

# Family Business Succession Planning

DATA AND ANALYSIS  
Parts 1-3

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## DATA AND ANALYSIS PART 1

### INTRODUCTION

Every year, two or more exceptional surveys come out around the world detailing the succession planning habits, pros, cons, and gaps of family businesses. Pulling from multiple sources, we wanted to illustrate a fairly typical succession plan case study (not actual names of clients or company(s)) along with some of the sobering statistics about the still-evolving succession plans of family owned businesses.

Family business is big business. There are about 24 million family businesses in the United States alone, and they account for about 89% of the business tax returns. 82 million people or 62% of the work force are employed by family enterprises. According to the Small Business Administration, small companies (those with 500 or fewer employees) create approximately three quarters of the net new jobs and generate 64% of the U.S. annual gross domestic product. When the media portrays business, it almost always emphasizes big business and focuses especially on scandal-plagued companies (think Enron). Family businesses represent the silent, virtually invisible majority of the world wide free enterprise system.

This series of three articles will explore:

- Exit strategies, retirement planning, and ownership transition among family enterprises
- The management succession plans of family enterprises
- The barriers to succession as identified by family business owners themselves and by family business consultants

Each article will present key statistics along with commentary, real-life family business examples, and a call to action for the individuals who manage and own the companies which make up the massive family business marketplace to rouse themselves to undertake the difficult task of self-perpetuation.

John and Mary Jones, the co-owners of JZ Jones Construction Company, were enjoying a pre-dinner drink on a Saturday night. After a terribly busy week, they were reflecting on the states of the company and of their lives now that they were approaching 65 years old.

"I'm worn out!" exclaimed John. "Our growth in the last three years has been a great thing for the company and our finances, but I'm working harder than ever! I really thought by the time I was 65 years old that, as a man who ran his own business, I'd be able to slow down a little bit. The way things are going right now, I can't see a time when that's going to happen. I'm not sure how much longer I want to work this hard!"

"Well dear, I've told you how important it is for you to take more time off," said Mary. "We've been married almost 40 years, and I can't remember the last time we took a vacation that didn't revolve around a business convention. Before we get too old to do it, I'd like to travel and see a little more of the world. We've worked so hard all our lives to build up a little money, and I'm afraid because you're still having to work that we'll never get a chance to enjoy it!"

"I worry about our kids, too. You've created opportunity for Steve and Jody in the company, but poor Robert is barely making ends meet with his rock and roll band. He's got child support to pay for little Amy too. As a mother, I just don't know what to do about Robert. In fact, Steve told me the other day the way our current estate plan is written, if something happens to us the business would go to all three of the children equally, and he thinks that's a rotten deal for him; he just doesn't see how he'd be able to get along in business with his brother! The other thing that I don't really understand is all these trusts; the

long and short of it is that the business would go to me if something happens to you, and that's about the last thing I want! I'd rather find a different way to have financial security and keep me out of the middle of the children and business affairs."

John and Mary aren't alone in their discussion over the future of their family company, and studies show that many family business owners share their frustrations and concerns.

### THE FAMILY BUSINESS MARKETPLACE IS UNDERGOING REVOLUTIONARY CHANGE

There is a coming sea change in the family business marketplace. 40% of family businesses in the surveys expect the leadership of their companies to change hands within the next five years.<sup>1</sup> Well over half (56%) expect a leadership change within 10 years. More than four out five businesses are still controlled by their founders. As in the case of John and Mary Jones whose three children will inherit the business, the succeeding generation of owners and managers won't have an easy time coordinating the respective roles of owner and manager; the need for communication between sibling partners is infinitely greater than the need for communication in the case of a sole owner.

About a third of the companies surveyed in the Mass Mutual study have a chief executive who's older than 60, and the average age is 54.<sup>2</sup> Only about 11% are younger than 41, and about 11% are older than 71. About 88% of the survey respondents believe the same family or families will control the business in five years. But succession statistics undermine this belief: about 30% of family owned businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family business operates into the fourth generation or beyond. The statistics say there's a disconnect between the optimistic belief of today's family business owners and the reality of the massive failure of family companies to survive through the generations. Interestingly, according to the Canadian Federation of Independent Businesses (CFIB), Canadian family business owners assume that a family member will be the successor in only about 64% of the cases.

### FAMILY BUSINESS ESTATE PLANNING

The state of estate planning among family business owners is probably better than ever before. According to the MassMutual study, 67.5% report a good understanding of the amount of estate tax due upon death. Having said that, other than preparing a will, almost 20% have *no* estate planning! Almost two-thirds of significant shareholders in the family company know of the senior generation's share transfer intentions, but that's a surprising drop in the figure of 76% from a prior survey. Even worse, over one in three next-generation respondents have *no knowledge* of the senior generation's transfer plans! Senior generation family business members struggle mightily with how to fairly divide up their life's work product. In John and Mary's case, their issue is how to treat Steve, Jody, and Robert equitably when they have such different strengths and ambitions. For example, a PriceWaterhouseCoopers survey found that 53% of the chief executives of the fastest growing U.S. private companies don't address the disposition of their business in their estate plans at all. In addition, only 22% of owners surveyed have revised the plan in the past five years.

