

Hidden Dragons: Handling Family Conflicts in Buy-Sell Agreements for Business Succession

by Paul E. White, Ph.D.

Executive Summary

- Buy-sell agreements are used as the foundation for transferring family-owned businesses across generations. For the process to be successful, relational issues are critical to understand and address. Astute financial advisors will understand that business succession can involve complex family issues and will use a process that addresses these.
- Two common approaches by advisors can create problems: (1) avoiding the relational issues or (2) trying to resolve all the relational issues present in the family. Rather, the goal is to address only those relational issues intertwined with the business succession plan.
- The article discusses five common relational traps advisors can be drawn into by family members that will create significant obstacles. These include one family member keeping secrets from another family member, the advisor becoming a messenger between family members (to avoid conflict), or attempting to make everyone feel good and have no negative interactions.
- The article suggests practical steps to avoid these relational quagmires. The process should include clarifying and articulating the current owner's goals for themselves and the future of the business, investigating the goals and desires of the primary owner's spouse, discussing the next generation's desires for ownership and participation in the business.
- Another key is attending to other possible hidden relationship issues such as conflicts among family members, important past family events, and loyalty to long-term, non-family managers.

Paul E. White, Ph.D., is a psychologist and director of family coaching for Navitas Ltd. with offices in San Francisco, California, and Jackson, Mississippi. His Web sites are www.navitasltd.com and www.drpaulwhite.com.

Financial advisors and business consultants know that a foundational tool for the successful transfer of a business is the buy-sell agreement. In family-owned businesses, the buy-sell agreement provides the framework for defining how the business ownership will pass from the current senior generation to the succeeding generation. The buy-sell agreement also delineates the terms and values of the business when either an owner wants to sell his or her portion of the business or when some event (such as death or incapacitation of an owner) triggers the need for ownership transfer to occur.

Numerous articles have been written that clearly outline the financial and legal issues that need to be addressed and included in an effective buy-sell agreement (Joy, Koehn, and Klimek 2004). Key issues include the types and triggers of buy-sell agreements according to the nature of the entity (C corporations, S corporations, LLCs, and so on), mechanisms for determining the value of the business, ensuring adequate funding for the purchase of stock or ownership interests, paying attention to tax issues important to both parties, and the process for drafting an agreement (Burgess and Hoekstra 2004).

Any advisor, however, who has been directly involved in the drafting (or implementing) of a buy-sell agreement for a family-owned business will know there is a completely different set of *nonfinancial* issues that can significantly affect the potential success of the process. Just as there are family dynamics and relational issues that complicate the management of a family-owned business (Gersick et al. 1997, Lansberg 1999), there are myriad relational, emotional, and family factors that intertwine with the financial, legal, and business issues in business succession (Carlock and Ward 2001, Hughes 2004).

In fact, most experienced consultants would agree that these nonfinancial issues are often the factors that

determine whether a buy-sell agreement and business succession plan are actually implemented. Unless the business majority owner, family members, and advisors can successfully address the emotional aspects of business succession, reaching a mutually acceptable buy-sell agreement is unlikely. Common issues include the emotional impact of selling the family members' business ownership interest; the interrelated extended family issues across generations; and the perceived impact on family members' lives (both present and future).

As a family coach who deals with the relational issues integrated with transferring businesses across generations, I have repeatedly observed families and business owners reaching an impasse in the process of drafting buy-sell agreements. I also have helped family members cope with the unanticipated results of a poorly conceived buy-sell agreement due to the death of the owner. Such situations can deteriorate into an angry conflict among family members, with resolution only through lawsuits and spending tens of thousands of dollars.

To better understand the various nonfinancial topics that are important to consider and address when developing business ownership succession plans, this article discusses the most critical issues and the common pitfalls that need to be avoided by advisors.

Owner's Goals

To craft an effective business succession plan, the goals of the current majority owner must be clearly defined and articulated. Key questions need to be answered, such as

- Will the proportion of ownership differ for those children involved in managing the business, as opposed to those who are not employed or managers.
- Does the owner want his or her heirs' ownership to be outright or in an entity structure, such as a trust?
- Does the owner want ownership to pass only to "blood relatives" (that is, not go to spouses of their children or grandchildren)?
- Does the owner want the control of the company to remain in the family? Or should it be allowed to pass to non-family managers?

