

3.3: Family Business Issues

Learning Objectives

1. Explain why communication, employing family and nonfamily members, professional management, employment qualifications, salaries and compensation, succession, and ethics are important issues for all family businesses.

Looking at the vision and hard work of the founders, family businesses “take on their unique character as new members of the family enter the business. At best, the environment can be inspiring and motivating. At worst, it can result in routine business decisions becoming clouded by emotional issues.” “Focusing on Business Families,” *BDO*, November 2009, accessed October 8, 2011, static.staging.bdo.defacto-cms.com/assets/documents/2010/04/Focusing_on_business_families.pdf.

The owners and managers of family businesses face many unique challenges. These challenges stem from the overlap of family and business issues and include communication, employing family and nonfamily members, professional management, employment qualifications, salaries and compensation, and succession.

Communication

Communication is important in any business, but the complexities of communication in a family business are particularly problematic. Experts say that communication is one of the most difficult parts of running a family business. Christine Lagorio, “How to Run a Family Business,” *Inc.*, March 5, 2010, accessed October 8, 2011, www.inc.com/guides/running-family-business.html. The approach to communication needs to include commitment, the avoidance of secrecy, and an understanding of the risks of bad communication.

Commitment

In a family business, it is critical that there be a commitment to communicate effectively with family and nonfamily members of the business. “Business leaders should be open about their awareness of the potential for communication issues to evolve and their willingness to accept feedback and input from all employees about opportunities for improvement and areas of concern.” Leigh Richards, “Family Owned Business and Communication,” *Chron.com*, 2010, accessed June 1, 2012, smallbusiness.chron.com/family-owned-business-communication-3165.html.

One important issue is whether there should be a line drawn between family and business discussions. Some suggest that setting up strict guidelines from the start that draw a clear line between the different types of discussions is a good approach. Leigh Richards, “Family Owned Business and Communication,” *Chron.com*, 2010, accessed October 8, 2011, smallbusiness.chron.com/family-owned-business-communication-3165.html. By contrast, the Praxity Family Business Survey “The Family Business Survey 2008/2009,” *Praxity*, 2009, accessed October 8, 2011, praxityprod.awecomm.com/News/...essSurvey.aspx, found that it is considered OK to talk about the business anywhere and at any time, whether at work or at home:

- Nineteen percent of the family businesses in the survey reported talking about business at home.
- Thirty-seven percent talk about it in the workplace.
- Forty-four percent talk about it when and wherever.

Secrecy

In family businesses, it is particularly important not to convey the impression that family members are more in the know than other employees. “...Even when this is not the case, the potential for the perception of exclusivity may exist. Steps should be taken to address any issues that may arise openly, honestly, and without preference for family members.” Leigh Richards, “Family Owned Business and Communication,” *Chron.com*, 2010, accessed October 8, 2011, smallbusiness.chron.com/family-owned-business-communication-3165.html.

Risks of Bad Communication

If good communication channels are not in place, the following can occur:

- “Family members assume they know what other family members feel or want.”
- “Personal ties inhibit honest opinions being expressed.”
- “The head of the family may automatically assume control of the business even if they don’t have the best business skills.”

- “One family member ends up dominating the business.”
- “Family-member shareholders not active in the business fail to understand the objectives of those who are active and vice versa.”
- “Personal resentments become business resentments and vice versa.” “Communication and Family Businesses,” *Business Link*, 2010, accessed October 8, 2011, www.businesslink.gov.uk/bdotg/action/detail?type=RESOURCES&itemId=1073792652.

These difficulties can be overcome if the family business makes a concerted effort to create and maintain an environment of open communication where people feel comfortable voicing opinions and concerns. It is important that family and nonfamily members have an equal opportunity to express their views.

Employing Family and Nonfamily Members

It is natural for a family business to employ family members, especially in management positions. Family members tend to be the first people hired when a small business gets started, and as the business grows, so do their roles. Philip Keefe, “Hiring Family Members for the Family Business,” March 30, 2010, accessed October 8, 2011, philip-keeffe.suite101.com/hiring-family-members-for-the-family-business-a220028. There are both pros and cons to hiring family members. Both need to be considered carefully. Who to hire may well be the biggest management challenge that a family business owner faces.

