

**Keeping It
in the Family**
Successful Succession of
the Family Business

James W. Lea, Ph.D.

John Wiley & Sons, Inc.

New York • Chichester • Brisbane • Toronto • Singapore

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Library of Congress Cataloging in Publication Data

Lea, James (James W.)

Keeping it in the family : successful succession of the family business / James Lea.

p. cm.

Includes bibliographical references.

ISBN 0-471-53913-9

1. Family-owner business enterprises—Succession. I. Title.

HD62.25.L43 1991

658.1'6—dc20

90-26862

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

Acknowledgments

A great many people have helped give this book shape and direction. The most help has come from Dick Levin, my mentor in subjects ranging from running companies to buying boats and my close friend. Dick inspired my commitment to family business, as he has inspired thousands of other colleagues and students, and gave me invaluable critiques on parts of this book. Ethen Ellenberg, my literary agent, helped with good ideas and tireless efforts. Steve Ross and Linda Indig at John Wiley & Sons helped with their encouragement and by insisting that their readers deserve the best possible book on succession. Laura Van Toll and Kim Karcher at Impressions, Inc., helped make the manuscript more readable and informative.

A special acknowledgment goes to the thousands of families whose efforts to sustain their businesses through the generations make up this book's heart and substance. They have talked and listened to me, shared their concerns and successes, and fired my enthusiasm. To those men and women, most of all, go my gratitude and great respect.

I Preface

"Solving problems is the work of a good mind.

Identifying problems is the work of a higher intellect.

Anticipating problems is the work of all the mental faculties, enhanced by an appreciation of the propensity of human beings for shooting themselves in the foot."

This book has been written with the hope of putting down on paper a few answers to some of the questions that I'm asked about handing over family businesses to the next generation of owners and managers. Business owners stop me in the hall following one of my seminars and tell me things like this: "I've worked for 30 years to build my company, expecting that my children would someday take it over and make careers out of it. Now I'm ready to retire and it seems like they aren't interested. What am I gonna do?"

Business owners' family members ask hallway questions, too: "I really would like to go into my parents' business. But I can't get them to sit down and make some kind of a plan. I've got better things to do with my life than waiting around to see who inherits the company. Is there any way this can be resolved?"

Behind the frustration of such questions are the human factors that influence—in some cases control—the success or failure of family business succession. As in all transfers of business ownership, accounting issues like the valuation of assets, compensation and incentives, and retirement plans play a role in succession. But when an ownership transfer is carried out within a family, accounting issues are often overridden by interpersonal issues, and even the simplest handover of the smallest business becomes a complex, emotionally loaded proposition.

Senior business owners may want their kids to take over their companies, but at the same time they just can't face giving the companies up. Sons and daughters of owners may want to come into their families' businesses, but they don't understand how the businesses work or how to run them successfully. The relationships and traditions that bind a family together can tear it apart when it comes time to pass along the family business—or they can be the basis of a dynamic, durable and profitable family heritage of business ownership and management. The outcomes of succession are often determined by how well the

family deals with its own special mix of personalities, priorities and choices.

This book begins with a look at families in business, how they got in business and the chances of their continuing in business for more than one generation. It describes the analytical thinking that senior owners and prospective successors should do about the current characteristics and future needs of both the business and the family, factors at the very heart of successful succession.

Mechanisms for generating and confirming family members' interest in and readiness for succession are discussed in terms of marketing principles. The book describes how to organize a businesslike succession plan and how to make the tough decisions that are inevitable during the ownership and management transition. Finally, it offers some answers to the questions of why, how and when a senior business owner should let go of control and finally pass responsibility and authority to the next generation.

A self-assessment, planning organizer or checklist appears at the end of each chapter to help systematize the planning and management of succession. The Appendix cites additional sources and resources that may also be of help but whose effective application to any specific succession situation can't be guaranteed.

Throughout, this book emphasizes the human factors in family business succession, the stresses they can create and the ways they can be handled. Such fine family virtues as love, respect and shared values can sometimes make business dealings among family members pretty thorny. But those same virtues can also make working together to sustain the family-owned business a rich and rewarding enterprise.

