Narrative – Five Reasons Family Business Plans Fail (presentation delivered 05-12-16)

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This article summarizes the educational event which focused on Five Reasons Family Business Succession Plans Fail:

The presentation discussed the following topics:

Few Facts on small business and succession
Financial Traps
Waiting too long to plan
Not dealing with family issues
Skills evaluation and Choice for Successor

Scott was introduced to the audience by Richard Wait. Scott began discussion by sharing to the group that it the core… Family Business Succession is Wealth Management Issue for the owner, family, and the successors.

A Few Facts...

- *8 to 10 trillion dollars are going to pass from one generation of ownership to another over the next 14 years.*
- *99% of businesses are small and privately held with less than 500 employees.*
- *95% of businesses have 20 or less employees*

- *Family Firm Institute and statistics*

- 88% of Family Business owners' believe that in the next five years they will transfer ownership to the next generation
- Actual statistics of survival rates are that only 30% of family businesses survive to the second generation while just 12% make it to the third.

Financial Traps

What are common traps?

1) *Inadequate price and terms for founder to sell the company and transition into retirement*

   One critical step to determine the founder's post-retirement needs:

   Prepare Financial Analysis of founder's post-retirement financial plan…

   – and a "Buckets" analysis

   A Buckets analysis separates the owner's financial resources into various buckets, one of which is a safe bucket that is invested in fixed income, safe investments that is protected from volatile stock and bond markets. Another bucket would be an investment fund bucket invested in the stock and bond market that has an objective that is high return with a high risk objective; and a third bucket with the objective to keep for entrepreneurial pursuits. The return objective is very high with a very high risk profile. The buckets analysis will allow the owner to consider how much to allocate for safety, investment returns, and entrepreneurial.

2) *Wherewithal to pay of successor(s)*

   a. *In some cases the SBA, Small Business Administration, is a funding source for buy-sell arrangements for family businesses. As Tom Traficanti mentioned, it is best to discuss financing plans and management transition with the company's lender as early as possible.*

   b. *Alternative plans to lending sources include an extended buy-sell agreement (installment sale over time) with owner and successors with or without insurance as funding vehicle upon the disability or death of the owner. The insurance strategy requires that the owner is insurable and that the business and / or successors are financially able to afford the insurance premiums. The installment sale usually is contingent* *upon the financial success of the business. In effect, with the growth in profitability, the business pays off the owner over time. The insurance vehicle would be available with the event of the disability or death of the owner.*

3) *Satisfying Lender requirements in the succession*

   a. *Collateral on lending relationships is an important consideration in the succession of the company as well as Personal Guarantees on company loans at transition time. In general, providing the lender confidence in new management and ownership commitment will allow for a smooth transition of the company. As Tom Traficanti suggested, having discussions with your lender early and often in the transition process is a best practice in maintaining a strong and healthy relationship with your lender.*

Waiting too long to plan

Common issues are liquidity needs of family upon the founder's death due to estate taxes. The classic case of the farmer who is land rich and cash poor. This is an issue with estates that are larger than the federal estate tax which in 2016 is $5.45 Million for a single taxpayer and $10.9 Million for joint filing taxpayers. If the founder and his wife's combined gross estate less liabilities is over $10.9 Million, then there is a potential liquidity problem upon the founder's death unless the family does adequate planning. Waiting too long can be catastrophic to the financial health of the family and next generation.

Wealth loss due to the founder's disability or death. Since the business is many times one of the largest asset's the founder and spouse own, if the there is little or no planning, the wealth in the business could be in jeopardy or even evaporate within days or months of the founder's death.

Leadership and transition crisis can result due to chronic health problems. With ill health, the owner may not be able to adequately transition the company that satisfies his or her financial and lifestyle needs. Here are a few examples.

1) *Printing company founder was not able to agree with successors on price and terms of sale / succession.*

- In a business that Scott was involved many years ago, the founder had six locations four in our area and two out of state. The owner could not agree with employees interested in buying his company or with competitors interested in in his company. Eventually, at the end of his career, he had one location and closed the store when he suffered a major stroke.

2) *Professional accounting office founder - no succession plan.*
    - Just recently, we learned of colleague who suffered a massive stroke and had no succession or continuation plan with employees or family. He closed the office due to his health condition.