Pros

On the positive side of things, several advantages can be identified for hiring family members: Dean Fowler and Peg Masterson Edquist, “Evaluate the Pros and Cons of Employing Family Members,” *Business Journal*, June 6, 2003, accessed October 8, 2011, www.bizjournals.com/milwaukee/stories/2003/06/09/smallb6.html; and Philip Keefe, “Hiring Family Members for the Family Business,” March 30, 2010, accessed October 8, 2011, philip-keeffe.suite101.com/hiring-family-members-for-the-family-business-a220028.

- Improved customer relations through family contact
- Intergenerational continuity
- Long-term stability
- Shared values
- Loyalty and commitment
- Inherent trust
- Willingness to sacrifice for the business
- Emotional attachment to the business; more willing to contribute to its success
- Share the same culture

“A family whose members work well together can also give the business a welcoming and friendly feel. It can encourage employees who aren’t in the immediate family to work harder to gain acceptance by those employees who are.” Philip Keefe, “Hiring Family Members for the Family Business,” March 30, 2010, accessed October 8, 2011, philip-keeffe.suite101.com/hiring-family-members-for-the-family-business-a220028.

Cons

There are also quite a few disadvantages to hiring family members: Dean Fowler and Peg Masterson Edquist, “Evaluate the Pros and Cons of Employing Family Members,” *Business Journal*, June 6, 2003, accessed October 8, 2011, www.bizjournals.com/milwaukee/stories/2003/06/09/smallb6.html; Philip Keefe, “Hiring Family Members for the Family Business,” March 30, 2010, accessed October 8, 2011, philip-keeffe.suite101.com/hiring-family-members-for-the-family-business-a220028; Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69; and Margaret Steen, “The Decision Tree of Family Business,” *Stanford Graduate School of Business*, August 2006, June 21, 2012, www-prd-0.gsb.stanford.edu/news/bmag/sbsm0608/feature_familybiz.html.

- Families are not perfect, so a dispute among family members can spill from home into the workplace.
 - There is always the possibility of managerial incompetence.
 - It may not be possible to separate family and work.
 - Patterns of conflict will be rooted in early family experiences.
 - Communication may break down.

- Sibling rivalry may create problems.
- Newly hired family members may feel that they do not have to earn their positions; their success will be seen as linked to their name instead of their abilities.
 - The company may be subject to charges of discriminatory hiring practices if job openings are not published.
 - Nonfamily members of the business may feel that family members get hiring preference.
 - Nonfamily members may feel that they will be automatically outvoted in decision making.
 - Hiring primarily family members for management positions may lead to hiring suboptimal people who cannot easily be dismissed. This could lead to greater conflict because of promotion criteria that are not based on merit.

Hiring Nonfamily Members

There will be times when the better decision may be to hire a nonfamily person for a particular job. Experience has shown that a family business is less likely to be successful if it employs only family members; bringing in the fresh thinking that comes with external expertise can be valuable at all levels of a business. “Focusing on Business Families,” *BDO*, November 2009, accessed October 8, 2011, static.staging.bdo.defacto-cms.com/assets/documents/2010/04/Focusing_on_business_families.pdf. In addition, nonfamily members can offer stability to a family business by offering a fair and impartial perspective on business issues. The challenge is in attracting and retaining nonfamily employees because these employees “may find it difficult to deal with family conflicts on the job, limited opportunities for advancement, and the special treatment sometimes accorded family members. In addition, some family members may resent outsiders being brought into the firm and purposely make things unpleasant for nonfamily employees.” “Family Owned Businesses Law and Legal Definition,” *USLegal.com*, 2010, accessed October 8, 2011, definitions.uslegal.com/f/family-owned-businesses. Because it is likely that a growing family business will need to hire people from the outside, it is important that the business come to terms with that necessity. Policies and procedures can help with the transition, but the most important thing is to prepare the family culture of the business to accept a nonfamily member. Not surprisingly, this is much easier said than done.

Professional Management

The decision to hire a **professional manager** is likely one of the most important and difficult hiring decisions that a family business owner will have to make. The typical definition of professional managers equates them with external, nonfamily, nonowner managers, thus declaring professional management and family management as mutually exclusive. Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69. “A typical argument...is that professional nonfamily managers should be brought in to provide ‘objectivity’ and ‘rationality’ to the family firm.” Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69.

