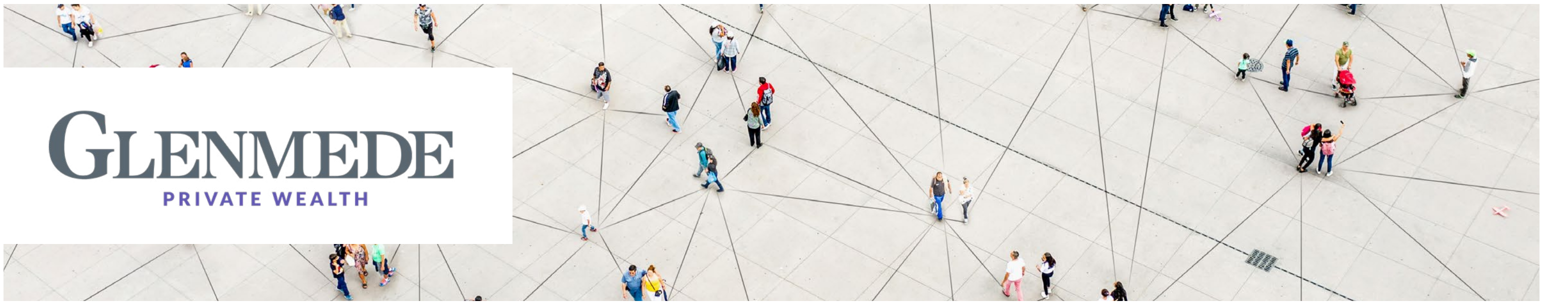

How Family Enterprises Can Survive – and Thrive

Best practices for preserving wealth for the next generations

What might cause a family business not to succeed past the first generation? External disruptions like societal changes and economic shifts matter, but more prevalent are internal forces, such as delaying or ignoring estate and succession planning, failing to promote financial literacy in the second and subsequent generations or lack of asset protection planning. Here we review some best practices for family business owners that can be applied in any family of wealth to address this generational conundrum.

The proverb “from shirtsleeves to shirtsleeves in three generations” is used to describe the phenomenon of wealth gained in one generation being lost by the third generation. It is often attributed to industrialist and philanthropist Andrew Carnegie, although it is not unique to any one industry, country or culture. The adage warns us of an indisputable truth: that wealth amassed by an older generation through hard work and tenacity, if not responsibly stewarded, can be easily depleted by the time there are great-grandchildren — setting the family back to where it started.

Like families that have amassed wealth, families that have built businesses are faced with the same challenge. Nevertheless, many family business owners have managed to avoid the shirtsleeves-to-shirtsleeves trap, and the good habits they practice can also apply to family wealth.

Business has changed much since Carnegie’s time, but it is possible for family enterprises to survive, even thrive, past the first generation and more. Family businesses are a dominant force in the economy: The Family Business Alliance reports that nearly 5.5 million businesses in the U.S. are family-owned, accounting for 50% of the U.S. workforce and nearly 50% of GDP.[1] Although the majority of the oldest family-run businesses are foreign, the U.S. is home to several companies that have been around for five generations or more, among them the Zildjian Company in Norwell, Mass. — a 14th generation company.[2]

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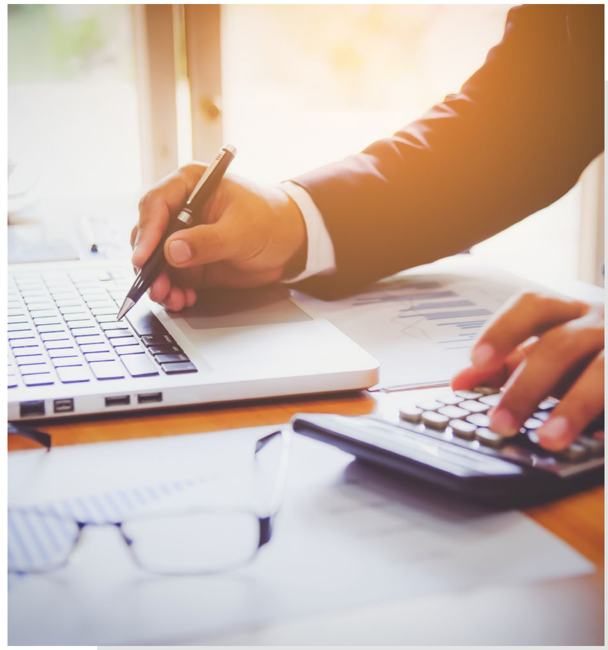
[1] *Family Business Alliance. “About.” https://www.fballiance.org/about.*

