LESSONS LEARNED

SUCCESSION PLANNING

The often-knotty problems of family businesses trying to stay that way

by William P. Barrett

Bill Hickey is the third-generation head of Lapham-Hickey Steel Corp., a family-owned business based in Bedford Park, Illinois. With four family members—including children and himself—working at the 500-employee firm, next-generation leadership is the obvious next step. Right?

"I enjoy what I'm doing," says the 61-year-old Hickey.

He laughs, but then acknowledges he does indeed have ongoing discussions about succession. His situation is a little different than many other family enterprises: He shares ownership with five sisters, none of whom work in the business. "Ownership and management are two different things," he says. Any succession plan he develops, therefore, will almost certainly be more complex than a transition involving, say, a single son, daughter or spouse.

Hickey's issue may be a bit more challenging than others, but he has plenty of company in the metals service industry, where transition, whether from family succession or a business sale, is a common topic of conversation. Of the 400 member companies of the Metals Service Center Institute, nearly three-quarters, by many estimates, are family owned and managed. And nobody is getting younger.

There are an estimated 5.5 million family-owned businesses in the United States, spawning a considerable industry of consultants and advisers on managing transitions to the next generation. The leading non-profit umbrella group, the Family Firm Institute (FFI) of Boston, Massachusetts, has more than 1,600 members.

No Lack of Advice

But the proliferation of would-be advisers and the piles of literature on the subject can actually be a problem for those trying to create a wise succession plan. Advisers may not always agree, for example, and the research sometimes offers contradictory conclusions. Studies suggest that only about one-third of family businesses make it easily into the next generation of family control without leadership or financial problems. "That's a sobering statistic for business owners whose crowning achievement is the company they built," the National Federation of Independent Business, a trade group representing many family-owned firms, writes on its website.

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Some research suggests that passing a business down to successive generations increases the likelihood of its failure. The Family Business Institute, a Raleigh, North Carolina, consulting firm, for instance, estimates, "Only about 30% of family businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family businesses operate into the fourth generation or beyond."

On the other hand, a 2010 paper in the academic journal *Family Business Review*, "Family Business Succession and Its Impact on Financial Structure and Performance," by Vincent Molly, Eddy Laveren and Marc Deloof, declares, "No evidence is found that a family firm's profitability is affected by succession." The study looked at 152 small- to medium-sized companies from 1991 to 2006.

Barely half of more than 200 mid-market companies recently surveyed had a succession plan in place, according to Deloitte's 2013 study "Perspectives on Family-Owned Businesses: Governance and Succession Planning."

"Family-owned businesses frequently leave themselves more exposed than necessary because of their relative inattention to the value of good governance and succession planning," the report says. The survey found "gaps in governance, board operations, and succession planning" an issue that "is particularly pressing, as many family-owned businesses have founders nearing retirement."

Robert O'Hara, a family business consultant with O'Hara & Company, Chelmsford, Massachusetts, says one reason family succession is so important is that selling a business to a third party is usually not a viable option. "Only 10% of businesses listed for sale ever get sold," he estimates. Another complicating factor, he says, is that, with baby boomers reaching the end of their careers, the next generation is much smaller, so there are fewer family candidates.

Management Versus Ownership

Edward S. Rosenfeld, a family business consultant in New York City, says that an increasingly common issue in succession plans these days is working out the differences between the management and ownership of family businesses as they make a transition. As successive generations produce more family members who don't work in the business but still have an ownership interest—or who work there but aren't owners—the question becomes: "What does it take to be a responsible owner?" Rosenfeld asks.

Some other common succession problems listed by these advisers include:

> "No evidence is found that a family firm's **profitability** is affected by **succession**."
>
> — *Family Business Review*

- Ownership versus leadership. Family members who only have ownership stakes can have very different perspectives than kin who also run or work at the business.
- Who gets ownership, who doesn't. The way the equity in a family business is distributed or re-distributed can have a lasting impact on the family dynamic, not to mention the business.
- Siblings versus siblings. This is especially an issue when the oldest child is not considered the best candidate to be the next leader.
- Siblings versus cousins. A variation of the siblings-versus-siblings dilemma but with another branch of the family tree.

The list can go on and on: "There often is an elephant in the room," says Paul Karofsky of Transition Consulting Group, Framingham, Massachusetts. Messy questions of trust and reliability. A son who is a recovering alcoholic. A son-in-law who stole from the business but paid it back. Adultery and marital problems. These all can cast doubt on the fitness of the next potential leader.

Generational Values at Work

Even with an obvious offspring successor, generations may have different mindsets. "It's Dad's perception of the son not working hard enough," Karofsky says. "In our generation, it was about work. You didn't have to love it. Our generation was more tolerant of not loving the business. [But now] if the younger generation doesn't love it, they may be more likely to screw it up." The trickiest part is deciding who has the chops to run the business.

Like many consultants, Steve Swartz, a family business adviser with Swartz Consultants, Minneapolis, Minnesota, describes his role as that of a facilitator, and a temporary one at that. "My job is to work myself out of a job," he says. As a recent example, Swartz cites an impasse between the founder of a family business and his designated successor son-in-law. "While there was general agreement as to the ultimate goal, the criteria and timetable remained ambiguous, and the principals were stuck," he says. Over two days, Swartz interviewed all of the interested family members privately, then facilitated two meetings with the founder and son-in-law. The result: "development of a much clearer succession plan—and a clearer channel of communication between them."

When to Start? Early

The standard advice on when to start planning succession is six to 10 years before the CEO wants to leave. Swartz takes a far longer view. "The time to start is when your oldest child is a junior in high school," he says. "That's when they start exploring college education."

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> — Steve Swartz, Swartz Consultants, Minneapolis, Minnesota

In terms of how long an outside adviser might be helpful, the engagement can run from a few months to several years.

Karofsky, for example, meets with all family members and stakeholders one on one, in what amounts to confidential interviews “to gain everyone’s perspective.” That includes understanding that the departing generation’s expectation and desire for retirement cash flow may drain the business of needed resources. It can also include understanding interfamily disputes such as a divorce of an owner. In many cases, the succession process is as much psychological as professional. “You’re going to have intra-family relationship issues,” says Jane Hilburt-Davis, a former FFI president and founder of Key Resources, Cambridge, Massachusetts. Dad might not want to let go, or one kid might be working like crazy while the other is playing golf.

The Process

The succession-planning process can involve a number of mechanisms. Among them:

- Creation of a family council outside a traditional corporate or legal structure at which family members meet regularly to learn and plan.
- Staging of family retreats: family meetings that can last several days.
- Development of a family charter, a signed agreement specifying shared values, goals and policies.

Fortunately, except for the smallest family businesses, there likely are non-family members in positions of responsibility who could take the top management spot. That might not deal with future ownership issues, but it’s a start and can buy time.

Hickey, for example, says his company has a strong non-family bench. “We have a lot of excellent managers,” he says.

“How do I know I have the right person? The answer is, you don’t. They will rise to the occasion.”

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