There are several problems with this way of thinking. First, it perpetuates the outdated notion that family members are not professional, that the smartest thing for a family business to do is to bring in professional management—as quickly as possible. Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69.

Second, professional managers are not always prepared to deal with the special nature of family-owned businesses. “The influence of families on businesses they own and manage is often invisible to management theorists and business schools. The core topics of management education—organizational behavior, strategy, finance, marketing, production, and accounting—are taught without differentiating between family and nonfamily businesses.” Kelin E. Gersick et al., *Generation to Generation: Life Cycles of the Family Business* (Cambridge, MA: Owner Managed Business Institute, Harvard Business School Press, 1997), 4. This does an injustice to the unique workings of a family-owned business.

Third, a professional manager from the outside is not always prepared, perhaps not even most of the time, to deal with the special nature of family companies. The dominant view on professional management downplays the importance of the social and the cultural context. “This is a problem in family firms where family relations, norms, and values are crucial to the workings and development of the business.” Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69. It is argued that the meaning business families attach to their businesses is guided by family values and expectations—so much so that “anything or anyone that interrupts this fragility could send the business into chaos.” Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69.

The hiring of an outside manager, therefore, should include an assessment of both **formal competence** and **cultural competence**. Formal competence refers to formal education, training, and experience outside the family business. Although it is certainly helpful and appropriate, formal competence is not sufficient for managerial effectiveness. It needs to be supplemented with cultural competence, an understanding of the culture of a specific firm. Interestingly, most family businesses look only to formal competence when selecting a CEO. Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69.

Culture and Nonfamily CEOs

It is extremely important to understand the culture of the family firm. It means that as a leader you have to be sensitive to the organization’s reactions on the things you say and do. I have a long-term employee on my management team, and she is my guide in these issues. She can tell me how the organization will react and how things are likely to be received. We have to build on the past even though we have to do a lot of things in new and different ways. But because of the culture, this might be very sensitive. (The words of a nonfamily CEO in a family business.)

As a nonfamily CEO, you have to have in-depth respect for the invisible forces among the employees in the family firm. You cannot escape the fact that there will always be special bonds between the family firm and the owner. Always. (The words of a nonfamily CEO in a family business.) Annika Hall and Mattias Nordqvist, “Professional Management in Family Businesses: Toward an Extended Understanding,” *Family Business Review* 21, no. 1 (2008): 51–69.

One concern of family businesses may be that the hiring of a nonfamily manager will result in the loss of their “familiness.” However, one study found that, even with nonfamily managers bringing nonfamily management activities, styles, and characteristics, “the special and unique aspects and forces of the system of the family, its individual family members, and the business itself provide a synergistic force that offsets the outside influences of the [nonfamily managers].” Matthew C. Sonfield and Robert N. Lussier, “Family-Member and Non-family-Member Managers in Family Businesses,” *Journal of Small Business and Enterprise Development* 16, no. 2 (2009): 196–209. This same study acknowledged, however, that their research did not focus on understanding at what point, or percentage of nonfamily members, the feeling of “familiness” will begin to erode. Matthew C. Sonfield and Robert N. Lussier, “Family-Member and Non-family-Member Managers in Family Businesses,” *Journal of Small Business and Enterprise Development* 16, no. 2 (2009): 196–209.

Employment Qualifications

One of the more difficult challenges that a family business must face is determining employment qualifications for employees, both family and nonfamily. The lack of a clear employment policy and process can lead to major conflicts in the company. Unfortunately, it would appear that, despite their benefit, most family businesses have a family employment policy. “GARBAGE IN—GARBAGE OUT: Family Employment Policies,” *ReGENERATION Partners*, May 2002, accessed October 8, 2011, www.regeneration-partners.com/artman/uploads/20-2002-may-news.pdf. As a result, many family businesses may end up with more employees from the family than the company needs, and some of these people may not even be qualified or suitable for the jobs they have been given. “Some family businesses even find themselves acquiring businesses that have no relationship with their original business or keeping some unprofitable business lines just to make sure that everybody in the family gets a job within the company.” “Family Member Employment Policies (Case Study 1: SABIS),” *IFC Corporate Governance*, 2006, accessed October 8, 2011, www.smetoolkit.org/smetoolkit/en/content/en/6742/Family-Member-Employment-Policies-Case-Study-1-SABIS%C2%AE-. This kind of situation benefits no one.