Steve, John and Mary's oldest child, joined JZ Jones Construction after completing a couple of years of college. He was a bright but marginal student and couldn't wait to sink his teeth into the operations of the

<sup>1</sup> American Family Business Survey October 2007 interpreted by Kennesaw State University and underwritten by Massachusetts Mutual Life Insurance Company (MassMutual) and the Family Firm Institute

<sup>2</sup> 2003 Mass Mutual Family Business Survey - Family Business Australia

family company. He's proven to be an energetic and capable manager and has handled his assignments in the family business successfully. Middle child Jody was a straight A student and went to work for General Electric for six years following her college internship. She was a successful manager, received several promotions and uniformly outstanding employee reviews, and was on a fast track before she decided to return to her family's hometown with her husband Eric. At 31, she's been employed in the family company for three years but has spent a great deal of her three-year tenure away from the business due to two troubled pregnancies. Youngest son Robert is a musician who travels the region with his band and has a hard time making ends meet. He was married, but got divorced after less than three years. Robert has one daughter, Amy, who lives with her mother. Because the divorce was so bitter, it's still a topic of conversation at family gatherings.

A massive challenge for John, Mary, their children, and their key managers is to decide who should one day run the business. With all her talent and big business training, Jody is probably the better candidate for future CEO. She's a great mother and can't reasonably be expected to put in the 70-hour work weeks that John considers the norm, but she gets her job done quickly and effectively. Steve is a good manager and leader, has acquitted himself very well in business, and has more experience and tenure than his sister. John and Mary love Robert a great deal, but worry about what owning a third of a successful company might do to him. He's never handled money well, and Steve in particular has indicated that he has no interest whatsoever in sharing future ownership with his "black sheep" brother.

The estate planning that John and Mary have done is sophisticated and is extremely tax-wise. However, like most tax-wise documentation, it places control of the family business empire solely in the hands of Mary if something happens to John. Mary has indicated she doesn't like this arrangement and is quite uncomfortable with the prospect of having business debt and potentially refereeing between her children. Furthermore, if Mary lives for 20 years beyond John's demise, and Steve and Jody run the company effectively during that period, a modest 7% growth rate would quadruple the size (and presumably the value) of the company, and that would earn them the perverse privilege of paying vastly more estate transfer tax than they would have otherwise. While John and Mary have spent thousands of dollars in the estate plan's execution, they're still uncomfortable with all of the unknowns and with how to treat their three very different children equitably and reasonably.

## EXIT STRATEGIES

According to the CFIB, for company owners who are considering their exits, the most common method is to attempt to sell to non-family members. 26% intend to transfer their business to family members, and 26% of the others have created no plans at all. Since the surveys<sup>3</sup> indicated that approximately 40% of family companies will transition within the next five years, to have no plan at all for how that's going to happen is downright startling. Having worked with and observed family companies for the last three decades, we also have to challenge the wisdom of basing an exit plan on selling to someone outside the family. Though it may be an owner's dream for a deep pocket purchaser to waltz in at the precise moment when the founder is ready to exit, in reality it almost never happens.

The owner of a successful mechanical contracting company was recently chatting about his exit. His thought was that if he couldn't transfer his company to his son and daughter in the next few years to assure his financial security, he could just sell it to an outsider. When asked what exactly would attract a purchaser to his company, he said, "It's perfect for an outsider; we have almost no structure here. Someone who's a good corporate manager could really come in here and make this thing work and take

<sup>3</sup> American Family Business Survey October 2007 interpreted by Kennesaw State University and underwritten by Massachusetts Mutual Life Insurance Company (MassMutual) and the Family Firm Institute

it to a whole new level!" This owner had an inverted view of what purchasers actually want. He considered it a strength that a buyer would be able to select a company with little or no structure, create systems for success, and imprint a new stamp upon the company. What purchasers actually want is a company which is *already* engineered to be successful. They don't want to have to reinvent the wheel; they want to see a machine which is capable of producing a predictable stream of sales and profits in the future. The things they look for – market dominance, structure, systems, independence from one or a tiny handful of managers, stable, predictable cash flows, etc. – are exactly the things this owner identified as missing from his firm. Most family business owners – to be very blunt – have pipe dreams about the "sellability" of their enterprises.

According to the CFIB, a significant portion of business owners intend to participate in the operations of their companies after the transition. How they plan to do this if almost 40% intend to sell to people outside their families is not exactly clear. 38% of owners intend on being "special advisors." 7% intend to remain on board as senior executives, and 29% don't know what their role will be after transition. Only about one-fourth (24%) said they will have no attachment at all after transition. When asked why they plan to have a role after succession, 44% of owners said because of "personal attachment". The longer an entrepreneur has been at the helm increases the likelihood he'll want to have a role after transition has taken place.

Even those who have planned their exits seem to have done so in a way that may jeopardize their success. A business owner is planning on selling his company to his family's junior generation. They spent time, energy and tens of thousands of dollars on all the things leading up to the sale. However, the lion's share of the deal was contingent (due to considerable seller financing) on the next-generation family business owners running the company profitably over the next 15 years in order for the transition to become a true win-win. If the junior generation runs the company into the ground, the senior generation stands to lose millions and will experience a significantly restricted retirement. There was precious little time and attention spent on preparing the successor generation to run the company successfully in the absence of the founder. The advisors on this transaction should have spent the same amount of time, energy, and money on preparing second generation leaders in their proper roles, leadership mandates, and success strategies to strengthen the back part of the deal – where 90% of the financial transaction would take place – in order to guarantee it would have been as sound as the front-end legal and financial parts. Without successful company management and operations, this could become a transaction which works only on paper.

The data and statistics above paint a none-too-flattering picture of the succession plans of family business owners. Family business is a massive economic engine in North America, and given that well over half of family companies expect a transition event in the next 10 years, one would think that there would be a virtual state of panic among owners and stakeholders to get their plans in place.

John and Mary finished up their cocktails and were preparing to go to their club for dinner. John said, "You know Mary; I know how to run my business and make money, but we've never had to deal with these complex succession issues before, and, if you think about it, no family business owner really has to go through this except once per lifetime. We need to think about how to get through these next five or 10 years of succession the best way possible. I think the best place to start is to have a heart to heart among the whole family about how *they* envision the future. What we learn from our kids and their spouses might even surprise us when it's all said and done."

