Succession planning must address family and business transitional issues

BY GEORGE A. ISAAC

During generational transitions, many family businesses are sold or experience declining business performance and family problems. Inadequate or nonexistent succession plans are generally the underlying reason. Even when succession plans are developed, they often fail to deal with the many quantitative and qualitative issues necessary to properly transition a family enterprise to the next generation.

Succession planning is a difficult subject for the current generation to face. Such discussions often trigger a range of deep emotions, among them fear, conscious acknowledgment of personal aging and death, loss of personal identity defined by involvement in the business and a desire to avoid family conflict. These factors contribute to the company leadership's lack of will to address succession planning on a timely basis, despite prodding by the next generation.

Inevitably, a transition *will* take place, whether planned or unplanned. Transitions can be caused by death, disability, health challenges, family disputes and other life events. Unplanned transitions generally are marked by problems that often prove devastating to the business, family relationships and the family wealth.

A well-thought-out succession plan provides an essential advantage to those families seriously concerned about continuing family enterprise ownership and success into the next generation.

Problems with succession plans

Many succession plans only identify the next CEO and update the family's estate plans. Critical and existential issues about ownership, governance, organizational development, financial and retirement planning, and business strategy often are not addressed. These issues impact the health and very survival of the business and should be addressed years before a generational transition is forced upon the company.

> Many succession plans fail to address critical issues about ownership, governance, organizational development, financial and retirement planning, and business strategy.

The lack of a comprehensive succession plan also creates problems for the business prior to a transition. For example, key managers and employees need to feel confident that the company will survive beyond the aging current generation's ownership and leadership. Their careers and family security depend on it. Customers, both current and prospective, want to be comfortable that the business will continue to meet their needs in the future. Similarly, suppliers will be concerned about maintaining long-lasting vendor relationships. Companies that lack clear direction on succession suffer business downturns after the inevitable transition.

Nine-step succession planning road map

Succession plans must address both family and business transitional issues. When I was asked to resign from my Deloitte management consulting partnership to become the Gen 3 CEO of our family business, I wanted to be certain we had alignment and clarity among our third-generation ownership on how our business *and* our family members would function.

Based on my family's Gen 2 to Gen 3 transition, several years of CEO experience and my subsequent family business consulting work, I developed a nine-step succession planning road map. This road map captures the complexity and breadth of issues that should be addressed in a family enterprise succession.

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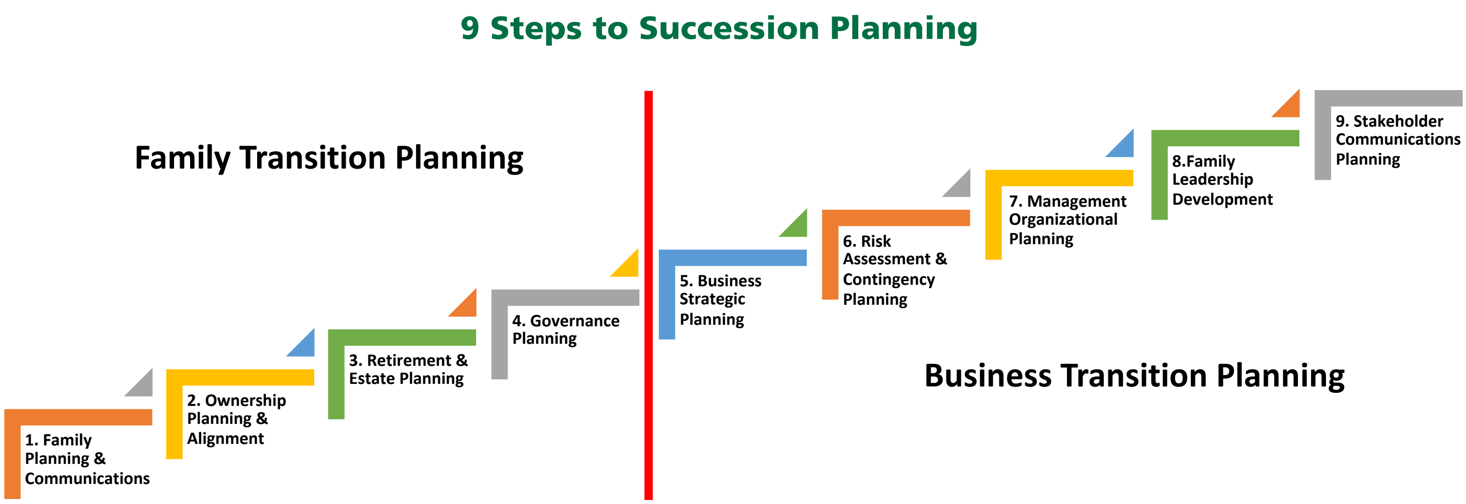

Family and ownership transition planning

Planning issues related to the family should be addressed first.

