The downside of wealth

Selling a business can make a family rich. The newfound fortune brings new possibilities—and new challenges.

BY JAYNE A. PEARL AND RICHARD A. MORRIS

MANY BUSINESS OWNERS (and their heirs) dream that one day they will be able to convert the family's sweat equity into financial equity —i.e., cold cash. But often after a family sells its business, family members encounter some unwelcome side effects. Unless they anticipate and avoid the pitfalls of a sudden "liquidity event," family ties can fray.

Lifestyle 2.0

One of the first and most pivotal issues to be dealt with is the extent to which the new wealth can and should impact the family's lifestyle. It's tempting to trade up to a bigger home in a fancier neighborhood, get that sports car you've always pined for and indulge in exotic vacations.

Some families suppress that urge. They may be concerned that flaunting their fortune could make them the target of a robbery or, worse, a kidnapping. Others fear distant relatives, long-lost friends and dubious charities will approach them with their hands out. Many want to keep their financial circumstances private to prevent the wealth from negatively affecting their children.

It's critical for parents to think and talk through the pros and cons of making dramatic changes to the family's lifestyle. "It's not just about what you tell your kids about money, it's about where and how you live," says Susan Goldenberg, a partner at Chicago law firm Neal, Gerber & Eisenberg LLP. "Even if you can afford to take kids to school in a Rolls-Royce, do you choose to do that?"

It's also essential to consider how spending today may affect the long-term sustainability of the wealth. Parents assume that their fortune will enable the next generation to maintain the lifestyle they become accustomed to as children (which we call "intergenerational equity"). But the parents' spending and investment approach must be taken into account, as well as assumptions about long-term inflation, taxes and investment fees—not to mention the number of children who will eventually share the parents' estate.

How much to spend becomes an intellectual and emotional question. When the family had a business, the amount of money they could extract was limited because funds were needed to run the company. Now that they've converted their company to cash, they think they can spend at any speed they like. If they want to create an intergenerational legacy for their children, they may have a rude awakening: Often, they find that if they want to preserve their fortune for future generations, they must hold their spending to about 1% to 2% of the family's net worth. The calculator at www.kidswealthandconsequences.com allows you to test your assumptions and see how adjusting any of the variables will affect future net worth.

Ann Dugan, of the Institute for Entrepreneurial Excellence in the University of Pittsburgh's Joseph M. Katz Graduate School of Business, notes that families who overspent on "toys" like big houses, boats and airplanes had to face the music after the recent Wall Street meltdown. "They're trying to figure out how to dump things they've accumulated," Dugan says, because they no longer can (or want to) absorb the cost of maintaining those items. "Many are trying to go back to being more entrepreneurial."

Some may decide that instead of reining in spending, they'd prefer to adjust their expectations about intergenerational equity. There's nothing wrong with that choice. But it's important to communicate with your children so they don't base their own decisions—about spending, education and career—on what may be false assumptions. Otherwise, they will be not only surprised (and probably resentful) to learn they're not destined for Easy Street, but also unprepared to support themselves and their own families at anywhere near the level they expected.

Telling the kids

When should children learn that their family is wealthy? "No earlier than their mid-20s; ideally after school or grad school," suggests Goldenberg. Disclosing the information earlier is a bad idea, she advises, "because they haven't left home or experienced the world." Managing their own expenses and connecting with a diverse group of people, she explains, helps young adults mature financially and

emotionally. That will enhance the odds that they will handle their family's wealth responsibly.

Even if parents decide not to tell their children about the family's fortune, the kids are likely to find out—especially if the parents have decided to indulge a few whims. Even if they don't, the news often leaks out. If the media cover the sale of the Smith family business, for instance, the Smiths kids' friends may hear their parents talking about how wealthy the Smiths must be now—and might announce to Sally Smith and all their classmates, "Now your family is really rich."

This is what happened to Jamie Johnson, an heir to the Johnson & Johnson fortune. In his documentary film *Born Rich,* he says when he was in the fourth grade one of his classmates found his father's name on the *Forbes* 400 list of the wealthiest people in America. "The kid read the article aloud to the whole class," Johnson says in the film. "Everyone, including my teacher, ran over to check it all out for themselves. It was strange, all my friends and me finding out at the same time how rich my family was. I felt like I was learning a secret I wasn't supposed to know."

A pre-emptive discussion with children may deflect this problem. This doesn't mean divulging the family's bank balance. But it is important to acknowledge what the kids can expect now that the family business has been sold. One family business owner told his kids, "We are no wealthier today than we were yesterday. The assets of the business are now simply converted to a different asset, which we will invest in other businesses—in the stock market."

Parents should explain the extent to which the newfound wealth will affect the family's lifestyle, and ways it will not. It's also helpful to emphasize any plans to use some of the money to help less fortunate people, and for parents to discuss their feelings about setting aside money so there will be funds left over to help their kids when they start out on their own—and for future generations. Those who want the liquidity event to provide a legacy for the kids, as the business did, can talk about how that money will be invested in the children's education, set aside for family members' entrepreneurial ventures or used to fund a foundation that will carry on some part of the family business legacy.