Mary replied, "John, I think that's one of the best ideas you've had in a long time. It really makes sense for us as parents and stewards of this family to do a little focus group study of the next-generation to figure out what they want. Why, they might tell us to sell the business, put a few million dollars in our pockets, and move to Florida. Until we ask them we simply won't know!"

John, in a flash of insight, had come up with a brilliant idea. Beginning a productive dialogue among the family is a great place to start to determine future succession and transition strategies.

In the next section, we undertake the questions surrounding management succession, explore the definition of what management succession really is, present some key statistics, and talk about a proven solution to help resolve succession planning riddles.

## DATA AND ANALYSIS PART 2

### INTRODUCTION

As we discussed in Part 1, there has been an avalanche of family owned business surveys and studies over the last 15 years, and they paint a bleak picture of the state of succession planning.

In Part 1, we related some intriguing statistics about family businesses, visited with John and Mary Jones as they contemplated the future of their family business, and discussed the coming sea change in the family business marketplace. About 40% of family businesses expect the leadership of their companies to change hands within the next five years, and well over half expect a leadership change within the next 10 years. Currently, more than four out of five closely held businesses are still controlled by their founders.

We learned that the state of family business estate planning is better than ever before, but that day to day management succession strategies are largely missing – a huge planning blunder.

In Part 2 we'll undertake the issue of management succession, define it, present the statistics, and visit again with John and Mary. The final article in the series will discuss barriers to succession as defined by family business owners themselves and by family business writers and researchers.

### DEFINING MANAGEMENT SUCCESSION

When family business owners, their advisers, and business writers talk about succession, they're almost universally talking about OWNERSHIP succession. In fact, ownership is one of the key ways businesses define themselves as family companies. In a study conducted by KPMG in Australia, 93% of the survey respondents perceive "ownership by family" as the most important characteristic in determining whether or not they're a family company. Determining who will own the assets of the family enterprise in the future is an important task for any family business seeking to perpetuate itself.

Sadly, however, scant little attention in the literature is paid to MANAGEMENT succession issues in closely held companies. There are several reasons for this. First, since family owned companies permeate virtually every industry, there's not one common management or operational issue upon which writers can easily seize to create a compelling, universally interesting story. Second, operations and the nuances of daily management aren't considered "sexy" topics for family business commentators. Third, most family business consultants have little to no expertise in business operations or management planning, so when they write articles or provide quotes for reporters, they talk about that which they know best: estate planning and tax minimization or the need for counseling and communications improvements. For these reasons, management succession, roles, responsibilities, and accountability, and strategic business planning addressed only rarely by family business "experts."

When we think of management succession, we're not talking about who'll own assets in the future; we're talking about who's going to do the dirty, often thankless, and countless tasks which make the family business an asset worth preserving in the first place. If the daily "dirty work" doesn't get done effectively, the goose stops laying golden eggs, and other family business planning loses most of its significance.

Management of the family company requires focus on the four key departments present in a business of any size: administration and finance, operations and customer fulfillment, sales, and marketing. Someone or some group of people must oversee and populate these functional areas of the business for them to be viable and profitable.



John and Mary Jones, the owners of J. Z. Jones Construction Company, were driving to a nearby city to visit their granddaughter Amy.

Mary said, “John I’m so worried about you. I thought by the time we neared 65 the business would be operating on cruise control and you’d have a little more time off. The money in the last few years has been fantastic; we have money to buy a beach house and a nice boat, but we never get a chance to use them. You’re working more hours now than you did five or six years ago!”

“Mary, I understand exactly what you’re saying. Back in the old days, I thought if I could get this company up to \$40 million in sales we’d be on easy street – especially with Steve and Jody working in the business alongside me. I worry about them though. I’m just not sure they’re as committed to the business as I was. Steve does a good job and seems to be a pretty good manager, but he has to leave work early a day or two a week to go to some little league soccer game or some such thing. Jody never works more than about 35 hours a week. I know she’s a good mother and a good wife, but I just don’t believe you can be successful in business working so little. Maybe I’m working so many hours now to set an example of what it takes to be the CEO of a prosperous company for them. I have to admit I’m getting tired of having to be involved in every little decision.”

John continued, “I don’t know; Steve and Jody show flashes of what they’re capable of, but at the same time they sometimes show immaturity and poor decision making. I don’t want to sound like an old coot, but I think it’ll be at least 10 years before we’ll be able to tell whether either one of them has what it takes to really run this thing. By that time, I’ll be almost 75 years old, and I don’t want to be working so hard! My goal is to get down to working about three days a week and having plenty of time off in the summers. Exactly how I do that, I haven’t the foggiest idea. I’ve talked to Steve and Jody about it, but they’re so busy I don’t think they have a plan for learning new things at all.”

“I’m at least relieved to know that you’re thinking along these lines,” said Mary. “I sure would feel better if we saw light at the end of the tunnel. We’ve always dreamed of having a successful business, but I guess I never thought it was going to take so much out of my husband and children. There must be some way to make this process a little easier.”

## MANAGEMENT & SUCCESSION PLANNING

John and Mary aren’t alone. The median age of CEOs in closely held companies is 54,<sup>4</sup> and almost a third are older than 60. Most family businesses are experiencing at least modest growth in the “New Normal” economy. Many chief executives, like John, don’t necessarily want more growth; it’s almost thrust upon them as their customers grow and prosper. A successful business owner once related the phenomenon of growth this way: “it’s like we’re a train engine, and new customers and new business opportunities are cars behind us. But after a certain point, it’s not us pulling the cars along. Their weight pushes us forward. You feel like you can’t turn away new opportunities, but at the same time you almost dread them because it’s just another thing you don’t have time to do the way you want to do it. Adding more cars to the train inevitably adds to the work load of the engine.”

