THE FAMILY BUSINESS CONSULTING GROUP

Family Business Succession: 15 Guidelines

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Succession is the most painful and critical time for family businesses. Less than one-third of family businesses survive into the second generation, and only about 13 percent make it into the third generation.

How do the successful ones make it? After working with hundreds of family businesses, we'd like to offer 15 guidelines that we hope will help you during the succession process.

1. Succession is a process, not an event.

Rather than thinking of succession as an event that happens on a designated day, consider thinking of it as a process that occurs over a long period of time.

Parents lay the groundwork for succession while their children are still small. How? By the way in which they talk about the business at home.

As the classic story goes, the business owner comes home from a typical day at the shop and complains that three key people quit, a customer didn't pay his bill, the suppliers sent the wrong order again, and the bank is threatening to jerk the loan. Then, he turns to his son or daughter and says, "Someday, this will all be yours."

Of course the truth of the matter is that most people who are in business for themselves love it, or they wouldn't be doing it. However, the tendency is to talk more about the bad events than the good ones. Making a conscious effort to present a balanced perspective on the family business can help the next generation gain a better understanding and appreciation for the business.

2. Present the business as an option, not an obligation.

Many, many parents hope that their children will want to follow in their footsteps and join the family business. But some fall into the trap of over-selling the need to follow the family tradition. Others never bring up the subject because they don't want to pressure their children. The key is to present it as an opportunity, not as an obligation.

How? We encourage parents to tell 15- or 16-year-old children, "Whatever you choose to do with your life, we will support and we will encourage you. It's probably too soon for you to know now what you want to do. If you should be interested in the family business, you will be very welcome. We have found it to be very rewarding and very fulfilling, but it's clearly not the easiest way to live or the only way to live. It's one of your many options. We will support and encourage you no matter what you decide."

That's a conversation that rarely, if ever, takes place in a family business. But we think it's very important to extend a non-conditional offer of support during the child's high school years because it is very healthy for the son or daughter to think in terms of options. Speaking of sons and daughters, beware of making assumptions on the basis of your children's sex. In terms of interest and capabilities, both sons and daughters can contribute to your firm's success.

3. Get outside experience.

Of the hundreds and hundreds of family business successors we've interviewed, all of the people who have had outside experience said that they recommend it highly.

Why should your child work for someone else after finishing school? There are many good reasons why the outside work experience is an advantage. Your sons or daughters can build their own identity, get outside knowledge, increase their self-confidence, bring back knowledge to the business, grow up a little bit, make mistakes on someone else's time, find out what it is like to look for a job, discover what their market value is and learn how to take criticism. But the best reason is that this is how they will learn that the grass isn't greener on the other side of the fence. They will learn that there is no such thing as a perfect boss or a perfect business. If we can make only one recommendation to young people, it is to work for someone else for three to five years.

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But what if that isn't possible? What if the daughter is 32 years old and is now vice-president of marketing? Or, what if the business is small and they need a family member on sweat-equity just to survive? Then we try to find out other ways for that son or daughter to get the same sense of reality and outside perspective. Sometimes that means getting involved with their trade association or with other sons or daughters of another family business or with a community service group.

For many parents, however, it's hard to believe that their children will want to come back after working somewhere else. But the odds are better than two to one that they will come back, because magnetism to the family business generally increases with age.

Two Warning Signals

Succession is not easy for anyone, but there are two warning signals that may indicate that the founder is going to have an especially difficult time.

Lack of other interests: Does the founder, by age 55, restlessly pursue other interests? If he or she does, it's like saying, "I can't wait to get out of here! There's something I want to do that I don't have enough time to do! Get ready, kids!" If, however, by age 55, the founder is still working 70 hours a week, and says, "Sure, I'm looking forward to retirement. Maybe then I'll have some time for the garden," we never believe it.