Unfortunately, these issues often are approached solely from a business perspective. Realistically speaking, these issues are not just business decisions. They are also *family* decisions. The answers to these planning questions affect numerous family members—the owner's spouse, their children, daughters-in-law and sons-in-law, ex-spouses, stepchildren, siblings, and extended family members (nieces, nephews, grandchildren.)

In addition to being family-related decisions, the goals to be accomplished in a buy-sell agreement also have tremendous implications for the personal life of the future owner(s):

- What will the future owners' role be in the business and with whom will they be dealing with as co-owners?
- Does the current majority owner want to try to use the ownership of the business to keep the family connected with one another?
- What are the owner's wishes regarding the family selling the business (or their partial ownership in the business)?
- Can ownership interests be given to nonprofit organizations?
- Upon the current owner's death, what legacy do they want to leave behind regarding the future of the company?

In reality, the critical issue is not what the answers are to these questions, but what will be the *process* for obtaining the answers to the questions. That is, does the current majority owner make these decisions on his or her own and inform the family (and other owners)? Or should the owner include others (spouse, children, minority

owners) in the process of creating the initial draft of the business succession plan? If so, whom do they include? Everyone in the family? Their spouse and children only? The in-laws and grandchildren? Note that there is neither a right nor wrong answer to the question of who should be involved. But there are certainly pros and cons to each process, depending on the family situation and dynamics.

The basis for the answers come from deeply held personal beliefs and the values of the owners—both individually and the family collectively (White 1999). And the answers typically are obtained through multiple, in-depth discussions.

Spouse's Goals

A second critical source of information that needs to be consulted is the spouse of the owner(s). If advisors treat the buy-sell agreement solely as a business decision and ignore the owner's spouse, they will frequently run into major difficulties in getting agreement by all parties.

In a meeting, spouses may communicate that they don't care about the specifics of the agreement, and they just want whatever is best for the children and grandchildren. They often are quiet, listening, and pleasant during the discussion.

Although there may not be overt opposition voiced directly by the spouse, telltale signs may begin to appear. The owner may vacillate from their initial position. They may delay in reviewing the document. Or they may say something like, "I need to think about it a while." These may be signs of potential resistance or conflict with the spouse over the conditions of the agreement. Some psychotherapists would cite this pattern as an example of passive-aggressive behavior.

But spouses of business owners often have a different perspective and a different set of goals for the buy-sell agreement than the owner does. They tend to focus more on maintaining harmony among family members than maximizing financial returns. Usually they are especially concerned about fairness—they want to make sure the children and grandchildren are all treated fairly.

Prudent advisors will actively pursue obtaining the spouse's input and addressing his or her concerns. Otherwise, the advisor will most certainly be doing a significant rewrite! (See the sidebar about John and Sarah O'Riley.)

Next Generation's Goals

Frequently, the person at the center of the discussion regarding formulating a business succession plan is the current primary owner. He or she has final decision-making authority, and often is the person who hired the advisor to help develop the business succession plan.

But it is critical that the opinion and perspective of the next generation also be obtained in developing the buy-sell document. It is not uncommon for founders to assume that their family wants to continue to run the business and wants primary ownership of the company. Yet this often is not the case.

Some family members work in the family business from a sense of family duty, while others do so due to a lack of clarity for their career direction. In either case, if given a clear choice (with no secondary consequences of being considered disloyal to the family), many of these individuals would rather receive monetary assets and the freedom to pursue a different life direction. At other times, the family members who are in line to manage the business and receive primary ownership of the company have mixed feelings about the pressures that go with being responsible for the "family jewel." There are expectations to build upon the success of previous generations, as well as the practical reality that their family members have a financial interest in the continued well-being of the company—either by receiving current cash distributions, or from the value of the business if it is

sold.

Frequently, the practical issue of financing the buyout of a current owner is a primary obstacle. Even though the parents want their children to be able to pursue their own dreams, the fact of the matter is that most businesses do not have the liquid capital to buy the ownership interests of the minority owners. So, family members often feel stuck (sometimes with feelings of resentment) until the primary owner dies and funding is available through life insurance proceeds. This obviously can create an uncomfortable dynamic for family members—waiting for a parent to die so they can receive the financial resources to do what they want. (For a case example of family dynamics and how they can affect ownership transfer, see the sidebar, "Pressures for the Next CEO.")