In hundreds of conversations with family business owners and managers over the years, we’ve asked them for the most common constraint in their personal and business lives. The number one answer (and it’s not even close) is TIME. John and many of his CEO peers are trapped in a vicious cycle. Because day-to-day execution demands so much, there’s no time or energy available for learning new skills and new roles. Ironically, learning new skills and new roles would help alleviate current management and operations pressures in the business. The lack of learning and experimentation, in turn, causes a

<sup>4</sup> 2003 Mass Mutual Family Business Survey - Family Business Australia



continuation of the pressure, stress, and even crisis which makes it impossible to have time to learn and practice innovative behaviors. Leaders become ensnared in a trap of their own making.

When asked why they don't have succession plans, respondents in the CFIB survey said that "time to deal with the issue" was a significant constraint.

Other reasons why business owners don't have succession plans included:

- Too early to plan for succession
- Can't find adequate advice/tools to start
- Too complex
- Don't want to think about leaving
- Fear of conflict with family or employees

According to the MassMutual study, of the CEOs who expect to retire or semi-retire within five years, 42% have not chosen a successor. Older CEOs who are closer to retirement are no better at planning. Of the CEOs 61 or older who are expected to retire within five years, a surprisingly high 55% have not yet chosen a successor.

In the KPMG study, family business managers were surveyed about current issues and challenges, and they rated 10 issues as uppermost in their minds.<sup>5</sup> Seven of the top 10 had to do with management (not ownership!) succession.

Listed in order of importance they are:

1. Growing profitably
2. Balancing different interests
3. Planning succession
4. Future directions
5. Exiting by retirement
6. Establishing professional business management
7. Selling the business.

Taking these two nuggets of survey information together, we can discern that operating issues like growing profitably and establishing professional business management are quite important, but the time to mentor next-generation leaders is so scarce that most CEOs haven't even nominated their successors yet. The requirements of the urgent overwhelm planning which is reduced to merely important status!

CFIB found that only one-third of closely held business owners have a formal plan to sell, transfer, or hand down their businesses in the future. Even those with a plan, moreover, say it's likely to be unwritten and informal. Successful management succession planning requires a structured and formal approach because the transition timeline is quite long, and the need for crystal clear communication and understanding among the concerned parties is vital. Shockingly, *only 16% of closely held company owners are seeking the input of their successors* in the development of their plans!

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<sup>5</sup> KPMG Australia Family Business Survey 2006

The desire to sell a closely held company is one that's persistent among family business owners. In the CFIB and KPMG studies, about 37% of closely held business owners plan to sell their companies; however, not many had adequately prepared their businesses to make them attractive to prospective buyers. They very rarely have the infrastructure in place to realize the potential value of their businesses.

In an attempt to discover what potential purchasers of closely held companies want in acquisition targets, The Family Business Institute undertook an informal study. It was a surprise to find out that most individuals or companies interested in buying closely held businesses look at dozens or even hundreds of deals before ever closing on one. Most of us who dream of selling our companies would never envision the competition would be so intense and the potential buyers so discriminating.

Among the things that potential purchasers want are:

- A management team which can run the company without the owner being there
- Relatively little competition
- A company with a unique niche and barriers to entry
- Motivated employees who are excited and willing to stay with the company rather than leaving and competing (buyer's worst nightmare)
- A recurring, predictable stream of revenue
- Customers and suppliers who are loyal to the company, not just the owner
- Assets which can be leveraged (like property or receivables)
- An industry where giants cannot easily squash the business

The absence of *any* of these items dramatically reduces the value to the potential buyer. As a result of not having sufficient structure in place, most sellers receive far lower prices than they anticipate.

If management succession is, in fact, severely under-planned, what exactly IS being planned to promote business continuity?

According to CFIB, the most commonly cited components of a succession plan deal with technical issues and include:

- The legal transfer of business ownership
- Tax implications of disposing of the business
- The financing of the successor
- The division of future profits after a transition

The things that are *NOT being planned* are:

- Building a common vision for the business
- Strategic planning
- The need for communication in the business and in the family
- Clear roles and responsibilities in the business with appropriate accountability
- Processes for transitioning day to day responsibilities
- Development of marketing and sales initiatives
- Growing both revenues and profits

The intergenerational disconnect in family business communication is enormous. CFIB reports that 74% of current closely held business owners who say they have a succession plan (although usually informal and unwritten) claim to have shared it with their successors. However, 38% of successors didn't know if a plan existed in their family companies, and 40% attest a plan did not exist at all. In other words, while 74% of the senior generation leaders report there is a clearly communicated succession plan, 78% of their successors report there isn't! This indicates a serious gulf of communication between the generations, and surely both sides can't be right.

Clearly, management succession planning is a complicated and vexing issue. Since most family business owners are rational businesspeople, they'd ask a simple, straightforward question: "What's in it for me? What's the payoff to undertaking all this planning and analysis?"

Here's what the data tells us *senior generation family members* viewed as the benefits of succession planning after the events took place (CFIB):

- 82% assisted in providing for family's future
- 76% minimized future tax liability
- 75% provided financial stability to business
- 73% maintained family harmony
- 72% prepared successor for the future
- 72% maintained harmony with employees
- 64% increased value of the business
- 56% improved financial standing of business

Perhaps just as importantly, CFIB surveyed *recent successors* of closely held companies. Here's where they saw benefits:

- 86% prepared me to be a business owner
- 69% assisted in stakeholder relations
- 68% provided financial stability to the business
- 66% improved financial standing of the business
- 65% increased value of the business
- 63% fostered harmony with employees
- 55% fostered family harmony

Senior generation business leaders worry about what will happen to the companies they built after their successors take over, so CFIB surveyed a group of successors AFTER their transition events took place. 68% reported increased profits post-succession, and only 11% reported decreases. 60% reported increased market share versus only 7% who saw less. 54% increased employment versus only 11% who decreased it. This encouraging data coincides with another study from the United Kingdom which concluded business performance usually *increased* following the intergenerational transition.