Genealogy of letting go: What did the founder's parents do when they retired? If the parents traveled to Europe and generally had a wonderful time, you can predict that the founder has a good chance of having a positive outlook on retirement. If, however, the founder's parents died the week after they retired, or moved into a nursing home, or just never stopped interfering with their adult children's lives, you can predict that the founder has a negative view and may resist retirement.

4. Hire into an existing job.

It's very important to hire your son or daughter into an existing, meaningful, defined job. Why? You will know how much to pay and what to expect. The rest of your staff will know how your child fits into the office hierarchy and how to treat him or her.

But very, very often family businesses hire their children into ill-defined jobs and say, "Because you're family, you can do anything that needs to be done around here. We wear a lot of hats and now you do, too." But then you open the door to resentment on the part of the rest of the staff. Sometimes, employees doubt that the second generation is qualified to lead the company. Don't set your son or daughter up for failure by giving him or her an overwhelming but undefined job. Create a situation where progress can be measured.

5. Encourage the development of complementary skills.

After the next generation has entered the business, encourage the development of skills that are complementary to your own. Why? Your own skills are probably well-ingrained in the business by now. If the parents are super salespeople, then the children are going to need to bring some operations or information system skills to the business. If the parent generation is "make it and invent it," then the next generation is probably going to have to know what the terms "market segmentation" and "break even analysis" mean.

Is it easy to accept the fact that your child can improve or add to your business? No. You have to be very secure person to be open to this type of action from your own child. But consider the alternative: is your business better off having a second generation who brings nothing and can only try to duplicate everything you have done?

There is a cartoon that shows a son saying, "Dad, sales are up 200 percent, production costs are down, and we're on the cover of *Business Week*." The father says, "Yes, and your shoelace is untied." It's hard to recognize and praise our children's professional achievements.

6. Teach the foundations

One of the most valuable things the parent generation can give the next generation is an understanding of the historic, cultural and strategic foundations of the business. It's very useful for the children to be aware of the firm's underpinnings — of the underlying principles that hold the enterprise together.

Even though you, the business founder, have lived the business, you may not be able to take a step back and identify your strategies. You may be too close to it all. If that is the case, let your child learn from a key employee who is able to explain why you do the things you do, as well as how you do the things you do. For example, instead of just showing your son or daughter how to treat your customers, the key employee will explain how the customer service policy evolved and what and what advantages the current policy has.

7. Start with mentors.

We always recommend that when the children enter the business, they should work for a mentor rather than with the parent. The mentor should be the most valuable, the most loyal, most secure, most long-lasting employee. That person should be your alter-ego, the one who does all of the things that you don't like to do.

When you set this arrangement up, you should have a conversation with the mentor that goes something like this: "I would like Karen to work with you because she can learn a lot from you. But I know what will happen in three to five years. You two will clash. It won't be anybody's fault — it's just inevitable that she will want to do something on her own. The moment that happens, the mentoring relationship will end, and I will move her into the next step of the plan that I have in mind for her." It's very important to clarify all of this and set it up right from the start.

We would like to add a word of caution here. Even if you have always made it clear that you intend to keep your business in the family, you may have an employee who believes that he or she is better and more qualified and rightfully deserves the opportunity to lead the company. Could it be that the employee may attempt to undermine your successor's efforts? Be aware that this possibility exists. Be clear, keep your eyes open, and don't let an unpleasant situation build up. You may have to offer the employee two options: recognize the successor's role, or leave the company.

Case history:

The Robert Worth story

Robert Worth is the second-generation CEO of the Worth Company, a business that manufactures fishing tackle, marine accessories and parts for other manufacturers in Stevens Point, Wisconsin, and employs about 75 people. Here is his story:

My father started the company in 1940. I took over in 1959, and now the third generation, my son David, has been running the company for the last three years. It was my son's decision to come into the business. I never pressed him. As a matter of fact, when we talked about it while he was in high school, I told him that he might not be able to come into the company because my partner made it clear that he thought that our sons should not join the business. My partner and I did have a buy and sell agreement, which was fortunate because he died of a heart attack while my son was in college. When that happened, my son said, "Does this make a difference now, Dad?" When I asked him what he meant, he said, "Would it be possible for me to come into the business?" I said, "You just asked a question that I wanted to be able to say 'yes' to for a number of years."

