WHY IS FAMILY BUSINESS SUCCESSION SO HARD? AND WHAT SHOULD WE DO ABOUT IT?

Glenn Kurlander

This article examines the difficulties involved in family business succession and how planning that addresses qualitative challenges can result in successful transitions.

So, did you hear the one about the family business? You know, the one that, just like only 13% of family-owned businesses in the United States, failed to make it to the third generation?

If you have ever attended a program on family business succession planning, you have probably heard that one. And if you have had occasion to deliver such a program from time to time, you may even have told that story.

But here is the real punchline. There's reason to believe that the family business failure rate, which so many of us recite as if it were gospel, is actually a myth.

In a fascinating article in the Harvard Business Review,[1] Josh Baron and Rob Lachenauer take issue with our common understanding of the limited duration of family-owned businesses. In their article, titled "Do Most Family Businesses Really Fail by the Third Generation?" Baron and Lachenauer maintain that there is reason to believe that, on average, family businesses actually last longer than non-family-owned businesses, and they explain the deficiencies in our commonly held view to the contrary.

First, Baron and Lachenauer point out that the three-generation idea comes from a single, rather small 1980s study of manufacturing companies in Illinois.[2]And as limited as that study was, they note that the core finding of the study is often described incorrectly: it's often said that only 1/3 make it *to* the second generation.[3] But the study actually found that 1/3 make it *through* the end of the second generation, a 30-year or so difference.[4]

But here is the most critical point: the study did not compare family-owned businesses to non-family-owned business. And if we do, we see how short the duration of the average non-family-owned business actually is: Baron and Lachenauer note that a study of 25,000 publicly traded companies from 1950-2009 found that, on average, non-family-owned businesses lasted only 15 years, or not even one generation.[5]

And when we look at the list of the world's longest-lived enterprises, we quickly see that family-owned business dominate the list.[6]

And yet, our empirical experience tells us that many family businesses fail even to plan for succession, leaving succession to be worked out after the founding generation has died or otherwise has ceased to manage the business. And those family-owned businesses that do attempt to plan for succession often encounter extraordinary difficulties, such that the process becomes hopelessly bogged down, leading to frustration and resentment; or, even worse, devolves into horrendous family conflict.

We do not need to rely only on our empirical experience to reach this conclusion: one academic study after another supports our empirical understanding that families fail to plan successfully.

As one example, consider the 2007 American Family Business Survey by MassMutual and Kennesaw State University[7] of over 1,000 firms. In that study, 40% of business owners said they expected to retire in the next 10 years. Of those, only 45% of those expecting to retire in five years had picked a successor. And of those expecting to retire in 6-11 years, only 29% had picked a successor.

Or consider the 2014 PwC Global Family Business Survey[8] of almost 2,400 firms from more than 40 countries, with annual sales from $5 million to over $1 billion. Forty-four percent of such firms reported they had no succession plan for key senior roles.

But don't get carried away and think that means that 56% of such firms were in good shape, because when you dig into the numbers and find out the extent of the planning those 56% of firms actually have done, one comes away with a pretty dismal picture.

Indeed, we see that 20% have a plan in place for a small number of senior roles[9] and 18% have a plan in place for most senior roles.[10] Only 16%—only one-sixth—have a plan in place for all senior roles.[11]

Finally, PwC's 2021 Global Family Business Survey[12] of 2,800 firms, with annual sales from $5 million to over $6 billion revealed that only 51% of such firms had a documented vision and written purpose statement; only 30% had a succession plan and 29% reported resistance to change.

We can hold two ideas in our heads at once: first, that, as Baron and Lachenauer have shown, there is reason to conclude that the belief that on average, family-owned businesses tend not to survive beyond the third generation is a myth. And second, that it is extremely hard for family-owned businesses to plan for succession. So, the question then becomes, why is it so hard?

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WHY IS FAMILY BUSINESS SUCCESSION SO HARD?

We're sometimes tempted to see the answer through the lens of family functionality, but that is a mistake. The TV show Succession demonstrated why it was hard for Logan Roy and his family to deal with business succession—they are all psychopaths. Each one of them has one or more forms of mental illness. Of course, business succession in the Roy family is destined to fail spectacularly.