When my grandmother reached her one hundredth birthday, she observed to the assembled family that if she'd known she was going to live so long she'd have taken better care of herself. This book is about how to make sure a solid, satisfying family business lives a long time and how to take care of it—and the family that owns it—in the process.

James W. Lea, Ph.D.

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Introduction

This is a book for families in business who want to stay in business. It's for those who want to start planning for the continuity of business ownership and management by the next generation of their families and for those who are already into the process and aren't happy with how it's going. It's for the CEO in the executive tower, for the service station owner pumping gas in the rain, and for their sons and daughters. It's for people like Larry.

Larry is 40, and his company, Pro Machines, Inc., is a clear winner. Eleven years ago, Larry made a long-standing dream come true by starting his own high-tech machine tooling company, using money borrowed from a few friends, some optimistic relatives, and one very nervous banker. A lot of hard work followed—days, nights, and weekends spent sweating over the drafting table, the telephone, and the adding machine.

But now Pro Machines is doing over \$20 million annually, riding the cutting edge of industry technology, and looking solid. Larry owns 74 percent of the company and is making more money than he ever imagined. He's enthusiastic about Pro Machines' long-range prospects and even considering diversification. Most of all, he's excited by the idea of his own kids coming into the company, eventually owning and running it, and keeping Pro Machines, Inc.—and his dream—alive into succeeding family generations. ■

Larry's desire to see his company become a true family business is not unusual among entrepreneurs who have had the courage to step off into the unknown and then worked themselves silly to build a successful business. Among the many reasons why men and women take the risks and make the sacrifices necessary for business success is their need to be good providers, to give their families "the good life." They crave the satisfaction of creating with their own hands and minds the financial means for nice homes, vacations, education for the kids, the best of everything for those they love. Having scrambled to make it themselves, they dream of topping it all off by giving their chil-

dren the best gift of all: a no-sweat start and a secure future. They dream of one day giving their sons and daughters the business.

For many business owners, the dream comes true. Thousands of thriving businesses in the United States are in the third and fourth generations of family ownership. They are headed by people who see the business not only as the source of a comfortable living but also as a focus of deep family pride and tradition. Many of these business owners have gone through some trying times in planning and managing the passing of ownership from one generation to the next. Others are running business organizations that still bear the family name but have no other resemblance to the companies founded by their parents or grandparents. While maintaining the continuity of a family business isn't always easy, most of the men and women who are doing it wouldn't have it any other way.

Of course, not all businesses survive their current owners. Some of them turn up their financial bellies and go quietly under. Others have founders who are textbook entrepreneurs, building a company only to sell it and build another; they have no interest in passing along a family business tradition. And many businesses are sold, merged, or liquidated when their owners want to transfer ownership and management to the next generation but somehow can't make the transition work.

What happens? In some cases, the business owner's family members just aren't interested in coming into the business and making a career of it. The manufacturer's son would rather sell real estate. The software developer's daughter opts for medicine. In other cases, the family has learned to enjoy the financial benefits of the business, but it hasn't developed much zest for the hard work and responsibility required to keep them flowing. Or sometimes when the owner's sons and daughters do come into the business, they turn out not to be competent managers. If the parent accepts that bitter truth in time, he or she gracefully puts the business to bed before retirement. If not, the business not so gracefully goes down the tubes.

