

5 Steps To Create A Viable Succession Plan For Your Family Business

By Michael Evans

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The importance of the family business to the United States economy continues to grow, and in a striking development, family businesses are beginning to reverse the trend of mega-businesses wiping mom-and-pop stores off the map. The recession of 2008 provided the catalyst for laid-off workers to create home-based businesses using the Internet and a low cost website to create and sell products and services.

Family businesses account for a staggering 50 percent of the gross domestic product of the U.S., and it is not just in small storefronts or website businesses: 35 percent of Fortune 500 companies are private or public companies that are controlled by families.

Consider the role family businesses play in job creation: family companies are responsible for 60 percent of the jobs in America and nearly 80 percent of new jobs created. But according to a recent PWC survey, only 52 percent of them expect that members of the next generation can do it on their own. Uncertainty about whether junior members will have the aptitude and experience for running a company is the leading concern that family businesses have about keeping management in the hands of one or more family members.

Growth and Sustainability

Family businesses often have intimate histories and complex cultures that are hard for outsiders to understand. Families today are often more complicated and less traditional than they once were.

Family businesses have several other issues that work against the successful continuation of the business. Fortunately, with focus and planning, most of these can be easily overcome by paying attention to the details.

Key issues include:

1. Generational transition. Only a third of all family businesses successfully make the transition to the second generation.
2. Alignment of family interests. Alignment of interests between current owners and others becomes more pronounced as members retire and turn over the reins to the new generation, while at the same time looking to the company for their retirement income.
3. Balancing of financial returns. Creating buyout agreements is challenging. When the retiring generation looks to the value of their interest, they sometimes tend to look to a balance sheet number. In fact, the true value of a business should probably be based on an earnings capitalization model, a concept unfamiliar to many smaller family companies.
4. Interfamily disputes. The interest of one family member may not be aligned with another family member. These situations can become even more difficult where there is, for example, a divorce of a family owner or a death and the surviving spouse is holding stock (and voting rights) but is not involved in the business.
5. Estate and Inheritance issues. These include taxes and probate delays upon the death of a family owner.

What to Do? A Five-Step Process

By following five key steps relevant to almost all family businesses, the business can create a viable succession plan, provide for the financial independence of the retiring owners, and position the business for continued success and growth.

Step 1: Establish Goals & Objectives

- Review current succession plan and reasonableness of achieving desired goals.
- Develop a collective vision, goals, and objectives for the business.
- Determine the importance of continued family involvement in leadership and ownership of the company, but consider the option to bring in professional management.
- Establish personal retirement goals and cash flow needs of retiring family owners.
- Identify goals of next generation management, both personal and business.
- Identify and retain a team of professional advisors.

Step 2: Establish a Decision-Making Process

- Identify and establish governance processes for involving family members in decision-making.
- Establish a method for dispute resolution if needed.
- Document the succession plan in writing.
- Communicate succession plan to family/stakeholders.

Step 3: Establish the Succession Plan

- Identify successors – both managers of the company and owners of the business.
- Identify active and non-active roles for all family members.
- Identify required additional support for the successor from family members.

Step 4: Create a Business and Owner Estate Plan

- Address taxation implications to the owner/business upon sale or transfer of ownership, death, or divorce.
- Review owner estate planning to minimize taxes and avoid delays in transfer of stock to remaining owners or spouse.
- Create a buy/sell agreement that is fair, reflective of the value of the business, and minimizes taxes.

Step 5: Create a Transition Plan

- Consider options: outright purchase, gift/bequest, or a combination of these.
- If the business is to be purchased, consider financing options including financing from an external party or self-financed from the retiring owners on a deferred payout basis.
- Establish a timeline for implementation of the succession plan.

Not every family business will survive and many do fail, primarily due to differing family interests and the ability of the next generation to grow the business. Taking these five steps now will save money and time and will help assure the continued success of your business.