How to Minimize Risks in Family Business Succession

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If you own a family business, there's a good chance that you hope to one day pass it on to your children, grandchildren or other family members. Family-owned businesses have formed the backbone of entrepreneurship in America for hundreds of years, and their success is vital to the ongoing economic vitality of our nation.

There are, however, risks to family business succession that you must be aware of as you devise your family business succession plan. Not anticipating and planning for these risks can result in the failure of your family business to make it to the next generation. In fact, statistics reveal that only 30 percent of family businesses are passed from the founders to the second generation, and only 12 percent make it from the second to the third generation.

5 D's That Can Derail Family Business Succession

As you develop your family business succession plan, you should keep in mind 5 D's that can potentially derail your carefully laid plans. They are as follows:

1. Death — Nobody likes to think about death, but the fact is, 10 out of 10 people will eventually die. And the untimely death of the owner and/or key decision-maker in your business poses perhaps the greatest risk to your family business succession plans.

The best way to safeguard your succession plans against the risk of death is to purchase life insurance. One option is to have the business entity purchase a term life insurance policy on the owner(s) that will pay out to the entity in the event of an owner's untimely death. Alternatively, family members might purchase one or more term policies on the owner(s). These proceeds can provide the cash necessary to help ensure the continuing operations of the business after the owner(s) dies.

A buy-sell agreement funded by life insurance is an especially useful tool when it comes to family business succession planning. This is a legal document that helps ensure the smooth transfer of a family business to the next generation if an owner dies. With a buy-sell agreement in place, ownership interests can be easily transferred to other family members at a pre-determined price, thus minimizing potential business disruptions during an already stressful time for the family and the business.

2. Disability — This risk goes hand in hand with the risk of death when it comes to potential disruptions to your family business succession plan. If the owner or key decision-maker is no longer able to serve in this capacity due to a long-term or permanent disability (either physical or mental), this could not only put your business succession plans at risk — it could jeopardize the entire future of your company.

In the same way that life insurance is the best protection against the risk of death, disability insurance is the best protection against the disruptions that an owner's unexpected disability could cause to your succession plans. Proceeds from a disability policy can provide much-needed cash not only to help meet the owner's family's ongoing living expenses, but also to meet business capital needs. A buy-sell agreement can be

structured to help ensure a smooth family business transfer to the next generation in the event of an owner's disability as well as his or her death.

3. Disaster — Whether natural or manmade, disasters can wreak havoc on business operations and thus, its succession plans. Disasters can take many different forms — from natural disasters like earthquakes, fires and floods to computer crashes, employee embezzlement and cybercrime. Therefore, one of your most important duties as you plan for family business succession is to make sure your business is well prepared for a disaster.

One way to do this is to create a disaster recovery plan. Such a plan usually consists of two main components: emergency response procedures in the immediate aftermath of a disaster, and plans to keep the business running in the weeks or months after the disaster strikes. You should also determine where your business is most vulnerable to a disaster by identifying risks that are specific to your company and then quantifying their potential impact on your operations. Then you can prioritize the various steps in your disaster recovery plan so the most important functions are brought back up to speed first.

4. Divorce — This is something else that most people don't like to think about. However, a divorce is not only disruptive to a family, it can also destroy a family business and its succession plans. So it's usually better to plan ahead of time for what will happen to the business if a divorce occurs than to ignore this possibility.

One way to do this is to draft a marital property agreement that lists all of the company's assets, debts and ownership and management responsibilities. You might also consider drafting a prenuptial agreement — or insist that children who might possibly inherit the business one day draft prenuptial agreements before they get married — in order to minimize the potential disruptions of divorce on your family business and your succession plan.

5. Disagreements — Finally, you should think about how disagreements between family members involved in the business could lead to arguments, conflicts and disruptions that jeopardize your succession plans. The best way to guard against this is to ensure that lines of communication remain open between all family members at all times. Any family member should be made to feel comfortable talking to you or other leaders about any concerns they may have, whether related to the business or the family.

Concluding Thoughts

There are risks to family business succession that you must be aware of as you devise your family business succession plan. Not anticipating these risks can result in the failure of your family business to make it to the next generation, so remember these 5 D's that can derail your carefully laid succession plans. An outsourced CFO services provider can help you with family business succession planning.

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