

Family Business and Its Future: A Plan for Ownership Succession Training

By **Stephen G. Salley, Esq.**, Family Business Center

Like their publicly-held businesses, most sizable closely-held family businesses devote considerable time, attention, and money to employee development and retention, with a strong focus on training, review, education, and assessment. The significance of this effort is exemplified by the existence of an entire industry devoted to “human resources.” Consultants, executive coaches, and employees are hired to negotiate the complexities of state and federal employment law, pension and retirement planning, leadership development, and the emotional and psychodynamic needs of employees necessary to maximize their potential. In some cases, family businesses may overlook a parallel and equally critical development need of the family business’s future—the development, preparation, and incentivization of succeeding generations, those individuals who will, like key employees, promote the growth and stability of the business. It is the intentionality with which businesses approach their key employee development that should serve as the model for the development of future family business owners. From an early age, these family members must receive the same encouragement, preparation, and necessary training given to any key executives who face the complex responsibilities of business ownership.

Why Do I Want to be an Owner Anyway?

It may seem to be an obvious statement that being an owner of a family business is a good thing. However, a little reflection may make this truism less evident. When future owners are not properly prepared to appreciate the business and its contributions or to shoulder the very real burdens of ownership that such a complicated asset entails, an imbalance of perceptions and expectations begins to arise between the company and its ownership, too often leading to conflict or disenchantment. Consider the following examples:

- “I watched my father become a slave to that business, working seven days a week and consumed with worry. The only comments my father ever made about the business were ones of frustration and stress. Why would I want to follow in his footsteps and be involved in that?”
- “The employees seem to take for granted the benefits we are sacrificing to provide, while all I get is the privilege of signing guarantees at the bank. “
- “I can’t believe the board cut dividends this year. What is the good of even owning stock?”
- “I have no idea what is even happening in the company. A friend whose wife works in the business asked me

(Continued on next page)

(Continued from previous page)

about a new merger taking place—how embarrassing that as an owner I know nothing about it?”

- “I had a call from an investment banker friend who says we could sell the business for a bundle. I can’t get my cousins to even look at selling. . . . I might not care either if I got the paychecks they get from the company.”

The simple truth is that the complexities involved in owning and operating a significant business (and the stresses and rewards of doing so), are not part of any standard educational curriculum. Yet surprisingly large numbers of businesses are passed from one generation of owners to the next without any real preparation given about the responsibilities of ownership. When a business relies on kinship and bloodlines to assure its continuation, the families sometimes operate as though business management skills are transmitted through DNA rather than learned through training and education.

Ownership as Privilege; Ownership as Stewardship

For most families, a prime benefit of owning a business—especially a passive investment asset— is strictly financial. True family enterprises, however, are very different. To value them simply in terms of dividend growth or appreciation in value is both short-sighted and may ultimately be self-defeating. Indeed, it is the experience of many advisors that a family that is held together into its second or third generation solely by the economics of a shared family business is unlikely to remain either a cohesive family or maintain its family business identity over the longer term. Considering the parallel to employee benefits provides an interesting insight into the types of ownership benefits that can and should supplement

the financial and helps to make the satisfaction of family ownership worth the patent stresses. Studies that review employees’ perceived stock benefits commensurate with stock ownership plans have identified five sources of satisfaction, of which only one was economic.

1. Financial

The financial aspects of ownership in an enterprise connect family members to a quantifiable and hopefully appreciating asset. As the value of the company’s stock increases, so too does the sense that their service to the company is contributing to their own future economic well-being. This alignment of interests can drive motivation and enhance loyalty.

2. Participation

As employees who are also owners, there is an increased sense of pride that their contributions and involvement are, in part, leading to the success of the company. Because they are more involved in the business, they assume greater responsibility for efficiencies they are uniquely able to identify.

3. Influence

Employees ideally value their sense of ownership as being company-wide, giving them a stake in decisions that affect the business as a whole. With ownership considerations, the previously narrower role as employee, expands the scope of involvement to the furthest reaches of company policy and involves the employee in broad concern for company success.

(Continued on next page)

(Continued from previous page)

4. Community

Ownership promotes a sense of vested interest, supporting identification with the company. This element is accentuated where the employee ownership is shared exclusively with “key” employees. Inclusion in this group represents an election to the inner circle that amplifies the feeling of community.

