

Preparing for Family Business Transitions

Achieving the Vision for the Business and Family

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The Family Business Transition Landscape—You Are Not Alone!

Most families of wealth create their wealth through private business enterprise. In fact, studies have shown that 65 percent of households with at least \$25 million in investable assets are business owners.¹

Moreover, owners of family businesses are aging. A recent survey suggests that approximately 60 percent of all business owners are over age 55 and nearly one-third are over age 65.² Another survey suggests that 51 percent of business owners intend to transition the ownership of their business during the next ten years, with about half intending to sell their business to an independent third party, and the other half intending to transfer the business to insiders, such as family members, employees or management.³

Whether you are contemplating selling the business one day to a third-party buyer or moving the business down to the next generation, there are several important family business best practices that family business owners should consider institutionalizing well in advance of the eventual business transition. Some best practices relate more to the finances of the business, while others are interpersonal family issues, but all are critical to the stewardship of the legacy you have worked so hard to create.

This white paper draws on years of applied research and professional practice in family business transition planning to discuss the key elements and best practices that can help increase your odds of a successful family business transition.

The Challenges of Transition

Over many decades, studies have consistently shown that families have roughly a one in three likelihood of successfully transitioning their business from one generation to the next, regardless of country, culture, industry, or economic environment.⁴ Cultural proverbs like “shirtsleeves to shirtsleeves in three generations” from the U.S., or “rice paddy to rice paddy in three generations” from China, or “clogs to clogs in three generations” from England, further underscore society’s general recognition that the likelihood of successfully navigating intergenerational transitions of wealth for owners is relatively low.

The first step to overcoming this alarming failure rate is understanding why transitions of wealth fail. The reasons for failure may be very different than conventional wisdom would offer. A study conducted by Roy Williams and Vic Preisser helps to shed light on this question; Williams and Preisser studied 3,500 families of wealth over a 20-year period to identify what differentiated those families who successfully navigated intergenerational transitions, versus those families who had not.⁵

Williams and Preisser identified four factors that most often lead to failed transitions. While the study focused on transitions of family wealth generally,⁶ these four identified factors are particularly instructive and no less relevant when applied to family businesses:

- Breakdown of communication and of trust within the family unit (60 percent of failures)
- Inadequately prepared heirs (25 percent of failures)
- Absence of a clear vision or mission to align family members (12 percent of failures)
- Failure by professional advisors to correctly interpret (or anticipate) taxation, governance, and wealth preservation issues (less than 3 percent of failures)

While understanding why transitions fail is important, identifying the best practices of families who have successfully navigated a major wealth transition is equally important, particularly if family business owners would like to increase the odds of a successful business transition in a material way.

Increasing the Probability of a Successful Transition

In the family business context, families who have successfully navigated major wealth transitions tend to share a set of eight identifiable best practices in common, including the following:

- They started their transition planning early.
- They articulated a clear vision to family, employees and key stakeholders.
- They formalized a succession plan as part of a larger business plan.
- They worked to prepare the next generation.
- They communicated the plan to the extended family.

- They anticipated and purposely addressed where potential conflict might arise as a result of executing the plan.
- They built an experienced transition management team.
- They developed a written business succession plan with an implementation timetable.

Plan Early

Many professionals recommend putting a business succession plan in place at least three to five years ahead of a planned business transition. Some business advisors even recommend that an exit strategy be built right into the business plan. A good first step is for everyone to recognize the value of early business transition planning.

Articulate a Clear Vision

Business owners and entrepreneurs are typically independent and strong leaders. They have a dream for where they'd like to see their business go and are regularly making decisions that they feel will get them there. Other family members, however, may not be aware of this vision, which can breed misunderstandings, disagreements, and even resentment when things seem to be going in a direction that they don't understand.

The success of any business is dependent on all stakeholders (owners, managers and employees) having a clear understanding of the organization's goals. A significant difference for a family business is the addition of family members as yet another group of stakeholders. When family members also understand how the future will look, everyone can work together to help realize the future vision.

Before a vision can be shared, it needs to be more fully developed. It's easy to get busy with the day-to-day aspects of running a business, but it is essential to make time, often with the assistance of a good business advisor, to turn the "dream" into a practical written plan that outlines the future of the business. With the confidence that comes from having a strong plan in place, the business owner can then share that plan with employees, both family and non-family members, so that everyone is on board.