A written family-business employment policy can solve a myriad of problems because it spells out the specific terms for family and nonfamily members with respect to recruiting, hiring, promoting, compensating, and terminating. One recommendation is that an ideal family employment policy should include the following: “GARBAGE IN—GARBAGE OUT: Family Employment Policies,” *ReGENERATION Partners*, May 2002, accessed October 8, 2011, www.regeneration-partners.com/artman/uploads/20-2002-may-news.pdf.

- “Explain the family employment policy’s purpose and philosophy.”
- “Describe how family members will apply and be considered for positions.”
- “Cover the general conditions of employment, including compensation and supervision.”
- “Outline the approach to be taken in developing and promoting family business members.”
- Make clear that family members will be completing the same applications that other candidates will complete.
- Include an inspiring and upbeat reminder that the policy’s purpose is to help the family business succeed and to support, develop, and motivate family members to lead successful and productive lives.

- Have all family business owners sign the policy, indicating they have read and agreed to it.

Others have recommended “that family members meet three qualifications before they are allowed to join the family business on a permanent basis: an appropriate educational background; three to five years’ outside work experience; and an open, existing position in the firm that matches their background.” Craig E. Aronoff and John L. Ward, *Family Business Succession: The Final Test of Greatness* (Marietta, GA: Business Owner Resources, 1992), as cited in “Nepotism,” *Reference for Business.com*, 2010, accessed October 8, 2011, www.referenceforbusiness.com/small/Mail-Op/Nepotism.html.

There are no rules that dictate the content of a family business employment policy, so differences from one family business to another can be expected. However, it is very important “to set employment conditions that do not discriminate against or favor family members. This would help establish an atmosphere of fairness and motivation for all employees of the family business.” “Family Member Employment Policies (Case Study 1: SABIS),” *IFC Corporate Governance*, 2006, accessed October 8, 2011, www.smetoolkit.org/smetoolkit/en/content/en/6742/Family-Member-Employment-Policies-Case-Study-1-SABIS%C2%AE-.

The benefits of an employment policy notwithstanding, the idea may be met with resistance. There may be the feeling that hiring decisions for family members should be separate from the hiring decisions for nonfamily members because being a family member provides special qualifications that cannot be matched by someone outside the family. How to proceed will ultimately fall on the shoulders of the family business owner.

Salaries and Compensation

As difficult as hiring decisions may be for the family business, decisions about salaries and compensation are probably even worse. No matter how well intentioned and well designed the company’s compensation plan may be, there will still be jealousies, hard feelings, severed sibling relationships, and even lawsuits, particularly among those family members who feel they have been treated unfairly. “Family Owned Businesses: Compensation in Family Businesses,” *Gaebler.com Resources for Entrepreneurs*, 2010, accessed October 8, 2011, www.gaebler.com/Compensation-in-Family-Businesses.htm. This presents a daunting challenge: how to develop a compensation plan that will be fair to family members and good for the business:

One of the greatest struggles of operating a family business is separating the family from the business. Oh yes, there are many great benefits to having family in the business and to being a family member in a family business, but the most difficult problems result when “family values” and issues take over, leaving business values and needs wanting. There is no greater source for family business problems—nor more fertile ground for their cure—than the family business compensation systems. Bernard J. D’Avella Jr. and Hannoeh Weisman, “Why Compensation for Family Members Should Be at Market Value,” *Fairleigh Dickinson University*, 2010, accessed October 8, 2011, view.fdu.edu/default.aspx?id=2344.

Some of the Problems

Family businesses often make several common mistakes when developing their compensation plans.

