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SPRING 2014

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SUCCESSION PLANNING

TO AVOID LANDMINES,
SEEK ADVICE OUTSIDE THE FAMILY

BY WILLIAM H. JENNINGS, CPA

The head of the family-owned development business was confident—there were seven younger family members, and certainly one of them would take over when he retired, ensuring continuity and keeping the operation under family control. A business advisor who was not a member of the family was less certain. He had heard each of the younger relatives express reluctance or doubt. But none of them was willing to say so to the patriarch.

In the end the business advisor was right. Not one member of the next generation was willing to take on the leadership role. After having to run the business for an unanticipated two additional years, the founder was forced to transition the ownership to an unrelated third party.

Succession planning is a difficult matter in any business. In a family-owned business, the difficulty is, if anything, much greater. Family politics and interpersonal relationships are always challenging—all the more so when the future of a business is at stake.

Most family businesses are dominated by one or two strong leaders—often a founder, always an authority figure. These

individuals are often willful—in many cases, it was their strong will that established and grew the business in the first place—and they are inclined to make assumptions about the talents and intentions of their children and other younger relatives. They leave succession planning until the last possible moment, confident that someone in the next generation will take over the reins. Their strong feelings and loyalties can lead them to back the wrong horse, settling on a successor who doesn't have the makings of a good future leader.

These challenging family dynamics also affect the younger generation. Relatives are often afraid to tell the founder the truth. Do they want to take over the business? When the older relative asks point blank, the younger relatives will “yes” him or her. But when they speak to friends or other outsiders, they’ll be honest—“if I take over, I’ll sell this thing as soon as I can.” They won’t level with the person in charge, but they will with a peer or outsider. It’s not that they want to deceive—but they are afraid to disappoint.

The results can be disastrous. Picking the wrong successor can destroy the business. It can be equally bad to pick no successor at all. Yet this is common. An owner doesn’t begin to think

about succession until he's in extreme old age. Then, because he's tired and because there's so little time to go through the process, he effectively throws up his hands and divides the kingdom in thirds. Or perhaps he dies without naming a successor. The result is the same. Control is split equally among family members, true colors come out, and the next step is litigation. And the courts do not care about the future of the business. An ownership split can lead to litigation even if a successor is nominally in charge. Some organizations manage to survive the litigation process. But many do not.

How can the head of a family business ensure a smooth transition? The best practice is to call on the services of a trusted outside advisor—a third party familiar with the family. The role of the advisor is to serve as an honest broker, able to speak directly to both the founder and the candidates, and arrive at an accurate assessment of the next generation's talents, skills and willingness to take over the enterprise. Getting at the truth requires trust, and trust requires intimacy. The advisor should have a history with both generations.

An effective recommendation depends on commanding knowledge of the business and the industry, not just the family. Let's say that no family member is willing or able to succeed to leadership. In a rental business, that may not present a problem. The owner can hand the operation over to a third party manager. But construction is different—it's a service business where success depends on longstanding relationships. If there are no family candidates, the owner will be well advised to hire an outside manager far in advance, to allow plenty of time for the new leader to build trust with clients and contractors.

All of this means that the best qualified advisor is right under your nose—an attorney, accountant or longstanding business consultant. Such an advisor is probably already on board and already grappling with difficult succession issues. There are many. Consider, for example, ownership structures: When passing on to a family member you may want to take advantage of current gift tax rules to give them discounted business interests so they have skin in the game, whereas when adding an outsider, you are less likely to do that.




You would have to attract outside candidates by offering significant profit sharing participation.

It is critically important to grapple with such issues, and to engage qualified professionals to ensure that you arrive at the right answers. But it would be a significant, and perhaps fatal, missed opportunity to rely on your professional advisor simply for answers to compliance and routine structural questions. The question of who will take over leadership deserves equal if not greater attention.

The time to start interviewing and to choose a succession planning advisor is sooner rather than later. Sound out the potential advisors and identify the one who knows the players, knows the operation, is able and willing to have frank conversations, and, most important, can effectively address the critical question: Who should take over the business? ○

William H. Jennings, CPA, is Partner-in-Charge of the Real Estate Group at New York-based accounting firm, Marks Paneth LLP.

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