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Wealth Planning Update

8 best practices to prepare the next generation for the family business

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Eric J. Smith
Senior Business Transition Strategist
Wells Fargo Bank

Arne Boudewyn
Head of Family Dynamics Consulting
Wells Fargo Bank

Key takeaways:

- Preparing the next generation to take over a family business is not easy — statistically, only one in three family businesses transition successfully to the next generation. It's important to understand the reasons why as you navigate your own transition journey.
- Families who have successfully navigated major wealth and business transitions tend to share a set of identifiable best practices. These actionable lessons can be leveraged to help improve transition outcomes.

What this may mean for you:

- Preparing the next generation for family business stewardship is a process that requires intention and a clearly articulated plan. Eight best practices are recommended to help achieve business transition goals.

Whether you are contemplating selling your business one day to a third-party buyer or passing the business down to the next generation, there are several best practices that family business owners can use to help prepare the next generation for business or wealth stewardship. Some of those best practices relate more to the finances of the business while others address interpersonal family issues, but all are critical to the stewardship of the legacy you have worked so hard to create.

Studies have consistently shown that families have roughly a 30% chance of successfully transitioning their business from one generation to the next.[1] Factors that can interfere with successful transitions include:

- Insufficient communication and an absence of trust within the family system
- Inadequately prepared next generation family members
- Absence of a clear vision or mission to align the family cross-generationally
- Failure by professional advisors to properly address taxation, governance, and wealth preservation issues

When asked to rate the difficulty of achieving specific corporate objectives, family business owners rate two issues in particular as being both highly important and difficult to achieve. The first relates to resolving conflicts among family members working in the business, and the second relates to formulating a family business succession plan. Interestingly, these issues are rated as more important and more difficult to achieve than developing strategic plans to sustain or grow the business. The results of these two surveys[2] suggest that issues pertaining to family dynamics are top of mind for many wealthy family business owners as they contemplate family business transitions.

Eight best practices for family business transitions

Understanding why transitions fail is important. But identifying the best practices of families who have successfully navigated a major wealth transition is equally or more important if family business owners want to increase the odds of a successful business transition and position the business for effective stewardship by the next generation. Families who successfully navigate major wealth transitions tend to share the following best practices:

1. Start their transition planning early.
2. Articulate a clear vision to family, employees, and key stakeholders.
3. Formalize governance structures and processes as part of their larger business plan.
4. Actively work to prepare the next generation.
5. Communicate the transition plan to the family.
6. Proactively anticipate and address where potential conflict might arise in executing the plan.
7. Build an experienced transition management team.
8. Develop a written business succession plan with an implementation timetable.

Preparing the next generation involves more than focusing on individual roles and formal education, job training, or financial education. Transitioning stewardship of a family business from one generation to the next is best approached as a long-term process that incorporates — and encourages next generation participation in — all eight best practices.

Plan early

Many professionals recommend putting a business succession plan in place at least three to five years ahead of a planned business transition. Some business advisors even recommend that an exit strategy be built right into the

[1] Family Business Institute: https://www.familybusinessinstitute.com/wp-content/uploads/2019/01/Family-Business-Succession-Planning-White-Paper.pdf
[2] Grant Thornton, Results of Family Business Survey and the Family Office Exchange research

business plan. A good first step is to recognize (1) the value and downstream impact of early business transition planning and (2) that it is never too early to start the process.

Share the vision

Business owners and entrepreneurs are typically self-directed and decisive leaders who have a vision for where they'd like to see their business go and are regularly making decisions to incrementally get them there. Next generation family members, however, may not always be aware of or clearly understand this vision. This can lead to misunderstandings, disagreements, and even resentments when things seem to be going in a direction that hasn't been shared with them and that they don't understand. A well-articulated vision provides guidance for both the organization and the family over the short and long term and establishes context around planning and decision-making. When well communicated, a vision statement can boost engagement and satisfaction among all family business stakeholders, increasing the likelihood that next generation family members can work together effectively to make important decisions about the future of the business and management of the family's wealth.

