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How to Transfer Control in a Family Business – and Keep the Business Viable

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Family businesses are a vital part of any national economy. In Canada, something like 90 percent of all businesses are either owned or controlled by a family. It's about the same in the U.S.A., the U.K., Australia and New Zealand.

But, though family businesses are prominent, they have a historical weak spot. Statistics show that only one out of three family businesses survives the transition from the first generation of ownership to the second. And less than one out of two survives the transition from second to third generation ownership!

While this poor survival rate is daunting, it's generally not the result of the type of notorious family disputes that make newspaper headlines. More often it's the result of poor planning for the future.

Based on the current business environment, about 40 percent of family-owned businesses are facing a transfer of ownership or control issue at any given time. The issue can arise due to the death or incapacity of a family member. Or it can be the result of new family members being brought into the management of the business.

Four options for ultimately giving up control

A founder of a family business looking at transition planning has few options when it comes to ultimately giving up control. These generally fall into the following four categories:

1. Cease operations and liquidate the assets of the business
2. Sell the business to someone outside the family
3. Retain family ownership but bring on outside management to operate the business
4. Retain family ownership and family management of the business.

Statistics show that the survival rates of businesses choosing either the third or fourth option are low. It follows that advance attention needs to be given to transition planning *before* the need to transfer ownership arises.

Just why is the survival rate of a family business so low? Family business management experts have cited four basic factors as the cause. The factors can occur independently of each other or they can be linked together – and the result is often a major issue for the business.

Causes of business transition failure

The first and most common cause of business transition failure is the lack of planning. The business reaches a point of crisis. Yet there is no documented plan in place to facilitate the transfer of ownership from one family member to another. The resulting disruption and lack of direction during a time of crisis often leads to the eventual demise of the organization.

Another important factor often overlooked is the future viability of the business. This frequently occurs when the founder's personality and abilities represent the core of the business. Successor generations haven't been groomed to be successful leaders of the business.

In some cases of transition failure, the owner will have little interest in handing the firm over to the next generation. The owner just accepts that, when they depart, the business will end.

A fourth cause of transition failure is simply that no one else in the family wants to take over the business. The family prefers to sell it off.

Even if one of these last two factors applies, it makes sense for the owner of any family business to optimize their return from the enterprise. They do this by making plans for a smooth transfer of ownership when the time comes. With the right kind of planning, the business will usually survive the transfer and remain viable.

In looking at business succession planning, you need to address four components. Each component is a complete and separate plan that complements the others. All four components need to be prepared to ensure the greatest success of the organization's survival.

Development of a strategic long-term plan for the business

A strategic plan for the business charts a course for the firm and details the goals of the business. Is growth of the enterprise the goal – or is the enterprise there to provide an income for family members? Will the business trade aggressively or conservatively? Does the business need to diversify from its core business to remain successful? Is the business financially viable to meet its future operational and capital needs?

Working through these kinds of details will allow business owners to create a clearer picture of the intended future of the business.

Creating a plan for each family member

This plan addresses the issues of importance to all members of the family. The plan should outline the role of the family in the business and the part each family member will play. It is important that this plan addresses policies regarding matters such as:

- employment of family members
- how they might leave the business and what their entitlements would be, and
- what support family members will receive from the business to ensure they are adequately trained and qualified to take a part in the family business.

Creating a formal business succession plan

The succession plan should identify who will take over the leadership of the business when the present owner leaves the position – and when the transition will take place. It should address what role the former owner will have and what compensation they will receive.

The succession plan needs to include a timetable for the handing over of executive power. It should address remuneration expectations for the family member who takes over. As part of the succession plan, depending on the business needs and individual qualifications of family members, this family member may be identified to assume board or management positions in the business.

Structured estate planning

Many family businesses fail because the owner passes on without addressing the business succession or transition arrangements in their overall estate planning. The business is an asset like any other asset. The business can be subjected to destructive taxation costs if the estate planning isn't done correctly to minimize taxes arising on the transfer of ownership from one generation to the next. It is important to understand and quantify the tax costs that may arise on ownership transfer. Then these can be funded with minimal impact on the business.

Prepare – or your business may not last

Preparing these four separate plans to handle the transfer of control in a family business may seem like a lot of work. If done properly, yes, it will be. But the alternative is for the enterprise to join the high numbers of failures and either fade away or self-destruct.

As a family business owner you have an opportunity to plan the process and to significantly impact the eventual outcome for you and your family. Recognizing the need for proper process, inter-active communication amongst the family and formal documentation of your plans will give you and your family the greatest chance of a successful transition.

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