



They Don't Know What They Don't Know

The Crucial Development Opportunities for the Next Generation of Owners in the Family Business

Most entrepreneurs by nature are lifelong learners. That skill allows them to continue to grow with their company while navigating the increasing complexity and risk company growth brings. By the time they are ready to transition their business to the next generation, operating the business has become second nature to them. They often don't even realize just how much they know.

What they do understand is, precisely because of the size and complexity of the company, the next generation of ownership has some development work that is necessary for them to be ready if the business is going to not only survive but thrive after the current generation steps away. If the next generation is not well prepared the company performance will normally take a step back.

All the learning is important, but there are a few things that we find are crucial things for them to know. If business owner(s) want to put the "odds in their favor" during the transition following are some things that are important in the development of the future leaders.

The next ownership generation in the family needs some intentional focus on:

- 1) The importance of good business governance.** When mom or dad started the business, even if they had partners, there was likely little thought about the different roles or “hats” they wore as an owner. They moved easily between running the business with their job hat and making decisions as a member of the board of directors. There was little thought or formality around company governance, and most likely there was little need for it. Formal board meetings were seldom/never held.

Things change regarding governance in subsequent generations. Suddenly the company finds itself with new owners who need money to invest into the company and money to pay their parents for the ownership they are purchasing. Parents may now have less operational insight and feel some understandable stress when they find out the research, development and launch of a new product line could put their dividend or purchase agreement payment in jeopardy. And to complicate things further, maybe young cousin Bobby showed up looking for a job and believes he should have a leadership role in the family business since his last name is on the door.

Teaching the incoming generation of owners, and the exiting generation of owners, how to separate their roles between their job in their company, their role as shareholders, their role on the board (and how a healthy board functions), and possibly how a family council can play an important role in maintaining healthy family relationships - are all important development opportunities that help companies navigate generational transfers and keep the families still enjoying happy Thanksgiving dinners together!

- 2) The reality of the financial responsibilities they are stepping up to meet.** As the family business transitions the financial picture is also more complex. Although gifting of ownership sometimes happens, most of the time the exiting generation needs to receive most, or all, of the value of the business so they can secure their retirement. The incoming generation needs a plan. They have to understand where their personal finances are, and what they can afford as they step into ownership. They need to understand the potential dividends that could be available based on company profitability that could be used toward paying for the acquisition, making investments, etc. They need to understand banking relationships, especially how to finance some or all of the acquisition in order to get the allow the founding generation to move on. Additionally, the company likely has existing banking commitments that they will step in to as the exiting owners want to be removed from the note (and they should be!).

For many new owners, even if they have worked with the family owned business for a long time they may not have been involved with banking and financial commitments at this level. There is both a learning curve and some important reflection needed about the debt and financial risks (and rewards) that exist for any business owner. They should walk in to ownership with solid financial management skills and a thorough understanding of the financial road ahead.

- 3) How to analyze and make risk decisions.** Understanding the financial realities and risks of the ownership purchase is an important first step, but not the only risk reality the next generation needs some development help in. The current generation likely has decades of experience in analyzing risks about everything from buying a new truck to considering an acquisition of a

competitor. Helping the current owners slow down and think through the steps they use in evaluating risk and moving are important as they teach that process to the next generation. We find the next generation may have a far different risk tolerance than their parents. They may be risk adverse, or they may be fearless. Understanding their wiring and tolerance for risk is a key component of helping them prepare for a whole new world of risk as an owner.

- 4) What to do when the inevitable slow down comes.** Any business owner who has been in business long has seen the market turn. Sales slowed, contracts were canceled, customers stopped buying, and owners spent sleepless nights watching the ceiling fan turn above their bed while they calculated how much they need to come up with to make payroll Friday. Often those owners shielded their kids from the financial realities of life in the world of business ownership.

Adding to this challenge is most owners transfer when the company is doing well and has been doing well for a while. Mom and Dad waited for business to come back because they needed some good years to pay down debt and put away some cash. So, here comes the next generation, optimistic that today's strong marketplace will still be there when the sun comes up tomorrow and unaware Dad once had to put the company payroll taxes on his personal credit card.

The next generation needs some honest discussions about what happens, and what to do, when the slow down comes. They need to learn how to run a company that is not doing well, when cash is tight.

- 5) How to handle conflict when it arrives, especially within the family.** Just as the economy inevitable cycles, seemingly so does conflict. Family members get upset. Business partners have different visions. Employees decide they have been wronged. A customer conflict escalates, and potential legal liabilities emerge. Managing business means managing conflict and problems well. Conflict resolution, especially major issues when the stress levels are high, is a learned behavior the next generation needs help in developing.
- 6) Ready, set, go!** Most of the next generation have been in the family business for years and are anxious for the opportunity to drive the business forward. Even when they have done a lot to be prepared, they don't know what they don't know. Having an individual development strategy for family members in the business so both knowledge and tasks can be transferred to the next generation is important in helping them prepare.

Companies of all sizes, family owned or not, struggle with developing leaders. According to a McKinsey study more than 66% of companies say executive development is a high priority, but only 7% of them believe they are good at it. Real world work experiences offer the most impactful opportunities for growth. As adults we only retain about 10% of what we learn from a formal education setting. The transfer of knowledge and experience within the life of the actual business offers the best development opportunities. For the exiting generation time spent reflecting on the gaps they see in the younger executive allows an opportunity to match the learning needs with the developmental opportunities.

Family business ownership transition and succession is a long-term journey, not a sudden event. Lots of stats are touted talking about the failure rate of ownership transitions into the next generation. No doubt there are challenges, but we see it differently. Over 20 years of experience helping family businesses transition well make us confident when the transition is well planned, when the existing owners know when to let go, and when the next generation is well prepared, the opportunities for success are strong!