So how do closely held business leaders assure themselves of achieving the lofty goals of a satisfying retirement, financial security, competent management succession, and blissful family harmony? The

answers can be varied and complicated. However, one rather counterintuitive solution produces consistently outstanding results. As hard as it might be to believe, engaging in *strategic business planning* is the single highest payoff tactic to achieving the ambitious goals above. Researchers writing in *Family Business Review*, the scholarly journal of the Family Firm Institute, reported that business planning, because it fosters communication, information, and knowledge sharing, simultaneously improves family unity and helps develop family culture. Strategic planning coupled with an effort to professionalize the internal management of a family business is quite productive. The empirical evidence observed over the decades by the consultants at The Family Business Institute bears this out. Doing practical business planning can produce the heady results of increasing sales and profits while simultaneously increasing the levels of quality family communication and harmony.

The recommendation to undertake strategic and business management planning runs counter to what most family business consultants have recommended over the years (i.e. family retreats, family councils, counseling, and estate planning). All of these are important tactics and considerations, but none have been demonstrated to produce the long-term benefits of engaging the family and management of the business in the process of practical strategic planning.

#### JOHN & MARY

“You know, Mary, our CFO, Peggy, has been talking about this book she read last year. She thinks we should undertake some of the concepts she read about and try to employ them in our business. I’m pretty skeptical of trying to bring big business tactics into our family company, but she says this process can really be the thing that puts us over the top.”

“I’ve tried talking to our CPA and banker, but all their solutions seem to have to do with planning for the future of our money and the ownership of the company. I’m intrigued with this process of Peggy’s which may help us focus on the operations needs of our company. Maybe if we could get that fixed, I’d be less stressed, and we’ll have more time to travel together.”

“John, I think that sounds like a great idea,” said Mary. “Getting Peggy together with Steve, Jody, you, and your other top two or three employees is probably a great idea. I’ve always said you all don’t meet enough to work ON the business; you all seem to just work IN the business. You’re all so smart and energetic, if you put your heads together, good things are bound to happen. I don’t know what Peggy is proposing, but it makes sense to meet periodically to think about where you’re all going to be in five years. If you don’t try to grab the bull by the horns now, think about how hard you all will be working in the future if the economy stays strong. I’m proud of you for being so open minded. I think that’s one of the reasons you’ve always been successful in business; you’re willing to listen to others’ ideas.”

John’s on the right track. While it may take an attempt or two for Peggy and the team to develop their internal planning processes, working ON the business even a little is quite likely to pay dividends. The first step in developing a management succession plan between the senior and junior generations in a closely held company is to think about what their vision for the business looks like. Once they develop the big picture view (Stephen Covey’s concept of “begin with the end in mind”), filling in the details becomes easier, and everyone’s enthusiasm for pursuing the common goal goes up.

In the final section we examine the question of succession barriers, present some key data, and visit with John and Mary again as they ponder the future of their family enterprise.

## DATA AND ANALYSIS PART 3

### INTRODUCTION

In Part 2 we talked at length about the propensity of the business and financial press to refer to “family business succession planning” as having to do with ownership succession questions only. We pointed out how little attention is paid to management succession and the reasons for this lack of attention.

Management succession in a family or closely-held company deals with the four functional areas present in any business of any size: administration and finance, operations and customer fulfillment, sales, and marketing. Family business executives and managers must dig into each of these functional areas of their businesses and execute the hundreds of tasks, large and small, associated with producing goods and services and keeping customers happy. Big picture strategy is largely ignored, and there is virtually no attention paid in the literature to practical management succession planning for the benefit of these businesses.

In Part 3, we’ll again undertake the issue of management succession planning, identify the top 10 roles for progressive CEOs, look at some key statistics for what happened to family businesses *after* succession actually took place, and offer potential solutions to the thorny problem of how to plan for the management succession of your closely-held company.

### CURRENT ISSUES AND CHALLENGES

Given all the attention paid to the tools and techniques of estate and ownership succession planning (i.e. wills, trusts, IDGTs, ILITs, GRATs, GSTs, etc.), and given the claims we’ve made in this series that ownership succession planning, while vitally important, is less near and dear to the hearts of most closely-held business owners than one might believe, what do family business owners *themselves* define as the issues uppermost in their minds?

Current Issues and Challenges Defined by Closely-Held Business Leaders Themselves:

1. Growing profitably
2. Balancing different interests
3. Regulatory challenges
4. Planning succession
5. Future directions
6. Exiting by retirement
7. Establishing professional business management
8. Selling the business
9. Managing family relationships
10. International growth

Source: KPMG

KPMG undertook a study<sup>6</sup> to identify the business issues most challenging to family business leaders. Referring to the table above, only three of their top ten concerns have to do with ownership planning. Those having to do with ownership succession issues are:

1. Balancing different interests
2. Planning succession (this could relate to management succession as well)
3. Exiting by retirement

All the others, growing profitably, establishing professional business management, etc. have to do with ongoing operations, roles and responsibilities, duties and tasks, and driving the business forward into a secure and prosperous future. From the perspective of the professionals at The Family Business Institute, it's a mystery, given all the attention paid to big business innovations in management techniques, why discussions of management practices are largely dismissed in family and closely-held companies. A possible answer to this mystery is that while family businesses are the engines driving new business creation and the identification of new market niches, they lag behind larger companies in their development of efficient management practices, systems, policies, and procedures.

