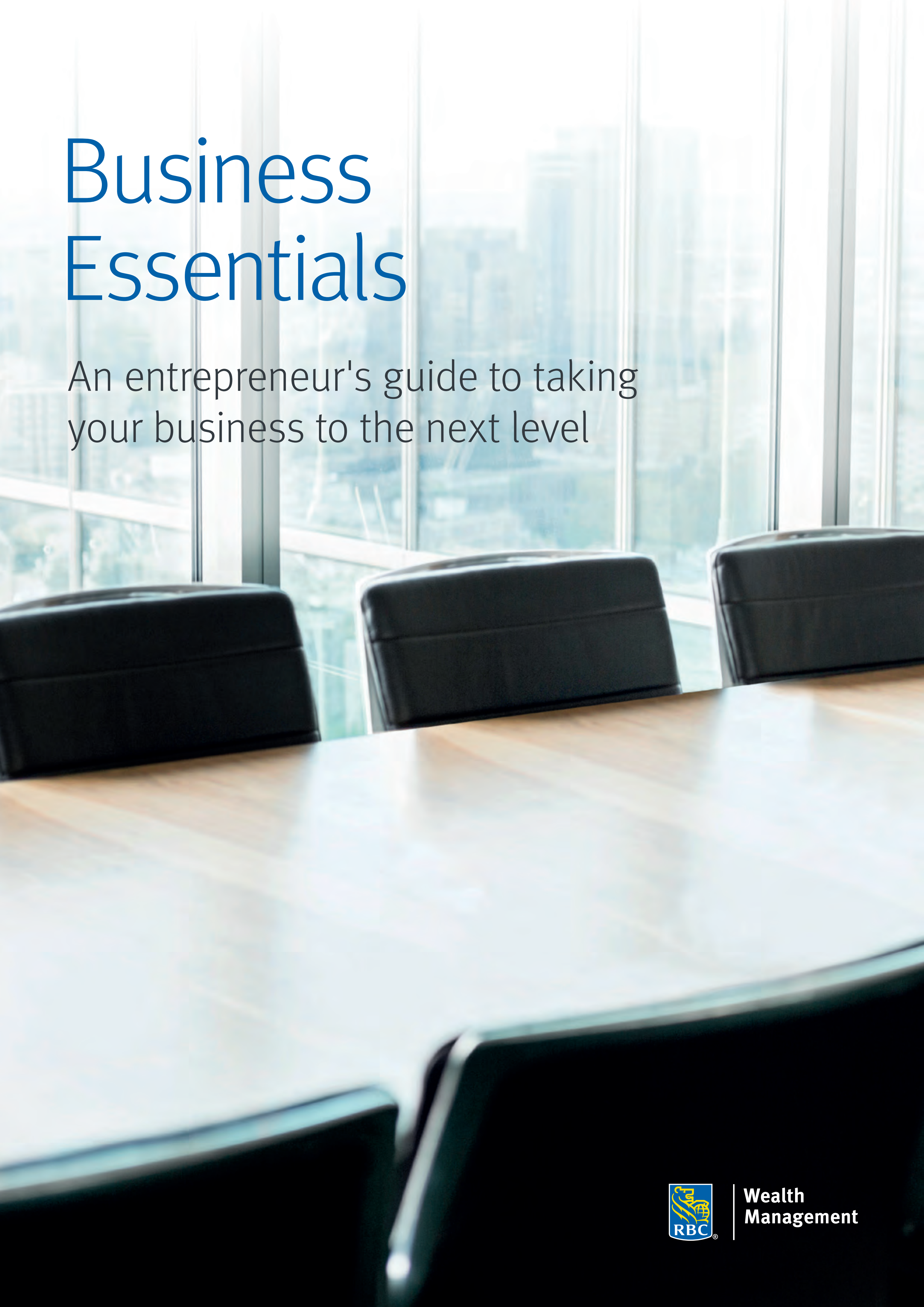
Business Essentials

An entrepreneur's guide to taking your business to the next level



Wealth Management

Contents

RBC Wealth Management is committed to helping you build a goal-based financial plan that reflects what's most important to you. Discover how we can help you grow more than wealth.

Incentivising your employees for the future

Employee share plans – why they can be good for your business.

