LOS ANGELES BUSINESS JOURNAL

September 20-26, 1999 Volume 21, Number 38

How to Painlessly Pass Family Firm to Next Generation

ENTREPRENEUR'S NOTEBOOK

ERNEST DOUD JR.

Any family business that has looked at keeping it in the family and successfully transitioning ownership to the next generation can tell you it's a tremendous challenge.

For these firms, succession goes far beyond estate planning and management. If you're thinking about passing your business on to family members, it's never too early to start laying the plans. Start as soon as possible to move through the following phases of family business succession.

■ The first phase is known as the "founder's transition" and serves as the foundation for the rest of the process. If the founder is not willing to make a graceful transition, the rest of the going will be rocky, if it occurs at all.

If you're the founder, how can you prepare to take this leap? First, create a vision of what an enjoyable life will be like after the turnover. You've devoted yourself to the family business; now it's time to find and pursue outside interests.

While it can be difficult, you must learn to truly delegate. Transferring titles is easy, but letting go of authority may be one of your most daunting challenges.

Another important step is to position yourself so you're financially independent of the business. If your retirement income depends on the operating income of the business, you will never let go. Start putting retirement assets into other baskets.

■ Phase two is the "family transition," which requires the help and understanding of every relative involved. Initially, you want to manage your "hat" collection. There are dozens of hats one can wear in a family business, including owner, boss, employee, mom, dad, spouse, son, daughter, sister or brother.

Every hat has different rights and responsibilities. Understand who owns which hats and what the related responsibilities entail.

Learning to communicate effectively is an important aspect of the process. Too many successions fail because families can't make important decisions. Effective communication doesn't happen by accident. Take the time to learn and practice good communication skills.

Also important are problem-solving and conflict resolution. Conflict is a fact of life in all family businesses. Developing ways to solve problems and resolve conflicts is vital for a healthy transition.

After attending to personal and family matters, focus on phase three, the "business transition." Because the firm provides the economic fuel that keeps your family's financial fires burning, you must fan the flames.

You should be optimizing the operating effectiveness. Most family businesses employ outdated systems and procedures that may be hurting the bottom line. If you have not conducted an objective, independent operations assessment within the past three years, now is the right time.

You must also communicate your vision and strategy to the company's new leadership. Does every member of management know and share your vision? Have you developed a strategic plan – a road map for realizing that vision? If not, develop and share your plan with every member of the organization.

You must also understand what to expect financially. Family businesses can be either growth investments or income investments. Most cannot be both. Everyone in the family should understand what they can realistically expect in financial terms.

■ Phase four is the "management transition." Your current management model will invariably change for the next generation. Plan for and manage this change. Leaving it to chance creates fertile ground for conflict.

Make sure everyone knows (and agrees to) the education, skills and experience that the ideal management candidate will possess. Equally important is determining the search universe. Will you only consider family members as candidates? Does that include in-laws? Or will you look beyond the family to find the best candidate?

■ Phase five is the "ownership transition." You must determine who will control the business in the next generation.

Any effective ownership transition must provide for business continuity. Remember that "equal" is not always "fair." Dividing business ownership equally is often not a good decision, particularly when some family members are more active in the business than others.

Furthermore, owning the family business may not be attractive to everyone in the family. Most family businesses pay few dividends, and liquidity is hard to achieve. Family business stock may not fit well in the portfolios of family members not active in the business.

■ Last, but certainly not least, is the sixth phase, the "estate transition." Assuming you want to treat your heirs equally, the estate transition can be improved if you follow several guidelines.

First, provide for business continuity. Make ownership transfer decisions that protect the well being of the business before you complete your estate plan. Also provide for equality. If the business is not being divided equally, you will need to find other ways to equalize the division of your estate.

The sooner you start making these decisions, the more options you have.

Ernest Doud Jr. is a certified management consultant and a principal in Glendale-based Doud\Hausner and Associates. He can be reached at edoud@doudhausner.com.

Entrepreneur's Notebook is a regular column contributed by EC2, The Annenberg Incubator Project, a center for multimedia and electronic communications at the University of Southern California. Contact James Klein at (213) 743-1759 with feedback and topic suggestions.

Doud\Hausner & Associates • 100 N. Brand Boulevard, 6th Floor • Glendale, California, 91203-2637 • Phone: 818-539-2267 • Fax: 818-539-2253