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The Tricky Task of Handing a Family Business to the Next Generation

Too often it's mishandled due to miscommunication, poor planning and reluctance to let go

Transitioning out of their front-and-center role can be hard for many family-business owners.

PHOTO: SONIA PULIDO

By Cheryl Winokur Munk

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For many family-business owners, passing on the business to the next generation can be as challenging as starting the business in the first place.

Among the obstacles: a lack of communication between generations, a failure to plan ahead and, perhaps most difficult, a reluctance to let go. Left unresolved, such issues can lead to business disruption and strained relationships when a family is least able to cope with it. Not the kind of scene most patriarchs and matriarchs have in mind to leave as their legacy.

In a worst-case scenario, if an owner dies or becomes incapacitated without a plan in place for a smart and smooth succession, "it's like trying to put Humpty back together again," says Rick Goossen, a member of Nicola Wealth's business-development team who advises family-owned businesses.

Of course, such a lack of planning becomes even more problematic at times like these, when so many small firms are struggling to survive.

"The reason to do future planning now is so that when negative events hit, you have a plan to work with," says Bruce Werner, managing director of Kona Advisors LLC, a Skokie, Ill.-based provider of advisory services to owners and investors of private and family-owned companies. "When the crisis hits, it is too late to start planning, and there is no time to think."

Here, then, are some tips to help smooth transitions to the next generation.

Communicate, communicate, communicate

It's fairly common for entrepreneurial parents, many of whom are Type-A personalities and singularly focused on building their businesses, to find succession-related discussions with their children difficult. Sometimes they don't naturally communicate well with their children, and other times they make assumptions about their children's business intentions and desires. Failure to communicate business plans effectively, however, can cause serious repercussions, experts say.

Joan Crain, senior director and global family wealth strategist at BNY Mellon Wealth Management, counsels parents to talk through succession plans with their adult children as soon as they are in their late teens or early 20s. And ask questions, such as: Do you see this as your career? Is this something you are interested in taking over? What do you think it would take for the company to continue to flourish? What do you think will be the challenges? Would you want to keep it in the family and hire professional managers?

"These conversations are difficult, but they have to happen," she says. "They are old enough to handle it, and not having these conversations can be more detrimental in the long run," she says. Independent facilitators, such as a financial adviser, can help if it's difficult for the family to do it alone.

The stakes can be high when families don't communicate their intentions clearly. Ms. Crain offers the example of a family that sold the business out from under their adult children who worked there, rationalizing that the money from the sale would compensate for hurt feelings. The plan failed miserably. The private-equity buyer fired the children, leaving them unemployed and resentful. The business faltered, and the anticipated payouts didn't materialize. Deep rifts occurred in the family, and relationships remain strained years later, Ms. Crain says.

Mr. Goossen offers another example of how making assumptions can lead to family strife. The owners of a family-run business decided that their sons were going to inherit the company. The well-meaning parents, who intended to financially remunerate their daughter, assumed she wasn't interested in being involved. She only found out after the sale, which led to "seriously fractured" family relationships that have yet to be repaired, Mr. Goossen says. Even if children tell you when they are younger they aren't interested, it's a good idea to inquire again before making definitive plans, he says.

Start early

Many family-business owners make the mistake of waiting until they are in their 60s or 70s to start thinking about succession-planning; this process should start two decades or so earlier, experts say.

Rob DePalo, director of business planning at National Financial Network, a wealth management firm in New York, offers the example of a client who informed his sons a few years before he intended to retire that it was time for them to start thinking about taking over the family construction business. Neither son, who had their own careers by that point, wanted it—which surprised the father. The father, now in his 60s, will probably need to work into his 70s, which was never his intent. Had he spoken to his sons when they were midway through college and contemplating their career path, he would have had time to make other arrangements and retire as anticipated, Mr. DePalo says.

Create a clear, written transition plan

Wayne Rivers, co-founder and president of the Family Business Institute Inc., a business management consultancy, recommends family-business owners formalize their succession plans in writing. This can help avoid problems for when life throws a curveball.

He offers the real-life example of a successful food-processing business whose owners began succession planning in their early 70s. They were planning to give ownership to their daughter, who was in her early 50s, had worked for the business for years and was charged with handling day-to-day responsibilities. However, the wife died unexpectedly, and there was nothing in writing to say that the daughter was supposed to take over. A son who was uninvolved in the business, meanwhile, prevailed on the father to put him in charge. The daughter had no legal claim to the business without something in writing, Mr. Rivers says, and the son ran the business into the ground. Had this particular family made a formal plan earlier, "they could have created the protections that everybody wanted and deserved," Mr. Rivers says.

Figure out postwork life plans at least three to five years before transitioning

Transitioning out of their front-and-center role can be hard for many family-business owners. Critical questions that need to be answered include: When will the parents start to slow down? What does that mean? Which, how and when will major responsibilities be turned over? And how do children ensure that the parents will let them lead?

As parents start to think about handing the business to the kids, they also need to think about what they are going to do next and how they are going to spend their time, says Mr. Werner of Kona Advisors. For example, many family-business owners make grandiose plans and then find themselves bored after six months.

To avoid retirement doldrums turning into business and familial issues, Mr. Werner says it's advisable for family-business owners to start planning in earnest three to five years before they think they'll retire.

He recommends family business owners create a list of activities they think they would enjoy and test each idea. Travel a bit without checking into the office, or take classes in a hobby you've always wanted to try, he suggests. If something doesn't interest you as much as you previously expected, he recommends going back to the initial list and trying something else. "It's about finding the niche of three to four things that will fill your day and make you happy," he says.

Don't hang on when it's time to let go

Robin Satyshur, principal in the Nashville office of Diversified Trust, a wealth-management firm, routinely tells family-business owners to avoid becoming a third-wheel. This means letting go when the time is right.

Achieving a clean break from the company requires strategic measures to prevent the patriarch or matriarch of the family from continuing to exert control over the business, which can lead to both professional and familial discord, she says.

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For instance, a leadership and ownership transition should be developed as part of the company's strategic planning process and should clearly outline roles and timeline. This plan should be clearly communicated to the entire family, which promotes their commitment and engagement, says Ms. Satyshur.

If there is not an agreed-upon plan, with clear expectations, it increases the risk that the parents don't really leave, Mr. Werner says. "In too many cases, Dad still comes to the office every day, well into his 80s or 90s, for a few hours because he has nothing else to do. This doesn't help anyone."

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