



THE SITUATION ROOM

The Executive Overview for:

Succession and Transition for the Family Owned Business

"There is nothing more desirable or difficult than to effectively transition a family business from the current generation to the next generation. The key theme of this segment is that it is critical to make generational transition planning a process and not an event. It is also very important that it be done as part of a long-term plan surrounded with communications to all family members and stakeholders. The situations around transitioning a family business are all very different. There are many potential scenarios. Each one may have some additional twists but we have tried to provide some general thoughts and guidance on this critically important topic.

We have attempted, based on many years of observation, to provide some insights regarding some of the critical points that should be considered while planning and moving through a family business change of control." - YourBoard.US

1. Opening thoughts.
2. Steps to raise the potential for a successful family business transition of leadership and control.



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Transitioning the family owned business is possibly the most difficult topic to deal with in business. The reason is because there are many, many different situations within both the family, the family's role in the business and the desired outcome that the current generation of ownership desires for both their retirement and the future of the company.

A very experienced patriarch of a large family, who had many family members participating in various roles within their fairly successful business, once told me that the absolute best way to involve family members in the family business is to hire all outside professionals to man the leadership and management positions and give all family members equal stock and provide them with dividend income. Each member of the family would then be able to pursue their personal avocations and, depending on the success of the business, have a revenue stream to supplement their lifestyle and an asset with value to be sold at some point in their future. In his mind that would remove all of the potential family issues that could potentially develop. Since I initially heard that comment many years ago, I have heard variations of these same thoughts repeated over and over many times.

In a non-family owned business, if a particular associate is not performing to the level outlined in the RROI-Position and Performance Agreement, there are several coaching and performance recovery steps and then there can be a decision made on the potential for correcting the situation through development or go as far as separation. While this separation, done with respect and fairness, causes pain for the person released, it generally does not have a long-term impact on the ownership, leadership, managers or the business in general, in a non-family business.

In a family-operated business, on the other hand, the correction of poor performance attributes, attitudes or passion and work ethic results in significant pain for the family member(s) involved.

This includes the siblings, their spouses or other family members and certainly, the patriarch and matriarch of the family. It can be the most difficult situation for a family and a business to get through. Even if it is not a "corrective action" but instead a perception of unequal treatment between family members the negative emotion and resulting stress is the same.

The number of family members involved in the family business, their relationships, and in what positions they are assigned, will determine the seriousness of the potential conflict. Many times the family relationships will never be the same and in many cases the business won't either. The sad part is that in many cases the company, under this troublesome family environment, will not function at full potential and much of the potential profitability and company value go unrealized for all members of the family who are involved. Harmony and maximum profitability and shareholder value are sometimes the victims of improperly planned family succession.

Another consideration for limiting family members within the business is that if, in time, there is an interest in selling the business, and the value is much greater if family members are not filling several key positions.



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The real truth, however, is that it is the American Way to prefer a family business stay in the family.

- Having passed along all of that anecdotal information and the warnings regarding “transitioning family owned businesses from generation to generation” we must accept the fact that most current generation owners want nothing more than to develop a succession plan that includes a son, daughter or multiples sons and daughters in the leadership and management of the business. Quite honestly, it is part of the American Dream.



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Steps that raise the potential for a successful succession and transition of the current family business to the next generation.

Step 1

The first step is for the current generation of ownership that will be exiting the business, to agree among themselves, before involving any of the next generation, what their plans are for retirement and the financial transfer of the business to the next generation and even more importantly, what their vision is for funding their retirement through the business.

There are potentially many combinations of ownership transfer and succession visions and situations that can be in play among the current generation of owners that need to be discussed on a non-emotional and professional business basis. Before anything else occurs, the current generation must first be on the same page.

- If the current generation ownership is one family member (father or mother) with no current generation siblings involved and one interested decedent to pass the business on to, this process is a lot less complicated.
- In many cases, however, the ownership is currently between several family members with different visions for the transition of the business to the next generation. It is nearly impossible with this situation to keep emotion out of the planning process without outside guidance.
- In this case, it is always more prudent to bring in an outside facilitator to work through the plan for succession. If you reference the section on Portals for Expert Support, there is a recommendation for a firm who does this type of family succession counseling. This move will take a lot of pressure off the family members and generally produces a good outcome. Everyone has to agree to this “semi-arbitration” process up front.
- If it is a simple succession transition to the next generation of family, generally a trusted family advisor like your legal counsel, your accountant or someone with family credibility (experienced in succession plans and buy-sell agreements) or a trusted friend who has been through a similar situation can help form a support team that helps you maneuver through the succession planning process and the execution of the transition.

A trusted friend or key advisor who can bring experience, credibility and stature to the succession planning process is key to its success.



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Summary of Step 1

In either of the two scenarios discussed above, there should be an outside support person or team pulled together to develop the plan for succession. This is generally best done without direct involvement, at this point, of any family members who would be recipients of the business or a key position within the succession plan.