[2] *Family Business, The World’s Oldest Family Companies. https://www.griequity.com/resources/industryandissues/familybusiness/oldestinworld.html. Accessed Feb. 4, 2022.*

However, that kind of longevity is not typical, and does not happen without substantial effort. The Family Business Alliance reports that only 30% of all family-owned businesses survive into the second generation, 12% into the third and just 3% into the fourth generation and beyond. The reasons cited include external disruptions like societal changes and economic shifts, but more prevalent are internal forces, such as delaying or ignoring estate and succession planning, failing to promote financial literacy in the second and subsequent generations or lack of asset protection planning. Some business owners err by being too formulaic or rigid, instituting procedures for decision making that do not align with family dynamics. Yet others are too flexible, prioritizing family cash needs in making distributions or declaring dividends, instead of the realities of the business's operating budget and cash flow.



"The road to successful management of a family business endeavor is littered with traps for the unwary."

How, then, does a family business avoid the shirtsleeves-to-shirtsleeves outcome? With diligent adherence to a customized strategic plan consistently over time, many highly successful family businesses and wealthy families have done just that. By partnering with Glenmede to develop and implement a Goals-Based Wealth Plan and participating in an ongoing process of periodic Goals-Based Wealth Reviews, many families have been able to ensure that their investment portfolios, financial and estate plans all serve to bring about the desired results for the family's lifestyle and legacy.

Following are a few best practices for family business owners that can be applied in any family of wealth to develop good habits that connect them to their family's values, stewardship and philanthropy.

Make it a family affair

For family operations, business transition and continuity of operations are real concerns. Many, if not most, family business owners say they want to transfer their company to a family member and will typically look to their children — the second generation — to carry on the business and grow the family wealth. The knowledge that your children are committed to your business can provide a sense of security surrounding your company's future. One challenge in this scenario is creating a business climate that encourages younger family members to have a say in business operations.

Creating and maintaining open lines of communication is essential. When business and family roles overlap *(or collide)*, conflicts may arise that need to be addressed in a timely and constructive manner. Families should be prepared for personal concerns that carry over into the workplace and have mechanisms in place that facilitate impartial resolution. A family business that succeeds will leverage the expertise of outside advisors to ensure shareholder or operating agreements are in place and appropriate for the circumstances. When policies exist that predate the issue at hand, any appearance of partisanship can be avoided, and all parties are equally informed of likely outcomes in advance.

Likewise in the family wealth context, business or no business, communication between and among generations is crucial to maintaining family cohesion as time effectuates a transition in decision making and care taking. An understanding of each generation's priorities and concerns can foster empathy and respect. Glenmede's Goals-Based Wealth Planning process provides the impetus for consideration of these issues and the forum to articulate aspirations for the eventual transition of wealth. Your Glenmede team can propose strategies and techniques that, when implemented in conjunction with your other advisors, more closely align your trajectory with your desired outcomes.

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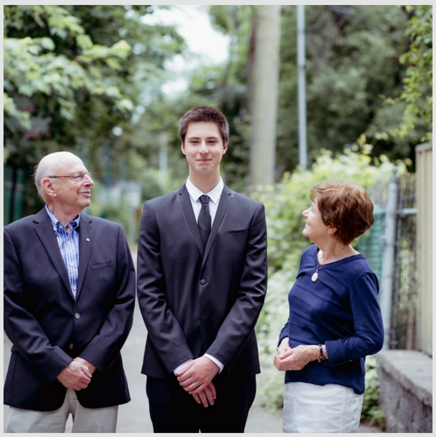
Share your story

We have found that successful family-owned businesses, those that survive multiple generations, have owners who share their stories — how the family wealth was created, who created it and what family members sacrificed to make the venture successful. It is important for family firm wealth holders to transfer not only their financial wealth but also their values to subsequent generations, including encouraging children to earn their own money and engage in philanthropy. Glenmede can work together with your family to create and maintain a "mission statement" that reflects the guiding principles the family strives together to uphold. Once created, the mission statement serves as a touchstone for children and subsequent generations to remember their shared history and the values and legacy that serve to unite them.

