and ownership? So, the more questions you ask yourselves and

your next gen before embarking on this journey, I think, the better because it will help you, it will help them, and it will no doubt help the business.

Russell Prior
Thank you very much. Look, panellists, once again, my thanks. I’ve really enjoyed having you on our conversation today. And I think we've covered some fantastic points and I'm sure our viewers have gathered some great insight. So, for our audience today, I do hope you have enjoyed the session and the discussion. There is a feedback tab on your screen, so please, if you have any feedback, do complete that feedback on that tab.

If there’s anything from today's conversation that you found particularly interesting, or you'd like to know more about, or you'd like perhaps to speak to one of our experts, please do take the opportunity to get in touch with your HSBC Relationship Manager. And finally, don't forget to sign up for our future Beyond Business Ownership webinars. Sorry to say we're taking a break for the summer, so the next one isn't due now until the 27th of September, but we will be back on the topic of post-sale planning and investing in September. So, in the meantime, have a great summer and thank you very much for joining us today. Goodbye.