- They consider fair compensation to be equal compensation for all family members, sometimes even for the owner. This creates a very sticky situation because all family members are not created equal. “It is sometimes difficult to assess and compare the talents of family members who are also employees. Nor do all family members contribute equally to the business. As a result of the stress that this causes, many family business owners ignore the problem and let compensation become a breeding ground for dissension in the family.” Kathy Marshack, “How to Arrive at Fair Compensation in a Family Business,” *American Chronicle*, February 29, 2008, accessed October 8, 2011, www.americanchronicle.com/articles/view/53757.
- They do not compensate wives for the work they do. The reason often given? It saves on taxes. Not surprisingly, this approach leaves wives isolated from the business, invisible in the decision-making process, and unappreciated. This problem extends to the compensation of sons and daughters as well. A survey by Mass Mutual Insurance Company Referenced in Kathy Marshack, “How to Arrive at Fair Compensation in a Family Business,” *American Chronicle*, February 29, 2008, accessed October 8, 2011, www.americanchronicle.com/articles/view/53757, reported a big discrepancy among the salaries of sons and daughters in family businesses across America. The average salary of the typical son in a family business was \$115,000, while his sister earned only \$19,000. This may be due to the tendency of sons being groomed for leadership, while daughters are groomed for the supportive roles that command lower salaries.
- The compensation for family members is higher than that for nonfamily members, but the differential is not tied to the actual job requirements or performance. This situation can lead to anger, reduced motivation, resentment, and eventual departure of the nonfamily member from the firm.

- The business overpays family members—for a variety of reasons: Ellen Frankenberg, “Equal Isn’t Always Fair: Making Tough Decisions about Transmitting Family Assets,” Frankenberg Group, 2010, accessed October 8, 2011, www.frankenberggroup.com/equal-isnt-always-fair-making-tough-decisions-about-transmitting-family-assets.html.
 - “Guilt, because mom & pop were so busy working when the kids were young.”
 - “Fear of conflict, because someone’s wife threatens not to come to the family picnic.”
 - “Resistance to change, because ‘That’s the way we’ve always done it.’”
 - “Inability to confront family members who feel ‘entitled’ to inflated salaries.”
 - “Determination to minimize estate taxes by transferring wealth through compensation.”
- Emotional pressures are allowed to determine compensation policies. What this means is that compensation is not correctly determined by job requirements and performance in those jobs. When this happens, small problems develop centrifugal force: Ellen Frankenberg, “Equal Isn’t Always Fair: Making Tough Decisions about Transmitting Family Assets,” Frankenberg Group, 2010, accessed October 8, 2011, www.frankenberggroup.com/equal-isnt-always-fair-making-tough-decisions-about-transmitting-family-assets.html.
 - “Fighting between sibling/cousin partners increases.”
 - “Hard-working family members and employees lose morale.”
 - “Well-motivated competent employees leave the company.”
 - “The company loses its competitive edge and growth potential.”
 - “Family harmony decreases.”
 - “The value of the company declines, or it is sold—for the wrong reasons.”

Some of the Solutions

Developing a fair compensation plan for the family business is not easy. It requires good faith, trust, and good business sense. The dollar amounts offered to family members will be critical, but the more pressing issue is fairness. Dean Fowler and Peg Masterson Edquist, “Evaluate the Pros and Cons of Employing Family Members,” *Business Journal*, June 6, 2003, accessed October 8, 2011, www.bizjournals.com/milwaukee/stories/2003/06/09/smallb6.html. Unfortunately, fairness is often construed as equality. This must be avoided.

There is no template for designing a compensation plan for family businesses, but there are several recommendations: Bernard J. D’Avella Jr. and Hannoeh Weisman, “Why Compensation for Family Members Should Be at Market Value,” *Fairleigh Dickinson University*, 2010, accessed October 8, 2011, view.fdu.edu/default.aspx?id=2344.

- Develop accurate job descriptions for each employee that include responsibilities, level of authority, technical skills, level of experience and education required for the job, and goals for an annual performance review. In a performance-based company, the amount of stock owned by a family member will not be related to his or her compensation.
- Develop a clear philosophy of compensation so that everyone understands the standards that are used to pay people. The following is a sample of a written compensation plan philosophy that was developed by one family.

Family members employed in the business will be paid according to the standards in our region, as reported by our trade association, for a specific position, in companies of our size. In order to retain good employees we will pay all employed family members and other managers within the top quartile of our industry’s standards. Additional compensation will be based on success in reaching specific company goals, with bonuses shared among all members of the management team. Individual incentives will be determined according to measurable goals for job performance determined each year, and reviewed by the appropriate manager. Ellen Frankenberg, “Equal Isn’t Always Fair: Making Tough Decisions about Transmitting Family Assets,” Frankenberg Group, 2010, accessed October 8, 2011, www.frankenberggroup.com/equal-isnt-always-fair-making-tough-decisions-about-transmitting-family-assets.html.

