Where will the children work? Family business succession is not a given

Believe it or not, family business owners fail 70% of the time trying to successfully pass the business on to the next generation.[1] They fail in a number of ways — children no longer speak to one another, employees have low morale and the business performance suffers. At the heart of the matter is the difficulty that families can have communicating effectively and truly understanding one another.[2]

Naturally, parents love their children and want to pass on to them more than they had. However, when the gift is the family business, problems arise. All too often the business owner's quest to leave a legacy conflicts with the children's search for identity.

The challenges of transition planning

Business transition planning is not an easy process. It is complicated by a number of factors; the owner's difficulty in letting go, differing aspirations between parents and children, rivalry among siblings who have a sense of equal entitlement but who are not equal in talent, attitude and energy. To further complicate matters, children grow up, marry and form new family units of their own, introducing powerful new influences in the form of their spouses.

The starting point for the owner of a family business is vastly different from that of a successor. Typically, the business was started out of necessity. Putting food on the table is a powerful motivator. Consider the case of Joe Smith, who founded a chain of convenience stores in Western Canada. He assumed that his children would eagerly step in to assume his role once he was ready to stand back. He was, however, unaware of the motivations of his potential successors, who had grown up hearing Joe describe the daily challenges and frustrations of running the business. The son, Bill, and his sister, Susan, had grown up watching their father struggle and endure incredible stress. They recalled how he sacrificed time with them and the rest of the family to ensure the survival of the business.

How the children view transition

Children may not view the business positively and may choose to seek their own path. A business owner wishing to leave the business may find their vision for its future, and their dream of passing down a legacy, on a collision course with the aspirations of their children.

Where there are several children in a family business, sibling rivalries and the painful choices owners feel they must make further complicate matters. Parents typically want to treat their children equally but come to realize that simply dividing private company stock equally among them can create more problems than it solves. Children active in the business resent creating value for their siblings who are not active participants. Because of the difference in their ages, children come into the business at different times and often with different sets of expectations and experiences. Parents often hire in their own image and unknowingly suffer from biases and tendencies to favour those children who they hope will run it the way they did.

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[1] Beckard, R. and Dyer, W. "Managing change in the Family Firm- Issues and Strategies". Sloan management review, 1983 a, 24, 59–65.
Beckard, R. and Dyer, W. "Managing Continuity in the Family-Owned Business". Organized Dynamics 1986, 12, 5-12.

[2] Roy Williams and Vic Preisser, 2003. Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values. San Francisco Robert D. Reed Publishers.

Balancing ownership, management and heirship

Beyond ownership, there is the additional need to settle the leadership and management of the company, as well as compensation for family members in the business. When there is a combination of children who are inactive and active in the business there is often insufficient liquidity or non-business assets to provide the inactive children with equal value from the estate. This usually results in the active children resenting those siblings who are sitting back and opposing expenses in the business.

Others take a wait-and-see approach with children, postponing the vesting of control of the business until a later time when a successor might be more apparent. Some business owners try to create incentives for their beneficiaries by structuring matching gifts. This is a process whereby children who perform are rewarded with an amount of capital or voting stock equal to the value they have created through their own effort.

Getting an outside perspective

Experience gained in other businesses can often be brought back and the returning children have a sense of contributing new ideas and energy as opposed to doing things the way they've always been done.

Stewardship and communication

Families that have successfully planned for business transition tend to emphasize the role that communication and stewardship play in the process. Stewardship is the attitude that successor owners of the business are like trustees who have the privilege of not only holding it and caring for it but also passionately building it for the benefit of the next owners. This is a very different attitude from one that believes ownership and employment in the business is merely a right of birth.

The role of family council

The creation of a forum for communication and conflict resolution goes a long way in families. Establishing a family council, using an objective family business facilitator, and crafting a mission statement around what the family wants the business to stand for is critical. The family that knows its values and how they relate to the business will drive much of the business transition planning process, as well as the strategy and structure of the business going forward. The family that wants to keep the business will embark on a much different process than the family which prefers other options, such as a sale to a third party or a management-led buyout.

Stewardship – An attitude of gratitude

For those families who have successfully made the transition to the next generation, stewardship has been a critical component of the transition. Those families that taught their children early on that the business is something that they are privileged to be involved with and to take over, thrive over those families where the children believe they are entitled to their share, regardless of the challenges the business faces.

The stakeholders in the transition process

What many fail to realize is that there are three, not two, stakeholders involved in the transition planning process. The shareholders and the family are both stakeholders, but the business itself is also an important stakeholder, though it tends to get less attention at the planning table. When potential successors see the business as an entity with its own needs, they appreciate more deeply the opportunities and potential threats for its future. When the needs of the business are fully understood, selecting and grooming a successor becomes easier.

To instill a sense of stewardship requires more than the right attitude. It requires communication of values and a sense of the history. It also requires the tools of implementation: the successor development plan, the business continuity plan, the shareholders' agreement and the owner's estate plan. These are the roadmaps for the business transition.

How much is enough for my retirement?

A key stumbling block is the financial welfare of the business owner who is expected to step back from the business. Addressing and providing for the financial planning of the business owner is one of the most important aspects of business transition planning. A business owner who has built a successful business and has realized the material rewards and comforts that flow from them cannot be expected to lower their standard of living. Selling a family business has a huge advantage, freeing up the business owner to pursue interests such as travel and philanthropy. Typically, liquidity is an issue, and creative planning, sometimes involving insurance, is required.

Giving up control

In some businesses, money is not the issue; control is. It's difficult for a confident, self-made owner to give control to offspring. Emotion and reason frequently collide, resulting in the worst scenario — the owner who steps in and out at random, confusing the successor and senior management alike as to who is really in charge. This creates unbearable tension and frustration. Once the business transition planning has been done, the successor selected and the maturing process is well underway, the business owner must ultimately relinquish control. This act of letting go can be the toughest and yet ultimately the most rewarding.

While the difficulties inherent in business transition planning can be mitigated by meaningful and on-going communication and by developing a mentality of stewardship, odds are that keeping the business in the family over a number of generations is not likely to be successful. Successive generations are shaped very differently by the forces around them, forces that are entirely different from those faced by the business owner.

Set the children free

In the end, the best we can give our children is the opportunity for them to develop not only roots but also wings. We owe them the opportunity to stand on their own, to achieve independently and to develop a strong sense of themselves. For the business owner, this may ultimately mean letting the idea of keeping the business in the family go.

For more information

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