I set up an apprenticeship program where he spent time in every department of the plant so he could learn about it. Whoever was running that department was his boss.

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When he first came to work, I said, "We'd better have a buy and sell agreement in case something happens to me before you're ready to take over." We did negotiate that, when a pre-determined stage was reached, I would sign a purchase agreement whereupon the stock was placed in escrow. A price was placed on the stock. The date was his 35th birthday, which was my 57th birthday. When he became 35, he was the CEO of the company, and the fifteen-year buyout agreement went into effect. Everyone in the company knew about the arrangement that we had made.

The buy out will take care of my wife and me very well for the next 12 years, at which time I will be 70. At that time, I'll take out my profitsharing. So I really don't have any financial worries.

I'm still the Chairman of the Board, and I represent our company at our association functions. Sometimes he gives me a special project and I follow through on it. But he is running the company, and he's doing a very good job of it. I make no suggestions. I make no comments. Believe me, there are times when I have to make fists in my pockets. But to his credit, his ideas normally turn out better than they would have if I had opened my mouth.

When people ask me why I had the foresight to set up a 15-year buy-out, I tell them that my dad died when I was 29. I didn't want my son to go through what I went through. And I knew that I wanted to set a time when I would turn the business completely over to David because I often dreamed that my father had come back into the business and it frightened me. Besides, I had a lot of other interests that I wanted to pursue when I was 57.

I also have two daughters, the oldest of whom is ten years younger than David. My wife and I decided, right or wrong, that the company would be David's, and that we would take care of the others by educating them at any institution they wanted. Our daughters are also taken care of in our will. We believe we did the right thing.

One last note: over the years we have benefited from the advice of our advisory board. My banker, my attorney, my CPA, another manufacturer and I got together every quarter to discuss the business. I gave them a small honorarium, which didn't cover their hourly rates, but they were very willing to help out anyhow. It was very helpful to the company over the years.

8. Designate an area of responsibility.

What is the next step of your plan? Give your son or daughter his or her own area of responsibility. It should be well-defined. It could be a certain department. It could be handling the advertising. It could be doing personnel. As your child gains in experience and competency, increase the number of areas of responsibility. By giving pieces of the business, you will be working toward a smooth succession.

The model that we encourage you to have in mind when you think about succession is the track relay race. One runner has the baton, and the other runner has to catch up, take the baton, and continue the race. Your business will pass to the next generation much more smoothly if that second generation is running at full speed right next to you. It should be an exchange that is almost imperceptible.

9. Develop a rationale.

I've just described the ideal transfer. But what if somebody breaks stride or the wind changes? Lots of things could happen.

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As a matter of fact, the transfer zone is usually a very painful period. The parent may go through a grieving period as he or she says goodbye to the business. But the son or daughter has pain also. He or she may have the most pain. Maybe there is a disagreement over money.

Maybe it is over power. Maybe the founder is not entirely convinced that the successor is ready. How do you make it through this period?

You, the founder, and the successor could both benefit from forming a rationale or a statement that says why all this is worth it to you. When things are particularly painful and you are wondering why you are going through this, you can tell yourself, "It's difficult now, but it's worth it because..." For example, after thinking things through, you may conclude, "It's worth it because we employ a lot of people, and I'm proud to be part of this business." Sorting out your feelings will help you though this difficult time.

10. Recognize that you are not alone.

We have found that it often helps families to know that they are not alone. All families face the same difficult issues such as "How should we valuate the business?" and "Should the founder keep a title like Chairman of the Board?" Somehow, it helps to know that these issues are difficult for everyone who tries to settle them. It can also help to know that the way in which family members respond to the issues is fairly predictable.

