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Insights and Resources

As a member of the RSM US Alliance, we would like to share the following with you:

10 success tips for the family business and its next generation

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Following these lessons can propel the enterprise to greater heights

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June 2019

At RSM's Center for Business Transition, our advisors consult with all types of entrepreneurial businesses of varying sizes in myriad industries. A significant number of those businesses are family-owned and several generations are involved. Some of these business arrangements are not only financially successful, but also incredibly satisfying for the owners to witness the next generation succeed and create a legacy, achieving financial security for all involved.

For every success story, however, there are multiple failures. Instead of an effective transition, the business suffers and the familial relations become strained, or worse. This happens because the proper foundation for success was not established. Below are some lessons learned and tips that, if addressed, are likely to improve the likelihood that your business can be one of those success stories where the next generation develops the right traits to propel the enterprise to greater heights.

1. Have your successors work somewhere else first

Before allowing any members of the next generation to enter your business, have them gain valuable experience working outside the family business. Some companies have even taken the step to make this a written policy when there are multiple families owning and operating the business.

Such an approach forces members of the next generation to prove their work ethic and demonstrate their values, while in situations where they have no familial advantage compared to their co-workers. It also affords the opportunity for them to learn how other businesses operate, and, hopefully, provide some independent ideas when they join the family business.

2. Put family members in positions they are qualified for

Only hire a family member for a position he or she is qualified for, and where there is a demonstrated need in the company. If you would not give family members the responsibility if they weren't your offspring, then don't put them in the position.

Our advisors have seen numerous situations fail. For example, one advisor worked with a family company that named a nephew as chief financial officer, when he barely had any background in accounting or finance. The company suffered. It was obvious to the employees that he did not have the experience and the skills. The controller quit because his boss provided no guidance and even made his job more difficult.

It is better to wait until you have the right opening than to bring a family member into the operation prematurely and risk having that member not be able to perform at the needed level.

3. Communicate behavioral expectations upfront

Set expectations from day one. It should be understood that being a relative means he or she will be held to a higher standard of conduct. Other employees will be watching. Any behaviors that are viewed as taking advantage of privilege will create negative feelings toward the family member specifically and the company generally.

Simple things, such as showing up on time, not watching the clock, meeting deadlines and living company values are just some basic behaviors that are expected; these should be communicated to the family member upfront and not be left to chance.

4. Establish independent reporting relationships

Try to avoid having the next generation report to you, the owner, or any family member for that matter. Make certain you communicate to both the next generation and the nonfamily member supervisor that the expectations of that person are no different from any arm's length new employee.

Have others independently evaluate performance. Make it clear to the next generation to not come to you with any complaints or issues, but rather follow the chain of command.

5. Pay market rate

It is important to compensate family members at market rates. We had a client where the owner offered to pay his granddaughter an annual salary of $50,000 to be the receptionist, when the previous receptionist was paid $30,000. Employees who found out just shook their heads. As much as the owner believed such information was confidential, he soon discovered that when there is perceived privilege and outright inequities, word travels fast. Immediately, a sense of entitlement was created with the granddaughter and that created more issues.

If you want to fund the next generation with above-market compensation, do it personally.

6. Keep confidentiality sacred

Set the tone that away from the office you are not going to discuss office politics or personnel issues. It is fine to have a dialog about how the business operates and strategic challenges, but not personnel matters. Sometimes, employees will try to get the next generation to carry their issues to the owner. Employees may try to circumvent proper channels to try to accomplish some objective when they have not been able to get traction. Both you and the next generation should be aware of this technique others may employ.

7. Make the tough calls

For whatever reason, if employing a family member does not turn out to be a good fit, deal with it, directly and swiftly. That doesn't mean that you shouldn't be compassionate. On one occasion, a business owner lamented for years about how his son was not performing up to the level he expected and needed if he were to entrust the business to him. After much stomach churning, he finally had a meeting to gently suggest to his son that he may be more fulfilled doing something else. Much to the owner's surprise, the son was relieved to hear that his father would not be disappointed if he left. The son said he felt like a prisoner, but didn't want to let down his dad. The father subsequently sold the business, and gifted the son seed money to pursue his passion.

8. Avoid compensating for your mistakes as a parent

Being an entrepreneur and building a business from the ground up takes an incredible amount of energy and time commitment. Feelings of guilt can sometimes be misdirected in a business setting. We have seen numerous examples where the owner has looked the other way when an adult child in the business did things that would never be tolerated by a nonfamily member. For example, a son started a competing business when claiming to work full-time in the father's business, buying inventory at cost from the father's business, collecting sales commission and then reselling the inventory at a mark-up to customers and pocketing the profit, working in a field location from headquarters but rarely coming to work.

Blatant disrespect for the business only happens because owners let it happen. When questioned about why the owner looked the other way, what we have found is it comes down to guilt for some misdeeds or shortcomings by the parent.

9. Don't stand in the next generation's way

There will hopefully come a time when the next generation is prepared to take the reins. Owners sometimes don't recognize this when they should. It may be because they look at the next generation, regardless of their age, as just not experienced enough, or the owners' egos and time frame are causing them to retain their ultimate decision-making authority.

We suggest utilizing someone whose judgment you trust, an advisor or board member, to assess whether the next generation is ready, or if not, what shortcomings should be addressed to get them ready.

As far as the owners not wanting to change the status quo, we've found forthright discussions with the heir apparent about the struggle between not wanting to hold back the next generation and the desire to keep working often leads to previously untapped solutions. Look for win-win solutions.

10. Balance what is best for you, the next generation and the company

When the time finally comes to transfer ownership to the next generation, there are myriad options to explore: selling of the ownership interest, gifting, receiving ongoing compensation as a chairman or senior advisor and exploring recapitalization, just to name a few.

Our caution is to make certain you engage your financial advisor to evaluate your long-term personal financial requirements and these requirements do not overly burden the next generation's cash flow needed to keep the business on sound financial footing. We had a client that was a successful business owned by two brothers who continued to take significant salaries from the business plus note payments for the sale of their interests to the next generation. It choked the business until the next generation told their father and uncle that the business had to cut back on their payments. The brothers refused, so the adult children left the business and started a competing enterprise. The brothers received nothing more except for a permanently damaged relationship with their children and nephews.

For additional insights related to this topic, check out the following:

- 10 mistakes business owners make when thinking about whether to exit
- Why we call it business transition planning
- Keeping the business in the family: Third generation's challenge
- Business succession planning resource center

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