5. Respect and Fairness

With an ownership stake, employees often receive greater respect that comes with the status of being an owner. In particular, the existence of procedures to implement “fairness” are powerful tools for maintaining the alignment of personal and business goals, especially during times of stress or turbulence. Being treated as an owner, in short, provides tangible evidence of the sense of belonging, an intangible that takes on its greatest significance in tough times.

Each of these perceptions of the benefits of ownership should be equally cultivated among present and future owning family members (if not more so). In other words, the family member who does not embrace the full measure of the satisfactions inherent in identity and alignment with both the family and the family enterprise may not be participating to the fullest in the benefits of ownership and may be a less likely candidate to become the savvy and dedicated owner the family and business requires.

Unlike an employee stock plan in which the goal is to use ownership to foster participation through merit, family owners usually already have (or at least may expect) future ownership,

largely unrelated to their personal contributions. However, the sense of ownership that comes from “automatic” ownership may be inadvertently muted for a number of reasons.

1) Authoritarianism

A patriarchal establishment that creates ownership for family members at a very young age (for instance, gifting to trusts) transfers ownership without meaningful responsibility or involvement. This is particularly true when the recipients are young or inexperienced and the senior generation (usually the donor), is dominant in the business. The donor sees little to no benefit of the participation of typically inexperienced junior family members. Primarily driven as a gifting and/or estate planning strategy, business transfer via trust is often not a substitute for long-term succession.

2) Protectionism

Parallel to the authoritarian who unintentionally separates involvement from ownership is the paternalist who insulates the younger generation from the business “for their own good”. In this circumstance, the senior generation tries to protect younger owners from the realities and stresses of operating the business. While this may be appropriate when the successors are young, it becomes counter-productive as the heirs mature into adulthood. Familiarity with the costs of being an owner is a priceless inoculation against the “disease” of perpetuating disinterest and/or entitlement that can poison future owners.

(Continued on next page)

(Continued from previous page)

3) Non-Voting Interests

One unintended consequence of most common legal structures for gifting of ownership interests to the next generations is that those interests are non-voting or non-participating in nature. If that lack of a vote translates into passivity, the non-voting shareholders again become relegated (not only in their own minds but also in the minds of key employees and senior owners) to passive recipients of only the economic benefits of ownership. Little attention will be given to inculcating the information and training necessary to appreciate or participate in the business. Further, the non-voting shareholders may not realize that non-voting stock can be a legal impediment to control, while participation, or voting stock, can present the opportunity to build community and a shared legacy. These two are not mutually exclusive.

The Longer Time Horizon

As many family business advisors understand, if a family enterprise is to succeed through multiple generations, each generation must be ready and able to accept the ownership responsibilities as well as benefits that come with control of a large and complex enterprise. Only then will the enterprise achieve what many see as the ultimate goal of dynastic family enterprises—successful succession across the generations (Hughes, 2004; Collier, 2002; Gersick, Davis, Hampton, Lansberg, and Marion, 1997; Ward, 1997; Jaffe and Lane, 2004). The same energy devoted to management succession must be given to ownership succession in order to avoid the all-too-familiar history of failed multi-generational family

enterprises. If there has been no intention or plan developed for the preparation, training, and transition of owners with the same rigor that was devoted to employee training and development, the odds of family owners spontaneously growing an appreciation of both the privileges and responsibilities of the family enterprise are discouragingly low. By applying the five benefits of ownership that employees identified to family owners, we can begin to formulate a disciplined approach and process of training next generation family owners. The following paragraphs present some adapted insights that apply the context of benefits of ownership to family members.

Financial

While all family businesses are not created equal, financial returns can be a major benefit of owning interest in a family business. It is crucial for the future owner, however, to understand that those financial benefits may at times be elusive or deferred, as explained in the following examples.

1. Plan

The company is committed to utilizing its profits for growth and for the ultimate expansion of the business rather than for current distribution to its owners.

2. Redemptions

It does occur that, as generation's transition, available business funds will be needed to redeem either outside owners or senior family members. The sophisticated owner is both prepared for this investment and educated enough to perceive its long term return.

(Continued on next page)

(Continued from previous page)

3. Debt Reduction

Particularly when recovering from a difficult economic time, businesses may elect to restructure and/or reduce their debt in order to reduce mounting interest. As a result, restrictions on distributions to owners required for redemption of debt facilities may leave the impression that there are “profits” undistributed, when in fact, there is insufficient cash flow to pay dividends to shareholders. Again, it is the well-educated owner rather than the “dividend addict” who sees that the short-term use of funds towards debt reduction provides the seeds of future growth.

