The Rites of Family Business Succession

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A family owned business can be defined as a family owning fifty percent or more of the equity in the company and more than one family member working in the business. A family owned business is also defined as a business being managed by a member of the founder's family, after succession has taken place and the family still has controlling interest. A family business can be redefined as two or more family members working in the business who have financial and managerial control and an intergenerational transfer has taken place.

Most family businesses fail to survive the second generation. It is estimated that only 30 percent of family owned businesses survive the transition.[1] Only 13 percent of businesses survive through the third generation.[2] The failure rate can be attributed to, lack of business knowledge, skills, and commitment on the part of successor generations, family problems that impact the business and lack of planning for succession.

The entrepreneur of a business is seen as having high levels of commitment to the business and customers. Ninety percent of all businesses start out as family owned.[3] Family firms account for eighty-nine percent of all businesses in the

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[1] Reynolds, Paul D., William D. Bygrave and Larry W. Cox, 2002 *Global Entrepreneurship Monitor*.
[2] Ibid.
[3] Ibid.

United States.[4] Family owned businesses reported revenues of $36.5 million, an increase of fifty percent since 1997.[5] Family owned businesses account for 34 percent of the Standard and Poor's 500 Index. On average, the founding family owns 18 percent equity in these companies.[6]

The family owned business on average, employs fifty full time employees and 6 percent have over 500 or more employees. Family companies tend to keep employment levels stable and avoid layoffs. Young family companies and family firms older than fifty years outperform non-family firms. Forty percent of family businesses will experience leadership changes in the next five years. Thirty-four percent of family owned businesses report that the next CEO may be a woman.[7]

The typical family owned business is deeply involved in the community. Some family members fear that selling the business would spoil family members who receive financial support from the company. Owners try to keep family members' wealth tied up in the company. Owners continue the business to provide employment for these family members. Under these circumstances, business leadership can start to erode.

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[4] Astrachan, Joseph H., and Melissa Shanker, *Family Businesses' Contribution to the U.S. Economy: A Closer Look* (2003).
[5] Astrachan, Joseph H., and I. Elaine Allen, *Mass Mutual/Raymond Institute American Family Business Survey* (2003)
[6] Anderson, Ronald C., Satter A. Mansi, and David M. Reeb, *Founding-Family Ownership and the Agency Cost of Debt* (2002)
[7] Anderson, Ronald C., and David M. Reeb, *Founding-Family Ownership, Corporate Diversification and*
[7] Reynolds, Paul D., William D. Bygrave and Larry W. Cox, *2002 Global Entrepreneurship Monitor.Firm Leverage* (2002)

Many family members cannot face their egos or the thought of selling their parents or grandparents business. Of the family owned businesses in the United States, 33 percent have an owner of sixty-one years old and only 28 percent have a succession plan in place.[8] Families that are committed to the continuity of the family business shares three general characteristics; they believe that owning the business helps serve their family's mission, they are satisfied with the values exemplified by their business, and they believe that the company is contributing intrinsic value to society.

Commitment is the key to successful family owned business succession. Every family owned business should define and establish a shared vision for the future. The owner must decide what to accomplish for the business, the family, key employees, and the stockholders. Family owned business leaders must establish individual goals that relate to succession, retirement, and personal lifestyle.

Should the owner keep the business or sell it? If the decision is made to keep the business family owned, who will be the next leader? If the business is sold now, could the owner maximize its value?

A family owned business is an excellent example for companies to exemplify values that are important to them. Values bring

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[8] Anderson, Ronald C., and David M.Reeb, *Founding-Family Ownership and Firm Performance: Evidence from the S&P* 500 (2002)

strengths to both the business and the family simultaneously. Family businesses can be great financial investments but owners are usually more knowledgeable about their business than alternative investments for family members. Family owned businesses have excellent financial returns but this can be an insufficient reason in some instances to continue as a family owned company. Different family members focus on different roles of the business in society and their importance. The success of the small family owned business is an inspiration for others to follow.

Family business is very fragile during the first generation. The business usually begins with little capital and few customers. The founder of the business may be forced to take on marginal customers and suppliers. This relationship allows for the growth of the business. This same type of situation often occurs for employees of family owned businesses. Relationships among the founder, suppliers, customers, and employees are unique in the beginning of a new business. A family owned business could be particularly trustworthier because of the integrity of the family's name and the company's economic future. The emphasis is on building long-term relationships with customers, suppliers, and distributors in order to retain their long-term preference and business. Relationship marketing is transforming indifferent customers into loyal ones. This type of marketing relationship benefits both the company and the customer. The reason behind this relationship is that the businesses engage customers in long-term partnerships that positively influence the company's bottom line. Long-term productive employees provide the customer with excellent service that leads to customer satisfaction and loyalty.

Every customer has the potential to make or break a business.

Trust is another issue of relationship marketing because long-term relationships are built on trust. Trust operates on a number of different levels. Levels include between business and the customer, between business and the supplier, and between the employees and management. For example, management must trust employees, but employees must trust management for the relationship to work.

Family businesses are particularly skilled at relationship marketing because of the way the business grew up and the founder's entrepreneurial style. The first generation family business owner builds his relationship with customers by understanding their importance, willingness to take risks, commitment to the customers' well being, and the willingness to bend the rules. Founder's closeness to employees and the establishment of trust with all members of the business family contribute to helping the owner establish a practical business.

Second generations bring on a new change in relationships with customers, suppliers, and employees. The second-generation business owner may have a different agenda than the founder. Customers and suppliers, who have been doing business with the company because of the relationship with the owner, may use succession as a reason for discontinuing doing business with the company.

Relationship marketing is building one customer at a time. When business passes from first generation to second generation, the initial relationships may be tested. The successor must assure customers, suppliers, and employees that they are valued assets to the company. Decades ago, a family father had a very simple task of choosing who would receive the family fortune or take over the family business. Passing on the torch is an apt image for business, in which a family business leader hands over the power to a child. For the founder it means giving up control not only of the business, but also the parent-child relationship. First, is to have a long-term plan for increasing the child's knowledge of the family business. Parents need to be able to separate personal feelings from business issues.

Leaders that are successful in the family business are often outstanding stewards. Most business owners may be experts in the day-to-day operations of their family owned business but are not equipped to handle the special challenges of succession. Attorneys can protect family members and the business from claims of creditors, ex-spouses, and other parasites. Do not treat family succession as a secret.

Family owned businesses should understand how critical it is to treat non-family employees like family. There is an importance that the family business replaces the equity component for non-family members.

Family business owners need to do a compensation study to ensure that non-family employees are enjoying a competitive package. Family business owners should add on what is called, "handcuffs" programs, such as vesting and incentives designed to keep non-family employees satisfied and motivated to stay with the company. Many retiring family business owners have difficulty giving up control even when they have faith in the successor. Many businesses are turning to outside family business consultants to help them steer their operations. Family business consultants come in various disciplines including banking, education and psychology. Succession planning is essential to business owners and their families. A business owner must have a transfer plan for every significant asset. The will and trust can never protect the owner's family and business, because these documents only speak when the owner dies. The owner should never sell his or her business to younger members of their family. The owner's business is out of the estate.

Proper planning and the help of well-trained consultants can help to keep the family in business by using an overall analysis. Part of this analysis includes looking at constituents of the succession. There is one final test that a family business succession plan should take before the process is implemented. Three groups should be involved in this test. The first group is adult family members who are employed in the business. Secondly as a group, are adult family members who are not employed in the business but are stakeholders. Third, an important non-family group is employees and advisers. Are these three groups involved and considered in the succession process? If all groups are not involved, the succession will be difficult at best.

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