

PASSING ON CONTROL OF YOUR FAMILY BUSINESS

BY PATRICIA FRISHKOFF

One magical day, the father walks onto the job and, with a hand on his son's shoulder, says something like, "Son, it's time you took the reins of control. I've watched you work; I know you can make this business a success." At this point the father exits to pursue other interests and keeps his nose permanently out of the business, unless someone asks for his advice.

At least, that's the storybook version. In reality, it's rarely that simple. The fact is, in the father's eyes, the kids are never quite ready to assume control. And as anyone who's ever nursed a business from start-up to maturity can tell you, divorcing yourself from the day-to-day affairs of that business is traumatic. Most owners are terrified that their successor will destroy the company, so they hang on long after they should have retired. In fact, the only way most founders will really leave is in a horizontal position.

Home building, for all its sophistication and high technology, is still a very traditional industry. While it's hard to get a precise figure, reliable estimates show that at least 75% of all construction and remodeling firms are family-owned and operated. By "family-owned and operated," I mean that at least two family members are involved in the management or ownership of the company.

There are plenty of positive points to working with family members. Obviously, trust and mutual respect are important. But even more crucial is that family members share values and have similar kinds of goals. Also, there may be more commitment to seeing a business succeed when your family stands to benefit.

There can be lots of drawbacks as well. The family business can be a veritable minefield of emotions. There is no shortage of horror stories about family members who haven't spoken for decades because of a business disagreement. Nor is it unusual for families to haul each other into court to settle their disagreements.

But never are the problems more acute than when it's time for one generation to shift control of the business to the next generation. It's a process that is rarely smooth. Preparation helps. But there are so many potential trouble areas involved that no amount of planning will avoid all the struggles.

As a family business counselor, I work with all kinds of different companies that are trying to work out "the forward pass." Whether they are family-owned restaurants, stores, or construction firms, the problems are the same. Transferring control is a touchy subject. It means

addressing all sorts of unpleasant things like retirement and death. Many business owners have a hard time believing the business can survive without them; retirement plans and wills are never made. The kids have a hard time discussing their parents' death, so they don't. These things are left unresolved until, suddenly, it's too late.

Statistically, only 30% of all businesses survive to a second generation. Only 13% are still in the family by the third generation. There are lots of reasons for this. In some cases, the family sells out or the product becomes obsolete. But a healthy number of family businesses fail because of problems in transferring control.

The Entrepreneur

By now most people are familiar with the term "entrepreneur" and all that it implies. Business publications celebrate the skills of entrepreneurs on one page and condemn them for their irresponsible ways on the next. It seems that all you have to do to qualify as one is to start a business.

These people are risk-takers with a great capacity for work. They're often charismatic, intelligent, and confident. They also tend to be autocratic and controlling. They want to do everything from buying the nails to selling the houses. It's hard for them to

believe anyone else can do as good a job as they can.

Part of what makes an entrepreneur good in business is an ability to manage intuitively. "Flying by the seat of their pants" gets many entrepreneurs through a lot of tight spots and helps them make good decisions. But it also may prevent them from putting the right amount of effort into planning and organizing their business. Some entrepreneurs may be great at managing people, but they may not know the first thing about how to balance the books.

It's often difficult for the entrepreneur to train a successor. It's just not possible

MAKING THE SWITCH: HOW MY FAMILY SURVIVED

BY TOM DUNCAN

My father and I always knew that one day I would take over his kitchen and bath business. As a kid I worked summers, evenings, and weekends to learn the ropes. After college, my father taught me everything he knew, from working on site to managing the warehouse. Yet despite all our preparation, when the time came for my father to retire, neither of us were ready for the emotional and financial strains that developed.

Looking back, I think those months were among the hardest in my life. There were times when I wondered if owning the company was worth all the bad feelings the transition caused.

But we got through it. Now my father, who's 67, is devoting his days to fishing and golfing and all the things you're supposed to do when you retire. I'm running the business and loving every minute it.



Tom Duncan and his father, Elmer, review a business plan in their office in Poland, Ohio. After hashing out the terms, the elder Duncan recently relinquished control of the family business to Tom. Elmer now acts as a consultant to the company.

My father, Elmer Duncan, worked as a plumber until he started E.H. Duncan in 1956. He started by redoing bathrooms but later expanded into kitchens. Eventually he opened a showroom and, in 1987, we added a heating, air conditioning, and electric division. This year, E.H. Duncan, The Bath and Kitchen Center, will do about \$1.35 million in sales.

I came on board after graduating from college in 1976. Much to my disappointment, my father ignored my business management degree and sent me out in one of the trucks to work as an apprentice plumber. I worked my way up and got my master's license 11 years later, but I learned the hard way that my father expected a lot from me, more than he expected from other employees.