01

For businesses both new and established, attracting and retaining the most talented employees is important for ongoing success. While competitive salaries might have secured that talent in the past, these days cash is not necessarily king.

Made popular in the U.S. during the 1970s and 1980s, employee share plans have established themselves as an essential tool for most businesses when it comes to recruitment and retention.

"Good news stories in America tend to eventually come over here and in the late 1980s Britain's companies started to put share plans in place at the demand of their employees," says Mark Le Saint, director, RBC corporate employee & executive services (RBC cees), part of RBC Wealth Management.

"In the past, employees were paid a salary and perhaps beyond that didn't really care about anything else, as long as things didn't get so bad that they lost their job," he says. "However, by linking a proportion of an employee's remuneration to how the business performs, a company is aligning the interests of the employees with directors and shareholders."

Aligning your interests with your employees

Deciding to offer a share plan is the first step, the next is finding the most suitable type of plan for your business and for what you are trying to achieve.

There are several types of share plan available to business owners in the UK, such as Company Share Option Plans (CSOP), Enterprise Management Incentives (EMI), Save As You Earn (SAYE) and Share Incentive Plans (SIP), all of which are HMRC approved and carry tax benefits. The right plan for your business will depend on a range of factors, such as the size and age of the company, the type of business, the number of employees and what it is you're trying to achieve by offering the share plan.

"Following discussions with advisers, a plan can be designed specifically for your business, depending on where you are in your growth cycle and what the forecast for the business looks like, among other things," Le Saint says. "Share plans can really align the interests of employees with the other stakeholders in the business. They are sometimes referred to as the 'corporate glue' that binds a company together."

For private companies, an HMRC tax-approved plan such as the EMI Share Option Plan may be an attractive choice. Awards granted under such a plan typically vest on an exit, such as a listing or sale of the business. At this point the value

> *Often, owners of a business have the vast majority of their wealth tied-up in the shares of the company.*
>
> Elanco Kanagasabapathy

of the company and its shares may have risen in value considerably, which could provide a significant financial gain for the plan members. The use of such plans are a particularly popular choice for start-ups or businesses that cannot perhaps offer large salaries or cash bonuses. However, through the use of equity and a share plan, these companies can still attract the talent they require by offering the potential for significant future wealth from the growth in value of company shares.

"Even if it isn't the type of plan where the awards only vest on a key event, such as a listing, awards may be based on individual performance or simply staying employed for a period of time, so employees can build up a shareholding in the business," Le Saint says.

Consider all the outcomes

Of course, there can also be perceived downsides to the decision to implement a share plan within a business, depending on the existing ownership culture and how strong the desire to change that culture is.

Elanco Kanagasabapathy, an associate director for RBC cees in Jersey, says some employees will prefer the certainty of having money to spend today, so offering shares partly in lieu of cash could potentially hinder employee recruitment in some cases. Also, by transferring shares to employees through a share plan, the owners of the business will need to accept a level of dilution and that the shareholder base of the company will grow.

Where a business owner prefers that the equity in the company remains closely held, perhaps within the family unit, providing shares to employees can present a dilemma. However, one potential solution is to create a new class of non-voting shares that are issued to employees through the share plan. While such shares may fully participate in any growth of the company's value, the control of the company remains with the holders of the original class of shares with voting rights.

"Often, owners of a business have the vast majority of their wealth tied-up in the shares of the company," Kanagasabapathy says. "In such situations, an employee share trust can be created to purchase shares from existing shareholders, thereby creating a market and allowing owners to realise cash from their investment." Such shares can then be held in the trust to be used to satisfy awards granted to employees under the rules of a share plan.

"What has become clear is that if you can't offer some form of equity participation to your key employees, then you are potentially not as an attractive proposition as those competitors that do," Le Saint says. "Often when talented people are looking to move or stay, an important consideration is whether there is a share plan in place that allows them to benefit financially, from any future growth in value of the company."

Governance for family businesses

A clear vision of how different generations can work together can help avoid future challenges.

02

Mixing family and business can make for a potentially fractious working relationship. While on the face of it running a business with family means you can benefit from high levels of trust and mutual commitment, this doesn't guarantee there won't be disputes over ownership or profit-sharing. This is why the implementation of clear governance structures is so important.