In many cases, mothers are over-protective, and fathers think they are invincible. Rather than blaming your oldest son for being too hard-driving and too achievement-oriented, consider the fact that almost all first born children are like that. Rather than blaming your youngest child for not taking the business seriously, consider the fact that the baby of the family almost never takes anything too seriously. Rather than thinking that your family members have "personality problems," recognize that it is very natural for the people involved to feel the way they do. Because conflicts are universal, you can learn from other people who have gone through them. That's why we generally recommend joining family-business forums or support groups. Not only will you be able to see how other people resolve their problems, you will also see that you may not be as bad off as you had previously thought. There is almost always someone who is in a worse situation.

11. Have family meetings

Of course, good communication among your own family is essential. Sometimes productive communication occurs spontaneously, and sometimes you need to plan for it. At a family meeting, the whole family gets together to discuss an important matter. Sometimes it is best to hold them at an outside neutral location, like a resort or a restaurant; sometimes it is best to sit around the kitchen table. How do you begin? You may wish to start by selecting a topic and moderator. We usually recommend, however, that you keep things informal and relaxed so that everyone can participate comfortably. The benefits of these meetings typically include a greater feeling of unity (or team-building), a clearer understanding of the issues, and a better understanding of the family's range of perspectives.

12. Plan, plan, plan.

Long before the succession should take place, we encourage the founder to write a business plan, an estate plan and a succession plan all at once. We always know that we're asking for the near-impossible, but we do it anyway because it works. You need to write these plans at the same time because they influence each other.

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This is not, however, a do-it-yourself project. Help from your accountant, your attorney, and someone who has knowledge of organizational development is critical. Your job is to bring these experts together and develop the plans that can guide you through the succession period. We're not going to tell you that it will be easy. We're not going to tell you that you will be able to do it quickly. But the long-range benefits of this approach cannot be overstated.

13. Create an advisory board.

We recommend advisory boards to all small businesses. Why? It is an extremely valuable sustaining resource. The board should include the type of people mentioned above (lawyer, accountant, and organizational specialist) and at least one other person from your industry who gives you respect. Often, the business owner will offer the board members an honorarium instead of a salary. If liability issues are a concern, you can call the board a "counsel." In any case, you will benefit from group discussions of important issues.

14. Set a date.

As you go through the planning process you will be able to determine a realistic and financially-advisable termination date. When your plans are complete, you should know exactly when the leadership evolution process will be complete and you should be ready to hand your business over to the next generation. It is essential that you are fully committed to that date, that your staff is aware of the plan, and that your successor can depend on you to follow through with it. We have emphasized many times that succession is a process. Choosing a retirement date, preparing your successor, preparing your business for transition, preparing yourself for a different sort of life are all important components of that process.

15. Let go.

Why do so many founders at the end of the transition process say, "Well, I was wrong. We are not going to be able to complete the transition this year after all."? Or, even worse, why do so many decide that they want to come back to the business two or three years after they left it for good? It is hard to let go of responsibility. It is hard to let go of authority. But it is even harder to let go of control. A psychiatrist can give you a lot of explanations about why this is true. Letting go is a very complex and difficult process that should not be underestimated. We're sure you know many business founders who are in their sixties who do not want to leave the business because they are afraid of giving up their identity, and they don't know what they're going to do with their time, and they know three people who died the day after they retired.

But we would like to offer an additional explanation for why letting go can be difficult for entrepreneurs. If you are tied financially to the business, it will be almost impossible for you to let go of it. One of the central goals that you should have while writing your business plan, estate plan and succession plan is to create financial security that has no ties to the business. You need to be financially independent. And if you aren't, you won't be able to resist the temptation of interfering with the business.

Conclusion

Perpetuating a family business is the ultimate management challenge. We're convinced, however, that you can increase your chances for success if you believe that succession is a process that may take fifteen or twenty years to complete. Fortunately, there has recently been a sharp increase in the number of resources (books, journals, support groups, and conferences) that have been developed to help you. We hope that you will take advantage of the support, plan ahead, be candid with your family and staff, and successfully transfer your business to the next generation. Good luck!

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