

A successful succession

How to create and execute a family business succession plan

The one maxim that holds true for all business owners is that eventually they will be forced to exit their business — either on their own accord or involuntarily. For many, the next best thing to perpetual ownership is having their children assume control.

However, 80 percent of family businesses don't transition to the second generation. And of the 20 percent that do succeed, 80 percent of those don't make it to the third generation. Why is it so hard?

"It's not only a complicated business transaction, but it's highly emotional," says Peter J. Smith, a Member at Semanoff Ormsby Greenberg & Torchia, LLC.

Smart Business spoke to Smith about the difficulties of family business succession planning and what steps can be taken to improve the likelihood of a successful transition.

Why are success rates for family business succession so low?

Because it's family and there are so many emotional layers. You have parents coping with the thought of giving up control of the business they spent their entire lives creating and nurturing. For some, it is their entire identity.

The next generation may or may not see eye-to-eye on the future of the business or their place in it. There may be children who aren't in the business, which must be addressed. And when it's all done, mom and dad have to make sure the business survives and thrives so it can provide the cash flow they will need in retirement.

What can parents do to make their family business succession plan more likely to succeed?

Plan ahead. A smart business person might

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plan two to three years out to sell their business, so as to position the business for maximum value and a quick, smooth sale. The same is true for implementing a business succession plan. If possible, they should start planning the transition well in advance.

They also need to start training the next generation to take over. This takes time. They should approach it like they are developing and running a management training program for their children.

What if there isn't time to adequately prepare or the next generation isn't ready to take over?

If there isn't time to adequately prepare, the owners should consider hiring an outside CEO to run the business for a period of time so they can take a step back and plan a transition in the future when everyone is ready. They might also put a board of directors in place that includes non-family members to help guide the business and provide objective advice.

What can the second generation do to make the transition a success?

Be objective and be patient. They need to realize that mom and dad aren't as dumb as they think, they're not as smart as they think and running a business is hard.

They also need to openly and objectively evaluate what is in the best interest of the business and not necessarily just for them. The kids must understand that everything doesn't always have to be equal to be fair. There will be certain things that make sense for the business, but don't put everyone on equal footing. It's important to realize that this is okay.

What if mom and dad are concerned about treating each of their children fairly and equally?

There are other ways to equalize the treatment of their children using business or non-business assets — through gifting, estate planning, or perhaps the business real estate or a vacation home, for example. They can also set up a trust or an LLC for family members not in the business to receive distributions from the business and/or hold a capital interest in the event the business is ever sold.

What should a business owner do if he or she is thinking about business succession planning?

Put a team together. Talk to your lawyer, accountant and financial advisor. If they're not experienced in family business succession planning, then find ones who are. The right professionals can make all the difference in the world. ●