WHY DO FAMILY BUSINESSES FAIL?
CASE STUDIES

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Common Family Business Mistakes

• “All this will be yours one day!”
  – Promising business to the next generation without long-term planning and development of the next generation.
Common Family Business Mistakes

- “All this will be mine one day!”
  - Assuming the business will be yours because you are family and work in the business without getting clearer on what is expected of you and what plans the senior generation has in mind.
Common Family Business Mistakes

• Not discussing (and dealing with) family secrets
  – Addictions
  – Intense family conflict
  – Inability of a family member to handle their role in the business
  – Favoritism (unrelated to ability)
  – G1 has no desire to see G2 take over – only to sell
Common Family Business Mistakes

• Not employing family business-specific governance practices
  – Family council
    • Representative group of family members planning, creating policies, strengthening relationship between family and business
  – Family assembly/retreat
    • Larger and more inclusive than family council with a largely educational role
  – Family constitution
    • Written document includes family vision and values and policies governing family members’ relationship to business
Common Family Business Mistakes

• Having professional advisors unfamiliar with family business dynamics/issues
• Having professional advisors who want to provide only “technical” services and are unfamiliar with resources to help families balance interplay of family dynamics and business.
Common Family Business Mistakes

• No money to pay senior generation when the time comes
  – All the right things can be done (Developing next generation properly, giving them responsibility and control with mentoring)
  – Senior generation needs to be paid for shares and cannot retire without it
Common Family Business Mistakes

- Next generation has not saved it/cannot finance it
- Senior generation must hope G2 can pay salary for life.
Common Family Business Mistakes

- No independent Board of Directors (or Advisory Board)
Common Family Business Mistakes

• Lack of coordination between professional advisors
Common Family Business Mistakes

• Not respecting and harnessing the vision, energy and creativity of the next generation
Common Family Business Mistakes

- Assuming the next generation wants to be in the family business
Common Family Business Mistakes

• Lack of professionalization
  – Family businesses often start with a single entrepreneur
    • high energy
    • doing most of the work
    • Very informal environment (few or no policies and procedures)
    • Family and business lives mixed and indistinguishable
How To Deal With Common Family Business Mistakes

- Communication, trust and preparing the next generation are ESSENTIAL
How To Deal With Common Family Business Mistakes

• Williams and Preisser – “Preparing Heirs: Five Steps to a Successful Transition of Wealth and Values”

• Research on 3,250 families

• 70% of wealth transitions fail
  – (includes families with operating businesses and liquid wealth without operating business)
How To Deal With Common Family Business Mistakes

- They looked at the FAILURES:
- 85% caused by:
  - 60% - breakdown of communication and trust
  - 25% - failure to prepare next generation
- Interesting – Less than 3% were due to errors by professional advisors
How To Deal With Common Family Business Mistakes

- Take a long-term view with PLENTY of open communication
- Articulate expectations/desires of current and next generation members
Case Example

• Third Generation **Successful** family business
  – Grew to 3 locations along east coast
  – G2 (60’s) & G3 (38) both involved (G1 deceased)
  – G2 (married couple) income of $500K/yr
  – G3 (38 year-old son) income of $300K/yr
  – G2 ready to retire and hand over reins
Case Example

- Parents have not saved a single dime (have only their home)
- Son has serious addiction to pain killers and uses company credit card for expensive dinners, fine wine, $5k/month
- Purchased and gave outright to daughter a company in the same industry for her to run (bankrupt within 1 year)
Case Example

- Never professionalized the company.
  - No:
    - Regular staff meetings
    - Performance evaluations or development plans
    - Compensation policy for family members
    - Strategic plan
    - Regular involvement of professional advisors
    - Well-defined roles and responsibilities
    - Shareholder agreements

- No formal meetings to manage interplay of family and business (and deal with inevitable conflicts).
Case Example

Case Study #1

- Successful, 3rd generation business
- Company has a lucrative franchise/exclusive distribution contract
- G2 retires, with a fixed income for life and continues to hold a majority of the stock; G3 takes over operational control, but holds minority interest in the stock
Case Example

Case Study #1 (continued)

- Company continues to produce significant cash flow, but G3 spends lavishly on things that have a dubious connection to the business (private jet contract; real estate; extravagant entertainment expenses)
Case Example

Case Study #1 (continued)

• G2 learns of the lavish spending and believes that G3 is siphoning money out of the Company, to G2’s detriment

• G2 comes back, exercises corporate control and ousts G3, leading to a highly-public and acrimonious legal battle
Case Example

Case Study #2

• Father (F) invents and patents manufacturing machine and process
• F’s sons (S1 and S2) build company around
• Machines sell for several million dollars a piece, and company derives revenue from sales and service of existing machines; annual revenues of tens of millions of dollars
Case Study #2 (continued)

- S1 has majority control of stock and runs day to day operations; S2 is involved in the business, but owns minority of the stock
- S1 has a strong leadership style and never fully involves S2 in the management of the business
Case Study #2 (continued)

• S1’s son (G2) and other relatives are involved in the business; S2 does not have children

• S1 and S2 do not have a shareholders’ agreement or other formal succession plan, but it is S1’s vision that the Company will remain a family-owned and operated business for many generations
Case Example

Case Study #2 (continued)

• S2 dies, and leaves his stock to more than 100 individuals, who were employees of the Company

• S1 and G2 devise a corporate transaction to cash-out the non-family stockholders, but the non-family stockholders
Case Study #2 (continued)

- The case is pending when S1 dies, never knowing how the matter will be resolved.
- Court ultimately holds that S1 and G2 breached their duties by failing to appropriately value the minority stock, resulting in a million dollar judgment, and requiring S1 and G2 to pay the minority stockholders’ attorneys’ fees in litigating the case.
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