DENTON LUKE ASSOCIATES
Management Consultants

HELPING BUSINESSES ADAPT, GROW AND DIFFERENTIATE IN A FAST-CHANGING WORLD

Preparing for Generational Change in Closely Held Companies

Family-owned businesses remain the most common form of business enterprise in the United States. Inevitably, the question of the options available to the founder to exit the work-a-day life arises. Often, when family members are involved in the business, the choice made is to pass it to the next generation. Sadly, while statistics vary, the success rate for second generation owners is low, and it continues downward for third and fourth generations.

This implies at least two conclusions. First, to increase the likelihood of success, the decision to transfer the business to family members must go through a lengthy and rigorous succession planning process and, second, other exit strategies must be carefully and simultaneously considered.

Like any human resource development activity, assessing and verifying that the next generation has the requisite skills must start years before the intended transfer. Several fundamental questions must be answered – what is the value that the business delivers to its customers, and what is the role of the founder in achieving that? Does that role require a strongly personal skill that is not easily substitutable? Does a strong personality lead the business now? Most often, simply because of the nature of family businesses, the role played by the founder is critical to the success of the enterprise. Importantly, it is necessary to try to filter the influence, overt or not, that family participants may have on the process of evaluating the succession strategy and incumbents.

If it is felt that succession is a possibility, comprehensive plans must be developed early, to groom the successor and address how responsibilities will be redistributed at the time of the transfer. As with any personal development plan, there must be timelines, roles and responsibilities. Will outside recruiting be required to fill any holes, and, if so, how far in advance?

This transition may represent an important strategic transition point in a business. Whatever the outcome with respect to leadership change, the company will undergo a period of uncertainty if not significant change in the eyes of staff, customers, suppliers and marketplace rivals. It is vitally important that a strategic business planning process supplement the succession planning process. Often the successful first-generation owner thinks and speaks of taking care of offspring, and coupled with the pride of having created a legacy, misses the opportunities inherent to alternative courses of action. Having the wisdom and discipline to conduct a thorough and objective evaluation can help the owner avoid under-valuing options or prevent the next generation from pursuing a course of action or inaction that diminishes enterprise value. But, again, basic questions need to be asked. At what point in the economic cycle is the business, and what are its relative strengths and vulnerabilities? What do its customers say about it? Will it need substantial capital to remain viable? Where is it with respect to competitors? The questions are many. But, when they are carefully answered with data, the findings may point in a different direction than just turning the business over to the next generation. Because conclusions are data-driven, family strife is likely to be minimized.

When talking about taking care of family members, many have a reflexive aversion to leaving behind money rather than a way and place to earn it. A lifetime of business earnings could exceed the pot of gold available presently. But we cannot lose sight of the statistical likelihoods when making the decision. All that has been built may be lost, leaving heartache and no resources. Surely it is worth a more careful look at a sale now.