Step 1: Family planning and communications. The first step is to communicate to the family any decisions that have been reached or are being contemplated. It is important to explain the rationale behind the decisions so there is no misinterpretation or misunderstanding of intentions. This step also provides an opportunity to craft the plans to meet individual family members' needs and concerns. For example, certain family members may prefer predictability of cash flow distributions while others may desire long-term capital appreciation.

Most family members understand that transitioning a family enterprise to the next generation triggers many issues. Certain topics are emotional by definition — who is picked to be the CEO, who is entitled to own stock, who may serve on the board (in control of the enterprise) and the equitability of the financial arrangements. These decisions impact family members' roles and their sense of purpose and even self-worth.

The family should engage in clear communications in which family members are transparent about individual and group needs. This will enable plans to be tailored to meet the next generation's financial objectives while also advancing the best interests of the family enterprise.

Step 2: Ownership planning and alignment. Once family matters are addressed, the next step is to create an aligned ownership group with compatible goals and approaches for running the family enterprise after a transition. The current generation tends to make inaccurate assumptions about the next generation's goals, concerns and risk tolerance. This is partially a result of the next generation's lack of candor with their parents for fear of appearing greedy or unappreciative.

Members of the next generation must reach agreement *independently* on whether they desire to work in the business and/or retain ownership in the business and, if so, for how long. Establishing criteria for employment and board participation is important to ensure family member involvement is based upon individual qualifications and not birthright. Key ownership and employment matters should be codified in an owners' operating agreement and a family employment policy.

Step 3: Retirement and estate planning. To ensure a healthy and sustainable transition, it's essential for current-generation family members to develop a personal retirement and estate plan. The plan should identify both a "purpose" and the future financial needs of each family member transitioning out of the family business.

The "purpose" may be recreational activities for some, while others may desire involvement in non-profits, part-time roles in the family business or membership on business or civic boards. The future financial needs of the current generation should be planned after taking into account the impact of inflation, healthcare and long-term care, travel plans, estate taxes and charitable giving goals.

Step 4: Governance planning. The next generation must establish effective governance for two related but separate entities: the family and the business. Both require objective and accountable governance, but each has different issues to oversee.

The two organizations are a family council and a board of directors. The family council represents the family and addresses family matters. The board of directors represents the owners of the family enterprise and addresses business issues. The board can be composed of all fiduciary members or a combination of fiduciary and advisory (i.e., non-voting) members. Every director should be qualified based upon specific business and ownership needs. Independent board members (i.e., non-family) are crucial to bring objectivity, management accountability and professionalism to the board room.

Business transition planning

These steps in the road map relate specifically to the business. If you overlook them, you might be putting the entire enterprise at risk and threatening future wealth creation.

Step 5: Business strategic planning. The initial step is to carefully examine the outlook for your business to ensure the strategic plan meets the next generation's goals. Many next-generation CEOs adopt the prior generation's strategies, organization and general way of running the business. While doing so might appease the prior generation, this practice is a missed opportunity and potentially a gigantic mistake. Business environments change continually, and strategic planning requires fresh and objective thinking.

Step 6: Risk assessment and contingency planning. The board and senior management team must identify and prepare for both the probable risks and the potential risks that could wreak havoc on the family enterprise.

While most successful business leaders are good risk managers, they do not regularly apply these same critical skills to evaluate the risk that the company will encounter a "black swan" or once-in-a-generation event. As we all learned from the 2008 Great Recession, unexpected and low-probability risks do occur. Having plans in place to mitigate them can be essential for long-term business success (or even survival).

Step 7: Management organizational planning. Once a strategic plan is adopted, the next step is to create a management organization that can implement the plan and meet the family's investment objectives. During management transitions, stylistic and culture changes often occur. In making any adjustments to the existing management team, be sure to consider fit with the family culture and other qualitative characteristics as well as technical and experiential capabilities.

Step 8: Family leadership development planning. Another step is to train and develop the management team for the future, including the next generational transition. It is also important to train family members who are not active in the business in responsible ownership and to develop future family directors.

Step 9: Stakeholder communications planning. The final step is to develop a communication plan to inform constituents about your transition and plans for the company going forward. A 100-day business plan with measurable milestones is an excellent way to focus the next generation's management team on results. Constituents include family members working in the business, family owners not working in the business, key customers, suppliers, the management team, employees/team members and the external community.

Proper planning takes time

Spending the time and effort required for comprehensive succession planning is essential in multigenerational family enterprises.

A step-by-step approach to transition planning will minimize the interference of problematic family dynamics and will promote buy-in from prior, current and future generations of family members. Perhaps most important, it meets the common goal of passing a successful family enterprise legacy on to each future generation — a goal that is too seldom achieved. FB