The Five Derailers of Effective Succession

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Succession problems rank highly among the common causes of family business mortality. The chief causes of family business deaths range from factors the family has little or no control over (industry and other disruptions, accidents and illnesses that affect family leadership of the business) to things the family can largely control (mismanagement of the business, missed business opportunities, shareholder and family conflicts). Ineffective succession can be caused by factors outside of the family's control (for example, the sudden death of the business leader) but is more often caused by things the family can anticipate and manage. The costs of mismanaged succession can be disastrous for the business; for its employees, customers and owners; for the family, and for family members who work in the business. Here I will expand on some of the remarks on this important subject.

Family succession isn't always the best choice. Not all family businesses should be passed to the next generation. Some businesses reach a point where they should be sold or merged with another company (with the family perhaps still holding a minority interest). A sale or merger can result from a family's lack of interest or ability in owning and leading the business and/or by industry changes that make a sale or merger the smart or inevitable choice. Some businesses can continue to be owned by a family but managed and even led by non-family business leaders. In all cases, I want the choice to be made based on what's in the interest of the family and the business.

If a family has considered what is best for the business and itself, and chooses to lead and continue to own its business into the next generation, it needs to make sure the transition of leadership and ownership is effective. An effective succession transition requires three things. First, the family must control the ownership of the business in a way that provides to the business both stability and the capital the business needs. Second, the family must lead the business in some constructive way, whether by the CEO, the board or even through the family's role as owners. Third, and importantly, the transition from one generation to the next must encourage the growth of the family's assets. If the family cannot continue to properly control or lead its company, or if passing the business to the next generation does not grow the family's assets, then the succession is not effective. To do these things, effective succession is not just a matter of preparing good family and non-family managers and leaders. It also requires the support and preparation of the family owners and the entire family.

So, what can go wrong with or "derail" these transitions? A lot, but mainly these five "de-railers" (things that make a train leave the rails) of effective successions.

DERAILER NO. 1

If you intend to pass the leadership of the company to a family member but nobody in the family is both interested **and** qualified to lead the business (typically as a manager, but perhaps as a board member or owner), you can't have an effective succession. Building the interest and capabilities to lead in one or more family members is not always possible. Other times it is possible but the family does not try, *in a proactive, systematic way,* to build interest in the business and the capability for leadership.

There are four main reasons why family members get turned off to the business: Typically, the family has not done enough planning for the next generation. It's also common to find that young family members have not had positive experiences with the family company. They have not been introduced to it in a positive way or they too often hear their parents complaining about it. A third common cause is that there are no interesting career opportunities in the business to attract the next generation. Some of my MBA students from family business backgrounds report this, which is ironic. Thanks to your educating the next generation, many potential successors now have other attractive career options that can compete with the family business. Or, fourth, there can be tensions in the family, including difficult relationships that discourage family members from joining the family business, even when they are sincerely interested in following that career.

Similarly, there are four main reasons why families don't produce qualified leaders. Lack of planning is also a problem here. So is a lack of key early developmental experiences that shape young family members to work hard, take risks and learn about business. The field of family business studies is now beginning to turn its attention to the questions of how strong family leaders are actually developed in childhood and youth. We will have more and better data on this in a few years. Another mistake is not giving future leaders assignments in the company that are challenging enough. Since producing a qualified family successor is challenging, it makes sense to have a backup plan with a qualified non-family manager. Sometimes families need to "skip a generation," or simply be patient, waiting for a new family leader to emerge interested and qualified at the right time. Non-family leaders can step in during these "waiting" periods. Families who neglect to cultivate non-family successor candidates are only shooting themselves in the foot.

DERAILER NO. 2

Second, if your succession process leads to a poor choice of leader, or if the leadership model itself is flawed, your succession is probably going to fail. Leaders need to have the necessary skills in management, leadership and governance. But that is not enough. If they don't have the support of the family, the succession can produce family conflict that can blow up after the next generation takes over.

Even if the next generation members are capable and interested in the company, the leadership model needs to fit with the realities of the family and the business. Take the example of Elizabeth and Edward, two very capable, well-educated siblings. Edward is working in the business and Elizabeth is working outside the business (but knowledgeable about it) when their father dies suddenly in his mid-fifties. They learn that they've each been given 49% ownership. Their mother has inherited a 2% ownership stake "to break deadlocks." So what's the problem? Elizabeth and Edward have never gotten along. (I mean never.) And their mother has never successfully broken a deadlock between them. The new leaders enter the business and work "together" for eight years. They fight over every key decision. Mother intervenes only to plead that they get along. What are their options? They can split the business. One can buy the other out. They can sell the business. Or they can watch its value evaporate.

What did they do? They chose the last option. Over the next several years, the once very successful business declined in value. Succession failed. I blame the father for choosing a leadership model that couldn't work.

DERAILER NO. 3

This concerns the poor selection and grooming of new **owners.** Please, do yourselves a favor. Never pass ownership to those who aren't interested in or supportive of the business, and who don't get along with other owners and with the new business leader. Ownership of a family business is a job that requires certain sensible qualifications. It shouldn't be treated as a birthright. So select owners with the same care you select key leaders of your family business. And then create the right governance (agreements, policies, plans and discussion forums) for the owners so they can discuss, decide, and manage conflicts in an effective way.

DERAILER NO. 4

The fourth common derailer of succession transitions is a leader or leaders who do not let go of power in a timely way. These leaders generally are vital, good leaders and often they are still better than their successor is right **now**, but that is not a good excuse for not letting go. Generally, these leaders believe they are indispensable and that nobody is prepared to replace them. Typically they do not have a long-term view of *family* success, no matter what they may claim.

I will remind you of a lesson about succession I have written about before in this column: **Leaders need to pass the baton not when they are ready to leave, but when their successor is ready to lead.** Incoming successors often are ready to lead in their late thirties or early forties and we shouldn't delay much in installing them as business leaders, because their motivation will suffer, along with momentum in the company. But to pass the baton at this time often means that the outgoing leader will still be quite strong and capable, often exiting before he or she reaches their peak.The outgoing leader can often move to another role that offers great strategic value to the company and can be very satisfying, but I recognize that leaving the CEO role at this time can be a sacrifice. Those leaders who do this have my admiration.

DERAILER NO. 5

Finally, your succession will go off the rails if the business is not prepared for the future. In some cases, the business has not paid attention to its changing industry conditions and finds itself in a precarious competitive bind. In these situations you will see that the business has neither reinvested nor diversified properly. The organization is not strong enough. The governance is not strong enough to support the business going forward.

Just as it seems unnatural for a vibrant, effective family leader to begin thinking of "retirement" before his or her peak, it can feel equally unnatural for business families to concentrate on reinvesting, diversifying, and growing new wealth at a time when their business is growing and performing well. After all, this is the most glamorous time for any business, and families may feel like they are thwarting momentum by turning their attention away from supporting strong growth in the business. But believe me, you have to do this. For an effective succession, you need to reinvest in your business, diversify your business, and grow more wealth before that business hits maturity.

For families who aim for great successions generation after generation, you need to be growing your wealth significantly every generation. That generally means entering new businesses in growth industries or sectors every generation.

The family that understands what can derail succession can prepare to meet these challenges. A business that is well led, supported by capable owners and a united, contributing family, with a long-term view of success—a business that is prepared for the future—will stay on track. With attention and commitment you can avoid going off the rails by laying strong track.

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