Family Business Succession 101

Find out what can go wrong with family business succession and how to avoid it in the first of a 2-part series that deals with passing the business on to the next generation.

By
Bill McCurry

Being a Sacramento native, I had an affinity for Tower Records, which is now quickly becoming a fading memory on the retail landscape. Founder Russ Solomon went to high school with my father, and we followed Tower's success. On Oct. 8, 2006, the *Sacramento Bee* reported the demise of this family business as "Bad Luck, Bad Decisions." The inference was the chain had $1 billion in sales when Russ Solomon's son took over, but things went downhill under the second generation.

Why are we so quick to point fingers at the next generation, along with outside factors like "bad luck" Let's have a reality check here. Entrepreneurs are good at starting businesses but have a spotty track record at building enterprises that last. There's a huge difference between starting a business and maintaining it. Starting and building can be exciting, fun and invigorating, but most people who enjoy the pace of start-ups don't have the aptitude for day-to-day operations. They also may lack the ability to delegate the most critical skills for succession.

Successions Gone Wrong

There are many factors that can go wrong when it comes to family business succession. This isn't a comprehensive list of successions gone wrong, but here are some real and recent situations:

Lame duck. A family business had 60 employees and was a marketplace leader when the son took over the operation on his 50th birthday. The challenge was that his mother still controlled the corporate checkbook and the son wasn't allowed to make any expenditures without first clearing them with her. Within a week after the takeover, the employees figured out he had no authority and didn't listen to him. His self-esteem was already in the cellar and being a figurehead CEO turned him into the worst kind of lame duck. As business began to slide, his mother lost what little confidence she had in her son and began to refuse most of his requests. The downward spiral accelerated, but nobody had the guts to take decisive action. The operation closed in 2005 after suffering through eight years of decline.

Unwitting son. A Mom & Pop business has 23 employees. After 29 years of marriage, the mom and pop owners had "irreconcilable differences" and split, leaving their son to take control. He had been working in the business (primarily on the sales floor) and going to some conventions. The need for cash was apparent, so the son mortgaged his home to pay some bills. Six weeks after the mortgage was done, the business was still short of cash, so for the first time in his career, the son looked at the general ledger — and didn't know how to read it. He knew the business was successful but didn't know how or why. The company was hemorrhaging cash the final year of the divorce and currently has negative cash flow. The son had no idea. Most vendors doubt he'll survive to see the spring season.

Expensive taste. Three cousins took over the business. The first cousin made sales calls, so he determined he must have a new corporate car and buys a BMW. He wanted to show clients the firm's success. In his mind, it was a totally legitimate business expense. The second cousin entertained clients on his boat, so he bought a new boat on

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company expense. You can see where this is going, but they couldn't. The company is gone — and for the record, so are the BMW and boat, which were repossessed.

Being fair. Three brothers took over from their dad, and the brothers' kids came to work in the business. To be fair to everyone in the third generation, each one was paid the same salary. The older brother's kids all have business degrees. One brother has a kid without a college education and another who didn't finish high school. Each child has a different work ethic. Employees complained that one child never showed up on time and the hourly employees had to scramble to cover absences, but the family refused to act. The banker called a meeting to tell the brothers that, after 43 years of handling their finances, the company was losing too much money to continue the banking relationship. That was the wake-up call.

It wasn't pretty, and it wasn't fun. A meritocracy was established in which the family members have to perform to get paid. The underperformers were terminated. Today, sales are up more than 50 percent. Last year's $250,000 loss looks like it will be a $150,000 profit this year with margins increasing every month. One of the remaining third-generation kids told me, "Think of the millions we lost over the years because we wouldn't deal with family."

Who Is To Blame?

Let's not blame the younger generation for these fiascos. The responsibility in these scenarios is very much on the shoulders of the older generations who assumed that "growing up in the business" would magically bestow management insights. It is understandable that some older generations would think this because that is how they learned the business. However, today's business is dramatically more complicated and problematic than it was 30 years ago. Every garden center owner I've talked with says things are tougher than they were even 15 years ago. The marketplace is less forgiving, regulations are more pervasive and margins are tighter. Years ago, management could afford to learn by trial and error. Today, there isn't the flexibility to make as many errors because companies are bigger and the errors could be dramatically larger, possibly fatal.

Back when the older generation started running the business, there were probably just a few employees (if any) and not a lot of debt, relatively speaking. Today, the upcoming generation has to step into bigger shoes than their parents did. Chances are the family's major asset is the business, and the older generation's retirement is based on the kids' success. Thus, the stakes are much higher, the pressure greater, the number of stakeholders larger.

Bring In Help

Most entrepreneurs hate to delegate, and passing the business to the next generation is the biggest delegation they will ever have to make. Most can't let go. An Atlanta business owner once asked me how McCurry's was successful in moving from second to third generation. I give credit to my dad and uncle (the second generation brothers) for doing two brilliant things.

First, four years before they retired they brought in an outside CEO. He was closer to their ages, so the brothers felt he was on their side, but he was able to tell them when they were wrong or excessively obstinate. He would also listen to the third generation (cousin, brother-in-law and me) and could tell "the kids" when we were out of line or too aggressive. When the brothers announced their retirement, they told us we should pick the CEO going forward. It was only logical to keep the person we had, thus averting a "family power play" for the top spot.

The second thing the brothers did was to absent themselves from any company contact for 90 days after their retirement. They felt the old-time employees would naturally gravitate to them if they were around the store or calling on the phone, which might undermine the new team's authority. It was "cold turkey" time for many senior employees who weren't sure they ➧

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Properly planning for your business's succession can help keep all the generations that are involved happy.

liked the idea of the kids taking over, but since the older generation wasn't around, they had no choice. It was "tough love" at its finest.

The Atlanta business owner listened patiently and then proceeded to tell me he had to be there everyday because his boys didn't have the smarts to run the business without him. I said, "If you really believe that, you're doomed. You need to be honest with your sons and then bring in an outsider to run the company and help the boys get jobs elsewhere so they can be successful." You should have heard him sputter!

Alas, now it's his business that's sputtering. He can't let go, and he won't trust his sons. The sons know that and respond accordingly. No surprises here.

Plan For Transition

At minimum, a good transition plan takes 5-10 years to execute. The new leader(s) must grasp the nuances of each area of the business, not just understanding crops or retail displays or pest control. Things like finance, forecasting, accounting, human resources and marketing are the soft skills of our industry. They can't always be understood just by working in the business. They must be learned through a program of immersion and understanding.

In looking back at McCurry's transition, we made one glaring error. My cousin and my brother-in-law "elected" me to be vice president of finance. Wow! How I loved that title. My challenge was I never saw the company's general ledger until my first day with the title, which was my mistake (also a mistake by the McCurry brothers). Until then, I had been responsible for merchandise buying. After my first day in my new job, I went home and dug in the basement for my old college accounting books. We ended up paying our CPA an hourly rate to go through the company books with me. I learned a lot and found some "material weaknesses" in our systems that we were able to correct. If we had it to do over again, every member of the management team would know how to read a general ledger and understand what it means.

Based on my background, I'm sensitive to upcoming generations not seeing their own company's books. In many cases, current owners tell me they don't want the younger generation to know "the truth" because they'll want raises or to spend the money on frivolous things like another greenhouse, more shopping carts or a new forklift. That's even more reason for the management team to see the books — so everyone can "agree to disagree" over what the company should do. Otherwise, once the kids come into control, they won't know how to make intelligent decisions, set priorities or know what to do or where to go for help.

Look for the second article in this 2-part business succession series next month. It will deal with more strategies for making family business succession a success.

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