Succession Planning for Family Owned Businesses

Family Owned businesses ("FOBs") have historically represented the lifeblood of the U.S. economy, occupying the greatest portion of the nation's wealth. According to the Family Firm Institute ("FFI"), family-controlled companies account for 80% to 90% of all business enterprises in the US and employ 62% of the U.S. workforce.

Family Succession Facts

The leadership of 39% of family owned businesses will have changed hands in the next five years and $4.8 trillion of net worth will be transferred over the next 20 years. It is estimated that at any given time 40% of FOBs are facing the issue of transferring ownership and control, and considering the following options:

1. Sale or transfer of the business to family members
2. Selling to management, partners, or employees
3. Selling to an outsider
4. Closing the doors entirely

According to a survey of family business owners by the National Federation of Independent Business, only about 30% of all family owned businesses survive into the second generation, some 12% into the third generation, and only 3% through the fourth generation and beyond. As a result, the average lifespan of a FOB is only 24 years.

Planning for Family Succession

Because building a comprehensive succession strategy can take years of careful planning, advisors recommend that business owners initiate the process at least five years before they plan to retire or exit their business. Failure to effectively prepare for and manage the succession or exit process is the leading reason for failed FOBs.

According to a survey of failed FOBs (conducted by the University of Connecticut Family Business Program), 48% indicated that the founder's death was the precipitating reason for the transition and ultimate collapse of the firm.

Benefits of Family Succession

The decision to keep business ownership and control in the family often depends on a number of preexisting conditions, including the presence and ability of a qualified heir, a stable financial scenario, and a secure plan for the future goals of the company. With these factors in place, family succession has a number of distinct advantages, including the following:

- Future leaders know the business
- Emphasis is on long-term gains
- Better employee relationships
- Significant tax benefits

Conversely, there are several drawbacks of family succession:

- Successor is not qualified or motivated
- Lack of family harmony
- Current owner cannot let go
- Disagreeing on how to run the business
- Retirement cannot be financed

Alternatives to Family Succession

For various reasons, including the lack of a logical and capable successor, the desire to truly retire, and the desire to cash out, family succession is not a viable option for many business owners. As an alternative to family succession, middle-market business owners have access to various liquidity or “exit” options, including:

1. ***Selling the company outright***
2. ***Recapitalization or Partial Sale*** — selling part of the business and partially cashing out now, while retaining some portion of the business for another future sale
3. ***Management Buy Out*** — partnering capable and qualified senior managers with a private equity source to acquire the company and cash out the owner
4. ***Taking the company public (IPO)*** — cost prohibitive in today’s Sarbox regulatory environment, unless the Company has reached a significant mass
5. ***ESOP*** — establishing an ESOP to sell part of the company to the employees; be careful this may not be a true cash out strategy since owners need to personally guarantee the ESOP funding

In each and every situation, the proper and most beneficial succession or exit plan will be different. Every family has different dynamics and each family member has differing desires, abilities, and talents. Furthermore, every business and industry is different. Consequently, numerous and multiple variables come into play.

Perhaps the most critical factor is for the owner to recognize the need for a succession or exit plan. Often owners are emotionally unable to “let go” or they feel they “need to be needed” and fail to establish a proper exit plan. All of the owner’s hard work and ability to pass along that wealth to family members is jeopardized if an owner becomes incapacitated, or worse, prior to implementing a succession or exit plan.

About Flatirons: Flatirons Capital Advisors, LLC (www.flatironscap.com) is an investment banking firm that helps privately held companies sell their businesses, acquire other businesses, and raise capital. Our services include accomplishing mergers and acquisitions, obtaining financing, sourcing loans for distressed or bridge finance situations, and financial restructuring. Our unique business model affords sell-side advisory clients the ability to improve their company’s performance, earnings and effectiveness in the short-term, while simultaneously increasing their market value for a future sale. Flatirons has offices in Colorado and Texas.

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