- Gather information about the salaries of similar positions in the industry of the family business in the applicable region of the country. Look at companies that are similar in the number of employees, revenue, and product. If possible, obtain salary and benefit information.
- Have the base salary for each position be consistent with the salaries and wages paid for comparable positions at similarly sized businesses. Paying at this market value will have an excellent effect on nonfamily members because they will feel that they are on an even playing field. There will be a positive effect on business morale.
- The family business owner might consider seeking outside help in determining compensation levels for individual family members. However, this assistance must be seen as truly objective, with no reason to favor one viewpoint over another.

Oh, Those Sleepless Nights!

A recent family business survey “The Family Business Survey 2008/2009,” *Praxity*, 2009, accessed October 8, 2011, praxityprod.awecomm.com/News/...essSurvey.aspx, reported that the following things keep family business owners awake at night.

Rank	The Nightmare	Percentage Citing as a Significant Concern (%)
1	Family members can never get away from work.	18
2	Business disagreements can put strain on family relationships.	17
3	Emotional aspects can get in the way of important business decisions.	16
4	Transition to the next generation is more difficult than a third-party sale.	10
5	There can often be conflicts regarding the fairness of reward for effort.	9
6	The business rewards are not necessarily based on merit.	8
7	Family members find it difficult to be individuals in their own right.	5
8	Difficulties arise in attracting professional management.	5
9	Children can be spoiled through inequitable rewards.	4
10	Outside shareholders do not contribute but take payouts from the business.	3
11	The family is always put before the business and therefore can be less efficient.	3
12	Past deeds are never forgotten and are brought up at inappropriate times.	2

Other urgent issues identified by a different family business survey included, in order of importance, the following: “American Family Business Survey,” *Mass Mutual Financial Group*, 2007, accessed October 8, 2011, www.massmutual.com/mmfg/pdf/afbs.pdf.

- Labor costs
- Health-care costs
- Finding qualified employees
- Foreign competition
- Labor union demands
- Domestic competition
- Oil prices
- Availability of credit from lenders
- Estate taxes

Succession

Another important issue that is particularly difficult for family businesses is **succession**. As mentioned earlier in this chapter, succession is about passing the business to the next generation. Decisions have to be made about who will take over the leadership and/or ownership of the company when the current generation dies or retires. “Family Owned Businesses Law and Legal Definition,” *USLegal.com*, 2010, accessed October 8, 2011, definitions.uslegal.com/f/family-owned-businesses. Interestingly, “only a third of all family businesses successfully make the transition to the second generation largely because succeeding generations either aren’t interested in running the business or make drastic changes when they take the helm.” “Family Business Statistics,” *Gaebler.com: Resources for Entrepreneurs*, October 10, 2010, accessed October 8, 2011, www.gaebler.com/Family-Business-Statistics.htm. There are family businesses that manage the transition across generations quite easily because the succession process chooses only the children willing and able to join and work with the prevailing family, business values, and goals. Unfortunately, there are also instances in which children have had to leave school as soon as legally allowed, not equipped to manage either the business, their lives, or their family. These children spend many resentful years in the business until it fails. Sue Birley, “Attitudes of Owner-Managers’ Children Towards Family and Business Issues,” *Entrepreneurship Theory and Practice*, Spring 2002, 5–19.

Passing the family business to the next generation is a difficult thing to do, but succession is a matter of some urgency because 40 percent of US businesses are facing the issue of succession at any given point in time. Nancy Bowman-Upton, “Transferring Management in the Family-Owned Business,” *Small Business Administration*, 1991, accessed October 8, 2011, www.sbaonline.sba.gov/idc/groups/public/documents/sba_homepage/serv_sbp_exit.pdf. This urgency notwithstanding, there are several forces that act against succession planning: Ivan Lansberg, “The Succession Conspiracy,” *Family Business Review* 1 (1981): 119–44, as cited in Nancy Bowman-Upton, “Transferring Management in the Family-Owned Business,” *Small Business Administration*, 1991, accessed October 8, 2011, www.sbaonline.sba.gov/idc/groups/public/documents/sba_homepage/serv_sbp_exit.pdf.