As part of the discussion, each family member could be asked what he or she believes money should be used for: To live as comfortably as possible? To help others? To afford the best education possible? To provide for a family retreat house or family vacations? Many parents also emphasize that the family is fortunate in ways that have nothing to do with money: We are lucky to be healthy, to have a close family, to have such an interesting history, etc.

Managing entitlement

In a television commercial for a Mazda CX-9 SUV, a little girl sitting in the vehicle's backseat asks her mother, "What does 'spoiled' mean?" The mother's face furrows in concern as she asks, "Why, did somebody call you that?" When the little girl answers, "No. Somebody called *you* that," the mother's face relaxes into a wide grin. The message: It's horrible for our kids to be spoiled, but isn't it grand to spoil ourselves? The problem: If kids see their parents indulging themselves, they will come to want—and, worse, expect—to be spoiled as well.

ILLUSTRATIONS: GARY HOVLAND

Dugan recalls a conversation she had with a client family. The parents, founders of a successful business, had bought new cars for themselves. Their adult children, who worked in the company, complained, "Why can't we get a raise so we can get a new car, too?" The family had never sufficiently discussed expectations related to money, Dugan says. She pointed out to the children that the parents had worked hard to build the company and had never lived a flamboyant lifestyle. If they thought they needed new cars, that doesn't mean everybody should get a new car.

Involving children in family decisions about donations, encouraging them to donate some of their own allowance or gift money to causes they find meaningful, and volunteering as a family will demonstrate that many people are less fortunate than they are.

Redefining the family legacy

The sale of a business that goes back two or more generations can puncture a family's connection to its shared identity and legacy. Lee Stephens, 52, helped his family sell their third-generation resort, The Tides Inn in Irvington, Va., in 2001. After the sale, he and his brother Randy, 44, struggled to get their footing in new careers. Lee returned to practicing law. Randy got into the outboard motor business, but owing to the economic downturn is now seeking yet another career.

The Stephens family has had to adjust to no longer working together, Lee Stephens reports. "We don't see each other as much," he says. "When the family business is sold, you lose that common thing you were working on together."

Parents should explain the extent to which the new wealth will affect the family's day-to-day lifestyle, and ways it will not.

Dirk Jungé, a fourth-generation member of the Pitcairn family, says his family encountered this problem in 1986, when it sold PPG, the company co-founded by their ancestor John Pitcairn in 1883. "We achieved our financial objectives perfectly, but we did not really deal with the emotional impact of the sale: the pride, the family legacy aspect of no longer having an association with the champion [original] company as part of the family's asset structure," says Jungé, who transformed the family office his grandfather and two great-uncles launched in 1923 into a multifamily office, Pitcairn, where he is chairman and CEO.

To achieve tax-free liquidation of Pitcairn's personal holding company, the family shareholders, then more than 300 strong, had to sell 100% of their shares back to the company; family members could not buy shares of PPG for at least six months. After that period, many family members bought shares, says Jungé. "It allowed them emotionally to be connected once again with Great-Grandpa's company."

Of course, it's not so easy to buy back stock in a company that is not publicly traded. Fortunately, there are many ways to retain the family's connection to its business history without possessing its stock certificates. Creating a family office can help family members stay connected in a business—in this case, the business of investing together.

Although there is no substitute for parental lessons, the family office can help next-generation siblings and cousins maintain close family ties—and a sense of stewardship—through shared activities and learning. Financial advisers, consultants or family office executives often help mentor family members and educate them about personal financial management, investing and responsible philanthropy, as well as the family's often complex trusts and holdings. The physical office can be a great place to hang pictures of the legacy business's founders and headquarters and to display artifacts of its products or services.

Family philanthropy can also keep the family connected, as family members discuss shared charitable goals. This could involve managing the money they direct into a family foundation or, less formally, discussing which causes to support and tracking the effectiveness of various non-profit organizations devoted to those causes.

This all hearkens back to the issue of what money is for. If the family business is no longer the centerpiece of the family's legacy, what is? Values? Close family ties? Community involvement? Or an entrepreneurial spirit that inspires next-generation members to create their own wealth? Your family's discussions about these ideas are as important as the answers you come up with.

Jungé notes that liquidity provides flexibility for each family branch to use the assets to meet their own needs. "By the time a family gets to the third generation, the members tend to have large dispersion of interests, needs and capabilities," he says. "Treating everyone equally through a liquidity event allows everyone to have their own financial plans directly, rather than sort of as a pensioner. It can be a very powerful thing for individuals in the next generation to actualize themselves, by having their own dreams start coming out."

Jungé points out that wealth amplifies whatever is positive and whatever is negative in a family. If the family is close, connected and involved in constructive personal, professional and community activities, wealth will enable them to pursue those productive endeavors more effectively. Conversely, if family members are mired in any type of dysfunction—substance abuse, feuds or gambling—wealth will exacerbate those destructive behaviors and tear the family apart. FB

***Jayne A. Pearl**, a member of* Family Business *Magazine's founding staff, is now a freelance writer, editor and speaker.* ***Richard A. Morris** is principal of Resource for Ownership Intelligence (ROI) Consulting and an adjunct professor at Lake Forest Graduate School of Management. They are co-authors of* Kids, Wealth and Consequences: Ensuring a Responsible Financial Future for the Next Generation *(Bloomberg, a Wiley imprint, 2010; www.kidswealthandconsequences.com).*