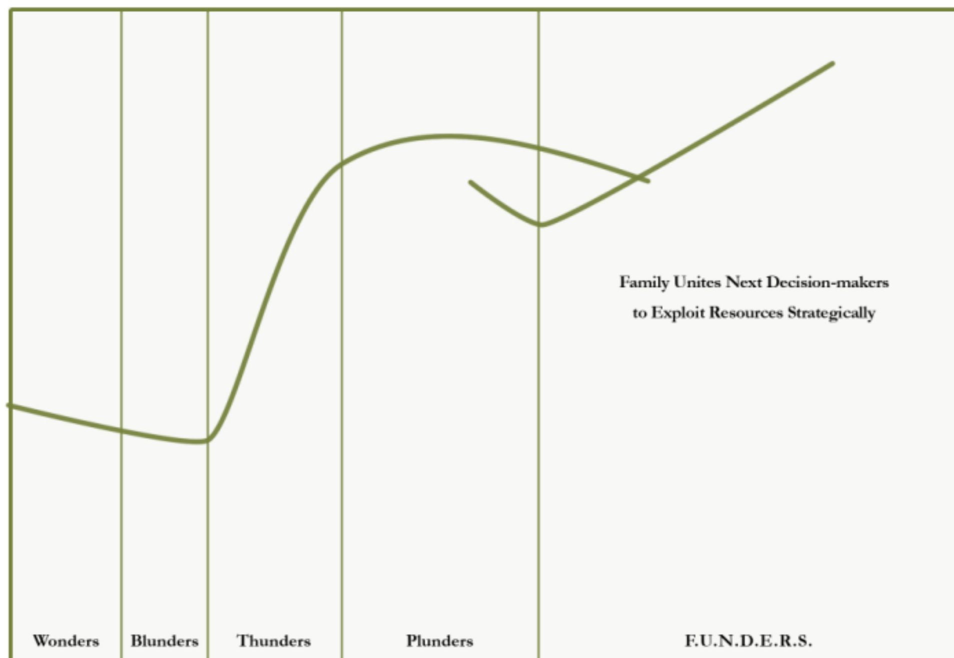
Transferring Business Value and Values to the Next Generation
by Tim Voorhees, JD, MBA

King Solomon warned, "An inheritance quickly gained at the beginning will not be blessed at the end."[1] Solomon's wisdom is especially relevant in the 21st century as millions of businesses worth trillions of dollars are being transferred from founders to the next generation.

Authorities on business transition planning have written many books and articles about the decline and fall of great family businesses. A generation one leader typically builds the enterprise with fire in the belly. During the early years, the business founder may wonder and dream about future possibilities. Initial attempts at starting the business usually lead to challenges. The founder learns from blunders, establishes a firm foundation for future prosperity, and enjoys thundering success, often for several decades.

Eventually the business owner must transition the business to the next generation of owners and managers. These successors will usually not fully appreciate the vision and values of the founder. Successors (or their family members and advisers) will often be tempted to spend corporate assets and cash flow instead of reinvesting with clear vision and values. This starts a process of plundering that will undermine most businesses.

This white paper summarizes more than a dozen studies detailing the consequences of transferring business value to the next generation without first transferring business values. After reviewing the problem in the first part, the second part examines how business owners can use 21st century assessment tests and proven planning methodologies to prepare successor managers for optimal stewardship of assets. This preparation of the next generation helps family leaders unite the next decision-makers in exploiting resources strategically. In this way, families can extend increasingly influential legacies across the generations.



The Problem:

Successor managers given assets typically have a strong inclination toward spending the resources on possessions, pleasures, or other purposes without lasting significance. Psychologists specializing in "sudden wealth syndrome" acknowledge that heirs, like lottery winners, tend to blow their windfall.[2] The availability of assets may undermine the pursuit of higher purpose. Andrew Carnegie, the 19th-century steel magnate stated, "The parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less worthy life."[3]

When beneficiaries receive business assets without prior coaching on the purpose of business, they will seldom take the time to understand the values that helped accumulate the value of the enterprise. Inheritors do not understand the blood, sweat and tears invested in accumulating business wealth.[4] Nor do heirs receiving gifts of corporate stock have much motivation to develop the bias toward diligence, delayed gratification, thrift, and other values needed to maintain healthy relationships with line and staff workers who contribute to the success of the corporation.