A separate, but related issue occurs when the buy-sell agreement is being written for second or other successive generations. Family members often desire to honor the wishes of the preceding generation or the founders of the company ("Dad would have wanted..."). Having a family discussion with the current generation about these issues will avoid unnecessary conflicts later in the process.

Making things fair for the children (usually meaning an equivalent amount of assets being distributed to each child) is a huge challenge in the planning process. Often there is a desire for the family member who is getting primary ownership of the company to receive some reward (or opportunity for reward) for the risk they are taking in leading the company. Many times the current owner is keenly aware of this issue and advocates for the family member stepping into leadership to receive sufficient reward for the risk and their hard work, but this frequently can be misperceived as favoritism by other family members, especially by those who do not work in the management of the business.

Other Relational Issues

The hidden dragons that devour the best-laid plans of business succession are the relational issues (both past and present) that color individuals' perceptions, feelings, and decision-making. In family-owned businesses, advisors must pay attention to the family issues that are intertwined with the business. The founder, their spouse, their children, and grandchildren will continue to be relatives after the transfer of the business. Add the strong emotional experiences family members have shared (both positive and negative), with the usual presence of grandchildren, and it quickly becomes apparent that in most families the relational issues outweigh financial or business factors in the final decisions of how to structure a buy-sell.

My colleagues and I have found it is best to bring these relational issues out into the open (family therapists describe this process as *making the covert overt*). In fact, educating family members about the complex nonfinancial issues enmeshed in a succession plan is a critical component of the coaching process. When these issues are discussed openly, it becomes acceptable to address them directly (rather than treating them like unexpected secrets).

In addition to family issues, there are other relationship factors that need to be attended to. Often there are long-term employees who are also family friends or who are in positions of management. Founders typically have very strong feelings of loyalty to these individuals and want to make sure these colleagues are treated well. Conversely, sometimes there are long-term managers who have been paid well and the founder believes they have already received sufficient compensation; thus, they should not receive any further financial benefits from the sale of the company.

Multiple Roles

One common challenge in constructing a business succession plan for a family-owned entity is the existence of multiple roles for the various players. The founders typically are the majority owner and decision-makers for the company. Thus, they occupy places on the board of directors (including chairman of the board). Depending on

the life stage of the senior-generation member, he or she may still be the chief executive officer and oversee the operations of the company. Additionally, these members are parents, grandparents, or aunts (or uncles) of employees.

On the other end of the spectrum, you have children and grandchildren who are stockholders (usually minority owners) and who also may sit on the board of directors. Some family members may be on the senior management team, while others work for the company but are not in management or are not connected to the operations of the business at all.

Typically, there are family members with very different financial circumstances—some are doing quite well, others are managing adequately, while some may be struggling. This obviously influences their perception and their focus—the need for cash flow, a desire for the future growth of the company, or just wanting to cash out and get away from the family.

The variations in closeness among siblings (sibling coalitions, for example), favorite children of one of the parents, current conflicts among family members, and consequences of important historical family events (often involving prior generations)—all are examples of relational issues that need to be considered when building the business succession plan (see sidebar).

Two Problem Responses by Advisors

I have observed that there are two responses by advisors when dealing with the challenges of business succession that can result in significant problems.

The first, which is the most common response, is *to try to avoid the relational issues altogether*. Financial advisors and business consultants commonly find themselves in the midst of relational issues among family members. There are certain issues that many advisors may try to avoid—conflicts between family members, topics that are emotionally charged, or decisions that the founder and their spouse can't agree on. Certainly, when it appears that the risks outweigh the potential benefits of raising a contentious topic, wise advisors skirt these issues. Trying to address them can be a "no win" situation.

The problem arises when these issues need to be addressed, but aren't. These disagreements could show up later and create significant difficulties, either in the initial discussions of the buy-sell agreement, or later at implementation.

The second response to complex family issues intertwined with the business is to try *to resolve all of the relational issues*. This approach can be equally disastrous (and sometimes more spectacular) than trying to avoid the issues. Many advisors have experienced the failure of attempting to help families resolve long-standing and deep-seated resentments.

We must keep the real goal in mind. As advisors, we are not going to be able to make everyone get along. And rarely are we going to help families (or their individual members) become healthier and more functional. (As an associate has correctly observed: "All families are dysfunctional. Some are just more dysfunctional than others.") These are unrealistic goals for advisors to attain with most of their clients.