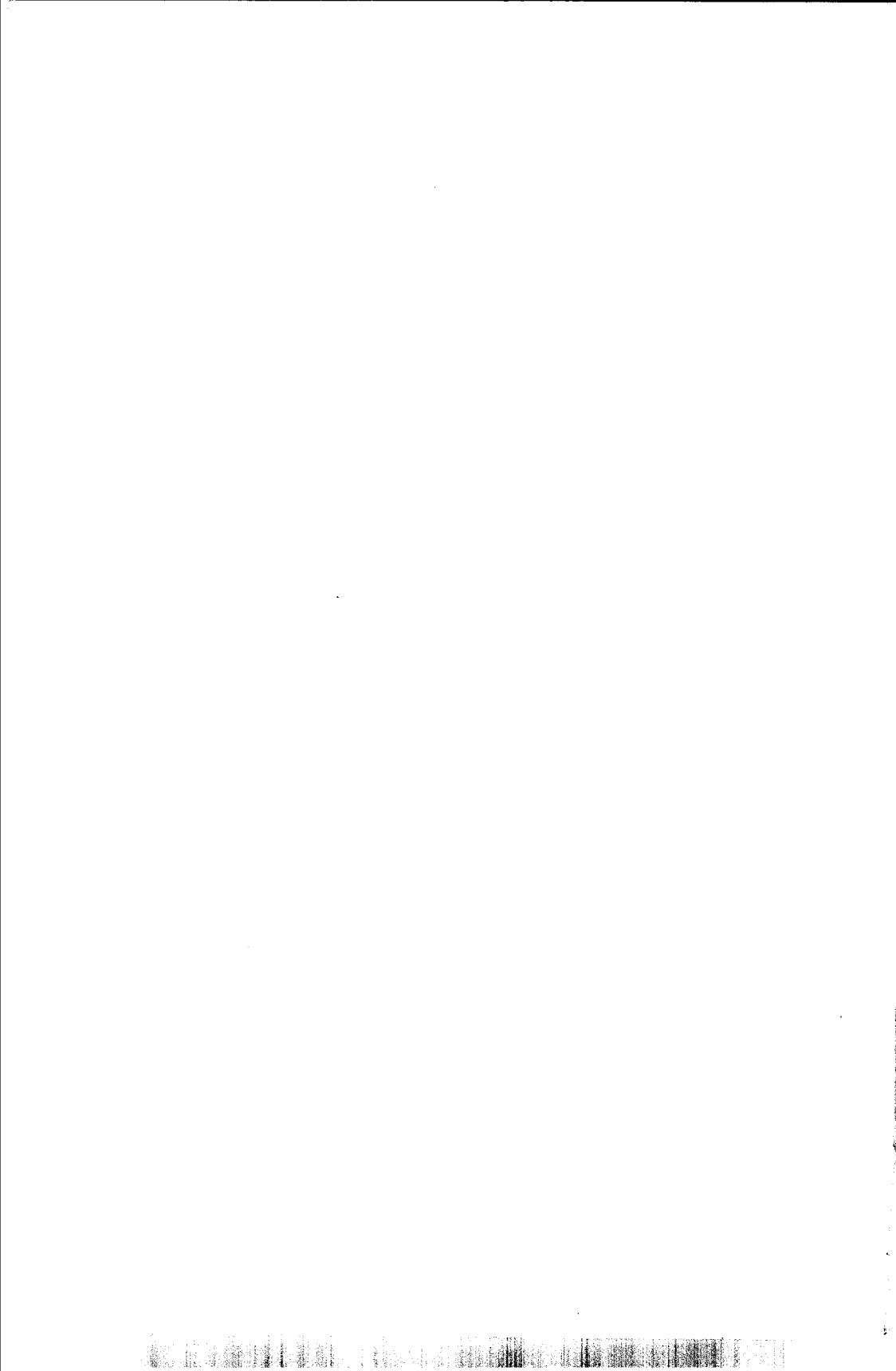
In almost every case where a solid business is successfully handed over to the next generation of the owner's family, it's because the business owner has analyzed, planned, and managed the transfer of ownership. The business owner has planned thoroughly and far enough in advance to give succession at least an even chance. Not only has the owner put down firm ground-

work for succession, but he or she has also allowed for those quirks of human nature that can wreck the implementation of even the best-laid plan. After analyzing the business, the family, and the chances that the two will make a good match, the owner puts together a sound succession strategy. For such companies, the change of management and ownership may not be perfectly smooth sailing but the company doesn't end up on the rocks, either.

