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"Succession Planning for Family Owned Businesses"

Eddy Rogers
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Over the next five years, many of the nation's family owned businesses will change hands. Only 30% of businesses are transferred to a second generation—13% to a third generation. Long-lived, family-dominated corporations are rare. Family dynamics are a key to a successful transition in the management and ownership of a business as owners and managers die, retire or otherwise move on. This transition process is especially difficult for founder-manager-owners. A founder-owner usually is a strong leader with strong opinions. And the owner of a family owned business is no better or worse than any of us in judging the capabilities and limitations of his or her own children in assessing whether to turn over the business to them.

WHY ARE THERE SO FEW SUCCESSION PLANS?

Identity of the Owner's Personality with the Business. Most entrepreneurs do not mentally separate themselves, their personal estates and their businesses. They are one. Moreover, working in the business is often quite connected to the owner's very being; if work was taken away, life would have no meaning. Often the owner has been so wrapped up in the business for so long that he or she has little life outside the business.

Avoidance of Recognition of Mortality. This impediment plagues proper estate planning as well as succession planning. Human nature makes us believe that we will indeed wake up tomorrow and continue on. Most owners believe that they can put off succession planning because succession always seems far off.

Unwillingness to Make Decisions Concerning Succession. Whether family members are involved or not, most owner avoid succession planning because they don't want to make the personal judgments concerning their subordinates that are required in choosing a successor. Besides, choosing a successor is an acknowledgment that there will be a departure at some date. In a family context employment decisions are especially difficult. The very thought of favoring one child over another or of terminating a child's employment is usually traumatic, regardless of the reasons.

Dominant Personality. Many times the person who establishes and leads a business is a dominant or even domineering person. To lose control of the business is not acceptable.

WHERE TO START

A succession plan often begins with estate planning or deliberations involving the sale of the business. Without that motivation, the best way to start the process is to ask the owner the most touchy of questions: What would happen if you died in a plane crash tomorrow? This has actually happened to companies, including Arrow Electronics. It took years for the company to recover.

If the topic of succession comes up in connection with a suggestion that the business be sold, the owner must ask why he or she is selling and what his or her plans will be after selling the business and what he or she would do if there is no further need for the owner's services after the sale--the truth is that 80% of the owners of businesses that are sold leave the business (voluntarily or involuntarily) within 18 months. Some owners are simply burned out and just don't enjoy managing their business any more but have not built a management team that can operate on its own or can't identify a logical successor. The truth is that the owner may be better off not selling, but rather continuing on with his or her business. Deciding to do nothing is an important decision, but in that event, the owner should establish a contingency succession plan.

WHAT DOES THE OWNER WANT TO DO?

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With Himself/Herself. The owner usually does not have a clear idea of what he or she would do if the business was sold and his or her employment terminated. Many owners are reluctant to admit that they enjoy the ego satisfaction and sense of productivity and power that owning the business gives; thus a sale of the business may simply cause stress and unhappiness. If a management transition is planned, the retiring owner must have a clear idea what he or she will do next and must vow to disconnect.

With the Business. This requires some forecasting. A sale is logical in an industry that is expected not to grow or to decline or is confronted with growing capital needs. Perhaps the business is worth quite a bit more with the owner alive and contributing than it would be if the owner died abruptly. The owners need to have a sense whether the business, as an independent unit, will survive the next several decades. Most believe that it is unusual for a business to survive more than about 40 years unless it reinvents itself and evolves to reflect changing markets and economic conditions.

With Management. When confronted by having to analyze whether current managers are capable of stepping up to higher positions, most owners have good judgment, even with their own children. Perhaps, if there are management voids new or replacement executives must be hired. Oddly, most entrepreneurs say that the main problem holding back subordinates from taking over more responsibility is their "lack of experience", not realizing that the entrepreneur's unwillingness or inability to share responsibilities is the cause of the inexperience!

What Can't the Owner Do? Many owners addressing the issues of sale and succession talk in terms of selling the business to be free of the hassle of owning and running a business. Many of these businesses are mature enterprises that could theoretically be placed in a "harvesting" mode, that is, in a mode that the business could be milked for its profits. Associated with this theoretical concept is the owner slowing down and changing his or her role to that of an "elder statesman" with a primarily strategic, non day-to-day role. While these concepts sound fine, most entrepreneurs cannot actually execute such plans because they can't let go and share authority with a strong operational manager, family or not. Besides, most businesses today cannot stay long in a harvest mode because of the competitiveness of business. Like a shark, most businesses must move forward or drown.

KEY SUCCESSION PLAN ISSUES

Control Issues: Who will control the future of the business? Will the future owners get along? Do the future owners share common interests and financial goals? Can the business be split up to allow each set of heirs to have their own business? Can the business be used to launch another business?

Management: Who will actually run the business? Is the surviving spouse capable of running the business? Is the executor? Are the heirs? Will the estate distribution contemplated by the owner simply encourage conflict between the heirs? There are a number of cases on the books with businesses torn apart because this aspect was left unclear when an owner died. Are the heirs really the right ones to run the business?

Ownership: Who will own the business? Will the ownership be pro rata? Does that split encourage strife? Who will be on the board of directors?

Employment: Who is to be employed by the business? Who decides how or whether managers, especially family, are to be controlled by the heirs and how compensation is to be decided? The difficult task of insuring that management does not become entrenched and too well paid is as great a risk as family managers not being paid at normal levels. If a number of siblings own a business, some common understanding must be fashioned to insure that the family members working in the business are fairly compensated (it is the author's experience that such employees are paid less than market). Should there be employment contracts?

Cash: Who gets the money? What are the cash needs of the heirs, especially any surviving spouse? Do these needs conflict with the financial needs of the business? Do they conflict with the owner's long-term desires (the owner may not want his or her heirs or his or her spouse's second husband or wife to be receiving a stream of income)?

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SUCCESSION PLANS.

The Letter of Direction. Most business owners begin with a simple letter of direction describing what he or she wants to happen in the event of death or disability. The letter of direction is purposefully made as a non-binding letter of direction in order to insure that the owner's wishes are known but do not bind survivors. Oft times opinions change about what should be done in the event of the owner's death; the author's experience is that such letters of direction change materially every couple of years. This letter, though simple in most cases, is certainly better than nothing and gives critical direction to executors and surviving family members.

The Formal Succession Plan. A formal plan, of course, is best. A formal succession plan should be a part of an overall long-term strategic plan for the business and must involve the owner's discussing the elements of the plan with family members and any key non-family managers so that if something happens to the owner, the plan can be quickly implemented with little controversy. The theory, at least, is that if the succession plan is adopted and agreed to and communicated to all critical parties, it will in fact be implemented. Problems can be discussed as a part of the planning process. Dates can be discussed and set for the owner to leave active management. Thorny issues, such as each person's place in the business organization after the owner's departure, involve the assessment by multiple parties of the capabilities of management, and consultants can help assess each person's true capabilities and what each person is thought of by the owner and other members of management. The owner may believe that certain family members are not "ready for prime time"; in that event it is better to institute mentoring programs or whatever else is needed to bring the skill and experience levels of the chosen successors up to par.

Sell the Business. This is the ultimate succession plan; lack of management succession structure is the reason most small businesses are sold. But this is the topic of another article!