But it likely is the case that the families with whom you work bear greater resemblance to another fictional TV family, the Cleavers. Remember them? Ward and June and Wally and the Beaver? While of course the Cleavers were also an exaggeration, in practice business succession is also hard for our clients who bear a greater resemblance to the Cleavers than to the Roys, as most of them probably do. Families who more or less love one another, who more or less want the best for one another, who more or less are working together in good faith. Families who know that they must turn to business succession and who generally want it to work, and nevertheless struggle. The comparison between the Roys and the Cleavers, while both families obviously are exaggerated for dramatic purposes, demonstrates that it is a mistake to see the challenge of family business succession through the lens of family functionally, because so many of the families who struggle are fairly to highly functional. And still they struggle mightily. Thus, the answer to the question, why is business succession planning so hard, must lie elsewhere.

One thing we do know: it is not you.

Estate planning advisors of course understand the complex mix of business, legal, and tax issues business owning families need to address. They are experts in the strategies clients need to bring to bear to address those issues successfully.

Thus, the challenges most come from elsewhere. The most daunting of these challenges come from three qualitative attributes that families must confront in order to work through business succession, and these three attributes present extraordinary challenges for most families. These attributes, conceptually distinct but certainly related, are change, identity and history. Let's examine them, one by one.

Change.

Change is perhaps the most difficult thing for humans to confront, even more difficult for some of us than acknowledging we are wrong and then apologizing for our misdeeds. And business succession fundamentally is about change; usually changing almost everything.

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As humans, in order to change, we typically must really want it, and we have to work at it really hard, and we usually have to work at it over a fairly extended period of time.

Think about the things we commit to change: to eat more healthfully; exercise more; lose weight; spend less time on electronic devices and more time with other humans; become more mindful and less reactive; become less selfish. Reflect, for just a moment, on things you may have committed to change about your habits or practices, and then ask yourself, how successful have you been?

Change is hard. Our habits, our proclivities, are hard-wired into the biological structure of our brains. And to change, we literally must rewire our brains. We have to create new neural pathways. When we decide we have to change how we manage our business, we must confront the necessity of changing, perhaps changing just about everything. To compound the challenge, it is not just the current leaders who have to change; future leaders need to change as well. It is hard for both.

Identity.

Identity is another attribute that presents an immense challenge for families when they undertake business succession.

Particularly in the case of a strong and dominant patriarch or matriarch,[13] one who either is the founder of the business or whose efforts have brought the business to new levels of success, that person's identity often will be largely tied up in that business. And turning the reins over to someone else, even when the current leader knows it is necessary, even when she or he is committed to the success of the transition, can be immensely hard.

Succession presents a frontal assault on that identity: if my entire sense of identity is tied up in this business, who am I if I am no longer in charge? Where does my sense of meaning, purpose and fulfillment come from if I am no longer the leader of this business? Of what value am I? What if the business carries on just as well without me? What if my children are even more successful than I was?

And while it's tempting to think of these challenges to identity only from the perspective of senior generation family members, we shouldn't overlook the sometimes deep insecurities or even paralyzing fears the challenges to identity that result from business succession can induce in the future leaders, even when they long to take the reins. After all, their identities have been shaped as well, but as dependents, not leaders, always able to look to senior generation family members as the ones in the hot seat, the ones who make the tough decisions and assume ultimate responsibility.

History.

Finally, we have the weight of history, both within the business and within the family itself. In *Requiem for a Nun*, William Faulkner wrote, "the past is never dead. It's not even past."[14] If Faulkner's words have any real resonance, they resonate within families most powerfully—where our family history can be the glue that holds us together, but where it can also keep us imprisoned. Where things that happened at the dinner table thirty years ago can still sting as painfully as if they happened only yesterday; where small slights and grievances can still have impact; and where our parents' perceptions of us as children, and our perceptions of ourselves and our siblings and cousins from decades long past, can be so hard to outgrow. The perceptions they and we have of ourselves and others, both as family members and business figures, can become calcified, and the weight of family and business history can become too much to crawl out from under.

In short, when we need to undergo the transformations that are necessary for business succession, it can be very hard to move past this history, whether it is more general family history or more specific business history.

When we think about the immensity of all these qualitative challenges to business succession planning, the shortcomings implicit in our typical approach to business succession planning becomes immediately apparent. Our typical approach is largely or purely structural, legal, and tax-driven, and it does not seek to address these qualitative issues at all. No wonder families find it so difficult; no wonder it so often goes adrift or becomes stalled.