This “current owner” succession plan centers on these topics that should be discussed and decided upon upfront:

- When should retirement occur?
- What is the initial thought on transitioning the business and what methodology is planned to fund the retirement?
- What role (if any) should the current owner have after retirement? This is a very dicey subject that needs to be thought through by the current owner(s) and then discussed thoroughly with the potential successor(s).
- Who is the recommended successor for the Senior Leadership position being vacated by the current owner?
- What skill sets and operational experience still needs to be developed prior to his/her selection as the successor for the next generation?
- How will the other owners, non-owner siblings, family members or company stakeholder (banks, suppliers, associates, etc.) react to the potential announcement of your successor candidate? What needs to be done, if anything, to improve the reaction to the announcement?

All of these considerations, and others, need to be thought through with the participation of your “trusted” outside support person before you move to the next step.



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Step 2

After the initial succession and transfer of the business plan is thought through and outlined, it is important to confer, first as a father or mother, and then as an experienced business person interested in the successful longevity of the company and organization of associates, with the successor you and your support team are nominating. It may be a son or daughter who is currently working in the business or it could be a son or daughter who is currently employed outside the business.

- Where this process gets very difficult is when there are multiple family members and siblings in the business who all “may” feel they have a shot to be the successor. Even more difficult, is when there are several siblings currently working in the business and the current owner and their trusted support team have selected a sibling from outside the business.
- All people, as is certainly the case with siblings, are not created equal. It is critical that there is direct and respectful communications with the siblings that are not recommended for the Senior Leadership role, that do have an interest and may have previously expressed an interest.
- Even those family members, who have not expressed an interest or who understand that they are not ready for the senior leadership role, need to have the courtesy of a direct and respectful conversation with the first generation about the decision and how the decision was arrived at for the benefit of the business and the entire family.
- The **perfect outcome** is when the family successor nominated by the current generation owner(s) would be the same family member that would have been selected if there were a vote.



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- A very critical part of Step 2, and the individual communications with the siblings regarding the successor plan, is to include all sibling spouses. What I have witnessed over the years is that it is among the sibling spouses where much of the family issues are percolated.

Taking the time to layout the plan for retirement, transfer of the business and succession far upfront and discussing the plans going forward for assuring the company performs profitably and gains value is important for every family member to hear. It is best for that communication to occur far in advance of the successor selection process.

It is important to sincerely express to all family members that all decisions regarding the business, can adversely affect the family if there is not a general trust that the first generation and their trusted advisors are making decisions based not only on the owner's behalf, but in the best long term interest of the business and the family.

There is a different relationship between parent and child than there is between parent and son or daughter-in-law.

The son or daughter is used to seeing the first generation operate in the family's best interest over many years, whether they agreed or not, while the son or daughter-in-law do not have that history and that string of understanding that is in the bloodline.

It is very important to take extra time outlining your vision for the business and family participants in the business, with the sibling spouses. They are a strong influence on the siblings and deserve to be included in the succession communication process.

- The "**Perfect Outcome**" can occur frequently when the transfer of the business and succession preparation is treated as a long-term plan over an extended period rather than a snapshot event that has not been thought through and "informally tested" within the family and organization over a period of time.
- I have witnessed worse scenario cases where the current generation has decided to retire fairly quickly (sometimes due to health or other personal situations) and has made the successor announcement to the organization without any pre-planning or pre-communication. That can be a nightmare.



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Step 3

- In a proper succession planning scenario, after all of the family is aligned, as best as possible, (and that may not be perfect), it is very important to align the non-family associates by including them in multiple communications and Q&A sessions after the pre-planning and family discussions are complete and the choice for the family business transition and successor is made.
- There is one statement that should be understood and memorized by the next generation family member successors to the senior leadership position and that is **“You may inherit the business but you never inherit the trust and respect of the organization . . . you must earn that by demonstrating the qualities of great leadership.”** (These qualities are discussed in detail in the Part I segment on “Leadership and Vision.”)
- Many successors “miss the boat” with the organization by acting as if they were crowned king rather than taking the time to “start from scratch” and build a broad range of internal relationships based on trust and respect with each key individual both family and non-family. Arrogance is a curse that can become painfully obvious during a poorly planned transition. That simply cannot happen if the transition and succession is to be successful.

Step 4 The Perfect Plan for Succession

- If it were a perfect world, the current owner’s selected candidate for succession would be accepted as the logical, and even preferred choice, by the family members in the business, the family members outside of the business, the family member in-laws and non-family members, and outside stakeholders.

This can happen if succession is truly a plan over time and not a reactive event.

Step 5

- How does this miracle occur...by identifying the “keepers” early on, just as we do in non-family business and creating the “keeper” development plan. That prepares them for the future. The segment on “keeping and developing the “keepers” is no different when applied to the family business than in non-family business and is the signal delivered to both the family and non-family associates, over an extended period of time, that a family member is being groomed for the next senior leadership role. There are no surprises. There still needs to be a lot of communications and one-on-one discussions but at least there is no surprise.