Setting a clear plan for the business and establishing distinct communication lines to deal with issues such as inheritance, share options and changing family dynamics can go some way to avoiding disruptions.

Oliver Saiman, a relationship manager for RBC Wealth Management in London, says history has shown the majority of family businesses don't survive beyond the third generation.

The foundation that a family business is built on provides the answers to fundamental questions such as the future direction of the business, the strategies that should be followed in order to ensure continued success and how inheritance and shares are handled as and when issues arise.

"Wealth is a highly emotive issue, which can sometimes lead to decisions that cause friction between family members. By introducing a governance framework the principal of a family can help ensure that the family wealth remains protected" he says.

Safeguarding family wealth

There are a number of structures a governance plan can include and it's important that all generations understand the intended direction of the family's wealth.

Some of the most common governance options available to families include the establishment of family offices, family investment companies, family partnerships or trust structures. The right structure largely depends on the individuals and their needs.

"Having governance in place is about safeguarding objectivity and ensuring fairness," Saiman adds.

A Family Investment Company, for example, is simply a UK company set up to hold investment assets where all the shareholders are family members. The benefit for business owners is that they can define who are the shareholders and distribute both voting and non-voting shares to denote control.

However, the most effective family governance should be designed in reference to the specific family and business situation rather than relying

> *Governance should not be created for its own sake, it should be used more as a stepping stone to achieving the family's goals.*
>
> Oliver Saiman

on an "off the shelf" solution, says Gerard Chinniah, a relationship manager at RBC Wealth Management in Jersey

"Governance should not be created for its own sake, it should be used more as a stepping stone to achieving the family's goals, such as keeping the business in the family or meeting certain philanthropic commitments," he says.

Similarly, Ben Taylor, a relationship manager at RBC Wealth Management in London, says that families should aim to keep their governance structures as straightforward as possible. "Keeping it simple is a good first step, making it too complicated with too many boards or committees could end up with the planned changes not actually taking place," he says. "It is important to think about who is on that board, what happens if someone was to die or how the family company or wealth is protected in the case of a family split. Without a governance structure in place, emotions can take over and have a considerable impact on the future wealth of the family."

It's all in the design

A well-designed governance structure will provide a wide range of protections to a family, from setting expectations and succession planning, to preparing the next generation to take over the management of the estate.

It will also ensure the correct level of decision-making within the family business or those managing the family wealth. For example, identifying those who can make decisions on the running of the business on a day-to-day basis and those that are in a position to make more strategic decisions on the future or how the family's wealth should be invested.

Other areas where a governance structure can play an important role include the long-term growth and sustainability of the business or wealth. It can also set out the procedures for family members who don't want to be a part of the business, or who want to remove their portion of assets from the pot, to exit in a fair and harmonious manner.

"One option for families is to explore the idea of setting up a family constitution, which is a written document aiming to codify the broad principles for which the family stands, in addition to the wider aims for the family wealth" Saiman says.

Dealing with disputes

Disputes within a family business, or concerning its wealth, can be costly and run the risk of damaging the future of the business and eroding the family's capital. A governance structure can include a 'dispute resolution process' that has predefined rules to be applied when dealing with certain matters.

This type of provision can be as simple as specifying the procedure for dealing with a dispute, or as detailed as naming the venue or a person – an adviser, non-executive director or family member – that will preside over the process.

It can also be beneficial when dealing with factors outside of the family, such as regulatory changes. By detailing the family's strategic vision and focus through a clear governance structure, the risk of investment decisions being made on an ad-hoc, unfocused and non-cohesive basis is vastly reduced therefore going some way to further protect the family's assets.

Chinniah adds, "It is important that family governance is seen more as an evolution rather than a revolution. There is a limit to the speed of change that families can absorb, so allowing members to adopt the changes and perhaps introduce a regular review of the governance processes in place can help make the implementation easier."

Succession planning for business owners

The right plans can ensure your business lasts longer than your lifetime.

03

Building a successful and thriving business takes a lot of time and a great deal of effort, particularly in the early years. But among all the growth strategies, marketing plans and brand awareness, there is one important piece of the business jigsaw that is often overlooked – a succession plan.