If you are the founder or owner of a business, the son or daughter of a business owner, or otherwise closely related to a privately owned business, this book will provide you with a realistic view of the ins and outs of business ownership succession. The ideas and information here are supported by research in the social, psychological, and management sciences. They have been shaped by observations of families and their businesses and by the practical insights of numerous businesspersons, including the author.

This is a book about how you, as the owner of a business, can plan and carry out the transfer of your company to your children or other family members. It's also about how a prospective successor to a family business can prepare for future ownership and management. It is a step-by-step guide through a very complex, often frustrating, and sometimes heartbreaking process. The book looks at the good and bad experiences of business owners, successors, and families, analyzing their brilliant strokes and their great mistakes; it summarizes the lessons learned by others and suggests how they can be applied to planning for the continuity of your own family business.

This book is not about taxes or estate planning or getting your cash out of your company. It's about the people factors in ownership and management succession in the family business and how to deal with them. It's about how to keep a family business in the family—and keep the family in business.



A Family Affair

What Is a Family Business?

A family business is a business that is owned either wholly or in the majority by one person or by members of one family. It may be headed by its entrepreneur founder and employ a spouse or other relatives, or it may be owned and operated by the founder's children, grandchildren, or other family members. The family business may be organized as a proprietorship, a partnership, or a closely held corporation, or it may be publicly traded, with one family owning enough stock to maintain a controlling interest. The family business's distinguishing characteristic is that one family owns and operates it, directs its management, or exercises another form of control.

The family business is probably the oldest business form in human history. When our prehistoric ancestors gave up chasing mastodons across the plains and settled down on the riverbank to scratch a living from the soil, one member of the clan went into the brokering trade, swapping his clan's sweet potatoes for

another clan's grain and brussels sprouts. The first time the clan trader persuaded the spouse and children to help schlepp the produce or operate the abacus at the checkout, family business was born. An illustrious history has followed, from Noah and Sons Nature Cruises, Inc., to the Gucci family's leather shops.

Today family business is big business in the United States. Approximately 90 percent of all American businesses are owned outright or controlled by families, and they generate more than 50 percent of the annual gross national product. Half of all the nonfarm private sector workers in this country are employed in family businesses. (One cynic has suggested that the other half works for the federal government.) Family-owned businesses range in size from mom-and-pop delicatessens to billion-dollar conglomerates. At last count, nearly 40 percent of the Fortune 500 companies were family owned or controlled.

Management Dream or Nightmare?

A family-owned company can be either the most flexible or the most cumbersome of business structures. When only a few family members share decision-making authority, a company can be aggressive in the marketplace and quickly respond to changes in the business environment. A well-oiled family business runs circles around its more diversely owned competitors. It may have better access to capital because of a long and cordial relationship with lending institutions. Perhaps it can also afford to take a longer than normal view of strategic planning because its stockholders may be willing to calculate their returns over generations instead of fiscal quarters. On the other hand, a family business that is unable to shake up shortsighted directors or come down on incompetent employees because "they're members of the family" is trying to figure-skate in a sleeping bag.

The Family's Mark on the Business

The family business is a unique business organization that integrates a business system with a fundamentally different family system. Generally speaking, a business system is organized to achieve specific goals, driven by tasks, and characterized by com-

petitiveness. A family system is bound and motivated largely by traditional responsibilities and loyalties; it is characterized by unity. Meshing one system with the other inevitably means that many of the family's biases, quirks, and internal relationships will bleed through into the business's operating style, decision making, and future prospects. The O'Brien family provides an example of the impact this influence can have.

Patrick and John O'Brien are first cousins who inherited equal ownership shares of O'Brien's Fresh Markets, Inc., a regional grocery chain, from their fathers. In 1968, ten years after they took over the business, the cousins nearly came to blows one night during a televised Nixon-Humphrey campaign debate. They haven't spoken to one another since. At family gatherings, Patrick and John stay at opposite ends of the room and sit at opposite ends of the table. Their families exchange Christmas gifts but with only the wives' and kids' names on them. The rest of the family regards them as lovable old cranks.

