

## Passing Your Family Business to the Next Generation - Succession Planning

As Penn State professor William Rothwell ominously points out in the forward to *Exit Right: A Guided Tour of Succession Planning for Families in Business Together*, more than 40% of the people who run the closely held operations that comprise 80% of the North American economy will retire by 2007. It makes me wonder, what is going to happen to all of those businesses? Although it is a noble gesture, passing a business down to the next generation is more often than not, unsuccessful. In fact, statistics show that only one-third of all family businesses are successfully transferred to the next generation and only 13% are transferred onto the third generation.

Many family business consultants say the primary reason for this low survival rate is the failure to develop and effectively plan for the transfer of ownership and management of the closely held family business. I agree that this is a factor, but in my dealing with family businesses I find that there are some more fundamental reasons.

The first is that the next generation has a lot different life style than the business founder and entrepreneur. They do not share the same drive and commitment that dad needed to build the business from scratch. They go to the good schools, get a taste of the good life and generally do not share the passion of the business founder. I recently was involved in selling a produce distributor. I found that most of the firms were in their second or third generation. I asked a third generation owner why this particular industry had such success with keeping the business in the family. He said, "When you are up and on the docks at 3 am and work 12 hour days, you don't have the time to spend the money."

The next generation may have a grand scheme to turn the traditional printing business into a media empire or a liquor business into an entertainment enterprise. A few years back the second generation of a well known Chicago area computer leasing and IT Services Firm tried to turn it into an Internet Venture Firm with disastrous results.

Before you just assume that your torch will be carried by the next generation, make sure that the next generation even wants to run the business. Imagine the loss in value that would have occurred if the real estate billionaire from the western suburbs had turned his empire over to his son who simply wanted to produce plays.

Are your heirs even capable of running your business? Have you held on to the reins so tightly that the kids involved in the business have not been able to develop their decision-making or leadership skills? Do they command company respect because of their personal strength and skills or are they grudgingly granted respect because they are the child of the owner? If that is the case, the odds are not good for them taking over when you retire.

Another 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 in fighting can absolutely grind the company's progress to a halt.

The business owner must make some difficult decisions when he or she decides it is time for them to retire. Why did I create this business? Was it to keep this business in the family for generations or was it to provide for my family for generations? If the desire and the capability of the children are not evident and the company is large enough, it may be the right decision to first get outside board members actively involved as step one.

Step two would be to hire professional management to run the business. A second alternative is to sell the company while you are still running it and it can command its highest value. If you have children that want to remain in the business for the immediate future, incorporate that into the sale agreement with employment contracts.

Another way to think of it is, while I am running the business, the best ROI is to keep the bulk of my net worth invested in this company. If I am no longer running the company what is the best risk reward profile for my net worth?

Would my heirs be better off if the business was sold and the value converted to financial assets?

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