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Here's A Radical Idea:

Don't 'Pass-On' Your Family Business

By: Tom Deans

Never in the history of civilization has so much wealth been created inside businesses – equity now sitting as cash, inventory, receivables, intellectual property, and goodwill. This wealth represents a lifetime of risk-taking by family business owners who created enterprises that beat the odds. These businesses didn't just survive, they actually thrived. But lurking around the corner is a question that confounds and frustrates the brightest business minds: 'Who will own my business when I'm gone?'

There's no denying that business succession planning is a morose subject. That's why legions of business owners put off planning for the most obvious event in one's life – death. But what makes this subject so profoundly important is not only the staggering \$10 trillion that some experts believe will transfer inter-generationally over the next decade, but also the fact that family dynamics have changed.

The problems confronting aging business owners today have their origin back in the 1960s, '70s, and '80s, when owners elected to have smaller families than their parents did and when college enrollment skyrocketed. Many children born during these decades heeded their parents' advice to follow their own passions and entered professions unrelated to the family business. For owners whose children did enter the family business, owners need to answer the succession questions. But instead of 'Who will lead my business when I'm gone,' the question is 'Who will risk their capital to buy my business when I'm still alive?'



Mask Real Threats

The sense of control can often mask real threats to a business owner's net worth. Market forces and life events often come out of left field and strip a business of its value with blinding speed. And with business owners concentrating so much of their wealth in one stock – their own company – the financial risk is significant. The success rate across all sectors of family businesses transitioning to the second generation is only 30 per cent. And of those, only 10 per cent will survive to the third generation. So if you are the founder of a family firm, you have a three per cent chance of having your grandchildren own and operate your business.

A business succession crisis is now in full swing and a small growth industry of consultants has predictably sprung up from disciplines ranging from accountancy to psychotherapy to help families in business sort through their issues. Underlying all of this well-intentioned work is a professional bias that a business should be, and can be, built to last. It's a perspective that resonates emotionally with business owners. It's a sentiment that continues to torment owners who feel lesser and diminished when their children show either no interest in or no capacity to lead the business.

But what if the secret to a successful legacy lies in the more radical idea that businesses themselves make poor legacies and seldom last? What if business owners could recast what a successful exit looks like and celebrate the finality of their life's work, instead of clinging to the idea that pursuing the perpetuity of their firm is the only authentic succession goal?

Cast an eye across the Atlantic to Europe's most successful and enduring dynastic enterprises and you'll see conglomerates. The undisputed heavyweight champion is the 250-year-old Rothschild dynasty. At the very epicenter of their family business DNA is the clear and unwavering ideal that their family, not their businesses, is their greatest legacy. The Rothschilds never confuse their love of a business with their love of business – the Rothschilds teach their progeny to love commerce.

It's a decidedly clinical idea that a business is merely an instrument of wealth creation – nothing less and nothing more: a business, a name, a building are simply assets; they are not the family. It's a sentiment that acknowledges that every business has a beginning, a middle, and an end and that the key to succession planning is finding the end of your business before the end finds you.

The irony is that as the Rothschilds build value and create wealth in one of their broad array of operating companies, they are always probing the market for its ultimate sale – a process the Austrian economist Joseph Schumpeter described in 1942 as the ultimate act of "creative destruction." Paradoxically, the more you seek to voluntarily 'destroy' your business through its sale, the longer your business lasts. This is not easy; it's phenomenally counter-intuitive and one of the reasons we find ourselves today on the precipice of the greatest wealth destruction event of all time among a lineup of business owners muttering, 'I'll never sell!'

Greatest Legacy

The smart money, the most successful dynasties, understand that a business owner's greatest legacy is not the business. It's not even their wealth. The real legacy investment comes in teaching, nurturing, and apprenticing their children to adopt and practice the very first principle of commerce that serves founders so well: there can be no authentic reward without authentic risk.

Successful dynasties seldom 'gift' operating businesses to their children. Instead, they pass cash and ask their children whether they want to purchase the business. This simple technique serves to trim the family tree by moving control to the siblings who are prepared to risk their inheritance to purchase the business. When this step is overlooked, we find business owners who do what so many parents feel is right and fair – when they die, they gift equal shares to each child, thereby creating sibling partnerships.

While some such partnerships succeed, the vast majority spin out of control and devolve into a litigious family-destroying, soul-destroying full-contact sport. Ask business founders whether they would have been business partners with all their brothers and sisters and most will roll their eyes and scoff at the mere thought. And yet hope overrules experience and leads these same owners to thrust their own children into business partnerships after the parent dies.

Families that can collaborate on the design and timing of the sale of their business – a sale either inside or outside the family – will protect wealth and fund the next generation's unique dreams and aspirations. If there is no buyer for the business in the house – no child willing to risk his or her capital – why not find out now? Unlike wine, families that fail to talk openly about the future of the business rarely get better with time.

If selling a business feels emotionally difficult for a founder, it's hard to imagine how that person can believe it will be easier for the succeeding generation to sell when they receive the business as a gift through the founder's estate. It's hard to exchange a gift, never mind sell one. Newspapers are brimming with daily examples of carnage resulting from the recipient generation operating the business purely as stewards or guardians of the previous generation's vision. The gifting of an operating business to children who are ill prepared to risk their own capital, to risk their time, to risk anything, remains one of the most toxic wealth destroying ideas there is. There can be no debate about the importance of innovation – creative destruction, if you will – to preserve and create value.

Fortune magazine, in one of its more sobering reviews of family businesses, noted that of the 100 largest firms in America in 1900, only 16 were still in business in 2000. This list of 100 included family and non-family businesses and serves as a stark reminder that businesses seldom last. When business owners can begin a different kind of conversation within their families – and make their plans less about themselves and their life's work – they'll take the first step toward cementing the last, most difficult, but vastly most rewarding deal of their lives.

Shred Families

The temptation to make a business the centerpiece of one's legacy will continue to shred families – their wealth and their relationships – from the inside out. It is the self-aware, introspective business owner who sets the family free of his own creation, that sows the seeds of a truly great and enduring dynasty.

A family business is not a building; it is not a company name. Rather, it's a set of values that puts risk and reward, humility not hubris, creativity, innovation, and entrepreneurship at the centre of the family and the business. Paradoxically, this is how the next family business dynasty will carve out its place in history – precisely by nurturing the next generation of risk-takers to step up to the plate with their own cash. ■

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