That was a hard lesson. I had a lot of respect for my father and always wor-

ried that I wouldn't be able to fill his shoes. It wasn't until 1982, when he moved me into kitchen and bath sales, that I learned one of the many good qualities I'd inherited: the ability to sell. That realization gave me some confidence. My father, in turn, showed me more respect.

We worked well together for about five years. All the while, my father talked a lot about his retirement plans. He had no intention of running the business until he dropped. He wanted to enjoy what he'd earned.

The retirement was set for 1987, but early that year my mother died. The prospect of all those lonely hours was enough to cancel my father's retirement plans and keep him on the job. But his heart wasn't in the business. It got to the point where I was running the company but still had no ownership rights. My father, mean-

to teach someone else to be intuitive. Subconsciously, the entrepreneur may not really want a successor. It means that someday he or she will be out of the business. That's hard to take, especially when the entrepreneur has devoted everything, emotionally and financially, to the business.

Strained Relations

Typically, the family business is started by the father. The mother may or may not be a paid participant, but she contributes plenty in terms of emotional support and stability, and frequently she helps with the bookkeeping or secretarial work. The kids, usually sons, are introduced to the job by working summers with their father. More so than in the past, daughters are also getting involved. But fathers and sons still run most family businesses.

There's often a lot of competition and jealousy between fathers and their sons. The father wants his son to do well, yet he may feel threatened when the son succeeds.

On the other hand, problems between fathers and daughters may center around the daughter's "traditional family role" versus the role she has chosen (to swing a hammer or run the company). Often, the father's natural instinct is to protect his daughter from the trials of running a business. He may feel that she's less capable than a son might be. Studies show that fewer than 5% of all family companies are transferred to daughters.

But family businesses come in all sorts

of combinations. One of the most common arrangements is for two brothers to start a company. Conflicts are born when the brothers start bringing in members of their own families. Pretty soon there's a fistful of cousins vying to take over the business. Instead of evaluating each child for his or her talents, the brothers may compete to see whose kid can gain control.

Some families may never encounter these kinds of conflicts. But those who do soon realize that family problems quickly become business problems.

Picking Your Successor

Deciding who gets your job when you're ready to exit is not always an easy choice. Sometimes there is a logical successor, a son or daughter who is capable and committed. But other times the field of candidates is remarkably wide. The first step is to single out your choice. The next step is to ask that person if he wants the job. While you may consider it an honor for someone to follow in your footsteps, that someone may have other ideas.

Perhaps your two sons and your daughter have worked on the job with you since they were kids. It's clear that one of your sons has his own plans but the other son, as well as your daughter, wants to stay with the company.

You may end up dividing ownership between the two. Or, if you only want one at the helm, you get the unpleasant task of deciding which one. Ideally, one child is the obvious leader and the other a talented employee. Regardless, some-

been a lot easier if my father had been more cooperative. While he realized that it was time to transfer control, he seemed to feel a sort of "seller's remorse." We had lots of arguments that seemed to boil down to the same problem: My father felt I was pushing him out of the business. We had a lot of long talks together and tried to hash out our differences. But fathers and sons aren't always the best communicators and it took months for us to resolve our problems.

My father finally retired last fall and we completed the sale in April of this year. We agreed to a selling price that is somewhat lower than the original estimate the accountants came up with. But we added in some interest and stretched out the monthly payments over the next 12 years. It's a figure I'm comfortable with and one that gives my father a good retirement income. Meanwhile, we paid upwards of \$10,000 in attorney and accountant fees as well as taxes. Transferring a business is not cheap.

I think of my father as the best consultant I could have. He doesn't meddle, but he's got 34 years of experience for me to draw on when I need it. I still hear stories about what a great businessman my father is. But I don't feel jealous or insecure because of them. Instead I feel grateful for the opportunities he's given me. At the age of 34, I've got my own business and a healthy income.

But I've also learned a lesson: My son, who's only three years old now, can be whatever he wants. I won't push him into working with me. But if he wants the company, the transition has got to be easier the second time around. ■

Tom Duncan is president of E.H. Duncan, The Bath and Kitchen Center, in Poland, Ohio.

one's feelings are going to be hurt and you're going to feel like a heel. Sometimes the best alternative is to ask your children to decide between themselves who will take over.

Things can get sticky when the transfer of power is to an in-law. Kids who never had any interest in the business suddenly get territorial when they learn that their sister's husband will be the next president. And what happens if the daughter and son-in-law split up?

With a national divorce rate hovering at about 50%, many parents will find themselves handing the business down to step-children. The son of the owner may find himself sharing responsibilities with his half-sister.

Training Your Successor

Carefully training your successor is the key to a smooth transition. It gives you a chance to retire, start another company, or just concentrate on one niche within the business that interests you most. If you do set out to train your successor, start that training early. You and the other working members of your company will be spending the better part of eight or ten years imparting your business acumen.