The goal is to address the relational issues that are interfering, or will interfere, with the successful acceptance of a business agreement. Practically speaking, this includes obtaining each affected party's input, making them feel heard and understood, addressing their concerns to the best of your ability, and facilitating clear, direct communication among family members throughout the process. This is still a difficult and sometimes daunting task. And wisdom is required to know what issues to address, which to leave alone, and which to avoid like the plague.

Medical Analogy

In fact, I try to help advisors understand the types of responses that a problem may require by using the analogy of a medical diagnostic model. In medicine, there are some conditions that can be successfully corrected. An example would be an infection that can be treated with an antibiotic. The problem is potentially dangerous, but it also can be resolved completely by proper treatment with medication, and all symptoms will disappear. An example of this type of problem in a family business would be the misunderstanding of the impact of the provisions of the buy-sell agreement on a family member's future. With some progressive education, along with listening to their concerns, these issues usually can be resolved fully. (See sidebar, "Fearful In-Law.")

The second type of illness is one that can be managed. An example would be most cases of diabetes. Diabetes usually cannot be completely cured—typically, it doesn't go away. But through a combination of proper diet, exercise, and medication, a person's blood sugar level can be managed so that the current symptoms are kept to a minimum. Similarly, some relational conflicts in families are manageable. The conflict may be relatively longstanding, but is confined to certain aspects of the family members' relationships (for example, they can't work together cooperatively). Clarifying roles, responsibilities, and decision-making procedures can help manage these family tensions successfully.

The final type of medical disorder is one for which the goal is damage control. Most terminal cancers fall into this category. There are serious forms of cancer for which we currently do not have a cure. Some cancers also cannot be managed effectively, and the person's health will eventually deteriorate. But there are interventions that can slow the growth of the problem and contain the primary damage to specific systems of the body. The most common family example of this type of problem is chemical addiction. The problem may never be fixed, yet not addressing the issue at all can place the survival of the family business at risk. Therefore, steps must be taken to limit the potential for systemic damage by setting up appropriate safeguards.

Five Common Pitfalls to Avoid

There are five traps into which advisors can find themselves drawn when working with business-owner families. Looking out for these snares and taking proactive steps to sidestep them can help advisors bypass much pain and turmoil.

1. **Keeping secrets.** One of the most insidious and potentially damaging traps is that of keeping secrets among family members. Examples of family secrets are current alcohol and drug abuse by a family member, significant marital problems (often with separation or divorce being imminently announced), current legal or financial problems, past marriages or children not acknowledged within the family, and extramarital affairs.

Often the sharing of a secret occurs during an individual interview with a family member and they state, "It is probably important for you to know..." Then, after they have shared the family secret, they say, "But I don't want you to tell anyone that I told you." At that point, you have a major challenge, and sometimes an ethical dilemma.

The best way to avoid getting caught in this trap is to state at the beginning of each meeting with family members that you have a policy of not keeping secrets between family members. Thus, if they share something with you about other family members, it will be considered public knowledge. Sensitive information about themselves would be kept private, although there are times it is important to help the family member share the information with others.

2. **Being pulled into the messenger role.** A second harmful role in which advisors can find themselves is that of a messenger (psychologists describe this as being triangulated). When family members are not

communicating well directly, they often try to use others to communicate. This is especially true when the message is a difficult one to deliver ("Tell them I don't trust them") or a difficult message to receive ("Your brother says that he will never agree to selling his shares in the company to you"). A primary reason family members use messengers is so they can avoid direct confrontation with one another.

The problem with being the messenger is that (a) this communication pattern will continue indefinitely, if allowed; (b) the use of a messenger leads to poor and incomplete communication; (c) talking through a messenger interferes with the flow of communication that needs to occur between the parties; and (d) being the messenger places the advisor in the middle of a conflict in a powerless position. Messengers are just a conduit and have no power. When you become a messenger you are no longer a facilitator or consultant, and you have largely lost your ability to influence the situation.

3. **Hearing only one side of the story.** The maxim, "There are always two sides of the story," is especially true in family business conflicts (and there are often more than two points of view that are important to know about). When a disagreement is based in differences of perspective about a situation, the tendency for advisors is to believe (or want to believe) the family member who hired them. Obviously, this partially has to do with the self-interest of the advisor—not wanting to offend the party who will approve payment for the services provided.

