Family business:
The rite of passage

By Irit Reichmann

A family business is one that is controlled by a single family. It is an enterprise in which the parents, the children and the grandchildren and the sons-in-law and daughters-in-law have senior positions and are involved in making important business decisions. A family business's founder is usually a dominant figure, often the head of the family or one of the children.

As in every enterprise, family businesses can be small entities that employ mostly family members, mainly children (for example, a corner store, a law office, etc.). Alternatively, they can be large companies that employ hundreds or thousands of workers, and the family members may make up only a small fraction of the senior staff.

Studies indicate that family businesses, which are the oldest and most prevalent type of business, make up the bulk of the world's economic activity (around 80% of businesses worldwide). Less than one-third of existing family businesses survive and continue operations into the second generation. Less than 13% continue on to the third generation. The statistics also indicate that family businesses are less at risk in the long term compared to regular businesses.

A number of studies revolving around the economic recession that began in 2008 have shown that family businesses had less of a failure rate than conventional businesses. According to the researchers, their higher success rate was due to these companies' being far less leveraged, as well as the fact that the owners had a vested interest in the next generation. Therefore, they were less willing to embark on risky ventures that might threaten the business's stability. When business owners are aware that if they take on significant debt it will likely pass on to the next generation, they are much less likely to incur debt.

In order for a business to survive the transition from the founding generation to the second or third generation, families must take necessary steps to ensure that the transitions occur in the best way possible.

First generation: The founder

A family business's inheritance plan needs to be developed during the founder's lifetime and be as detailed as possible. The division of the business among the children should be even and transparent, and the founder should identify each of the successor's strengths, entrusting each of them with a position in which they can utilize those strengths. It is also important that while the founder divides up the ownership of the business in his/her lifetime, he/she should retain the ability to revoke an inheritor's authority in the event of family members not performing their duties satisfactorily. In our line of business as attorneys, we often encounter situations in which the founders - i.e., the first generation -- transfer ownership to the next generation, leaving loopholes that will allow them to resume control if need be.

Many inheritance disputes occur when a number of family members feel they have been given a raw deal, usually less than they think they were entitled to. Consequently, the founder should take care to clarify to the second generation what their roles will be and what authority they will continue to have after the management has changed hands.

Making things clear is of paramount importance because disputes pertaining to inheritance can put a business at great risk.

Therefore, it is important to write a will that fosters agreement and not one that encourages family members to run to court.

Continuing power of attorney in the event of the founder's becoming incapacitated

Continuing power of attorney is one of the most important tools at a business founder's disposal. Under continuing power of attorney, a founder can determine in advance the guidelines and instructions for the attorney as to the manner in which he/she wants to act and the nature of the decisions that person will make. The founder can also authorize the attorney to act with full discretion in all business decisions.

Businesspeople can grant their surrogates or agents a lot of authority over the business, but they can also appoint a number of different agents with powers of attorney. They can also choose alternate agents to replace an agent who cannot or no longer wishes to continue his/her duties.

Second generation: The children

What is the difference between a child who works in the business and one who doesn't? Many business owners wonder how they should behave when the family is divided among those who actually work in the business and those who don't. Some of the questions that owners often have relate to the business's financial status - that is, whether to distribute shares to family members who are not actively involved in the business. What level of decision-making powers should they give to each family member and whether the level of each of the inheritor's active participation in the business should determine their powers? These questions do not have clear answers. Since there are so many variables that differ from business to business, it is impossible to compare the managerial strategies of small family businesses to those of large family businesses. It is recommended to contact a lawyer who deals with family businesses to analyze the nature and scope of the business and can then make recommendations based on the findings.

The issue of employing sons-in-law and daughters-in-law in a family business is very disconcerting for many of our clients. Bringing in an employee or manager who is not a blood relative may ignite passionate problems and cause family strife that may be difficult to resolve. It is therefore recommended to make every move fully transparent and in consultation with the entire family and that powers given to sons-in-law and daughters-in-law be determined in advance.

Third generation: The grandchildren

A well-known cliché states that "The first generation makes it, the second generation spends it, and the third generation blows it." Introducing a third generation into the business's management is more difficult than the second generation; but by using several rules of thumb, you can avoid the pitfalls and make the transition easy.

The most important rule is to determine the criteria for working in the business, based on the family's rules and traditions. When the requirements for involvement in the business are detailed and transparent, family members can responsibly choose whether to work in the business or do something else entirely. An attorney can draft the guidelines after studying the business, and those guidelines can be made to emphasize the family's core values and customs.

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