4. Economic Environment

As ironic as it may sound, junior owners can become so isolated from the fact of economic cycles as a detriment of their business’s profitability that reduced dividends in the midst of serious economic dislocation can come as a shock. Only education makes those rules explicit and personal.

As with the employee-stock ownership plan (ESOP) benefits discussed above, the non-financial benefits of ownership become crucial to keeping the family in a state of unity through periods when economic benefits are either not available or are, as a matter of business decision, not made available to junior owners.

Participation

To the extent that family owners have never developed a meaningful sense of participation in the enterprise, the benefits of ownership are greatly reduced. This is not to

say that minority or non-voting owners, (particularly when they are very junior or inexperienced), should be accorded a disproportionate or inappropriate voice in the affairs of the business. Rather, they can and should be included (in an age- and experience-appropriate) dialogue that results in both training in the affairs and risks of the business. Developing a sensitivity to the business’s needs for economic support from the family is as important as appreciating the businesses economic support for the family. In short, the responsibilities of a steward are paired with the privileges of an owner. The depth of training and access to information grows over time, but it must be an ongoing process rather than an isolated event.

Influence

Clearly, young or inexperienced family members cannot be accorded undue influence over the affairs of the enterprise. That said, the invitation to thoughtful questions can engender a dignity and a response that gives future owners a sense of the gravity of the issues and a very real awareness of how their influence will become crucial over time.

Community

The sense of community, also known as “familiness,” in a closely held business is frequently cited as one of its signal competitive advantages against far larger enterprises (Chrisman, Chua, & Steier, 2005; Nordquist, 2005; Pearson, Carr, & Shaw, 2008). Exposing future owners to the greater community created by the business promotes family cohesion and shared values. This greater awareness of the business’s influence and impact to all its constituencies aids future owners in learning and appreciating the values and standards that will prepare them for ownership succession.

(Continued on next page)



(Continued from previous page)

Fairness and Respect

No single element is more important to the long-term health of the family enterprise than the discipline of respect and fairness. . . to employees, to vendors, to each other. The death knell of family cohesion, often the hallmark of the true family enterprise is that, in the face of disagreement or turbulence within the family ownership ranks, there is a failure to listen and treat one another fairly. No training is more important for the future owners individually and as a group, and none requires more attention and self-policing.

Building the Program: Ownership Succession

Future owners of a family enterprise who grow up around the business begin shaping their impression at a very young age. They can grow to harbor resentment of the business or develop affection and a sense of connection to it. Negative feelings can be fostered unconsciously by parents if they, for example, have business arguments at the dinner table or miss important family events because of work obligations. Families have an opportunity to introduce the family enterprise to future owners in a positive way through sharing the values and legacy the enterprise represents. Though explicit communication and modeling, families can cultivate a feeling in children that the business means something and provides benefits beyond just a source of dividends. Further, future owners should begin to be educated at an early age about the basics of ownership. This includes building competencies around governance, financial literacy, asset protection, risk management, philanthropy, and family enterprise-specific concepts. It can be difficult for

business owners to envision that their teenaged children are already at a stage where they are being shaped into the owners of the business who will ultimately drive its success in the future. It becomes even more challenging to envision infant grandchildren as the “future of the company.” Nonetheless, the successful family enterprise dedicated to benefiting both the family and the community is well advised to begin the process of structured preparation for ownership with the same diligence that it approaches management succession.

Training

The training of an owner, as opposed to a manager, addresses a radically different set of skills and expertise than that of employees working toward a specific job or role within the business. The broader financial sophistication, experience with philanthropic and public relations matters, knowledge of and taking satisfaction in the continuity of the business, (most particularly of continuing employment for many families), can, and should, begin at a very early age. As the future owners develop their knowledge and expertise, they can be included in increasingly more complex conversations about risk, business decisions, and the competitive environment, for example. They can be actively engaged in governance by attending family board and council meetings as junior members, or they can join a junior board. This involvement and training, however, requires an infusion of energy that may be seen as taking away from the core activities of business. The importance of training for ownership responsibilities takes on significance only when it is viewed as a long-term investment in the future of the company.