3) *Manufacturer / distributor founder with chronic illness - business closed*
    - Some time ago, our office received a desperate call from the CFO of this company. He was referred by a local consultant. The company founder and president who had a chronic disease for many years had suffered a major setback and was incapacitated. The CFO asked for suggestion on what plans could be made. At that point, the only suggestions we could give is to attempt find a buyer immediately or at least consider selling company assets and intangible assets such as their customer list.

The solution to avoiding this issue on planning is to be proactive in your succession plan. We suggest you consider a five step process:

1- Transitional Objectives that answer the question – What does the owner want to achieve from their succession and exit? This is a goals analysis of the owner for the succession and his future goals review that includes his or her spouse and family into the future.

2- Personal Review and Personal Initiatives – What is the personal situation and what are the necessary planning initiatives? In this step, we suggest that the owner have a comprehensive financial analysis post-retirement and have the owner consider the top passions he would like to pursue and has started on those paths to-date.

3- Business Review and Business Strategy – What is the current business situation and how does it reach its potential? A business review includes a determination of the value of the company and a possible strategic plan for the company to provide even more opportunity for the next generation of owners.

4- Consider the best way to exit – What is the best method to transition the business and meet the owner objectives? This step should follow from the good planning and considerations of the previous steps. Having a plan A, B or even C is a best practice so that if the preferred successor and exit are not working out as planned, the owner can quickly change course on the next best path to an optimal exit.
5- Strategy for Transition – What needs to happen to optimize the owner's post-retirement lifestyle and how does the business and successors thrive after the transition? This is the tactical plan that builds on the previous step. It's the question of how to execute the strategy(s) chosen.

Not dealing with family issues

As with many family situations:

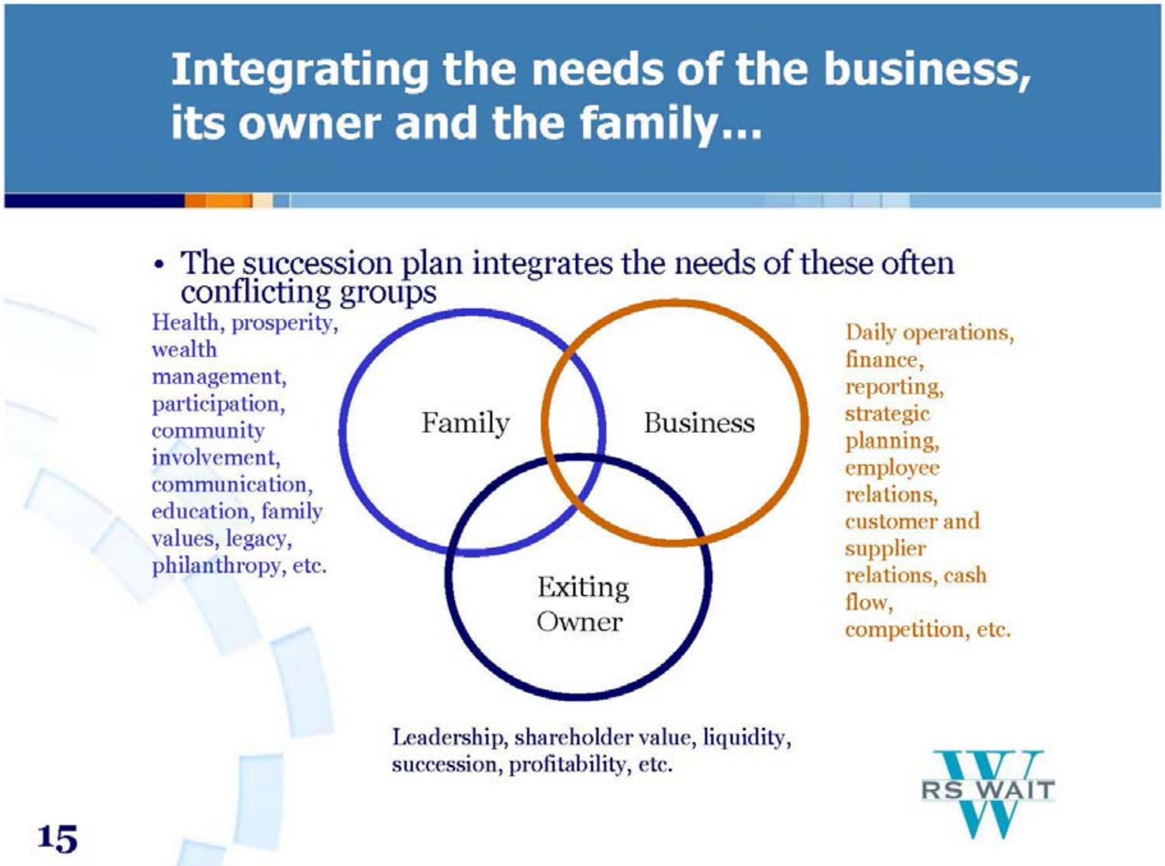
- *Siblings have strengths and weaknesses as well as a history of healthy collaborative relationships and*
- *There are relationships that are strained or have rivalries.*

