Wealt y sins

By Beth Bra

Avoid these mistakes

When it comes to running a family business over the long term, there are myriad ways that things can go wrong, such as product failures and external economic shocks. But often the reasons that a family succumbs to the "shirtsleeves to shirtsleeves" curse come down to basic financial mistakes.

Here's a look at some of the more common money mistakes that family businesses make — and guidance on how to avoid them.

Mistake #1: Taking an ad hoc approach to dividend decisions.

Dividend payouts should reflect the performance of the business and its current and future need for cash, rather than the needs of family member or shareholders.

Protect your business: Having a predetermined policy around dividends can make it easier for both shareholders and the business to plan for the future.

"Over the long-term, you should be setting dividends based on how fast you expect to grow, and how your business is expected to perform, while keeping some kind of cushion in the business," says Joseph Astrachan, founder and chair of family business consultancy Generation6. "Families often don't do that, and they distribute dividends based on family needs."

Mistake #2: Failing to prioritize estate and succession planning early.

For family businesses, estate and succession planning tend to intertwine, and they're among the most important tools for ensuring that a business — and the wealth it generates — get passed on to the next generation as efficiently as possible. However, many business owners fail to recognize how long it takes to put a succession plan in place and get started on the process too late.

Protect your business: If you haven't already begun working on your estate and succession plans, start now. Make sure to involve a tax professional to help navigate an increasingly complex and ever-changing tax landscape. Your team can help you determine the best structure for the transition, for both your business and your estate, whether that's using a trust or transferring ownership to the next generation or to other employees.

"There's no right or wrong answer, but you as the current owner need to make a decision about how you're going to transfer ownership and then communicate that decision to the next generation, so they're able to work with what they have," says German Herrera, who works in Egon Zehnder's family business practice.

Mistake #3: Not focusing on next-gen financial literacy.

Family members who will become the future shareholders (and potential employees) of a family business need education not only in the family business itself, but also on their responsibilities as heirs and shareholders

"They don't need to be trained and expected to become employees, because that's a choice, but they need to be trained and developed to be a family owner," Herrera says.

Too often, family businesses expect younger generations to make smart decisions as they come into their wealth, but do not give them the tools to do so.

"They're not going to be people who grow up and get a job with a W-2, so they need financial literacy skills," Herrera says. "They're going to inherit wealth, and perhaps an operating company or investment company, so they need to be able to make financial decisions. Everyone needs to have at least a minimum financial literacy to do that."

Protect your business: Start teaching children the basics of financial literacy — including how it relates to their future involvement in the family business — as early as possible. Having financially fluent family members who are committed to the family business can help minimize the first three problems on this list, Astrachan says.

"When you have a really aligned family that's committed to each other, they tend not to make big cash demands on the company, whether it's through dividends or estate planning," he explains.

As the children get older, start discussing business decisions with them, so they can understand how the family approaches such matters.

"They don't have to be making the decisions," says Mark Conrad, a partner with Compardo, Wienstroer, Conrad & Janes at Moneta, a registered investment adviser that works with family offices. "They have to be at the table understanding why decisions are made and developing relationships with outside advisers, having independent relationships with attorneys, accountants and financial advisers."

Mistake #4: The loyalty effect.

When you've been working with the same vendor or selling to the same customer for multiple generations, it can be difficult to change the terms of your relationship or to cut them off entirely. Such loyalty, however, can have an impact on the business's bottom line.

"Family businesses tend to be very good to their customers and supplies," Astrachan says. "They tend to pay their suppliers super quick and give customers a lot of time. But that is cash that they might need to run and grow the business."

Protect your business: In today's environment, with supply chain shortages and other unusual economic challenges, long-term relationships do have value, but it's still important to regularly look at whether your payment terms are in line with industry standards or whether making adjustments could benefit your cash cycle.

Mistake #5: Allowing family conflict to impact business decisions.

Particularly when family businesses make it to the second or third generation, the number of family members involved in a business can give rise to rivalries between siblings, cousins, spouses or other family members. That can create a danger to the company if such conflict spills over into the business, or if company leadership starts making decisions to placate other family members.

"Money will change family relationships if you allow it to," Conrad says.

Protect your business: Consider putting an independent board in place. A board can offer third-party guidance on decisions and help business leaders look beyond family traditions to make decisions in the best interest of the family. Establish policies and codify them so that family members understand the process before it goes into action.

"Having the right policies and practices in place before you need them is the best practice," Herrera says. "And it's the only way to avoid or minimize family conflict and the consequences of family conflict."

Mistake #6: Nepotism

Favoring family members in the workplace, either by promoting them more quickly or paying them more than their peers, is prevalent in family businesses. But nepotism can create resentment among non-family staff. Nepotism becomes particularly problematic when unqualified family members get promoted into leadership roles before more qualified coworkers.

Renee Fellman, an turnaround specialist who has been the interim CEO for 20 companies, shares the story of a grandfather who promised his granddaughter that she'd be CEO one day. Later, it became apparent she did not have the qualifications to take on the role.

"The expectations had been set years earlier, and ended up causing problems within the company, but also problems within the family," she says.

Protect your business: Arne Boudewyn, head of family wealth and culture services for Wells Fargo Wealth & Investment Management, suggests having a formal employment policy in place, so that family members don't believe they have a birthright to work at the company.

That policy might include qualifications such as getting an advanced degree or experience elsewhere before coming to work at the company.

Creating such a policy is a "very basic governance and communication opportunity," he says.

Mistake #7: Not protecting business assets from divorce.

For couples for whom the family business is considered marital property, the consequences of a divorce can have a devastating impact on the business itself. Doug Baumoel, founding partner of Continuity LLC, considers the potential financial damage from divorce to be the biggest threat to family businesses.

"There's often a lot of anger in divorce, and lots of desire for retribution and hurting the other person" Baumoel says. "In that kind of a divorce, they more they talk to their attorney and the more they fight, the more the attorneys get paid. So the incentives are aligned not for peace but for separation."

Protect your business: Trusts can go a long way toward protecting a divorcing spouse from claiming rights to a business. Families might also require all family members with an ownership stake to get a prenup shielding their shares in the case of a divorce.

"You should have all the protections in place that you can," Baumoel says. "They're not a solution to anger or hatred. But when there's clarity on who owns what, those mechanisms can protect the family business."

Divorcing families might also bring in a consultant who specializes in such situations to help align the interests of all parties. A family Baumoel recently worked with were arguing over a buyout agreement. One side felt they were losing out on potential future growth. Baumoel helped the two sides reach an agreement that included a clawback provision in the case of a windfall.

"Introducing ideas like that can calm down the tension in the room and hopefully get them to be more rational and less emotional about the economic decisions that they're making," he explains.

Other Related Articles

Voices carry
How CEO Kevin Hancock found his voice as an advocate

The great resignation
How family businesses beat the odds

The search for meaning and purpose
Start with gratitude

Stop your self-defeating patterns
Three psychological barriers you must overcome

More

1845 Walnut Street • Suite 900
Philadelphia, PA 19103

(800) 637-4464