"John, honey," said Mary, "you look so tired and frustrated, what's wrong?"

John replied, "You've always been able to see right through me, Mary. I *am* frustrated. I feel like I'm caught between a rock and a hard place. Steve, Jody, and our CFO Peggy have all come to me in the last few weeks pushing hard with some new ideas they think will make our business even better in the future. All the ideas seem really good, but if I agree to undertake any one of them, it would mean quite a few changes in the company. Some of their ideas would require us to spend considerable money. I'm really not sure in what direction to go. I've asked my CPA and attorney what they think, and they give me the same old answers: 'Well, it depends...' If I accept Steve's idea, it might alienate Jody. If I accept Jody's idea, it might push Steve away. And I don't know where Peggy would come down on any of this; maybe she thinks I need to ignore both of the kids and pursue her idea as a middle ground. If I was 35, I guess I could see engaging in these things a little more easily. But at 65, I'm not sure I have the desire to go on the hook for more debt and wait five more years for these investments to pay off. Worse, what if they're wrong and these ideas are just pie in the sky things that will never happen?"

"I don't know what direction to go in, and I don't know how to get these ideas right in my mind. Maybe I'm just getting to the point where the old entrepreneurial fire isn't burning as brightly as it once did."

"Another thing is something that my friend Eric mentioned at the club the other night. You remember Eric; he runs XYZ Industries and flew us on his corporate jet once. He said something that seemed silly at the time, but the more I think about it, the more sense it makes. His comment was: 'You don't know what you don't know.' He might be on to something. Did you ever think we'd run a \$40 million business? When we started this thing I never dreamed it would be this big. I'm not sure at the age of 65 I want to learn all the things that it takes to run a \$40 million company much less modernize it, professionalize it, and grow it so it's a \$60 million business. Maybe I should just turn it over to the younger generation and let them figure out what the right answers are. My fear in doing that is that Steve and Jody won't get along when they have to make tough decisions, or they won't treat Robert fairly. Even worse, they might run the company into the ground, and where would that leave us?"

"I *am* frustrated! I guess I just thought that my direction would be a little clearer at this stage in my life!"

John has expressed the lament of many successful family business owners. He's reached an age where he can think about his legacy and all the tremendous successes he's enjoyed, but he's troubled by the

<sup>6</sup> KPMG Australia Family Business Survey 2006



future. He's not ready to retire; he has lots of energy and great ideas to contribute, but on the other hand he's not nearly as energized by or interested in growth as he once was. He's interested in preserving the historical successes of the company, and not in undertaking expensive new projects or large amounts of debt. As the patriarch of the family and of the business, he also has to worry about how his management team will get along and whether they really have the tools necessary to manage a successful and growing enterprise after he slows down. John has always been a doer, and now he's struggling with how to become a teacher, a mentor, and a facilitator rather than a hands-on, get-it-done-whatever-it-takes, butt-kicking producer.

At a meeting a couple of years ago of eight successful CEOs, the group was discussing how to get the most out of an industry-standard software package. They all used it, but it seemed some were getting much more than others. One CEO asked a question about how to key in data into the program to produce a desired result. At that time, FBI's professional consultant slammed his hand down upon the table, leaped from his chair, and exclaimed, "You mean to tell me that you, the CEO of a \$40 million company, is at the office at 8:30 at night keying data into a computer program that one of your \$15 per hour employees could run when you should be home with your wife and children?" The CEOs were aghast; no one talked to them like that. One of them said, "That's why you're here; we've always run our companies this way, and it's the only way we know. What *should* a CEO be concentrating on in order to build his business?"

Since that eventful meeting, we've spent a great deal of time helping CEOs understand what it is that they should do (and what they shouldn't). The following is a top ten list of CEO behaviors which produce deep, impactful, and lasting results. The highest payoff roles for CEOs are:

- 1. Grandmaster of the corporate strategy.** CEOs must be the lead strategists in their companies. Developing and nurturing company strategy is a high leverage, high payoff activity. Abraham Lincoln once said if he had a cord of wood to chop in six hours, he'd spend the first four hours sharpening his axe. Even the best CEOs can't spend 100% of their time on high value, thirty-thousand foot views; however, it's reasonable to set a goal for a CEO to spend 20 – 25% of his time working on strategy and long term issues. Due to the press of work in closely held companies, many CEOs spend zero time on this critical activity.

A family business consultant once said "if you don't have weed control, you have weeds." Many family business owners are trapped in companies where the weeds are predominant (i.e. they're continually putting out fires). In order to get ahead of that fire-fighting, crisis management curve, they have to find ways to apply frequent doses of weed control so they aren't continually plagued by outbreaks of things unwanted. The way to get ahead – and to stay ahead – of the curve is to work ON the business rather than just IN the business.

- 2. Keeper of the corporate/family vision.** The CEO should be the steward of the corporate and family visions. Many corporations and families in business together don't have explicit, written, mutually understood visions for what they want their families and companies to be and become. As with undertaking strategic planning in a corporate setting, pursuing a common vision which is exciting to all stakeholders is a fun and rewarding exercise; the main benefit comes from aligning everyone on the team during the process itself.
- 3. Identifier, codifier, and protector of the corporate/family values.** The CEO is the policeman of the family business to make sure everyone's day to day activities adhere to the explicit and implicit values of the company. We were recently contacted by second generation business leader who was distraught that his newly instituted drug policy uncovered that one of their highest performing employees had been using marijuana. He wanted to give the employee another chance and keep the drug results confidential from other company officers until the employee had a chance to clean up his



act. We talked at length about the importance of the drug policy, about how they had adopted it wholeheartedly, enthusiastically, and unanimously as a zero tolerance policy, and what it might mean to the others if this young executive gerrymandered the results to protect an individual employee. He could see clearly after our discussion that protecting the employee – in spite of his perceived value – was inconsistent with the family business values.