At the office, John and Patrick communicate only through a secretary. "Ms. Jones, tell Mr. Liberal Democrat down the hall there that revenues at the Martinsville store are down eight percent this month, and ask him if inventory or employee cuts should be made, and if he says inventory ask him what product lines." John and Patrick have grudging respect for one another's management abilities. But since they don't have direct discussions, decisions are made with rapid exchanges of memos that the cousins address to one another by title but not name. When Patrick and John disagree, the one who generates the most paper in the shortest time usually wins. Vendors have to dash back and forth between the cousins' offices, making part of a presentation to John, another part to Patrick, then back to John for his decision on the order, and back to Patrick for a signature. Neither cousin will consider selling out to the other, the business continues to do very well, and the rest of the family can only wonder why. ■

Family businesses tend to be deeply and devilishly personal. If a business is not the owners' paramour, as some entrepreneurs' spouses suspect, it is certainly his or her child. So the business

owner may experience some wildly mixed emotions—a little like lending the new Jag to a teenager for his first prom—when he or she contemplates handing over the company, even to family members. Pride mixes with possessiveness, and the eagerness to see things go well for the next generation conflicts with terror of the consequences if they don't. Some owners treat handing over control of the business like giving up smoking. They know they need to do it, they say they want to do it, and yet they fight it every step of the way.

Even the coolest heads face some excruciating choices. Which person is best qualified to head the company? What will be the roles of other family members? What will happen to the loyal nonfamily employees? Transferring ownership authority and management responsibility to family members ought to be guided by sound business judgment, just as if the business were being sold to a stranger. But the prospect of ownership succession within a family sometimes clouds that judgment with contradictory loyalties and private preferences. When the owner's relationships with his or her family collide with devotion to the business, objectivity goes out the window and potentially destructive stresses can build up on all sides.

Finally, family businesses are surprisingly fragile. Few of them become thousand-year dynasties. In fact, according to Richard Beckhard and his associates at MIT, the average life expectancy of a family-owned business in the United States is only about 24 years, which coincides almost exactly with the length of time the average founder remains active in company management. Out of 100 family businesses in operation today, no more than 30 will pass successfully into the hands of their present owners' children.

Which Businesses Survive Succession . . . ?

What distinguishes the 30 businesses that make the transition into the next generation of ownership from the 70 that retire with their founders? What factors influence the probability of successful succession? Professor David Ambrose at the University of Nebraska at Omaha has identified several key character-

istics of those businesses that survive family ownership succession.

■ First, the surviving businesses are generally perceived by family members as *financially and organizationally sound*, profitable, and positioned solidly in their industries and their communities. Of at least equal importance, the businesses are also seen by the family as being satisfying, even fun, to own and operate and as a way to meet some of the psychological and emotional, as well as monetary, needs of living.

■ The surviving family business is likely to be a *family affair*. Ideally, family members are employed in the business. At the very least, they are kept informed about the business, and they provide encouragement and moral support through its ups and downs. The family understands the business and accepts it as a natural adjunct to family life.

■ The probability of continuity is higher when family members coming into the business get *prior training and experience* for ownership responsibilities and management jobs. Their training may include formal education in business administration or a relevant technical area, specialized seminars, experience elsewhere in the industry, or apprenticeship in the family company itself before they assume full responsibility and authority. The company is also more likely to avoid internal instability during and following a management change when incoming family members have a chance to earn their spurs and the respect of company employees instead of being handed the top jobs on a silver platter.

■ The most crucial characteristic of the surviving family business is *flexible, forward-looking leadership*. Here, the present owner anticipates and accepts change that benefits the business. The chances of family business survival are dramatically improved when the owner has carried out thorough *analysis and long-range planning* in preparation for succession and when he or she actively manages and monitors the transition in a humane but businesslike fashion.

And Which Ones Don't?

The family businesses that do not survive are not only those that fail to meet Professor Ambrose's criteria for continuity.