Take some time to think through the skills your successor must have and decide who can teach him or her best. For instance, if you have a sales person, he might do a better job explaining the sales side of the business. Introduce your son or daughter (or whomever will take over) to all the people you work with: your banker, your lawyer, the guys at the lumberyard. Let these people know that your child will one day take over the business. Then get out of the way and give your successor a chance to build on the foundation you've laid.

One option is to send the kids outside the business to another job setting to get their feet wet. This is good for building their self-esteem. It also avoids the conflicts inherent in the training process—remember teaching your kids how to drive? There's one drawback though, because you run the risk of losing them to someone else's company if they like it there.

Keep in mind that your retirement should come when the kids are ready to take control, not when you are ready to leave. Ideally, these times coincide. Depending on their experience and maturity, most people in an arrangement like the one we're describing are ready to take over while they are in their prime—usually their late thirties and early forties.

Taking the First Step

If you plan to sell the business to your children, you'll need a clear idea of what your business is worth. Setting the value of a construction business, or any service business for that matter, is tough. There are few tangible items, save some tools, vehicles, and real estate. The most valuable assets a family business has are its name and its reputation. But how do you put a price on those?

A professional appraiser or accountant can help. They measure various criteria, including earnings, growth rate, and sales, as well as your tangible assets, to develop an estimate.

While I'm on the subject of appraising a business's worth, here's a related situation. In the event that the business is owned by two partners, and one of them dies, raising the money to pay for that half of the business is difficult unless the partners have taken out life insurance on one another. For example, if the business is worth \$500,000, ideally each partner takes out a policy for

\$250,000 and names the company as beneficiary. But if you take this route, make sure the value of the insurance is adjusted as the business's value changes.

Another alternative is a buy-back plan. Whether your partner has died or quit, this option lets you make payments over a period of time to purchase your partner's share of the business.

Your lawyer can also help you arrange a buy-sell agreement. This is a document that gives partners first option to buy one another out.

Estate Planning

Entrepreneurs are used to "winging it." These are not the kind of people who worry about things like wills.

But think of the alternatives. The death of a family business owner becomes even more difficult to deal with when there is no estate plan. It leaves the kids to fight among themselves or with the business owner's spouse. To compound the situation, the family may be hit with taxes that can reach 55% of the value of the estate.

One way to keep your descendants in business is to provide sufficient life insurance to cover estate taxes. These "survivorship" policies will leave your beneficiaries enough to pay off the taxes while preserving the family business.

Inevitably, you will have to decide how to divide up your assets, often a tricky process. Sometimes there is a nagging fear that what you're doing may not be fair. Here are some options that may make the process simpler.

- Leave the business to the kids who are active in it. In most cases, they not only want it, but they've built up sweat equity and deserve it. Leave the rest of the family your other assets, like the house, cars, or a bigger share of the life insurance proceeds.
- If you've designated one of your children as president of the company, give that child the controlling vote in the business. If you divide the business equally among all the kids, it undermines authority and breeds conflict.
- If you haven't made your will yet, go out and do it now. You'll be doing everyone a huge favor.

One final bit of advice: take time to talk with your kids. It's easy to get so caught up in the day-to-day operations that you forget to look at the big picture. Hold regular family meetings, perhaps during a once-a-year outing, to talk about your company's direction in a relaxed setting. You may realize just how special your family is. ■

Patricia Frishkoff is director of the Family Business Program at Oregon State University and consults with family businesses on transferring control.

For More Information

Here are some books on the subject of transferring control of your business that might be of help.

Your Family Business by Benjamin Benson, with Edwin Crego and Ronald H. Drucker. Dow Jones-Irwin, 1990.

Keeping the Family Business Healthy by John Ward. Jossey-Bass Publishers, 1987.

Father, Son & Co. by Thomas J. Watson, Jr. Bantam, 1990.

while, was making all the money.

For the next two years my father talked about retirement but wouldn't take action. I realized that for everyone's sake, as well as the good of the company, it was time to take things into my own hands.

I talked to several lawyers and accountants about my options, and discovered there are lots of ways to handle the sale of a business. Some methods are more advantageous tax-wise. Others make the transition neater and quicker. Unless you get guidance from a good attorney or accountant, you'll have a hard time knowing what's the best arrangement for you.

Through a referral from a friend, I finally found an attorney who specialized in taxes and business transfers. Together with our accountant and five different appraisers, we set about determining a selling price for the business.

We arrived at our figure by evaluating the worth of our real estate, including the showrooms, office space, and some other offices the company rents out, as well as our assets, which include vehicles, inventory, cash on hand and showroom items. This was offset by our liabilities. It's not unusual for us to have \$70,000 in receivables and \$60,000 in payables.

We tracked the values of these items over a four month period and averaged them out. This gave us our figure.

When we told my father what the business was worth, he was surprised. Like most business owners, he assumed his company was worth whatever it was generating in sales. In fact it was worth much less than that. But he didn't believe us until we mapped it out on paper.

This whole process would have