4. **Architect of the corporate structure.** Because CEOs find themselves behind the strategy curve, they often react to their company's evolutions rather than being proactive. In terms of the corporate structure, the CEO should think of himself as an architect. An architect can envision exactly how a project will look upon its completion in the future; the CEO should attempt to develop the same vision for how his company will look both internally and externally.
5. **Bird dogger and evaluator of talent.** The CEO must be the steward of his talent pool. He must develop procedures and processes for evaluating the current employees of his company, and he must attempt to figure out where gaps exist in terms of placing future talent.

For most business owners, there is no strategy or technique for evaluating or attracting new talent and this lack of HR muscle keeps the companies from reaching their full potential. If you get talented, motivated people on your team, there will be no stopping you. If, on the other hand, you have poor talent it will detract from your company's success.

6. **Charismatic and authoritative spokesperson for the company.** The CEO should be the face and personality of the company. People are intrigued with courageous, fearless, rugged CEOs who succeed in spite of long odds. The CEO should be the point person on public relations efforts. It's good for overall company morale to see the CEO in public places and receiving recognition, it's good for the marketing team, and it's good for the company's business developers.

Suppose the CEO is shy and retiring and isn't comfortable being in the public eye? That's okay. Simply find another executive in the organization (a senior non-family manager or a rising NextGen executive) who can ably fill the role and train them on the messages you'd like to see conveyed.

7. **Personification of corporate teamwork.** The CEO should be the person who leads by example and gets on board as a team player. We recently had a call where non-family partner was frustrated. Led by the presidents' initiatives, the management team continually came up with new rules, policies, and procedures which the president summarily ignored. For example, employees were required to adopt new voice and email technology. The president was 100% behind the initiative, and promoted it enthusiastically. He, however, held onto a paper calendar and refused to use the technology. The appearance was that everyone else in the company should be available and reachable using the new tools; the CEO, however, didn't think the new initiative applied to him. This is an area where a CEO should lead by example; poor teamwork by company leaders trickles downhill quickly and undermines team building initiatives.
8. **Advocate for corporate quality and customer service.** The CEO should be the head cheerleader when it comes to providing perfect quality and outstanding customer service. He should be an advocate for the firm's customers.
9. **Custodian of the corporate cash.** The CEO doesn't have to be an expert on accounting or function as an unofficial CFO. However, it is up to the CEO to manage the corporate cash in a responsible way. Cash is king in business, and many profitable companies have found themselves perplexed by a serious lack of it. They ask the question, how can our margins be so good, how can we show so much profit at the end of the year, and yet we never seem to have any cash?

The CEO should have systems in place for forecasting cash. Simple budgeting is a start in this process, but cash management can be quite complex. It may require bringing in someone with excellent business forecasting skills for some tutorials and to help develop or improve systems and procedures.

**10. Referee and mediator of disputes and dissatisfactions.** Another way of defining this role for the CEO would be the Chief Morale Officer of the company. In the ideal organization there aren't any disputes and dissatisfactions, but the ideal is just that; it's a point which can never be reached. It's up to the CEO to make sure that he has the right people in place and the right chemistry among his employees. In a one hundred person organization, two or three bad, morale-busting employees sprinkled around the organization can be a nightmare. Many CEOs consider themselves to be stewards of their employees, and they're reluctant to let people, especially long term employees, go; however, it's much better to prune the business family tree and get rid of bad apples quickly.

The CEO should keep his finger on the pulse of the organization at all times and be continually looking for potential morale issues. When there are disputes and dissatisfactions, the CEO must be a wise, sage mediator.

### FEAR OF SUCCESSION

Like John and Mary, many business families view business succession – whether ownership or management – with a mixture of relief and fear. They're excited about the prospect of having more freedom in their lives, but repelled by the prospect that, in their absence, their children or key managers may make tragic mistakes and cripple the firm the senior generation worked so hard to build.

In what may be the first ever study of its kind,<sup>7</sup> the Canadian Federation of Independent Business undertook research to ascertain what actually happened after senior generation family business owners passed the reins. Their findings tell a happy tale of success following transitions. Referring to the table below, 68% of successors reported that profits rose; only 11% said their profits fell. 60% increased market share; only 7% lost market share. 54% increased employment while only 11% decreased employment. The data clearly shows that succession, far from being the death knell of a successful family business, can be a process which revitalizes and re-energizes a company. Contrary to popular belief, the letting go process generally improves the prospects of the company and increases the financial security of the senior generation rather than impairing it. Given that the survey also showed the vast majority of succession plans were informal, unwritten, and largely invisible to successor managers, the statistics should dramatically improve for companies which undertake a rigorous succession planning process.

Post Succession Results	
<i>Pro</i>	<i>Con</i>
68% Profits rose	11% Profits fell
60% Increased market share	7% Lost market share
54% Increased employment	11% Decreased employment

<sup>7</sup> A CFIB Research Document explaining the most current succession statistics from - The Survey on Financing and Growth of Small and Medium Enterprises conducted in 2011 by Statistics Canada on behalf of a consortium led by Industry Canada

## CONCLUSION

We at The Family Business Institute hope this white paper has been helpful to you in your family business evolution. The two key elements of family business succession – ownership succession and management succession – are both vitally important areas to address during the often crisis-filled period known as transition. Ownership succession planning has gotten lots of ink over the years; however, as both formal research and practical experience tell us, it is *management succession planning* which pays the simultaneous dividends of strengthening the company for the future and increasing the levels of interaction, communication, and harmony in the business family.

