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Family Businesses Rarely Transfer to the Next Generation - Here's Why It Matters

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Many U.S. private company owners dream that someday their children will want to take over the business, then successfully grow it to new levels, thus preserving the family's financial and reputational legacy that took years of scrimping and hard work to build.

For most, it truly is a dream; relatively few prosperous businesses transfer to family members.

While reliable data is elusive, one study indicated that of those which do – variously estimated to be 10-30% – less than two-thirds of them survive the second generation under the same company name and ownership, and only 13% of successful family businesses last through three generations before being sold outside the family, merged, or closed.

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Women May Help Intra-family

Succession

Will the number of intra-family transfers increase with an ever-building pool of women asserting a desire to take over the family business? Since women have steadily progressed from workforce participants to founders over the decades, it would seem reasonable to assume that more qualified women will express interest in controlling their family's business.

Reportedly, about 25% of family businesses are now run by a female president or CEO. Perhaps that will be around 50% in another decade.

Many Private Company Owners Nearing Retirement Age

With each passing year, the issue takes on greater importance to American business, because half of private company owners with employees are at or approaching retirement age. Ten thousand Americans per day turn 65, a traditional retirement age as shown in demographic studies and academic research, a rate that will continue through 2029.

According to Gallup, non-retired Americans' projected age of retirement intent was between 65-67 from 2009-2018. It averaged 64 between 2002-2008 – before the Great Recession. In April 2018 a record high of 41% expressed the intent to work until age 66 or later.

Researchers surmise that many owners delayed retirements because of insufficient savings. Now that the economy is robust again, most will have had the chance to rebuild retirement savings lost in the Great Recession. For many, rebuilding personal assets may be the impetus to retire or otherwise undertake their "next chapter," whatever that may be.

Baby Boomer Demographic Effects on Business Sales and Values

According to the U.S. Census Bureau, half of the 5.2 million privately-held employer firms are majority-owned by someone born between 1946-1964, also known as the "baby boom generation" who are now 55 or older. About 20% are owned by someone age 65 or older, suggesting that owners of over one million employer companies are "statistically ready" to change hands, with another million and a half queueing up behind them.

As basic economics would suggest, the more businesses on the market seeking buyers, the more bargaining power those buyers will have. Though several other factors affect the market, if many owners

decide to exit simultaneously, it could precipitate a shift to an extreme buyer's market for private companies.

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In any case, it is harder to sell a company for its highest price and best terms when there are a lot of similar companies in an industry on the market seeking to be acquired.

Aging Business Owners Need to Plan Their Exit

Through the 2020s, most baby boomer owners will exit their business; ideally, they will do so voluntarily.

The private mergers & acquisitions (M&A) market is still a seller's market (supply and demand imbalance in which demand to acquire or invest in good companies exceeds the supply), though the cycle is in its late phase. Some owners are divesting now to capture the opportunity that may not exist in a year.

Historic patterns over the past 40 years suggest that the current market may begin softening this year – in fact, transaction volume has tapered since 2017, though value is holding firm – and not return to favor sellers until the mid-2020s. Even then, the demographic and other factors suggest it will not be as robust as the past few years.

Counterbalancing the downward force of the waning cycle is a flood of private equity capital seeking to acquire solidly profitable and promising companies or invest in growth alongside the current owners. I am contacted multiple times daily by investors seeking company acquisition or investment opportunities in most industries.

Ownership Transfers Outside the Family Favor Larger, Healthier Companies

Fortunately, owners of healthy "Middle-market" private businesses, or the 170,000 U.S. private companies generating between $10 million and $1 billion annual revenue, may have several options to capture the value of their company and pass along ownership.

The set of options and their applicability depend on the owners' goals, the business, industry dynamics, and the market at the time. Owners will benefit by seeking the qualified counsel of a professional M&A advisor such as an investment banker who advises private companies to help assess options.

It is Harder to Sell a Very Small Company

Very small companies, particularly those under $5 million annual revenue, generally have more difficulty transferring ownership and transactions are far more likely to fall apart before completion. These companies, in particular, may have to lean on the next generation to take over - which isn't always an option. *(More to come on that topic in tomorrow's article, the next in this series.)*

Though transfer options are more limited for established smaller companies, specifics of the circumstance – such as growth rate, profitability, and overall health of the business – matter more than whether the company's annual revenue is $5 million or $10 million.

Many owners do little to nothing to ensure the overall health and attractiveness of their company in advance of a transaction and find themselves disorganized and unready to transfer it when they decide to, or if the sudden need occurs or opportunity presents. This position cripples marketability and may devalue a company significantly.

The path of least resistance is to ask family or employees to take over, but often the idea is not viable.

This article is Part 1 of a 6-part series running this week on Thomas Insights. The next article, "10 Reasons Why Your Kids Don't Want to Take Over the Family Business," will publish tomorrow on Insights and in the Thomas Industry Update newsletter.

This article was written and contributed by McGavock Dickinson Bransford, CM&AA, managing director with investment bank Mid-Market Securities, LLC. He advises and writes articles pertinent to owners and shareholders of mid-sized companies.

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