Family-owned businesses make up 85-90% of all businesses in New Hampshire; they employ two-thirds of the workforce and are responsible for creating the majority of new jobs in the state. A family-owned business is good for the family that owns it, often providing a higher standard of living; but it's also good for the customer, community, employees and the overall economy. Here in New Hampshire, there are many thriving companies that are owned by the fourth, fifth, sixth or even seventh generation.

That's the good news. The bad: nationally, two-thirds of successful first-generation businesses don't survive to the second generation—and fewer than 15% survive to the third generation.

What enables one family to pass the torch successfully from generation to generation, while so many others fail? Effective planning for the transfer of ownership and management. Succession is a complex process—not an event—that involves strategic planning, estate issues, governance, and family values and goals. It requires a plan that speaks to the specific needs of the family and the business; and all key stakeholders—including family and non-family, executives and advisors need to participate.

This assumes, of course, that the owner has decided to keep the company in the family, and that one or more family members have the talent and interest in taking over the business. Participation in ownership should always be an opportunity—not an obligation—nor should it be assumed that the oldest child will take over. Today we see siblings, cousins or a mix of family members and spouses taking over, which adds a whole new dynamic—as do the different lifestyles and values of the succeeding generations.

It can be a challenge to balance fairness in employing many children, and possibly grandchildren, with varying skill levels in the business. Does everyone with the right last name get a job no matter what their abilities, or are there rules for joining and a requirement that there is an opening that fits their talents? How should family members—whether actively involved in the business or not—be compensated, and what percentage of ownership is equitable?

The next generation needs the proper skills, education and work experience to take over. Working outside the family business before assuming a leadership role can provide the family member with greater confidence and credibility with employees when they enter the family business.

Still, having a qualified family member poised to assume the reins is far from all
that's needed. The senior generation must be willing to let go—and must have something to go to, since often their whole identity is tied up in the business. Family business owners frequently say to me, “If I die....” not “When I die...”

Communication is a key issue in family-run businesses, with ineffective communication at the root of many day-to-day problems. Effective and ongoing communication is absolutely critical in succession planning. To begin, a conversation about succession needs to be initiated. We've found that the senior generation typically needs to take the lead in bringing up the topic. Off-site family meetings—in which interruptions can be avoided—can be used throughout the process, but are especially helpful at the beginning. An outside third party, such as a family business consultant, can be used to facilitate discussion and provide counsel. Family business consultants have valuable experience in dealing with issues like sibling rivalry, nonactive family members, family and intergenerational conflict, and choosing a successor(s).

Next, a team that will be involved in planning and overseeing the succession should be assembled. We frequently recommend having a board of directors that includes people outside the family. Developing and implementing the succession plan will require experts in family business, such as an account, lawyer, a professional in business valuation, insurers, and bankers. These advisors should be committed to working together as a team to best serve the family's interest.

An estate plan should be developed for the senior generation, and likely will need to be updated on an ongoing basis as the family dynamics change. Valuing the business will require outside expertise to ensure that a fair value is established that will stand up to IRS scrutiny, should the business be sold or portions gifted in the future. This fair value also enables family members and their counselors to determine the impact of estate taxes. Once the plan is created, it should be shared with the younger generation so that they can make their own plans, knowing what the senior generation's plans are for the business and estate assets.

Financing the transfer can be a significant issue. The senior generation may not be in a position to give the business away if they need money from it to fund their retirement. As a result, the younger generation may need to enter into an agreement to buy the business over a period of time. The senior generation must be confident that the next generation has the ability to make the business a success, and make the payments while enabling the business to grow.

Passing the torch is often a lengthy process. According to Globe Manufacturing's George E. Freese, III, Senior Vice President of Manufacturing, “It took Globe over 10 years to come up with a succession plan. It wasn’t an easy process. Family members outside the business had different agendas versus the members
working the business. We joined the Center for Family Business to help other family businesses transfer their businesses from one generation to the next.” Today fourth generation cousins Freese, Rob Freese and Don Welch, manage the company.

Freese’s experience is not uncommon; few business owners can retire “cold turkey.” Instead they generally need at least five years to prepare—and interests outside the business to look forward to. It should be remembered that no succession plan is completed until voting control is passed to the next generation. The surprise return of a previously “retired” business head is more common than many realize, and can undermine the trust between generations.

Networking with other family businesses who are or have gone through the process successfully can be enormously helpful. At the University of New Hampshire’s Center for Family Business, families—along with key employees—can explore issues that face family-owned businesses, including succession planning. Being able to interact with other successors can help family members to realize that their problems and views are shared; and that as daunting as the process can be, it can actually contribute to the immediate and long-range health of the business.

*University of New Hampshire's Center for Family Business assists entrepreneurial families in finding solutions to their unique business challenges and concerns. The Center offers a series of interactive programs and events for family business members and key employees on a membership basis. For more information about the Center for Family Business and its programs, contact CFB's director, Barbara Draper, at (603) 862-1107, or email: Barbara.Draper@unh.edu. Or visit the Center's website, www.FamilyBusiness.unh.edu/*.