

SUCCESSION PLANNING NEEDS TO BECOME A PRIORITY FOR CLOSELY HELD BUSINESSES

There comes a point in the lifecycle of any family-owned or closely held business when the owners must step back and decide what will happen to that business once they are no longer at the helm. Too often, this fails to happen, putting even the most successful businesses at risk for failure once the founder no longer oversees the company's day-to-day operations.

Statistics confirm the worst. Seventy-three percent of closely held businesses don't execute any type of succession planning. As a result, 70 percent of closely held businesses do not make it to the second generation and 85 to 90 percent don't make it to the third generation. The greater majority—estimated between 95 percent and 97 percent—do not make it to the fourth generation. Considering that an estimated 11 million family businesses employ almost 60 percent of the American work force and are a significant portion of the United States' gross domestic product, the importance of keeping family business strong and smoothly and successfully transitioned among generations is clear.¹

Why the high failure rates? Sometimes the business is tied too closely to the founder to succeed once he or she is out of the picture; other times, despite the owner's natural predilection to assume that the next generation will take control, there is a lack of interest.

Take, for example, this common dilemma: A service business was founded 30 years ago and has since then grown to profitability and \$50 million in annual sales. The owner and founder, now 63 years old, employs his two children, ages 38 and 36,

in key sales development and operational roles. Neither has worked elsewhere and because of the personalities at play—Dad has a dominant personality and is a natural risk taker but lacks coaching skills, while his children remain passive and subordinate to their father's whims—there is no clear future leader should the founder be unable to run his business. No plans have been put in motion for either child—nor for any other executive—to succeed him, opening the door for a rough, potentially fatal transition should Dad be unable to continue.

That there is no clear future leader within the owner's bloodline is nobody's fault. After all, it takes a certain personality to found and lead a successful business, and such personality traits are not inherited, but rather inherent, which makes it easier to understand why the majority of companies do not proactively make the cross-generation transition.

Those companies that are led by the right person, at the right time, are most fortunate. In some cases, such as the one detailed above, to continue its success a company needs an entirely different leadership and management style than what its current owner possesses. Often, given the enormity of the task, these challenges lead to no one addressing succession planning.

One may be born with strong leadership skills, or they may be learned over time through observation and hands-on coaching and leadership development, but one thing that many experts agree on is that the most successful business leaders have five core competencies.



- *Goal Achievement*—the ability to set, pursue, and attain achievable personal, professional, and team goals regardless of obstacles or circumstances.
- *Influencing Others*—the ability to personally affect others' actions, decisions, opinions, or thinking.
- *Interpersonal Skills*—the ability to interact with others in a positive manner.
- *Personal Accountability*—the ability to answer for personal actions.
- *Self Management*—the ability to prioritize and complete tasks in order to deliver within allotted time frames; the ability to control oneself under stress.

When considering succession planning, family business leaders and their advisors tend to focus on the operational transfer of power, wealth transfer, and tax issues, as well as the relationship issues between the parent and the successor (see sidebar for more on this). Yet once the transition is complete, the mere support of the founder or training in the mechanics of the business is insufficient to achieve success if the new leader does not have the necessary leadership skills to maintain the performance of the business. The development of leadership skills takes time, practice, and commitment from both the existing leader and the future leader.

Pre-planning is key. Ideally, future planning should happen five to seven years in advance of the anticipated transition. While many business owners will get a greater sense of satisfaction when the company continues to thrive into the next generation, realistically, this is not always possible. Early discussions about expectations on both sides can help to plan the transition, or make it clear that that is not possible. Transitioning to the next generation is the goal for many businesses, and realistic expectations and sound business principles will only serve to enhance the process. ■

When the leadership transition also involves a change of ownership, there are numerous tax, wealth transfer, and operational considerations to undertake, including:

- The role of comprehensive financial planning to create increased business value
- Degree of financial interdependence (family/business overlap)
- Potential schisms between active and inactive family members
- Methods of ownership transfer – gifting, equity compensation, or selling the owner's interest?
- Timing—Will the transfer take place before the owner's death (which speaks to the owner's confidence in the new leadership) or after?
- Funding the transfer—Split-dollar insurance, owner financing, or deferred compensation model?
- Estate planning for the owner—Determining the role of life insurance trusts, family limited partnerships, Grantor Retained Annuity Trusts (GRATs), and Self-Cancelling Installment Notes (SCINs)
- Contingency planning—What happens if the new leadership fails to meet expectations?

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