Establish a governance system

There is rarely one person who can successfully step into the shoes of a family business founder, and often multiple people want to be involved — or even need to be involved — in order to accomplish what the founder does as a business leader. In these cases, founders need to ensure they position the business with a sound governance system that can involve multiple people fulfilling different roles and responsibilities, all working together within an integrated framework of structured processes to guide their decisions and contributions. Much of the family conflict that business leaders might anticipate can be avoided by helping each next generation family member understand whether and how they will be involved, the duties and responsibilities of their role, and how their role fits into the governance system and business strategy. Where a business involves many family members (e.g., cousins), establishing polices for family employment, compensation, dividends, and redemptions can be a powerful means to help avoid future conflict.

Prepare the next generation

Successful family business and wealth transitions are often backed by comprehensive and workable plans for helping next generation family members become responsible, educated, competent, and confident with regard to essential wealth matters. For family business leaders, this work often includes envisioning the future roles their children may inherit or wish to fulfill with regard to family business interests and then creating experiential learning and career development opportunities to support their success in pursuing those interests. Preparing someone who intends to work in the business and one day be a leader requires a different training mindset than preparing a next generation member who will not work in the business but may be an owner or shareholder. Most importantly, the next generation must also be proactive in identifying their skills, interests, and career paths, especially if they want to be leaders in the business.

Communicate with the family

An open discussion with family members may help reveal concerns or conflicts that could be addressed ahead of time. Parents, in particular, do well to express their feelings and intentions to their children early, in part to set realistic expectations. Next generation family members are more likely to support business transition plans when they are included in this dialogue. Make sure everyone has some level of understanding and appreciation for the business and that they're given a forum to share their perspectives and learn the facts about what's going on in the business. Put structures, such as regular family meetings and periodic financial reporting, in place so everyone has access to objective data about the business, an opportunity to share their thoughts, and the assurance that their perspectives are valued whether they work in the business or not. Third-party facilitation can be useful to free up all family members to more fully participate in the meeting.

Anticipate and address conflict

Differing goals and competing priorities can lead to conflict between family members. If these issues are not discussed in a calm, clear, and open manner, difficulties can arise. The best solution is usually to find ways to involve all parties, including spouses, children, and nonbusiness family members in a process that allows for honest communication, instilling everyone with the sense that they are contributing to a succession plan that works for all concerned. While this approach requires more time and energy, families often find that transition planning goes much more smoothly as a result. Working through conflict helps families move forward with their succession planning goals while also modeling the importance of conflict resolution to younger generations. It is important that everyone in the family can acknowledge that conflict is normal and needn't be a barrier to executing effective family business transitions.

Build an experienced transition management team

A succession plan demands expertise in several professional disciplines. Attorneys, accountants, bankers, financial and insurance advisors, and multigenerational wealth planners all can provide useful planning insights, but business owners do well to choose business advisors who can provide guidance that goes beyond tax and wealth planning. It's important that your team includes advisors who have worked with family-owned businesses in the past and who have experience in succession planning, family business transitions, and navigating family dynamics. Their ability to understand and provide guidance relating to both the financial and emotional aspects of the business transaction is often invaluable to the successful execution of your plans.

Develop a written plan and timetable to execute it

Clearly defined written goals are essential for a transition plan, as they provide a solid framework for achieving the vision of the family and the organization. Moreover, a transition plan is not something that is written once, filed away in a drawer, and forgotten until it is needed. Given the evolving nature of the business itself, the family's dynamics, and the financial and legal landscape, family business transition plans can be considered as project plans that will naturally evolve and should be regularly reevaluated and updated as necessary. It is critical that action planning includes clearly identified "owners" who are responsible for ensuring that each element of the transition plan is successfully executed.

Conclusion

Early planning, a shared vision, a formal governance system, preparing the next generation, clear communication, strong conflict resolution commitments, experienced business advisors, and a written transition plan that is regularly revisited are important best practices to facilitate a successful family business transition. The stakes are high where personal relationships are entwined with the success of the business. When possible, the eight strategies listed above should be followed by every family-owned business, with the assistance of outside advisors where appropriate. Implementing these practices early increases the next generation's chances for long-term success stewarding the enterprise, creating a legacy for both your family and your family business for generations to come.

For more information on preparing the next generation for family business stewardship, contact your advisor.

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