Vision is a long-term concept that focuses on where the business hopes to be in the future. Family business owners may expand this focus to include consideration of their future goals for the family. A clearly articulated vision provides guidance for the organization and the family over the long term. Vision statements often directly reflect deeply held core values, such as honesty, integrity, social responsibility, and the importance of family. They focus on what is really important, emphasize the future, and can be a unity building instrument to help families start the process of business succession planning.

It is critical to discover the expectations of all family business stakeholders during the visioning process. This reduces the risk of incorrect assumptions, increases cooperation in creating the plan, and helps to reduce conflict. This ultimately results in a better plan. Once in place, a clearly articulated vision statement can boost feelings of engagement and satisfaction among family business stakeholders, increasing the likelihood that family members can work together effectively to make important decisions about the future of the business and management of the family's wealth.

Formalize a Succession Plan as Part of Your Business Plan

Your succession and transition plans should be part of your formal business plan as well. Like business planning, succession planning often gets placed on the back burner, subordinated to the daily activities of running a business. This is sometimes due to the complex emotional issues that are involved in transitions. Founders often struggle with such issues as feeling they have to leave the business or be replaced, perhaps precisely when they don't want to leave, fear that duties and responsibilities won't be fulfilled and improper decisions will be made, which often manifests itself as a desire to retain control, and deciding who is the right person to lead the business into the future.

Founders often approach succession planning by searching for an "heir apparent," seeking to find the one person who can do everything the founder does to replace him or her. Unfortunately, there is rarely one person who can successfully step into the shoes of the founder, and often multiple people want to be involved—or even need to be involved—in order to do what the founder does. In these cases, founders need to replace themselves with a governance system that can involve multiple people fulfilling different roles and responsibilities, all working together within an integrated framework.

To start forming a succession plan, begin by defining your succession goals:

- What does a successful succession look like?
- Does it look like a completed sale to a third party strategic or financial buyer, to employees, or a transfer or sale within the family?
- Think about the different roles you hold within the family and business system (i.e., as a parent, a spouse, an owner, a manager, and/or a board member), and identify what you do in each of these categories (i.e., what specific tasks, duties, and responsibilities do you perform as an owner, a board member, a manager). Which of those functions are critical to a successful transition?⁷

You have probably never thought of yourself as having different roles before, and it is quite common for founders to struggle with identifying their duties and responsibilities as a role, particularly the role of an owner and board member. Identify the tasks within each role that you would like to transition, then seek to begin to identify who could succeed you in each of those areas. Which family members and/or employees have expressed interest? Do they have the necessary expertise needed to fill the role, and if not, what can be done to provide that education?

Children who are not involved in the business will often seek ways to become involved later, whether constructive or not. Future conflict can be prevented by helping each child understand how they will be involved, the duties and responsibilities of their role, and how their role fits into the system. Think about how those roles would work together if multiple people were to be involved, and how decisions would be made if no one person were to decide. An experienced business succession advisor can help you to understand how such a system would work and walk you through the succession planning process to develop a transition plan and facilitate its implementation.⁸

Prepare the Next Generation

Successful family wealth transitions, including family business transitions, are often backed by comprehensive and workable plans for helping next generation family members to become responsible, educated, competent and confident with regard to essential wealth matters. This includes consideration of how to create and implement ongoing and developmentally appropriate strategies for building financial literacy, imparting experiential knowledge, and fostering self-confidence with regard to money matters, three foundational aspects of becoming successful stewards of wealth.

For family business leaders, this work often includes envisioning the future roles their children may inherit or wish to fulfill with regard to family business interests, and then creating experiential educational plans to support their success. At other times this work may include thinking through how wealth can best be positioned to enable the next generation to flourish, regardless of their particular life's journey. Reflections of this kind often lead to added clarity for families about how to best prepare family members to succeed along specific developmental pathways.

The above comprehensive assessment process is also especially helpful to family businesses wishing to ensure that family wills, trusts, and other key wealth transfer documents make determinations about asset distributions based on heir readiness, as opposed to determinations based simply on the timing of a family business transition, an heir's birth order, age, or other developmental milestones, including getting married or having a child.