1. Founder
 - Fear of death
 - Reluctance to let go of power and control
 - Personal loss of identity
 - Fear of losing work activity
 - Feelings of jealousy and rivalry toward successor
2. Family
 - Founder’s spouse’s reluctance to let go of role in firm
 - Norms against discussing family’s future beyond lifetime of parents
 - Norms against favoring siblings
 - Fear of parental death
3. Employees
 - Reluctance to let go of personal relationship with founder
 - Fears of differentiating among key managers
 - Reluctance to establish formal controls
 - Fear of change
4. Environmental
 - Founder’s colleagues and friends continue to work
 - Dependence of clients on founder
 - Cultural values that discourage succession planning

These are powerful forces working against succession planning, but they need to be overcome for the good of the founder, the family, and the business. It will be tricky to balance the needs of all three and fold them into a good succession plan.

The Succession Plan

Voyageur Transportation, a company in London, calls its successful succession planning program, “If you got hit by a beer truck, what would happen to your department?” “Sample Succession Planning Policy,” accessed October 8, 2011, www.experienceworks.ca/pdf/successionpolicy.pdf. As a family business owner, you should pose this question in terms of yourself and your business. Hopefully, this will provide the impetus you need to develop a succession plan.

A good succession plan outlines how the succession will occur and what criteria will be used to judge when the successor is ready to take on the task. It eases the founder's concerns about transferring the firm to someone else and provides time in which to prepare for a major change in lifestyle. It encourages the heirs to work in the business, rather than embarking on alternative careers, because they can see what roles they will be able to play. And it endeavors to provide what is best for the business; in other words, it recognizes that managerial ability is more important than birthright, and that appointing an outside candidate may be wiser than entrusting the company to a relative who has no aptitude for the work. "Making a Difference: The PricewaterhouseCoopers Family Business Survey 2007/08," *PricewaterhouseCoopers*, November 2007, accessed October 8, 2011, www.pwc.com/en_TH/th/publications/assets/pwc_fbs_survey.pdf.

A good succession plan will recognize and accept people's differences, not assume that the next generation wants the business; determine if heirs even have enough experience to run the business; consider fairness; and think and act like a business. The plan should also include a timetable of the transition stages, from the identification of a successor to the staged and then full transfer of responsibilities, and a contingency plan in case the unforeseen should happen, such as the departure or death of the intended successor or the intended successor declining the role. "Family-Run Businesses: Succession Planning in Family Businesses," *Business Link*, accessed October 8, 2011, www.businesslink.gov.uk/bdotg/action/detail?type=RESOURCES&itemId=1074446767. It would also be helpful to get some good professional advice—from company advisors who have expertise in the industry as well as other family-run businesses. "Avoid Feuds When Handing Down the Family Business," 2010, *AllBusiness.com*, 2010, accessed October 8, 2011, www.allbusiness.com/buying-exiting-businesses/exiting-a-business/2975479-1.html.

Although each succession plan will be different, the following components should be seen as necessary for a good succession plan: "Components of a Good Business Succession Plan," April 18, 2011, accessed October 8, 2011, www.entrepreneurshipsecret.com/components-of-a-good-business-succession-plan.

1. **Establish goals and objectives.** As the family business owner, you must establish your personal goals and vision for the business and your future role in its operation. You should include your retirement goals, family member goals, goals of other stakeholders (e.g., partners, shareholders, and employees), and goals relating to what should happen in the case of your illness, death, or disability.
2. **Family involvement in the decision-making process.** If the family and stakeholders who are involved in the decision-making process are kept informed of the decisions being made, many of the problems related to inheritance, management, and ownership issues will be alleviated. Communication, the process for handling family change and disputes, the family vision for the business, and the relationship between the family and the business should be addressed. The surest path to family discord is developing the succession plan on your own and then announcing it. Susan Ward, "Six Business Succession Planning Tips," *About.com*, 2011, accessed October 8, 2011, sbinfo.canada.about.com/cs/buysellabiz/a/succession1_2.htm.
3. **Identify successor(s).** This section of the plan will address the issue of who takes over ownership and management of the business. Identification of the potential successor(s), training of the successor(s), building support for the successor(s), and teaching the successor(s) to build vision for the business are included here. Working with your successor(s) for a year or two before you hand over the business will increase the chances for success. Susan Ward, "Six Business Succession Planning Tips," *About.com*, 2011, accessed October 8, 2011, sbinfo.canada.about.com/cs/buysellabiz/a/succession1_2.htm.
4. **Estate planning.** Estate planning is important if you are planning to retire or want to take precautionary measures regarding the future of the business in the event you are unable to continue operation of the family business due to illness, disability, or death. You should consult a lawyer, an accountant, a financial/estate planner, and a life insurance representative so that your benefits will be maximized. You will need to consider taxation, retirement income, provisions for other family members, and active/nonactive family members.
5. **Contingency planning.** Contingency planning is about unforeseen circumstances. It is about strategizing for the most likely "what if" scenarios (e.g., your death or disability). By thinking in terms of the unforeseen, you will be taking a proactive rather than reactive approach.
6. **Company structure and transfer methods.** This section of the succession plan involves the review and updating of the organizational and structural plan for the organization taking into account the strengths and weaknesses of the successor. The following needs to be identified: the roles and the responsibilities of the successor, the filling of key positions, structuring of the business to fit the successor, the potential roles for the retiring owner, any legal complications, and financial issues.
7. **Business valuation.** This section is relevant only if the business is being sold. Passing the business to a family member would not involve a business valuation.
8. **Exit strategy.** With any succession, ownership will be transferred, and you will remove yourself from the day-to-day operations of the business. Alternatives will be compared, and a framework for making your final choices will be developed. The transfer