There is an ancient Hebrew proverb that says the first to present an argument always sounds right until his opponent presents his case. It is critical to take the time to meet with all key members in the situation and hear their point of view. And it is important to do so privately. Some advisors seem to feel it is acceptable to meet with some family members individually and then meet with secondary family members (the younger generation or junior managers) in small groups—or even in the presence of the family member with whom they are having a conflict. Obviously, this compromises the ability to obtain an accurate report of all perspectives. It is usually in the best interest of the advisor to go slow in the information-gathering stage; rushing through this stage in order to get started quickly on the design process may lead to missing important and sensitive issues that can create major problems later.

4. **Trying to make everyone feel good.** Obviously, we want the process with our clients to go smoothly and for everyone to get along well. But these desires can lead to behaviors that may sabotage accomplishing the goal of assisting the family in designing, accepting, and implementing a business succession plan. Telling family members what they want to hear or minimizing challenges that need to be addressed helps keep the process smooth at the beginning, but sets up scenarios that are more difficult to resolve later.

Most families do not like conflict and try to avoid it at almost any cost. The advisor must show the courage to lead the family into areas that need to be addressed, demonstrate comfort with leading the family through difficult discussions, and exhibit confidence that the process will work and lead to positive results. As a result, advisors must be comfortable with having family members, business managers, or other advisors not being happy with them at times. And it is often helpful to communicate this to the family. For example, an advisor might say, "There may be times you won't like me or what I am doing. That is okay with me. I just want you to know that I am committed to doing what is best for the family and business as a whole." From a psychological viewpoint, defining roles and responsibilities, and then maintaining appropriate boundaries, is critical for individuals and families to accept responsibility for their choices, and to function in a healthy manner.

5. **Losing sight of the goal: facilitating a business decision.** Many family businesses are fraught with complicated and emotionally charged situations.

Often, family members are desperate for someone to help. When someone outside of the system (the advisor) is willing to listen, appears personally concerned about the well-being of the family, and has the position to influence the family, the advisor can fall into the quagmire of trying to help in areas that are not directly related to the goal of creating an acceptable business succession plan.

It is especially critical for the advisor to keep focused on the goal and clearly delineate the boundaries of the

engagement, especially when there are multiple problems. Additionally, advisors should clarify the limitations of what they can and cannot do for the family ("I can't make your children get along with each other"). Otherwise, family members will transfer the responsibility for the unresolved problem to the advisor.

Conclusion

Business succession plans are a critical component for all businesses, especially family-owned businesses, to have in place. But it's a challenge to create a thorough succession plan, along with a buy-sell agreement, that is acceptable to all owners and involved family members. In addition to the complex legal, financial, and business management issues that need to be addressed, myriad relational and emotional factors complicate the process.

Financial advisors and consultants must be aware of the common nonfinancial issues that are present when developing succession plans. Advisors will be wise to think through the processes and procedures that will help business owners and their families develop a plan that successfully addresses all of the pertinent financial and relational issues.

Successful advisors will take proactive steps to structure the process by (1) gathering information from all relevant parties to the buy-sell agreement, including spouses and children; (2) balancing paying attention to relational issues with keeping focused on those issues directly related to the buy-sell agreement; (3) actively listening to family members' concerns but clarifying the limits of your influence and ability to change others; and (4) leading the family through difficult discussions they need to have, rather than attempting to avoid contentious interactions.

References

- Burrage, T. F. and C. Hoekstra. 2004. "Make the Most of Buy-Sell Agreements." *Journal of Accountancy* October: online.
- Carlock, R. S. and J. L. Ward. 2001. [*Strategic Planning for the Family Business*](#). New York: Palgrave Press.
- Gersick, K. E., J. A. Davis, M. M. Hampton, and I. Lansberg. 1997. [*Generation to Generation: Life Cycles of the Family Business*](#). Boston: Harvard Business School Press.
- Hughes, J. E., Jr. 2004. [*Family Wealth: Keeping It in the Family*](#). New York: Bloomberg Press.
- Joy, D., J. Koehn, and J. Klimek. 2006. "Structuring Corporate Buy-Sell Agreements." *The CPA Journal* (online).
- Lansberg, I. 1999. [*Succeeding Generations*](#). Boston: Harvard Business School Press.
- White, P. E. 1999. Understanding and Dealing with Clients' Emotions in Values-Based Estate Planning." *Journal of Practical Estate Planning* 2: 19–27.

