The majority of privately-held companies in the U.S. are family-owned, and more than 75 percent of family business owners have contemplated passing ownership to the next generation. Trends show that only 30 percent of these businesses will survive into the second generation, meaning things don’t always go as planned.¹

More than one-third of family business owners expect succession planning to be a significant challenge over the next five years. These individuals will face various obstacles as they near retirement, and unfortunately, nearly half of them currently don’t have any plans in place to ensure a smooth transition of ownership.¹

The low success rate of second-generation family businesses can be partially attributed to the lack of planning by first-generation owners. Succession planning is a difficult process, and in cases where owners are passing a business to their children, parents may be reluctant to start planning because it will require them to make uncomfortable decisions.

Even if owners develop a succession strategy, external forces can jeopardize their plans. Unforeseen challenges will arise during both the transaction and the post-deal transition periods that can affect the company’s performance. Without a carefully defined exit strategy, some challenges can be insurmountable and may have a negative impact on the long-term success of the company and members of the family. Succession plans can be broken or thrown off-course for a number of reasons, such as:

**Unexpected Economic Downturns**

During the recent economic recession, most banks tightened credit standards for family businesses, and to stay afloat, some owners were
forced to plow their own wealth back into their companies. Many family businesses are still recovering along with the economy, and as a result, some owners cannot afford to retire. While these owners may have planned to pass down ownership to their children, the only opportunity they may have to sustain themselves and their families after retirement is to sell the business to a financial or strategic buyer. In some cases, the children may have the financial resources to buy out the shares of their parents; nonetheless, a 2012 survey conducted by PricewaterhouseCoopers shows that half of family businesspeople either lacked the liquidity to purchase the shares from another family member or had never thought of doing so. A slightly larger percentage had not yet established procedures for purchasing the shares of a deceased or disabled shareholder.

**Lack of a Capable Heir**

Business owners often get their children involved in their companies with the assumption that they will be able to groom a capable heir to take over when they retire. When it’s time to transition ownership, however, owners sometimes realize that their child may not possess the right combination of skills, education, maturity, or even desire to run the company. Regardless, some owners may pass their companies on to an unqualified heir, even though it may not be in the best interest of the business or the family.

When a successor within the family is not prepared to take on a management role, owners sometimes hire external management or promote a non-relative within the company to oversee operations, while other family members take ownership of the company in a non-decision making role. This arrangement can sometimes create conflict, particularly when there is a gap in expectations or philosophy between the new managers and the family owners of the business.

**Poor Tax and Estate Planning**

Tax planning is one of the most important parts of succession planning. Family business owners need to be mindful of the tax liability that will be created when the ownership of their businesses is transferred upon retirement. Extensive planning should be done to minimize the tax liability of the next generation when they take over ownership. When owners don’t plan properly, new owners may be required to partially liquidate company assets to cover tax liability, which will have a negative impact on the value of the business. Implementing a plan early enough will allow owners to enact strategies that reduce the overall tax liability of the next generation.

**Sentimental Value of the Business**

Relatives involved in the ownership and management of a family business often see more sentimental value in their company than management at non-family owned enterprises. When determining the future of a

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business, this emotional connection could create tension and cause conflict among management, which in turn can have a negative impact on the company’s performance.

Taking an active approach to succession planning is necessary to ensure the long-term success of a business. By beginning to plan early, family business owners will not only be prepared to manage unexpected challenges that could jeopardize their succession plans, but they will also be more educated on alternative options, like selling to a strategic or financial buyer.