method and the timelines are decided. The exit plan should then be published and distributed to everyone who is involved in the succession process.

9. **Implementation and follow-up.** The succession plan should be reviewed regularly and revised as situations change. It should be a dynamic and a flexible document.

As difficult as the planning process can be, the goal should be a succession plan that will be in the best interests of all—or most—of the parties involved. Business interests should be put ahead of family interests, and merit should be emphasized over family position. “Family Succession Plan First Then the Succession Plan for the Family’s Business,” *Family Business Experts*, 2011, accessed October 8, 2011, www.family-business-experts.com/family-succession-plan.html.

The Family Business and Technology

In 2008, when R. Michael Johnson—Mikee to everyone who knows him—took over the pressure-treated lumber company his grandfather founded in 1952, he had a great idea: laptops for all managers and sales staff.

“You would have thought the world was coming apart,” says Johnson, CEO and president of Cox Industries in Orangeburg, South Carolina. One salesman—convinced that the computer would be used to track his movements outside the office—up and quit. A buyer who had been with the company for thirty-five years said he would like a fax machine but could not see why he needed a computer when he had managed just fine without one for so long.

And that was just the beginning. In an industry where some businesses still write delivery tickets by hand and tote them up on calculators, Johnson recently led the company through an ERP (enterprise resource planning) software conversion and distributed iPhones to the sales team so they can use the company’s new customer relationship management (CRM) system.

“Let’s just say I have spent quite a few Sunday lunches after church explaining technology acronyms to Granddad and Grandmom,” Johnson says.

The resistance to new technology quieted, however, after Johnson was able to point to market share growth of 35 percent at the \$200 million business in the past year. “The numbers are starting to resonate,” he says. “Five years ago, I couldn’t even say what our market share was because we didn’t have the technology to figure it.” Karen E. Klein, “When the Third Generation Runs the Family Biz,” *Bloomberg BusinessWeek*, April 9, 2010, accessed October 8, 2011, www.BloombergBusinessWeek.com/smallbiz/content/apr2010/sb2010049_806426.htm.

KEY TAKEAWAYS

- Important family issues include communication, employing family and nonfamily members, professional management, employment qualifications, salaries and compensation, and success. Each issue can create conflict.
- It is very important to understand the culture of the family business, especially by nonfamily CEOs.
- Succession planning is critical to the success of passing a business to family members.

EXERCISES

1. Select a family business in your area. Make arrangements to speak with three members of the family who work in the business. Develop a list of ten questions that cover a broad range of issues, such as the approach to compensation (but do not ask for specific salary or wage numbers), the process for hiring family and nonfamily members, and the plans for passing the business to the next generation. Ask each member of the business the same questions. Pull the answers together and compare them. Where did you find similarities? Where did you find differences? Did everyone know the answer to each question? Where were people reluctant to answer? Prepare a three- to five-page report on your findings.
2. The family business is looking to expand, and some members of the family, but not all, feel that it might be worth bringing in someone from the outside to fill one of the new management positions because the family talent has been pretty much exhausted. Design a process for hiring an external manager. What things should be considered? How might you get buy-in from all family members?

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