### *Relaxing on the deck of their beach house...*

“John, I’m so glad we were able to get away these last few weeks. Relaxing here without the telephone ringing constantly and meeting after meeting has been so restful,” said Mary. “To be honest, I thought you’d be checking in every day with Steve and Jody.”

“I thought I would too, Mary. But after we went through the process of strategic planning that Jody and Peggy put together, I’ve never felt better about the business. It took a long time for us to bat all the ideas around and figure out what direction we’re headed in, but after watching those three young people in action I’m more convinced than ever they can handle the job. You know they haven’t called me once in the last three weeks with a question; they have really stepped up to the plate!”

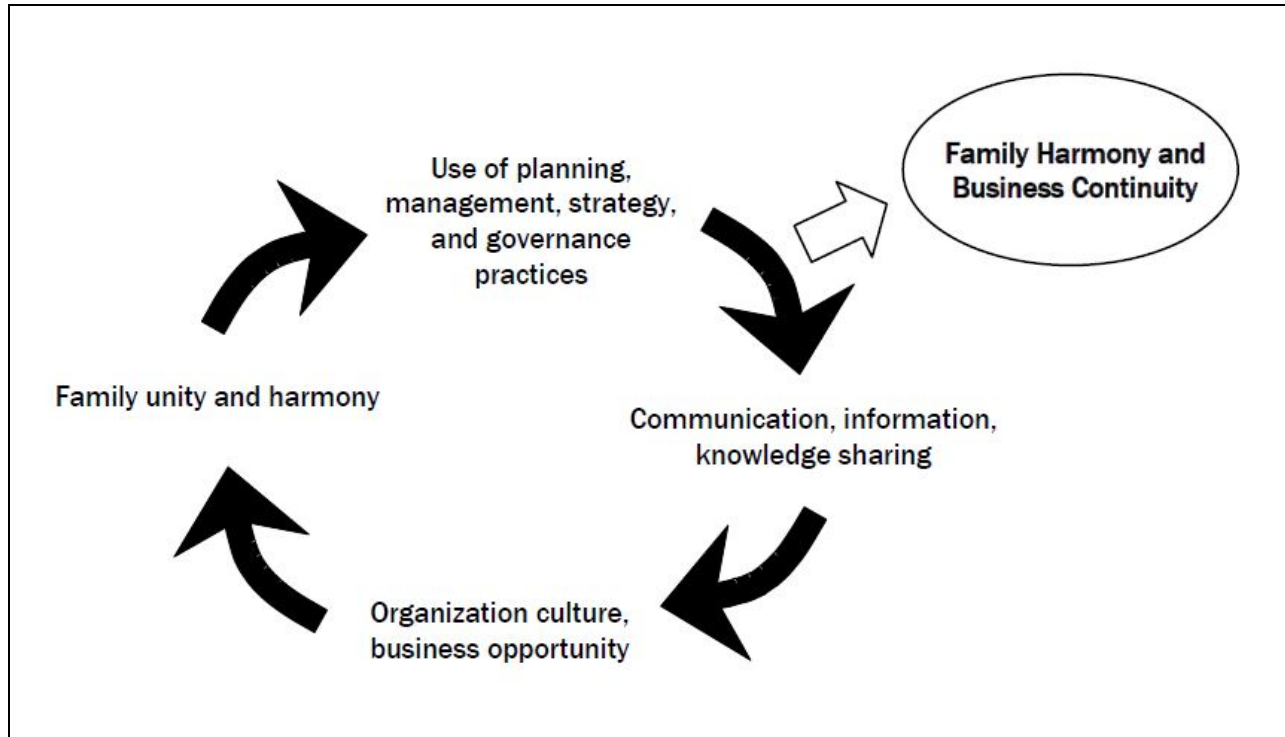
“I also feel a lot better after we had some frank and candid discussions in the family about what Robert’s place in all this is would be. I was always afraid Steve and Jody would want to kick him aside, but I guess I never really knew how much they care for their brother and what good stewards they’re committed to being. I’ve never been one for a lot of formal business planning, but I have to say this process we went through over the last few months has really paid dividends.”

“I’ll say; I can’t ever remember you being so relaxed. I really think we’ve turned a corner in our family and in our business!” said Mary.

## THE SOLUTION

Several years ago, *Family Business Review*, the scholarly journal of the Family Firm Institute,<sup>8</sup> published a groundbreaking article. The academics had confirmed through research what the professionals at The Family Business Institute have long known to be true. The most consistently effective way for families in business together to achieve the mutual goals of family harmony and business continuity is *not* to engage in a process of improving communications with psychologists or engaging in lengthy ownership succession discussions with financial services professionals. Rather, the most effective way to achieve lasting family business success is to engage in a process of strategic planning, management improvements, and improvements in the operations of the family company. This process simultaneously improves the quality of the family business (leading to increased sales and profits) and also improves the quality of communication, information sharing, and knowledge sharing among the members of the business family. That, in turn, increases business opportunities and strengthens the culture of the organization which, in turn, improves family unity and harmony. If you think back to your days as a youth active in sports, try to recall instances of dissension when you were on a winning team; there probably were few indeed. The point is the more successful the family enterprise becomes, the more opportunities for success – business and otherwise – the family is likely to enjoy.

<sup>8</sup> Family Business Review Vol. 1 Iss 2 (Published in June 1988) - The Special Role of Strategic Planning for Family Businesses



Is strategic family business planning a magic bullet or a panacea? Of course not; however, strategic planning and operations planning is the most tried and true, effective, and long lasting solution to resolving thorny family business issues. It can't be used exclusively in every family company situation, but it can be deployed much more often than virtually any other approach or system of problem solving. The fact is, it works.

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