Communicate with the Family

There's no sense in keeping secrets about what's going to be done with the business. In fact, springing business transition plans on your family after everything is in place may well create discord. An open discussion with family members may help to reveal concerns or conflicts that could be addressed ahead of time. Parents, in particular, do well to express their feelings and intentions to their children early, in part to set realistic expectations.

For many family members, the business becomes part of their identity. Some may feel tied to the business because it is their only work experience. Others believe the business is a birthright, the place where they belong. Family members who are not involved in the business may feel left out and may not understand why certain decisions are made. And don't forget the spouses of family members, who may or may not be involved in the business, but may be uncomfortable with the way the business dominates the family and impacts relationships.

Families working together to achieve a company's vision become a very strong team. Make sure everyone has some level of understanding and appreciation for the business, and that they're given a forum to share their perspectives and learn the facts about what's going on in the business. Openness builds trust, which was one of the primary failure factors identified by Williams and Preisser. Put structures in place, like regular family meetings and periodic financial reporting so everyone has access to objective data about the business, an opportunity to share their thoughts, and the assurance that their opinions will be heard and considered.

Very often a transitioning founder's chief concern is how to orchestrate the conveyance of a successful business while, at the same time, keeping peace in the family. Although every business and family is unique, there are a few typical situations that can affect the smooth transition of the family enterprise. One such situation can be best referred to as the "fair vs. equal" conundrum. Typically, a problem arises when the talent and hard work of one or more children have been instrumental to the success of the business; an equal division of ownership among all children, then, may not sit well with those who have contributed to the success of the business in very direct ways. Any other division may be viewed as unfair by the remainder of the offspring. An objective valuation of the company is often necessary to ensure that family members are treated fairly, even if not equally.

Another consideration concerns the role that extended family members may play in the future of the business. What happens if there is relative harmony among the founder's children but, subsequent to the transfer of the business, one of them dies? If some degree of control over the family business has the potential to pass to a brother- or sister-in-law in the future, this needs to be clearly communicated and discussed, if only to ensure that family members are fully aware of how comprehensive planning now may position the family and the business in the future.

Communicating effectively about wealth matters has proven to be a significant best practice in the successful multigenerational transition of wealth. A starting point for many families involves assessing to what extent family members communicate about family wealth matters, including how often, how much, and how broadly, and then outlining the potential costs and benefits of current family wealth communications. This communication cost-benefit analysis should ideally include a review of strengths, challenges, and opportunities with regard to family level communications about wealth. This process almost always helps families to gain clarity about actions they might consider to enhance family wealth communications. Typical actions might include choosing to share more information about the family's assets with next generation family members, previewing important wealth planning decisions that are under consideration, or bringing the family together for a formal meeting to discuss wealth matters.

Depending on the family's current priorities and interests, this process can be expanded to include comprehensive planning in support of family wealth communication goals. This intentional communication planning work is always beneficial to families of significant wealth. This work also positions families well for managing major wealth transitions, such as family business transitions, that may require special planning around communication. Typically, family wealth communication plans include a collection of key messages that family leaders wish to impart, and a clear process and timeline for communicating key messages to intended audiences. It is also helpful to periodically evaluate communication plans for timeliness and effectiveness.

In some cases, families may choose to utilize outside communication consultants to facilitate family meetings where complex wealth planning considerations, including sensitive topics, may need to be discussed.

Anticipate and Address Conflict

It is not uncommon for family dynamics to spill over into the business day. As a result, conflict is not always handled in a professional manner (or is avoided altogether), resulting in misunderstandings, hurt or anger. While conflict itself is not a bad thing (and may at times result in better decision making), it's important to learn appropriate strategies for handling conflict, so that it doesn't become a negative force. Some families choose to bring in a trained facilitator who can provide insight into how to conduct family meetings effectively, ensuring that everyone has the opportunity to contribute their point of view. Good communication leads to open decision making and builds trust.

Outside of formal meetings, strategies like establishing and sticking to clear policies and procedures can help avoid the appearance of favoritism or nepotism. Creating formal job descriptions for all employees can help everyone understand one another's responsibilities and authority levels. The formal succession plan described above can help to reduce friction by allowing all involved to understand how the business will be governed long term.

