Succession Planning & The Family Business

By Kenneth B. Collins

There are 24 million family-owned businesses in this country – employing 82 million people or 62% of the nation's total work force. Less than one-third of those businesses will actually make it to the second generation, and only about 10% of them will survive into the third.

Clearly, there is a disconnect between the optimistic belief of today's family business owners and the reality of the massive failure of family companies to survive through the generations.

For most closely held family businesses, planning for succession is the toughest and most critical challenge they face. It not only raises many complex financial, tax and legal considerations, it often raises critical and emotionally charged issues within the family.

A big challenge is trying to balance fairness in employing many children or even grandchildren in a family business with various skill levels, compensation levels and ownership levels. The jealousy and infighting can absolutely grind the company's progress to a halt.

Are you sure that the next generation wants to run the business? Are they even capable of doing so? Do they command respect within the company because of their personal strength and skills – or are they grudgingly granted respect because they are related to the owner?

If there is competition among your children for the leadership position, a decision to divide the power among them is not likely to be successful. Ownership may be divided, but management should be clearly delineated. Often ownership can be split between passive and active shares, giving the active successor the necessary control over the business while providing an equal economic benefit to the inactive shareholders. In some cases, too, the business can be divided along functional lines so that different family members can assume control over well-defined functions or business units.

If the desire and capability of the children are not evident and the company is large enough, it may be helpful to get outside board members actively involved as step one. One option is to hire professional management to run the business – another is to sell the company while you are still running it and it can command the highest value.

Transferring your business to family members or other insiders in an orderly and successful manner may be the toughest management challenge you face in the life of your business. Not only must you choose your successor wisely, you must also thoroughly prepare him or her as you are confronting and resolving conflicting goals and agendas. You must also structure the transfer to minimize the tax impact – while striving to keep peace within your family.

In my own experience of working with family business owners, many opted to sell their company to a third party rather than transfer it to their heirs. In at least one case, we advised a split decision – where certain divisions of the businesses were split off and sold; the owner retained and ultimately transferred the remaining units to his son.

Running the business day to day is relatively straightforward, but as retirement approaches, assessing all of these factors and developing a succession plan are best done with the help of an experienced advisor.

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