Moreover, the approach we typically follow is essentially top down, rather than bottom up. That is, it begins, in most families, first by choosing a successor and then by assigning other roles, typically more subordinate ones, to family members. And given that business leaders will often quite naturally attribute their and the business' success to their own inherent qualities, they just as naturally seek to find successors who seem most likely to exemplify those very same qualities. In practice, this search can lead to a kind of unhealthy King Learification of business succession planning, in which families live out Lear's tragic blindness:

> Tell me my daughters
> (Since now we will divest us both of rule,
> Interest of territory, cares of state)
> Which of you shall we say doth love us most?[15]

And when that happens, business succession can turn all these qualitative challenges into a truly Shakesperean drama, one where the challenges of change, identity, and history combine to form an even more toxic brew than that of the three witches in Macbeth, with an end that can be just as tragic.

HOW CAN FAMILIES DO BETTER?

In order to overcome these qualitative challenges, we need to take the business apart analytically and meticulously, piece by piece; in effect, to atomize it, as granularly, as minutely, as possible. In doing so, we do not focus on people and titles and roles, but instead we identify every single operational function, matter, and decision that is necessary to make the business run on a daily basis. In that methodical analysis, we determine how every individual function is carried out in the current state. And once we have done that, we devise a minutely granular plan for the transition of each such function based on how it should be carried out in the future state, step by incremental step, with precise, measurable goals, and detailed timelines. Such a plan specifies what each individual who takes on a new function has to demonstrate to progress from one stage to another. And precisely how the individual who previously held the function changes at each stage as well.

In planning for business succesion, we do not focus on people and titles and roles, but instead we identify every single operational function, matter, and decision that is necessary to make the business run on a daily basis.

In practice, this approach has several benefits, each of which overcomes the qualitative challenges families typically encounter.

First, it prevents backsliding, where senior generation family members begin to reassert control, in effect refusing to change, holding on to identities, and enshrining history. They do this practically by reasserting controls they had promised to give up and inserting themselves in decisions from which they had promised to abstain. By showing up in the office more frequently, they undermine younger generation family members by intentionally or unintentionally causing other employees to come to them for decisions that should be made by those younger generation family members, because others see senior generation family members back in the office and they too simply do what they're used to doing, giving in to their own challenges of change, identity, and history, by going to senior generation family members as they always have.

It prevents moving goal posts—continually requiring younger generation family members to demonstrate yet another skill or success, in order for the transition to move forward.

It promotes accountability and creates metrics, because the plan is so very granular and detailed, that where we are in the transition always can be plotted precisely, making it difficult to argue in good faith about where we are.

Perhaps most importantly, by creating small, incremental steps and transitions, it builds mutual confidence in both generations. As the family experiences a successful transition on one small operational element where the world does not come to an end, it gives the senior generation confidence in both the process itself and, where necessary, in the competence of younger generation family members to carry out their new responsibilities.

As senior generation family members develop confidence, it gives younger generation family members confidence not only that they can take on the mantel of leadership, if they need that confidence, but also that the process of succession itself will work, that the senior generation ultimately will turn over the reins, and thus it is worth it to keep working through the process.

Through this atomized, bottom-up, incremental process, families see that they actually can change, their identities can morph without entirely undermining their sense of self, and they can add a new chapter to their history.

End Notes

1 Baron and Lachenauer, "Do Most Family Businesses Really Fail by the Third Generation?" Harvard Business Review, July 19, 2021; https://hbr.org/2021/07/do-most-family-businesses-really-fail-by-the-third-generation

2 Id.

3 Id.

4 Id.

5 Id.

6 O'Hara and Mandel, "The World's Oldest Family Companies," Family Business: The Guide for Family Companies, 2003; https://www.griequity.com/resources/industryandissues/familybusiness/oldestinworld.html

7 MassMutual American Family Business Survey (2007); *https://www.uvm.edu/sites/default/files/2007MassMutualAmericanFamilyBusinessSurvey.pdf*

[8] PwC Global Family Business Survey (2014); *https://www.pwc.com/gx/en/pwc-family-business-survey/assets/family-business-survey-2014.pdf*

[9] Id.

[10] Id.

[11] Id.

[12] PwC Global Family Business Survey (2021); *https://www.pwc.com/gx/en/family-business-services/family-business-survey-2021/pwc-family-business-survey-2021.pdf*

[13] This article uses the words "patriarch" and "matriarch" advisedly, recognizing that they are not applicable in all families, and that to some readers they may suggest an outmoded view of our modern understanding of gender identity. Nevertheless, these words continue to apply in many families, and reflect the words that families themselves often use to describe family roles, irrespective of the gender assigned to these people at birth and the gender, if any, with which they identify. Thus, the article uses them here.

[14] Faulkner, *Requiem for a Nun*, 72 (Vintage International 1994).

[15] Shakespeare, *King Lear*, Act 1, Scene 1.