Too many business owners assume that generation two managers have learned business skills through osmosis. Experience teaches that children assuming control and ownership in a company will seldom have the acumen to lead the business until they have acquired academic credentials, earned a promotion outside the family business, and proven that they have the skills consistent with those needed in a family enterprise. Nonetheless, business shares are frequently given to children without a lack of personally and socially purposes guiding the transfer.[5] Jesse O'Neil, author of *The Golden Ghetto: The Psychology of Affluence*, documents how assets transferred to the next generation without a meaningful purpose often fosters "Affluenza." Heirs may lack the purposeful pursuits needed to cultivate self-esteem, self-worth, motivation, self-confidence, personal identity, and other qualities required of successful managers. Moreover, the vacuum created by the lack of a healthy purpose leads to negative character qualities, such as the inability to delay gratification, unwillingness to tolerate frustration, feelings of failure, and a false sense of entitlement. As problems grow worse, heirs withdraw from others, avoid accountability, and develop progressively more serious social disorders. The presence of money catalyzes personality dysfunction. These disorders limit the ability to form vital relationships with other people and leave victims unable to find a comforting sense of calling.

Business owners may think that they can minimize the risk of affluenza by having a business transition plan with a clear purpose. Unfortunately, the purposes of a business plan (e.g., "transfer the business to my sons" or "build company wealth tax efficiently with an ESOP") are usually too narrow to inspire and motivate heirs. Even if a plan is technically perfect, experienced advisers know that plans frequently do not get implemented because heirs and advisers do not have agreement on purpose. When the plans are implemented, they are too likely to transfer assets to heirs who liquidate stock, quit their jobs, and then live lives without clear purpose. Dr. Gerald D. Bell, of the University of North Carolina's Kenan-Flagler Business School, details how heirs can then drift into roles in which they play rather than work, pretending to be golf pros, skiers, artists, or writers but lacking the motivation to grow, preserve, or transfer wealth.[6]

Given the prevalence of successor managers without clear purpose, it is no surprise that 75% of parents worry that heirs' lives may be adversely affected by wealth.[7] Business succession planners who have watched inheritors over the decades will almost always agree that these fears are well-founded.

Around the world and across the centuries, heirs have squandered business values in a few short generations. In America, we say, "Shirt sleeves to shirt sleeves in three generations." In Asia, families speak of going from rice patty to rice patty in three generations. Europeans talk of the entrepreneur achieving enough success that he no longer needs to wear clogs but then watching grandchildren squander wealth, resulting in the family going from "Clogs to clogs in three generations."[8] Likewise, in Italy, families have been known to go "from barn stall to barn stall in three generations."[9]

Frequently, the loss of assets takes not three generations, but just three years. Zeeb and Cochell, in *Beating the Midas Curse*, tell of a family that squandered wealth accumulated over five decades in a mere twenty-four months.[10]

Studies in America provide contemporary evidence that families still lose their wealth following the time-tested pattern. 60% of families waste away their wealth by the end of the second generation. By the end of the third generation, 90% of families have little or nothing left of money received from grandparents. Ultimately, 95% of all traditional inheritance plans fail.[11]

Statistics collected from family businesses provide similar sobering facts. Only 30% of businesses make it to generation two and a mere 3% still generate profits in generation three.[12] Given the dismal success of family enterprises, it is no wonder that 65% of family wealth is lost by the second generation and 90% by the third generation.[13] By the third generation, more than 90% of estate value is lost and, even worse, the generation three can usually articulate very little about the values that accumulated the wealth. Even in Australia, where there has been no estate tax[14], families lose their financial wealth and the values that accumulated the wealth by the third generation.

Even if financial wealth is not lost, the vision is frequently lost. Family members without an effective wealth transfer process typically have heirs working at cross purposes. Disruptive changes of leadership are common.[15] Studies show that values are not transferred to the next generation.[16] Conflicts regarding succession planning cause businesses to fail.[17] Planners involved with wealth planning can usually share countless sad stories about broken relationships. It is common for businesses to dissolve within months after the founder dies.[18]

When the family business founder fails to train the next generation of leaders to maintain relationships based on the founder's core values, trust deteriorates. Surviving heirs engage in power struggles to fill a leadership void if the business founder dies suddenly.[19] Too often lawyers wrangle for years and dissipate much of the estate value.

If a family does defy the odds and maintain a clear purpose long enough to accumulate significant wealth, they will face greater challenges. As Ralph Waldo Emerson reminds us, "It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have got it, it requires ten times as much wit to keep it."[20] Experience teaches that

it is hard to accumulate business wealth, harder to maintain it, and hardest to transfers it prudently.