While a business owner may have been the driving force behind their company's achievements, nothing lasts forever. The secret to ensuring your business will continue to be a success after your retirement or death, lies with a well thought out succession plan.

There is no 'one size fits all' solution when it comes to succession planning, as every business's circumstances are different to another. Unfortunately, this often means that no formal plan is put in place and when the time comes for the business to be handed over, complicated situations can arise.

Start early for sustainable success

The key to a successful transfer of a business, or wealth, is to start early and not delay the planning until the point where an exit strategy has to be implemented. Waiting until the last minute could result in rushed decisions and have a fundamental impact on the future of the business.

In its *Wealth Transfer Report 2017*, RBC Wealth Management surveyed 3,105 high net worth individuals in Canada, the U.S. and the UK, asking about financial education and inheritance. The report found that in all three countries, this crucial financial education for the next generation was delayed until they had reached their late 20's.

The reasons for this delay were numerous, from the respondents not feeling prepared enough to discuss their finances or not being comfortable talking about their own death, to them not believing their inheritors were old enough or ready to learn.

The report rightly states, "Whatever the rationale, the late age at which heirs start learning about financial literacy undoubtedly impacts their ability to manage and preserve a lasting legacy."

Why have an exit strategy

The benefit of constructing a succession plan long before it's needed is that you have time to work with who will eventually take over the helm of the company. It provides an opportunity to pass on years of knowledge and instill a similar ethos and vision for the long-term future of the business.

Getting things in order in those early years also helps family-run businesses understand the plans and aspirations the younger generations have. It may come to light, for example, that a child has little interest in taking on the day-to-day running of a family business, a fact the parents may not have been aware of before they started discussing the needs of the business following their retirement or death.

> *One way to strip the emotion out of a succession plan is to consider setting up a trust.*
>
> Katherine Waller

If you are planning to pass on your shares to your children, it is important to seek advice from a tax specialist says Katherine Waller, a relationship manager at RBC Wealth Management in London.

"The current business owners need to be aware that if they are going to be exiting any shareholding, at any point of time, there will be a tax charge associated with doing so," Waller says.

It's not personal

For any business owner that has created a successful company over time, having an emotional interest in its continued success is natural and to be expected.

In order to put a competent succession plan in place, some potentially difficult questions need to be addressed. "There's an emotional value to owning and then gifting away a business," Waller says. "There may also be corporate governance issues that need to be considered, particularly in a family business environment. As the owner you need to consider what your exit will look like, how that leaves the business and also the emotional drain that it could have on the business."

She adds, "For example, you might lose employees because they believed in the previous management team, and that's a silent tax. You're losing part of the value of the business, by virtue of an emotional tie to the management currently in place."

One way to strip the emotion out of a succession plan is to consider setting up a trust, which is a legal relationship in which the trustees manage and administer the transfer of assets from one person or company to another.

Mark Le Saint, a director at RBC corporate employee & executive services (RBC cees), part of RBC Wealth Management, says that business owners need to think about the future of their business and how it will continue to be successful after they retire. "As a company starts to grow, there will come a point where the business owner will realise they can't grow the business by themselves forever and require senior support," he says.

"The challenge for entrepreneurs is whether they keep 100 percent for themselves and risk losing that senior figure expertise, or do they give up, say, 20 percent of equity and potentially be more successful as a result?"

As with any business strategy or plan, it is important not to simply draft it and then forget about it. Succession plans, once put together in the early stages of a business's life, should be regularly revisited to ensure that whoever takes over will continue to build on the success achieved so far.

Start the conversation

For more information about our products and services, please call our relationship management team on **+44-20-7002-2220* (UK) or +44-1534-501111* (Channel Islands)**, or visit our website **rbcwealthmanagement.com**

London
Riverbank House
2 Swan Lane
London
United Kingdom
EC4R 3BF

Jersey
Gaspé House
66-72 Esplanade
St Helier
Jersey
Channel Islands
JE2 3QT

Guernsey
PO Box 48
Canada Court
St. Peter Port
Guernsey
Channel Islands
GY1 3BQ

* Calls may be recorded

Wealth Management

RBC1406/JAN2019