Sidebar #1

Case Example: John and Sarah O'Riley

John O'Riley is a 69-year-old successful businessman. His father had a business delivering wholesale meats to grocery stores. After working with his father for a number of years, John developed new lines of business that were quite successful, and he then bought his father's ownership interests over time. John expanded the business, growing it from a local firm to a regional firm that serves six western states. Currently, two of his four

children work in the company and his two sons would like the opportunity to eventually buy the company from him.

Although there are important tax considerations in developing a buy-sell agreement between John and his sons, equally important are the family issues that are preeminent for his wife, Sarah.

First, Sarah wants to make sure that John can retire in the next three years and that they will have the financial security to do so. Second, she does not want the boys and their families to be financially strapped due to the buyout provisions. Third, she wants the other two children and their families to receive equivalent financial assets, so there will be a sense of fairness to all of the children. If these requirements are not met in the agreement, it is obvious Sarah will be a major obstacle in implementing the buy-sell agreement.

Case Example: Pressures for the Next CEO

Steven Wilson is the heir-apparent in his family's highway construction company. As the key member of the third generation, Steven has been groomed to take over the CEO position upon his father's retirement in the next few years. As a result, the plan is for Steven to obtain the majority of voting stock in the company. He has two siblings, and five cousins who will also own stock. And there are five family members who have mid-level management positions in the company.

Although Steven agrees with the current ownership transfer plan, he is anxious about the pressures he will face from family members in the future. Some have mentioned expectations for cash distributions from the company, while others have expressed interest in employment opportunities for the next generation (Steven's children and their cousins). Additionally, there have been occasional comments from family members about having stockholders' meetings in Hawaii, on a cruise, or while skiing in Aspen.

All of these issues create a sense of anxiety for Steven—becoming the CEO and maintaining the company's profitability, while also managing the expectations of family members.

Sidebar #2

Common Relational Issues That Affect Business Succession Planning

- Multiple roles for individuals
- Different levels of involvement within the business
- Loyalty to long-term employees
- Differing personal financial status among family members
- Favorite children and sibling coalitions
- Relational difficulties among family members
- Historical events that influence current thinking

Case Example: Fearful In-Law

As part of a business-succession advisory team, I helped lead a three-generation family through the process of developing a buy-sell agreement. We facilitated discussions among the senior generation, their children, and the children's spouses to help them design a buy-sell agreement for the family-owned entities. They wanted to achieve the following goals: (1) provide financial security for the senior generation, (2) ensure ongoing family control of the business, and (3) provide financially for family members in the case of death of one of the owners.

During the meetings, there was a fairly intense discussion on a variety of issues, including how to handle transfer

of ownership in the case of divorce. One of the children's spouses, Bill, had just watched one of his sisters go through a nasty divorce. He also had a good friend who had gone through conflicts with their family regarding family business issues. His sister and friend were encouraging him to "be sure you won't get taken advantage of."

After one meeting, Bill called me and told me he had become so upset that he shredded the draft buy-sell agreement and said he was not going to sign it. When we talked, I supported him in taking his time to make sure he understood the document before signing it and that this was wise on his part. He then raised his fears of not wanting to deal with the issue in court, should a divorce ever occur. He also communicated feeling badly about being somewhat suspicious toward the family.

I responded that it is normal for spouses of children (that is, in-laws) to have feelings of insecurity in family business dealings, but I also reminded him of his in-laws' stated intent to want to take care of all of the family members. After an hour-long conversation in which he expressed his concerns to me, he stated he was now ready to sign the document. Later that day he called back and informed me that he felt much better and thanked me for listening to him. Shortly thereafter, the buy-sell agreement was signed by all family members and was eventually implemented.

Web Sites for Further Research

- Family Firm Institute: www.ffi.org
- Family Business Review: www.blackwellpublishing.com/journal.asp?ref=0894-486
- Family Enterprise Publishers: http://www.efamilybusiness.com/fep_home.php
- Harvard Business School: Families in Business program: www.exed.hbs.edu/programs/fib