I've Got Forty Years in Harness; How Do I Exit My Family Business?

By Wayne Rivers

I came across an article last year about how one of Thailand's biggest businesses – the 23rd biggest in the country according to Forbes – was having trouble finding family members who wanted to succeed their father, the founder; it was a fun story and a good read. Having digested it, it began to dawn on me that the number of American family business owners who have this same dilemma has skyrocketed in the last 10 years. I can't begin to tell you how many senior generation family business moms and dads come up after public appearances or at industry gatherings and say "My kids aren't in my business with me, and I would like to have a clear plan for how I'm going to exit my company one day. What do I do?" Some family business owners who DO have their kids in the business with them ask the same question; they have little confidence that their kids will be able to succeed them, apparently.

So what's our advice for people who don't have a clear line of succession among ambitious, driven, and hard working children? Where can they turn, and what should they do?

Stated plainly, there are only four ways to dispose of a family business. It doesn't matter if your family firm is a corner drugstore or a family business giant with hundreds of millions of revenue and a nationwide footprint; the same four alternatives apply:

1. **Close the door and walk away**
2. **Give it away**
3. **Sell it to insiders**
4. **Sell it to outsiders**

Another possibility is, of course, to combine some or all of the alternatives above to achieve a more synergistic plan. That is, you could close the doors on an underperforming division, give some of the ownership of the business away to your children and grandchildren, and sell a portion of the company to

insiders and/or outsiders. There are probably an infinite number of ways to combine the four alternatives to achieve the best possible outcome. Sounds easy, huh? Let’s dig deeper.

With respect to the incidence of successfully selling a family company to outsiders, this outcome is exceedingly rare. I'm always amazed when family business owners with a small to modest size company come up and say “I'm just going to sell my business when I turn 65." I hate to rain on their parades, but, for the vast majority, that’s a pipe dream! They don't have businesses, they have jobs, and they have pretty thankless jobs at that. They work 80 hours a week, they have to make every decision in their companies, they personally indemnify company debt or lines of credit, they are the complaint department, the head of HR, the head of sales, the head of production, the CFO, etc., and they have the burden of being the mothers and fathers of not only their blood children but a percentage of their employees as well. For what many family business owners get paid, what kind of idiot would sign up for a job that has all those burdens, risks, and responsibilities? If you think I paint too bleak a picture, here are some statistics: In 2005, the last year for which we have solid figures, less than 6000 closely held businesses were sold in America. That is 0.03%. The sad fact is that most small to medium-sized family firms are simply not attractive to buyers and cannot be sold for substantial value.

Here's another story to further illustrate my point. One of our former family business consultants, himself a fourth generation family business owner, happened to have a father-in-law who was smart and successful enough to be able to sell his company to outsiders. Recognizing his son-in-law's vast potential, he gave him money and time budgets and instructed him to search out family companies in the southeast they could purchase and operate for their own portfolio. Over 18 months, they ended up doing due diligence on about 20 companies in three states, and they ultimately made offers on – you guessed it – ZERO! When asked why, our consultant whipped out a list he and his father-in-law had made for evaluating target companies. They, as rational and deliberate investors, specifically wanted the following:

1. Customers and suppliers who were loyal to the company, not just the previous owner
2. A company which had a unique niches with barriers to entry
3. Relatively little competition, and giants like Walmart couldn't easily squash the company
4. The management team could run the company without the previous owner being there
5. There were assets in the company which could be leveraged (property, receivables, etc.)

6. There was a recurring, predictable stream of revenue
7. There was motivation for employees to stay following the purchase rather than leaving to compete – the buyer's worst nightmare

Our consultant and his father-in-law recognized the absence of any one of these seven items dramatically reduced the value of the company, and if two or more were missing the purchase would have been absolutely foolhardy. They elected to make no offers having found what we here at The Family Business Institute have long known. In most family businesses, the entire company's survival, not to mention prosperity, is dependent on one or a tiny handful of people. Take that person out of the picture, and the company has dramatically diminished value.

Back to the four options, we have virtually eliminated an outside sale as a realistic alternative. We may also eliminate "close the door" alternatives as well; that's rarely the best way to get value from a lifetime of hard work. Giving the company away may work for those few who have managed to put millions away into their 401k plans or income producing real estate, but even those people still wish to get returns from their companies, the goose which has always laid golden eggs for them. That leaves as the most viable and commonly utilized alternative: selling the company to insiders.

While this may seem to be a risky or radical proposition, it's not all. In fact, in some industries, accounting, medicine, law, engineering – the professions – this methodology of transitioning a business from generation to generation has been the norm for decades. There's no reason in the world why this strategy couldn't work for a family business engaged in commercial construction, a convenience store business, a trucking company, a manufacturing company, a distributor, or almost any other form of closely held business. Inside sales can often be the best avenue for departing family business leaders to realize value from the businesses they've built.

What's the big variable in selling to insiders? It's PEOPLE. Without the right people in place, without people who are super-competent and eminently capable of replacing the departing owner, the deal won't work. But, in reality, how is that any different from an inside-the-family transition? If the departing owner doesn't have daughters and sons who are eminently capable of replacing him, then his inside-the-family transition strategy is just as flawed as any other!

More and more, smart family business leaders are keeping their options open when it comes to transitioning their companies into a new generation of leadership. Selling a company to established employees who have demonstrated their competence over a number of years is a viable strategy and one that's increasing in popularity. On Wall Street, they would call a transaction like this a management buyout (MBO). If it's good enough to have its own acronym on Wall Street, why isn't it good enough for family business owners to consider at transition/exit time?

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