(Continued on next page)

(Continued from previous page)

Communication

As the mentoring of future family owners increases, the amount and detail of business information related (both financial and non-financial) should increase. This does not mean that each owner with a relatively minor ownership interest should receive the full panoply of information available to the board of directors. Rather, that there is ample opportunity to knowingly participate in the satisfactions of the business in addition to being informed of the issues that threaten it. In this way, the “inevitability” of pecuniary benefits and sense of entitlement to cash flow from the business is replaced by participation in the success of the business and a willingness to sacrifice when investment back into the business is required. It is a matter of changing the mindset of the young owner from one of entitlement to business income to one that recognizes that the family and its businesses are mutually supportive.

Shared Vision

When a family takes the time to involve and include future family owners in the vision and shared values of the firm, two things happen. First, next generation owners feel valued and recognized as they share their views, values, and vision of the family enterprise. Second, current family owners are able to frame the core family business values and principles that ground the family business vision. Creating a shared vision of the family business’s identity helps to reinforce and build continuity for future leaders and establishes a stewardship principle in the family enterprise.

Conflict

It is always difficult to anticipate that as the family grows and expands through generational transition the opportunity for conflict increases. There is frequently a feeling that creating conflict resolution mechanisms is “inviting” conflict and that somehow the family’s’ unity will be contrive without further tinkering to weather any storms of disagreement. It has been the near universal experience of multigenerational business that conflict is inevitable and when properly channeled, can be beneficial. Proper channeling can only be managed by putting a plan in place before conflict arises.

Conclusion

In order to help family business members gain maximum satisfaction in their participation as owners (as opposed to employees or directors), family business advisors recognize that the focus of preparing future family members for the responsibilities of ownership must be on both pecuniary—and more importantly, non-pecuniary—benefits of ownership. Creating a cadre of family owners who not only understand and have internalized the risks and benefits of the business results in an active and supportive ownership structure. This effective leadership can provide the comprehensive support necessary for the business to survive in times of stress, just as the business provides financial benefits to the family in times of plenty. The forward-thinking family business leader has prepared for financial ups and downs by incorporating the risks and benefits of ownership into their financial planning and has adopted the maintenance of the business as a personal and familial goal.

(Continued on next page)

(Continued from previous page)

The non-financial benefits of ownership, specifically a sense of community, participation, and an appropriate level of respect for their input, parallel those incentives identified for granting employees ownership through ESOPs or similar vehicles. As families expand through generations and more and more family owners mature, greater attention to cohesion at the ownership level becomes crucial. The attenuation of a shared family vision for both the values and the benefits of being “stewards” of the family business for future generations is a far cry from the mere passive holding of a financial asset with the expectation of receiving a dividends stream or similar income benefit.

References

- Chrisman, J. J., Chua, J. H. and Steier, L. (2005). Sources and consequences of distinctive familiness: An introduction. *Entrepreneurship Theory and Practice*, 29: 237–47.
- Collier, C. W. (2002). *Wealth in families*. Cambridge, MA: Harvard University Press.
- Gersick, K., Davis, J. A., Hampton, Lansberg, I. & Marion M. (1997). *Generation to generation: Life cycles of the family business*. Boston, MA: Harvard Business Press.
- Hughes, J. E. (2004). *Family wealth. Keeping it in the family*. Princeton, NJ: Bloomberg Press.
- Jaffe, D., & Lane, S. (2004). Sustaining a family dynasty: Key issues facing complex multigenerational business- and investment-owning families. *Family Business Review*, XVII(1), 5-18.
- Nordqvist, M. (2005). Familiness in top management teams: Commentary on ensley and pearson’s “An Exploratory Comparison of the Behavioral Dynamics of Top Management Teams in Family and Nonfamily New Ventures: Cohesion, Conflict, Potency, and Consensus”. *Entrepreneurship Theory and Practice*, 29: 285–292.
- Pearson, A. W., Carr, J. C. and Shaw, J. C. (2008). Toward a theory of familiness: A social capital perspective. *Entrepreneurship Theory and Practice*, 32: 949–969.
- Ward, J. L. (1997), Growing the family business: Special challenges and best practices. *Family Business Review*, 10: 323–337.

The information published herein is provided for informational purposes only, and does not constitute an offer, solicitation or recommendation to sell or an offer to buy securities, investment products or investment advisory services. All information, views, opinions and estimates are subject to change or correction without notice. Nothing contained herein constitutes financial, legal, tax, or other advice. The appropriateness of an investment or strategy will depend on an investor’s circumstances and objectives. These opinions may not fit to your financial status, risk and return preferences. Investment recommendations may change and readers are urged to check with their investment advisor before making any investment decisions. Information provided is based on public information, by sources believed to be reliable but we cannot attest to its accuracy.



www.GenSpring.com