Privately owned businesses, liquidity and legacy planning

The vast majority of businesses in Europe are privately owned, bringing rise to a wide variety of liquidity and legacy planning issues.

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Family businesses represent around 70% of total businesses across most of Europe. In some countries, such as Finland and Spain, this figure is closer to 85%. The majority of these businesses are owned by the founding generation, and where the ownership has been transferred, it is most often in the hands of the second generation.

There are two main routes that owners of family businesses might contemplate exiting from the business: by selling the business or by transferring it to a future generation.

Business owners or investors in closely held businesses are likely to be concerned that potential family conflicts will impact the longevity of a family business. It is also not unusual for family members to inherit a minority interest in a closely held business that is difficult to manage. Alternatively an owner of a private business may want to maximise proceeds from the sale of a closely held stock.

Transferring ownership to the next generation

Inheritance and succession can be an emotional affair. The senior generation will typically have a different viewpoint to the next generation, and generations also perceive risks and rewards in very different ways. For example, where one influential person has been the sole decision-maker in the business for many years, it does not necessarily follow that the future decision-maker will be one single individual. Where siblings jointly inherit a family business, they often find themselves competing against each other, a practice sometimes encouraged by the senior generation. But although this may seem benign whilst the senior still has a hand in the business, once the next generation is left to its own devices, the competing interests of rival siblings may have disastrous consequences on the value of the business.

It is our experience that many families who transfer the business to future generations have not always put in place an appropriate legal structure or corporate-governance framework to address these risks. Often, the shares in the business are simply handed down to the heirs, leading to potential managerial conflicts further down the road. An additional concern to this type of structure is that the transfer of business assets to a next generation can also be affected by estate or inheritance tax issues that can seriously erode the value of the family's wealth.

Selling the business

Owners, shareholders and partners of closely held businesses know that placing a value on their ownership interests can be complicated. However, a valuation is critical, if an owner wants to sell the business, at the right price, to an outside party, a fellow owner or management.

Last year, the owner of a computer hardware business received an unsolicited offer from a private-equity firm to purchase a majority stake in his company. He had started the venture after college and, over the past decade, the company had grown to more than 100 employees. With his wealth concentrated in the business, he felt that it was a good time to diversify. While the offer seemed attractive, he wanted to make sure that it was the best deal he could get.

Many private banks have special groups which have expertise performing business valuations for a wide variety of companies and purposes, including those most common to privately held business owners. In the case above, our team valued the company at more than twice the offer, and the private-equity firm ultimately paid approximately two and a half times its initial bid for an 80% stake.

Structuring business and special assets

In some circumstances, the owners of family businesses are neither ready to sell nor able to pass the business to a future generation. To mitigate risk, centralise ownership and management of assets or to implement a succession plan, it may be appropriate to form a closely held entity to hold different types of assets.

A service that has traditionally been shunned by banks but that is becoming an increasing part of the business, is managing investments in closely held entities such as corporations, limited-liability companies and partnerships held in agency and fiduciary accounts. Clients who are looking to either sell the business or transfer it to a future generation now expect their bankers to help them with the legal structuring and holding of different specialty assets.

Changes of the legal frameworks in several jurisdictions have allowed banks to reduce their fiduciary responsibility to diversify assets and to offer more in terms of trusteeship for private companies and illiquid assets. It is now not unusual to see the fiduciary departments of large banks taking ownership of farming operations or oil and gas projects on behalf of their clients or as serving on the board of directors of privately held companies.

As an example, an influential Greek client with ties to the shipping industry sought out assistance with a new layered investment in a Greek hotel that had a gaming arm.

We partnered with our tax and legal advisors to design the structure and with our valuation group to manage the underlying assets. Our specialty asset group then visited the client and his professional advisors in order to understand the dynamics of the investment opportunity and ensure open lines of communication to deliver best-in-class fiduciary service.

We analysed various complex transactional and legal documents to assist with the deal, which had an approximate investment value of US$ 40 million and involved several entities and a well known European private-equity company.

All of the investments that transpired from this operation were made through trust and company structures that were managed by J.P. Morgan. Although the active involvement of a bank's internal fiduciary group in an operating business to this extent is unusual, we are noticing more and more demand for this type of service. Still, we would typically only enter into this type of business where we have a significant local presence as a bank and have the ability to effectively assess fiduciary risks

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