Family business: Beat the odds, pass it on

The importance of privately held family-owned business to our country's economic machinery is immense. This type of business generally accounts for nearly 60 percent of the total employment in the U.S. and over 75 percent of all new jobs that are created. Many of these companies' founders intend to pass the business on to succeeding generations of their family.

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While their intent is clear, the reality is that only about one-third of these businesses pass successfully to the second generation, 10 percent to the third generation and 4 percent to the fourth generation. Those are not very good odds.

The most frequent reasons for these poor results:

- No family member is interested in the business.
- No exit strategy exists for the senior generation.
- A lack of estate and retirement planning for the senior generation.
- The conflict between business prosperity and family unity is ignored.
- The conflict potential between active and non-active siblings is ignored.
- Illiquidity for inheritance taxes and stock redemption is ignored.
- Inappropriate business legal structures for succession.
- Planning is not started until an illness, accident, death or divorce forces the issue.

Let's consider the following example: John and Marcia, ages 62 and 59, respectively, founded a small manufacturing company 25 years ago. They now have 30 employees. Their three adult children are married and currently are 38, 34 and 29 years old. Their 34-year-old son, Jason, has worked for the company since college and is heading the sales and marketing department. John and Marcia feel confident Jason is capable of taking over the business someday. Their other son and their daughter have stated they have no interest in working for the family business. No one outside the family owns any stock in the company, and each of the three children have been gifted company stock over the years in minor amounts.

While Marcia has worked off and on in the business, she now prefers to help out just one or two days per week in the accounting area. Marcia would like John to slow down and give Jason more responsibility. John is heavily involved in the day-to-day operations and is beginning to wonder about his exit strategy. He has not discussed his desires or concerns with his children or a professional adviser.

John and Marcia have accumulated a good nest egg concentrated in 401(k) accounts, significant real estate and their business interests. As the senior generation, their primary goals are: 1) make sure their retirement is secure; 2) pass on the family business to Jason; and 3) treat all three children equally, retaining family harmony.

John and Marcia now recognize they had been so busy working "in" their business they forgot about working "on" their business. They realize they do not have the answers and do not know how to arrive at a solution.

They decided to meet with a financial adviser who specializes in working with family-owned businesses to analyze their business succession goals as well as their estate and retirement income needs. Soon after, their attorney and accountant were consulted and a process was started to help them answer the following difficult questions:

1. If they keep the business in the family, will it produce enough income to support both John and Marcia upon their retirement as well as Jason and his family? Or, will the business produce enough income to allow Jason to purchase the business from them?

2. If John decides not to retire and the business is bequeathed to Jason, how will Marcia be taken care of? How will the nonparticipating children fare in the equalization goal?

3. In the untimely death or disability of John, is there a buy/sell agreement to help with the transfer and will there be enough cash available to both meet the company's obligations and provide for Marcia's lifetime income needs?

4. If John and Marcia die in a common accident, will their estate and transfer taxes force the sale of the business and leave Jason without a career?

5. Will the other key employees (nonfamily members) stay with the company upon John's retirement or death?

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6. If all three siblings inherit the business equally, how can Jason run the business without controlling interest? Could this create a significant sibling conflict of interest?

7. If Jason doesn't get more responsibility and training soon on all aspects of the business, will he be able to handle the entire business if John dies unexpectedly?

So, how does a family business owner beat the horrible odds of transitioning their business down to the next generation?

The answer: Start your succession process now using an experienced and reputable adviser team. By starting early, you can integrate the solution into your normal business today and work toward a successful future business transition, whether the situation is a planned event or an unexpected event.