How Not to Let the Family Business Destroy the Family

By Steve Hancox and Leonard Eppel, Spring 2014

At Financial Resource Associates, we define Succession Planning as preparing for the owner's successful exit from the company. Simply closing up shop and walking away doesn't take much planning. However, selling the business or keeping it in the family requires forethought.

Take John, for example, at the fictitious company Widgets For All. John took over the business from his father fifteen years ago, when sales were $1 million. Over the first ten years, he grew sales to $10 million and the company made $0.5 million in annual profit. That is about when his three children joined the business (now Vice Presidents). Over the next five years, at the urging of John's sister, Jane, John also hired Jane's son and daughter, Bob and Roberta.

The company now has sales of $15 million (John is responsible for at least 90% of that) and annual profits are now $250,000. John's three children "earn" $125,000 each and Bob and Roberta are highly overpaid at $60,000 each. No one in the company is particularly adept at Finance or Accounting and the records are suffering.

Widgets For All is maxed out on its working capital LOC and the loan on the building. John needs to add some more equipment and wonders where the cash will come from. John's three children are clamoring for raises (needed for private school tuition for John's grandchildren, larger homes, and country club memberships). Jane has made it clear that she is not happy that her children, Bob and Roberta, aren't even making half of what John's kids make. She reminds John that it was her father too who created this company and John is not treating her kids fairly. John was hoping to retire soon, but he knows the place would be lost without him and the paycheck he was counting on continuing to receive is in jeopardy.

John knows he needs to take action. He also knows that whatever he does to save the company will make him the pariah of the family, even though he has been funding roughly $500,000 per year in salaries for the five children. John is in a no-win situation. He can improve the situation, but he knows he will never be appreciated for being the successful business owner he knows he has been. Possibly with the help of outside experts, John can save the company and his financial future, but not without causing tremendous angst within the family.

In this hypothetical example, John's mistake was a failure to plan. Whenever a family business contemplates employing family members in responsible positions or providing ownership shares to more than one person, some very important advance planning is needed.

John's problems were avoidable, and had they been avoided, the family and the business could prosper. Instead, John waited for the problems to occur and now needs to solve them. The difference between avoiding and solving the problems can be measured in dollars and deeply hurt feelings.

Family businesses that are successful enough to span multiple generations need to anticipate these types of problems and avoid them. By investing a relatively small amount of time developing four key policies, expectations and protections can be put into place to help ensure an enterprise's success for generations to come.

There is not enough space in this article to expand upon these four key policies; however, with a little thought, one can quickly see how these policies might prove quite helpful. The policies are: Family Employment, Family Compensation, Ownership, and Dividend. Experts in Family Business Succession Planning are well familiar with these concepts and are able to guide business owners through the process of developing policy statements that are appropriate for any individual business. The earlier these concepts are addressed, the more likely these problems can be avoided rather than solved.