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Step 6

- Use the core document i.e.: RROI-Position and Performance Agreement as the tool to outline both the career path and the personal and professional development plan for successor candidates with a special “keep the keepers” focus on development of the career path.

Step 7

We have discussed under the segment on Gatekeeping, the very important **Hiring Process**.

As the current owner begins the process of successor planning, it is a great idea to go through the same steps as you would if you were planning to hire an outsider to ultimately succeed you in leading your business.

The family member candidate you have spotted as your successor will be accepted by the siblings working in and out of the business, their spouses and the non-family associates, and will generate much more credibility if they have been selected under the guidelines and philosophies of a formalized hiring process. Again, this is best performed by a trusted friend like the company lawyer or accountant etc. or an outside facilitator.

The Hiring Process, the RROI - Position and Performance Agreement and the Keep the Keepers program and now the succession and transition process are all designed to create and sustain a high-performance company through an ownership and leadership transition that will assure the company maintains an ongoing competitive edge, growth, sustained profitability and longevity whether it's privately held or family operated.



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Apply the exact same principals and philosophies that are in play in a non-family business to your family owned business and communicate that philosophy to the entire family, early and often, and you will set an expectation from the beginning which will grease the skids for succession and transition going forward.

- It is critical that every family member working in the business, spouses, non-family associates and outside stakeholders know that your future is more positive with the next generation of leadership than it has ever been, because of the planning, development, training and OJT programs in existence for the next generation.
- The one thing to remember is that you want the best people to operate, sustain and improve your company. There are some common denominators, that must be present, or that we are certain are developable in our leadership candidate for the future. They include:
 - Formal Education and Strong Aptitude
 - Skill Set and Experience
 - Personal Attributes
 - Behavioral Attitudes
 - A strong work ethic
 - A Passion for Success for the company and all associates.
- If your family successor candidate is not ready yet, be certain there is time to get them prepared before retirement occurs. You may consider taking the bold step of mixing the Senior Leadership Team with both family and non-family members by selecting a non-family member, for an interim period, until a successor candidate finishes school and works his/or her way through the organization to gain experience.
- Many companies have as part of their charters that the CEO, COO or CFO must be outsiders to the family. All of these types of philosophies must be communicated up front to all family members.
- Many current generation owners require that their children secure their education and then work several years at a non-family associated company to both gain experience and better understand what they really want to do in life. It is best for family candidates to understand "who they are" and what they really want to do in life before they assume a role in the family business. This is why a long-term Succession Preparation Plan is so critical to making the transition successful.
- Remember the most important statement that can be made is: "the transition of the business and related succession planning process is not a 'snap shot' it is a movie." If you don't have the time to produce the movie, don't begin the transition until you do or appoint an interim leader until the time is ready to name a family member as senior leader.



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- A perfect story to conclude this segment of business transition and succession within the family business comes from a personal experience of a first-generation owner who wanted several of his children to be in key leadership roles. He wanted, in the worst way, to work with his children in the business. His motives were all pure. In each case, while the siblings were all very well educated, they were not at all equipped with the skill sets, experience, attributes and, most significantly, attitudes and work ethics to be in their assigned roles. After three or four of these poor assignments had been made by the father, the mistake was very obvious and it was necessary to begin backfilling for the missing skill sets and in essence, doubling the payroll in order to get the work done. Dysfunctional in-fighting was rampant and the business almost went under.

The father, who only wanted to bring his family closer together by having all of them in the business was very distraught by the outcome.

This is a true story, which I have seen repeated to certain degrees many times. The problem is rooted in not establishing up front with the family, the strong philosophy of hiring the right people with the right skill sets, aptitudes, attributes, attitudes, work ethic and passion for the role. This principle is sacred and should be applied equally to family and non-family businesses.

- One final important element that should be included in your family – business philosophies is that you constantly, and positively, communicate to the entire family that the family's role is to love and care for each other and to be positive influences on each other's growth and development. Business challenges must be left at the door at all times, not to be dealt with on family time.
- Keeping the conversations at the business conference room table and NOT the family Thanksgiving Day dinner table is a lot easier said than done. The pro-active example set by the patriarch, matriarch or eldest (most respected) sibling is very important. The most trusted person in the family must establish the role of separation between the family bond and the family business.



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References

The Goering Center for Family and Private Business in the Carl Lindner College of Business at the University of Cincinnati, has been assisting individuals through the challenges of business ownership transition for 25 years. During the last 10 years, they have done this through a formal program called "Next Generation Institute" Program. Over 175 firms, within the Cincinnati Regional area, mostly family owned, have taken part in this educational experience.

The leadership at the Goering Center concludes that transitioning a family business is probably the most difficult challenge that will be faced by a family owner over their career. It is complicated and highly emotional. The approach we have taken during our discussion here is similar, in most respects, with the Goering 8 Step Approach. The key, that is agreed to by every group who has done studies on family business succession planning and execution, is that clear and repeated communications upfront, and then consistently before and during the transition, is critical to success.



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