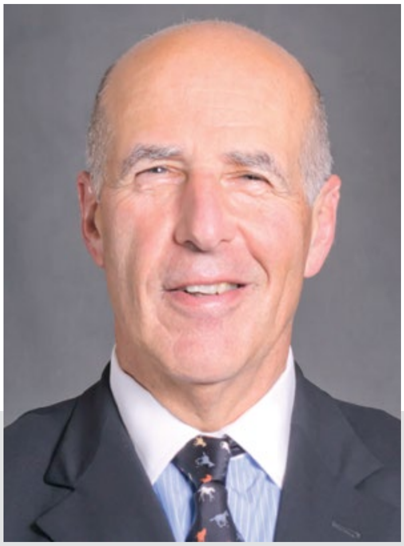
Transferring control

Considerations when making generational ownership transitions



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Some firms owned or dominated by family have achieved monumental success. Others have found the transition process difficult. Relentless competition, caused in part by the internet, and struggle for customer loyalty, combined with the thorny issues of family dynamics, are challenging.

Smart Business spoke with Howard N. Greenberg, managing member of Semanoff Ormsby Greenberg & Torchia, LLC, about making generational ownership changes in a family business.

HOW SHOULD OWNERS PREPARE TO TRANSFER CONTROL OF A FAMILY BUSINESS?

The first step is making certain each potential successor is fully committed. Talk to them well in advance and explain the benefits and pitfalls of ownership and control. Evaluate their interest, qualifications and commitment. All three are required. Performance in college, grades and choice of major are important signs.

Prior to joining the family business, outside employment in a related field is extremely beneficial. Working for an accounting, finance or legal firm can provide the younger generation with confidence, stature and valuable knowledge. Performance on the outside likely will evidence future performance with the family business.

You shouldn't, however, staff your business based on family. Staff it based on talent. Perhaps your family has talented managers, or people knowledgeable in finance. If not, you need to fill the gaps with non-family members. Similarly, if the third generation isn't ready to take the reins, bring in interim managers as caretakers until the younger generation is ready.

HOW DO GENERATIONAL MINDSETS AFFECT SUCCESS?

Typically, entrepreneurial founders do not have significant resources, but they do have lots of resourcefulness, drive and passion for the business, as well as talent and willingness to work very long hours with little pay. These characteristics and an intense drive to succeed help an entrepreneur create something that hopefully can be passed on to the next generation.

The second generation watched parents exert their efforts into their business venture, witnessed their passion and hopefully it rubbed off on them. They feel the responsibility to further the business and want to impress their parents. Though they might not have quite the same drive, they may have the privilege of greater resources and education. They are often successful at maintaining, growing and managing the business.

The next generation is where problems may arise and where outside help may often be required. The third generation usually has more resources, more education and more alternatives than the founding patriarch/matriarch had. But they may have other interests, lack the same drive and abilities, and there are usually more of them.

WHAT SHOULD BE DONE FOR NON-PARTICIPATING FAMILY?

It may be better to provide the people not actively running the business with other assets from the founder's or second-generation member's estate. To reward long-term performance for successor generations running the business, it's advised that the company recapitalize to lock in the current value with preferred interests. This provides the members of the next generation ceding control and those who choose a different career path with the value of their interests and provides the next generation who will run the business with the value of their future contributions. Include these provisions in wills, shareholder and operating agreements, as well as employment agreements and continuation plans.

It's extremely difficult for the first or second generation to objectively evaluate the talents and value of their children and grandchildren. And if the second generation comprises more than one sibling, there will be arguments concerning rewarding the third generation and picking leaders. Trying to make things equal for everyone is a mistake. People are not equal. Their talents differ. Outside advisers and consultants can help make these decisions objectively. They can assist in preparing the comprehensive agreements that are carefully tailored to the particular family business. Doing this in advance of the generational transition is imperative. ●