WISE COUNCIL

Generational Transition

CNY Business Exchange asks three family/generational business experts to identify the most common generational transition issues that family businesses face today.

PHOTO BY **JOHN BERRY**

BY ROBERT T. CHERRY, CPA, CVA; PARTNER, DERMODY, BURKE & BROWN, CPAs, LLC

It happens so often, it has become cliché: A family business owner holds the reins in a vise like grip, allows successors little say or control and refuses to step down when it is clearly time — causing the family, the business and the employees inordinate stress. For most family businesses, the transition of leadership is emotional and steeped in family politics. It is so difficult that just 33 percent of family businesses survive the transition from the first generation to the second, and only 16 percent survive to generation three. However, most transitional problems stem from one basic oversight: no formal transition plan.

A transition plan opens communications and establishes clear expectations grounded in fairness and shared values. Generally, retaining an outside, objective professional to help develop and execute a transition plan greatly increases the probability of success. A good transition plan helps prevent all three of the top transition problems:

1. The first-generation leader will neither delegate nor step down.

2. The next-generation leaders are neither evaluated for skills and aptitudes, nor positioned properly within the company, nor formally developed as leaders.

3. Key non-family management team members depart when faced with an unknown future when the next ›

gen enters the business.

Common Plan Characteristics

- Transition plans often take effect when the next gen is quite young. As soon as family members show interest in the business, operational cross training begins, often starting with basic jobs, throughout high school and college.
- After graduation, some plans require the next gen to complete three- to five-year stints at large multinational companies to gain perspective and managerial experience. They also serve another important purpose: When the next gen re-enter the family business, it is positioned to gain credibility with non-family employees, who can otherwise become disgruntled and may leave.
- Most plans also call for the members of the next gen to undergo formal, objective assessments of their abilities, particularly to lead and grow the business. Not all family members will be CEO material, and identifying their strengths and where they can contribute — perhaps in sales, operations or HR — enables a company to educate and groom them accordingly.
- Key nonfamily management team members are provided with long-term financial incentives to remain with the company.
- Finally, perhaps the most compelling reason to employ a transition plan is to circumvent "tight-rein" syndrome. By the time a well-planned transition actually takes place, company leaders are well-prepared to hand the reins of the business to properly educated, thoroughly trained and experienced members of the family.

Change is never easy … but in a family business, developing a transition plan for the inevitable changeover in leadership helps effect an evolution, not a revolution, that ultimately benefits the family, the business and the employees.

Robert T. Cherry, CPA, CVA, Partner, has been with Dermody, Burke & Brown, CPAs, LLC for more than 27 years and leads the firm's privately held business niche. He is a member of the AICPA, NYSSCPA, Associated Builders and Contractors, Construction Financial Management Association, and the NACVA.

By Philip I. Frankel, Esq., Bond, Schoeneck & King, PLLC

Family businesses are unique entities with no definitive classification except being owned and operated by at least two related people. This can range from a husband and wife running a small bodega to a corporate conglomerate that is in the hands of a fourth generation of family members. Yet each entity faces similar legal and psychological concerns. In order to avoid a Griswold Thanksgiving, family businesses must establish a business plan, use a flexible corporate entity, draft agreements and treat the company as a true business, not an extension of the family.

It is common for family businesses to ignore the legal aspect of the company structure and "deal with it later." This creates more problems later on when the family is dealing with succession planning, extended-family members and sharing in its success. Aside from the tax and liability issues, it is essential that the family select a flexible business model that allows it to take on the personality challenges of familial expectations, sense of entitlement, inheritance and worthiness, as well as spousal issues.

The family should set up a business entity with voting and nonvoting ownership to allow family members to share in the economic growth of the company but not necessarily the management. More importantly, the family needs to draft a shareholders agreement to codify the business strategy and intent. For example, most families want the stock ownership to remain with their heirs. Thus, they must address the restrictions of stock ownership. Can a spouse own the shares or will it be limited to direct descendants of grandfather? How do shares get sold and how are they calculated? What if a son or daughter wants to sell his or her shares? What happens in the event of the death or permanent disability of a family member? Since family businesses want privacy, they very well may require private arbitration to resolve disputes rather than have their dirty laundry aired publicly in court. All of these issues and more are incorporated into a shareholders agreement. These issues must also be coordinated with each family member's estate planning to make sure their mutual intentions are carried out.