

# Minimising succession risks: a definitive guide

Handing over a family business to the next generation carries with it many inherent risks. Tom Davidow sets out the steps you should follow to ensure that a succession passes off successfully and the business is ready for the next phase of its development

If you are the leader and family member in control of your family business and are wondering what you still need to do to plan for your succession, it can be useful if ask yourself what would happen to your family and business if, on a whim, you decided to take leave of your daily activities and responsibilities and make yourself unavailable for a year. How well would your family and business cope without you?

As you ponder this question, review the steps below and determine how thoroughly you have addressed each of them. Listen to your intuitive responses. If you are unsure, then most likely your family and your business are too dependent on you and your leadership.

If that is the case, these guidelines will help you promote the independence of the business, reduce the family's dependence on you, and minimise the risk of your business not surviving into the next generation.

## TAKE CARE OF YOURSELF

This is the first and most important step. Running the family business is almost always an experience of self-sacrifice. An overrated virtue, self-sacrifice, in addition to being emotionally and physically draining can create resentment towards family members and others. Being only human, we all expect, consciously or unconsciously, that others will somehow appreciate what we do. I have never seen a situation, however, in which the level of self-sacrifice is met by the expected level of appreciation. Denying your emotional needs in order to satisfy the needs of others fosters dependence in family members, who end up resenting you for their dependence rather than appreciating what you have done for them.

Take care of yourself physically as well as emotionally. Take the time necessary to reduce stress and relax, I guarantee that you will be able to review your family business situation from 30,000 feet. And it will be much easier for you to determine what needs to be done when you return from your time off to implement your succession plans. Working out what is best for the future of the business and the family can best be done when you are physically and emotionally healthy. The longer you are available, the more opportunity you afford everyone to take advantage of

your expertise.

## PLAN

You can never begin succession planning too soon - both ownership and estate planning, and preparing a successor. Ownership planning requires clarity about where the equity and the control of the enterprise will land. Make sure that the distribution of control and equity is consistent with the values of you and your family and is not driven by wealth preservation vehicles, which focus only on control and tax savings. It is a good idea to have your plan examined by someone trained in family dynamics. I have seen a number of brilliant tax savings instruments that preserve the wealth as defined by economic terms, but diminish the wealth of human capital as defined by the quality of relationships among family members.

*"The most important ingredient for the sustainability of the family business is its culture"*

It is also critical to develop a management team as well as a successor, so that you can begin to hand over control of the operations of the business. It is best not to wait too long. It is almost impossible to let go after the age of 70, at which time the aging process, as a defence against the fears that aging brings, creates the need to hold on. Ned Johnson of Fidelity, Sumner Redstone of Viacom, and Rupert Murdoch of News Corp are prime examples of this behaviour. They are entitled to their choices, but I doubt that any of their companies will be as strong after they are gone, because they will probably never relinquish control while they are still healthy.

## EXAMINE AND REVIEW THE BALANCE SHEET

The balance sheet is the most important tool with which to examine the financial strength of the business. Family businesses seem to err in one of two extremes. Some families keep all their

equity/wealth in the family business rather than diversify their assets through capitalisation methods/ financial engineering, making the family too dependent on the fortunes of the business. Given this rapidly changing, volatile world economy, keeping your assets in one place creates a level of vulnerability that is unnecessary and unwise. Other families err at the opposite extreme. They concentrate only on the profit and loss statement, pull out the profits, and decapitalise the business in order to match the lifestyle of the family.

**ESTABLISH CORPORATE GOVERNANCE**

It has been my experience that family business people are phenomenal when it comes to the operations end of the business. However, as the business grows and the market place becomes more competitive (read shrinking margins) they need to become more strategic. The presence and the role of a board, which ought to include independent board members, will push you into the desired process of strategic planning, budgeting and other traditional business methods.

These best business practices will allow for a more macro view of business, and will help you take the necessary steps for the business to thrive into the next generation. The board can also provide the accountability necessary for the next generation. Independent directors bring fresh eyes. I have seen family members take seriously a comment from a director that, had it come from another family member, would have been ignored or dismissed. The board takes a lot of emotion out of the business discussions. By basing business decisions on empirical evidence, the board can increase the quality of those decisions while reducing the power struggles among family members.

**ESTABLISH FAMILY GOVERNANCE**

When family members are stockholders, or prospective stockholders, tension among them regarding business issues is inevitable, whether they work in the family business or not. A family council consisting only of family members (some include in-laws, some do not) keeps the lines of communication open. It provides a structure through which family members become informed participants who have a history - of conversing about common interests. They can discuss and share relevant information about the business, including issues that affect all stockholders. It can also keep the significance of a particular issue in its proper perspective, reducing the risk of it becoming the flashpoint for a number of issues that remain unaddressed.



You must ensure your company does not sink after you exit your family business

I suspect that the Bancroft family did not have a comparable structure, which made them vulnerable to Rupert Murdoch's offer and subsequent sale of The Wall Street Journal to News Corp.

**PRESERVE THE CULTURE**

The most important ingredient for the sustainability of the family business is its culture, which comes directly from the values and the culture of the family. Time and again, I have seen family members take over a business in extreme crises and succeed.

I have seen two brothers, with very little training beyond what they heard around the dinner table, take over a business after their father suddenly died. I have seen surviving spouses hold onto the business despite the advice of the professionals to sell because they had no experience. I have seen two sisters, who were voted in by their board, despite the fact that their father had assigned them only trivial tasks, take their business and triple the market cap of their family-controlled, publicly-traded company. What all of these people had in common was their training through osmosis, their passion for the business, and their adherence to the values and culture of the family. The presence of family members is a constant reminder of the core values that are critical to the success of the business. Creating vehicles and opportunities for family members to

steward the business through management, ownership, or corporate and/or family governance significantly reduces the risk of the business not surviving into the next generation. I recommend the book *Built to Last*, by James C Collins and Jerry I Porras, who point out that the strongest companies are those that are able to maintain their culture and values.

**COMMUNICATE**

Communication is the key to progression. All the above principles are irrelevant if family members do not talk to each other. Most families are able to discuss these points if they take the time to do it. If you get stuck, call in an advisor to help. The biggest risk to succession is ignoring the Issues that stand in the way of moving forward. ●

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