In the case of a Glenmede client whose company has thrived for several generations, the family holds the belief that the younger generation should experience work outside of the family business before coming on board. The logic behind this tactic is twofold. If implemented, members of the younger generation:



- have agency over their careers and are not forced to work in the family business — this way, those who do are engaged and invested, and
- must fulfill the expectations of unrelated bosses in a “real” job where they need to learn how to succeed in an environment full of unfamiliar personalities and management structures.

A family that memorializes its story and priorities provides later generations with a roadmap to navigate changes in circumstances over time while staying true to its roots.

Start early

It is also important to teach financial stewardship. Working with your Glenmede team, you can decide how much information you want to share about your particular financial circumstances and the economics of the business. Families that operate successful businesses over the long term tend to be close-knit across generations and inclined to honor family traditions. Trust built between generations starting at an early age encourages cooperation.[3]

Play an active role in educating the next generation. With your input, your Glenmede team can introduce programs designed to facilitate responsible stewardship of assets by exposing younger family members to age-appropriate financial concepts early and often. We frequently work with younger generations to ensure basic understanding of budgeting, trusts and investment structures, and to provide a forum for confidential, nonjudgmental discussion and inquiry. Educational getaways, family business meetings and learning experiences shared with next-generation family members are just a few activities that serve to build the bonds that reinforce shared visions, values and learning. To be effective, education must be a continuous process.

Preparing future family leaders takes years of education, training and experience. You may be uncomfortable discussing wealth and inheritance planning, but failure to do so can create unnecessary challenges. Successor generations must be prepared for the responsibilities that come with inherited wealth and business control, both to ensure their personal financial sufficiency and assume stewardship of the family legacy, including the family enterprise. Younger family members need to develop sound financial management habits, understand family values and become familiar with the family’s investment, estate and philanthropic strategies.

[3] *Jaskiewicz, P., A. De Massis, and M. Dieleman. The Future of the Family Business. The Conversation. April 15, 2021.*

It is also never too early to start planning. Business owners who are contemplating a transition in favor of a subsequent generation or a strategic buyer must understand who will continue to hold business interests and the rights and tax implications of that ownership. This understanding can factor largely into the choice of one technique over another. Will the transition be part gift, part sale? Will it take place immediately, or over time? Is it a stock sale or an asset sale? Titling of equity interests will determine who exercises control over business decisions and who bears the burden of tax or other liability resulting from a transition; this structure should be analyzed and, if necessary, equity interests transferred appropriately well in advance of any transaction. Your Glenmede team can provide guidance on this and related topics in the course of formulating your plan.

Family wealth builders must also consider the eventual distribution of their wealth, especially when there is a business in play. Estate liquidity needs for distributions, administration and the eventual payment of transfer taxes should be considered and provided for in the estate plan. If equalizing distributions are to be made to some beneficiaries in lieu of business interests that are transferred to others, assurances must be made that assets are sufficient and appropriately situated to enable smooth, simple transfers. Deconstructing total wealth into discrete segments — providing for lifestyle needs, legacy desire and philanthropic interests — can help clarify how your assets can provide for your current financial needs and, at the same time, grow to serve the family's wealth and business interests for generations.

To be effective, education must be a continuous process.

How *not* to succeed for generations

Not planning for succession leaves the future of the business uncertain and could discourage younger generations of your family from participating. Moreover, maintaining rigid control over all business decisions and not allowing the next generation to feel ownership or control could be a recipe for disaster. The next generation may have new ideas for the company that would improve its agility in the face of economic change and help it thrive.

To be equitable, advances should be purely meritorious. Advancing an unqualified child, particularly at the expense of other qualified candidates, undermines the child's long-term success by creating an environment in which there is resentment and a lack of respect among employees. Policies must be applied evenhandedly, and advancements and opportunities meted out strictly on the basis of objective standards and performance. Do not be afraid to tap into the enormous talent pool that exists outside your family to raise the bar within your business, or to treat employees who excel and who demonstrate loyalty like family — resulting in a culture of integrity, pride and mutual respect.

Conclusion

There certainly are no guarantees that your family business will survive for multiple generations. As a business owner, you may have to decide who will operate the company after you retire, if something were to happen to you or you simply want to move on to something new. Ideally, you will plan for this transition before it is too late to implement many tax efficiencies.

It is never too early to start a conversation with your Glenmede team and other advisors about your business planning and transition options, when an option may or may not be appropriate and what the tax implications of a given course of action would be. This starts by considering what you would like the transition to look like and mapping out some contingencies — working toward the goal of disproving the shirtsleeves-to-shirtsleeves proverb.

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