FINANCIAL ADVISOR

Managing A Successful Family Business Transition

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Many business owners spend decades building a successful firm with the hope that they will one day pass it on to their children. However, more often than not, their adult children don't want anything to do with the business. Statistics show that less than a third of family businesses survive into a second generation of family ownership and only 12% make it to the third (Source: Joseph Astrachan, Ph.D, editor, Family Business Review).

Why do most family business transitions fail?

It could be due to issues within the business, such as an ineffective leadership succession plan or the failure to modernize the business over time. However, too often the failure to keep the business in the family stems from the conflicts that arise when family dynamics collide with business dynamics. The intersection between family relationships and business decisions often prove so challenging that family members believe that the best way to maintain peace is to sell the business. Though each family is different, there are several common challenges to be aware of when it comes to family dynamics. Some of the most common include:

• **The sticky baton effect**—While a founder's strong vision can be essential to a company's initial success, this level of control may suppress other voices in the family and make it difficult to ultimately pass the baton. They may talk about succession, but have trouble giving real authority to the next generation. This dynamic can create a lack of trust and respect among family members due to a perception that the next generation isn't ready to handle the responsibility.

• **Confusion around family and business goals**—Family members will naturally have different opinions over how to manage the business, but confusion over policies surrounding ownership, employment, or compensation can often lead to serious disagreements down the line. When thinking about how the business is structured and managed, families should consider basic questions such as: Who is considered family when it comes to the business? Who can own shares and how are they passed down? How are different family members treated within the business? Providing clarity around these processes will help avoid eventual conflict.

• **Poor communication**—Communication is key to a thriving family business, though at times tensions between family members may create an environment where they no longer listen to each other. Family members may stop speaking altogether or simply get caught up in the same unproductive conversations that inhibit the family's ability to constructively engage with each other.

• **Changes in risk appetite—**As family businesses transition ownership to the next generation, the appetite to take business risks from company leadership often decreases. Family members may become more focused on preserving the wealth they've created than entrepreneurial ways to grow that wealth. However, the next generation may be pressured by their predecessors into making riskier business decisions, which when poorly executed could erode the family's fortune.

These common situations can contribute to an environment of anxiety and frustration within the family and drive family members to give up on the business. However, these situations are by no means inevitable. There are many ways to improve family dynamics, and ultimately, the chance of a successful business transition.

Some Families Have It Right—What Are They Doing?

Family businesses that survive through multiple generations of ownership tend to have a combination of both good family and business governance. Though family governance shares many elements with basic business governance, it is intended to help clarify each member's roles and actively manage the family's expectations for the business. When both these governance structures are in place, it creates a solid foundation for transitioning the business to the next generation.

Below, we explore several best practices that may help clients improve their family governance.

• **Draft a mission statement**—The first step in creating a cohesive vision for the business is articulating the family's values and goals in the form of a mission statement. This will encourage families to evaluate the basic (but sometimes difficult) questions, such as why they have a business and what they're hoping to accomplish. This written document should be reaffirmed with each new generation.

• **Establish a legal framework**—A formal legal document should be put in place outlining policies and procedures for employment of family members. This could include compensation, distributions, ownership transfers, and more. These policies should be agreed upon by the family and there should be clear instructions for how these policies will be reviewed and updated.

• **Speak with a unified voice to the board**—In order to speak with a unified family voice and point of view to the company's board of directors, it's beneficial to provide a forum for family members to discuss their issues, such as a family assembly and/or a family council. These tools for open dialogue can help ensure safe and productive communication among family members to address disagreements before they grow into full-blown conflicts.

• **Prepare the next generation**—Educating the next generation about the family business should begin as early as possible. This may include age-appropriate programming such as workshops, seminars, mentoring programs, and more. Another option is a junior council, allowing younger family members to learn about the family's history, values and the business itself.

In addition to sound family governance, effective business governance is an equally critical component for protecting the interests of the business and maintaining its successful operation. As family businesses evolve, they often develop a more sophisticated board, shifting responsibility away from the family and more towards independent advisors. This can be a helpful step towards managing a business transition, as independent directors can help balance the interests of different family members.

Establishing an effective governance system takes time and patience. While governance structures aren't one-size-fits all for every family or company, putting these structures in place can significantly increase a family's chance of beating the succession odds. Business owners thinking about succession should be sure to consider the intra-family relationships at play and the potential benefits of a family business consultant to help put effective governance measures in place.

Donna Trammell is director of family wealth stewardship at Bessemer Trust.