How does the founder, the family, and successors manage and resolve issues in relation to the succession of the business?

Succession planning is a delicate process.

In reality, family, business and ownership are equally important.

Some owners consider using the "do-it-yourself" approach, and find trouble integrating the needs of the business, owner, and the family is summarized in the following slide:



Skills evaluation and Choice of Successor(s)

A method we have found successful with family business succession are using four phases:
Phase One- Assess the existing environment and team
Phase Two- Assess the candidates for succession and identify the successor
Phase Three- Develop the Professional Development Plan, job description, scorecard, and compensation program
Phase Four- Implement the Professional Development Plan, develop the team, measure and adjust as necessary
As noted in earlier part of this discussion, many family businesses have put in place parts of this plan consciously or unconsciously. The important aspect is to develop an objective plan that is fair and provides for an effective process to identify and develop the successor(s). Scott mentioned a client who owned an automobile dealership in the local area who went through a methodical process in determining which of his sons were best

suited to succeed him and lead the company upon his transition. One part of the development plan was to ask his sons to learn the automobile industry from the wholesale side of the business. Only one of the three sons agreed to do so. After several years in the wholesale business, the son had substantial experience in the industry and felt confident in leading the dealership upon his return. The son, chosen successor with the experience, was the best choice based on his experience and leadership skills he acquired during his time away from the dealership. The chosen successor implemented innovative changes to the service department including two and three shifts to allow for effective and efficient maintenance for their customers. He implemented the new shift routine based on the profit earned on service, new car and used car segments in their business.

- Identify Successor(s)
  - *Family Member(s) – predetermined? In, some instances family members need time to develop skills to run the company.*
  - *Employee(s) – predetermined? Employees, non-family members, may be the best successor for the interim period based on their whole skill set*

- Understand Successor(s)
  - *Interview Process. Interviewing candidates clarifies their goals and objectives as well documenting qualities that the owner and management discover in addition to past behavior.*
  - *Understand how successors are wired. There are many testing methods such as Emergenetics, Chemistry Match, and others.*
  - *Current Role(s)*
  - *Current Knowledge and Skills*

There are common evaluation criteria

- Experience
- Skills
- Leadership Ability
- Team Integration
- Fit with Owner Objectives
- Timeframe for Succession
- Financial Ability for Ownership

Here are criteria samples for timelines to succession:

- *High: succession in under 2 years*
- *Medium: succession in 2 to 3 years*
- *Low: succession in over 3 years*
- These time lines may be low depending on the experience and skill sets of the successor(s).

An optimal outcome is the preferred successor:

- The chart helps to identify the successor and/or the potential areas of challenge for the predetermined successor
- The next step is to document the new way forward in terms of development and training that is required to prepare the successor for the role of owner
- This is what we define as the Professional Development Plan

Why do you need to do this?

- To enhance business success
- To guide the succession transition
- To bring the team together
- To allow consistent decision making
- To create shareholder value
- To secure retirement plan

Scott summarized the presentation discussed:

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Waiting too long to plan
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Skills evaluation and Choice for Successor

Scott shared helpful resources as follows:

- **Finishing Big… Bo Burlingham, author of Small Giants**
- **Family Firm Institute website http://www.ffi.org**
- **Small Business Administration website http://www.sba.gov**

Scott concluded the program by asking for any additional questions and offered to meet with any members of the audience to discuss confidentially their specific questions and then adjourned the meeting.

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