It is helpful to be clear on how the goals of different generations of the family may differ when it comes to succession planning, which is a common concern for families in business together. Founding or more senior generations may have concerns about entrusting the business they have built and managed to younger generations and ensuring they have enough income to support these generations for the rest of their lives. Senior generations may have other concerns, such as treating all of their children fairly, whether or not that also includes treating them equally. This issue may be particularly prominent for families with children who have not been directly involved in the family business or contributed in only a small way. Finally, lifestyle issues such as health care, living arrangements, and preserving the legacy of the family business are common concerns among founding and senior-generation family business owners.

In contrast, younger-generation family members are often primarily concerned about revitalizing the family business beyond its current state. They may have questions about whether the business is able to support both generations at the same time. They may, often correctly, point out that significant changes to the operation may be necessary for it to run successfully going forward. Younger family members may also express concerns over whether they will truly have input into important decisions after the transition, or significant managerial freedom and authority to implement new ideas or make significant changes to the operation. These questions must be answered in the course of the business transition planning process.

Differing goals and competing priorities can lead to conflict between family members. If these issues are not discussed in a calm, clear, and open manner, difficulties can arise. The best solution is usually to find ways to involve all parties, including spouses, children, and non-business family members in a process that allows for honest communication, instilling everyone with the sense that they are contributing to a succession plan that works for all concerned. While this approach requires more time and energy, families often find that transition planning goes much more smoothly as a result. Working through conflict helps families to move forward with their succession planning goals, while also modeling the importance of conflict resolution to younger generations.

Build an Experienced Transition Management Team

A succession plan demands expertise in several professional disciplines. Attorneys, accountants, bankers, financial and insurance advisors, and multigenerational wealth planners all can provide useful planning insights, but business owners do well to choose business advisors who can provide guidance that goes beyond tax and financial planning.

While there are many tax and financial implications when business ownership, assets, and wealth are transferred, selecting experienced advisors to provide guidance in these areas is critical. It's important to select advisors who have worked with family-owned businesses in the past, and who have experience in succession planning, family business transitions, and navigating family dynamics. Their ability to understand and provide guidance relating to both the financial and emotional aspects of the business transaction is often invaluable.

Develop a Written Plan and Timetable to Execute It

It is critical to make a written plan with clearly defined objectives and goals and a timetable for implementing each phase of the succession process. Objectives and goals should be specific enough to describe conditions the family hopes to achieve at various time intervals, not only for the business but for the family. Each objective in the family business transition plan should be accompanied by a set of actionable steps that can be taken to achieve the objective, either partially or fully. It is of critical importance that action planning includes clearly identified "owners" who are responsible for ensuring that plans are successfully executed. It is no less important for families to be clear on the criteria they will use to evaluate the success of action plans, including the timetables that should be followed to ensure that progress is made in implementing the business succession plan.

Clearly defined written goals are essential for a serious transition plan, as they provide a solid framework for achieving the vision of the family and the organization. Moreover, a transition plan is not something that is written once, filed away in a drawer, and forgotten until it is needed. Given the evolving nature of the business itself, the family's dynamics and the financial and legal landscape, family business transition plans are project plans that are constantly evolving and should be regularly revisited, evaluated, and updated as necessary.

Summary

It's clear that early planning, a shared vision, clear communication, a formal succession plan, strong conflict resolution commitments, experienced business advisors, and a plan that is actionable and measurable are important to the success of any transition.

For family-owned businesses, however, where personal relationships are entwined with the success of the business, the stakes are even higher. When possible, these eight best practices should be followed by every family-owned business, with the assistance of outside advisors or facilitators where appropriate. Implementing these practices today increases your chances for long-term success, creating a legacy for both your family and your family business for generations to come.

Endnotes

- ¹ VIP Forum: "'Building Business Owner Loyalty" 2010
- ² Laird Norton Tyee Family Business Survey, Family to Family 2007
- ³ Price Waterhouse Coopers, "Trendsetter Barometer"
- ⁴ Joseph Astrachan, Ph.D., Editor, *Family Business Review 1999*
- ⁵ Roy Williams and Vic Preisser, *Preparing Heirs* (San Francisco, Robert D. Reed Publishers, 2003)
- ⁶ The Williams and Preisser study is not solely based on owners of family businesses, but its findings are material to most family business transitions.
- ⁷ For example, if selling to a third party buyer, focusing on management roles may be more important to ensuring a successful outcome than focusing on ownership.
- ⁸ For additional background information on governance systems, see *The Balance Point*.

Disclosures

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