Fortunately, 21st century assessment tests can help business owners identify potential problems in the areas discussed above. The eleven assessment tests below can help clients see the need to articulate clear plans for using inherited business assets to build healthy leadership teams in businesses and the families that own them.

The Solution:

Solomon honored God by upholding divinely-inspired leadership ideals. Business owners can likewise reflect God honoring ideals by articulating a clear vision and purpose, developing effective governance principles, establishing clear priorities and principles, clarifying rewards and consequences for managers, and preparing the next generation to inherit and manage business assets.

Developing a business succession plan takes time. Leaders must develop a complete evaluation of external opportunities and threats, as well as internal strengths and weaknesses. This process, summarized at www.WOTSMOST.com, helps focus a business and prepare it for successful transfer. The external and internal evaluation helps to clarify "what is" and sets the stage for creative discussions about "what ought to be."

All planning for the future must emphasize the corporate vision. The vision must remain steady and compelling even if the mission changes. An assessment of the organizational vision reveals much about the health of the organization. A vision audit can clarify whether leaders and managers communicate a sufficiently clear vision. A sample vision audit report is available at www.VisionAudit.com.

Before a business owner can state a clear vision for the enterprise, he or she must have a clear vision for his or her own life. This requires introspection into personal strengths and weaknesses as we examine the opportunities and strengths surrounding the business leader. In the competitive global economy, each business must know and leverage its core strengths in areas where the greatest opportunities exist. Computer assessments can help business owners "leverage the best and ditch the rest." A sample output from a computerized assessment is available at www.ClarifyValues.com.

The business achieves greatest success when leaders and managers pursue their passions, fulfill their callings, and experience success in harmony with their personal core values. The planning process should help businesses stay faithful to the corporate vision while coalescing personal core values into a statement of business core values. To assess faithfulness to core values, it is wise to use reports like the one at www.FamilyBizQuiz.com.

After establishing the vision, the company must mobilize a team. Jim Collins wrote about the importance of "getting the right people on the bus" and in the right seats. Successful leaders make this process practical by clarifying how the roles and goals of staff members lead to completion of workflows with growing cash flows, all with simultaneous loose-tight controls. Alignment of roles, goals, controls, workflows, and cash flows helps businesses develop the

right incentives (payrolls) to foster maximum commitment and teamwork. Assessment reports can gauge success. See a sample report at www.CAPABLETeam.com.

If a company out-sources advisory services, all advisers must understand the corporate vision and values as well as the key performance indicators ("KPI") used to monitor work flows and cash flows. To evaluate the effectiveness of each advisory team members, companies should generate reports like this one: www.PlanningTeamEvaluation.com.

Successful business owners understand the extreme importance of monitoring and projecting cash flow. The management process should examine cash flows related to a broad array of business entities and planning instruments. The most successful companies often use technology to integrate cash flow projections and model long-term changes in income statements and balance sheets. Such modeling should illustrate how business cash flows impact current and wealth transfers to all business stakeholders. As part of the modeling process, it is wise to produce reports like that pictured at www.ToolQuiz.com.

Modeling cash flow and preserving values requires identification and management of many risks. Astute managers evaluate the effectiveness of methods used to manage risks related to products liability, loss of key team member, regulatory and legal matters, intellectual property protection, and natural disasters. A sample risk management report is at www.PlanningCritique.com.

The success of a business increasingly depends on the effectiveness of Tax Planning. Planning in the 21st century must take into account a broad array of income, capital gains, AMT, estate, gift, GST, property, and other taxes. Cash flow and wealth transfer projections will probably not be useful unless the business owner actively involves a CPA and/or tax lawyer in developing realistic projections of after-tax cash flows. The tax planning process should integrate investment optimization with tax optimization to help optimize wealth across time. See a sample report at www.WealthEvaluation.com.

As a business builds after-tax value, business owners like to dream of experiencing the joy and excitement of a liquidity event. Monetizing the equity in a business requires careful development and execution of next actions related to shareholder value creation, exit date projections, choice of gift and sales techniques, preparation of the next owners and managers, selection of financing vehicles, funding of buy sell plan, appropriate transfer of management and control, maintenance of project management timelines, and management of key performance indicators. To evaluate these variables, it is prudent to use reports like the one at www.FamilyBusinessHealth.com.

Great opportunities come to light as business owners combine tax planning and risk management techniques. Advisers can often use tax savings to fund insurance-funded buy-sell agreements and other safety nets that protect businesses until more comprehensive plans are put in place for passing values and value to successor owners and managers.

Eventually business control, management, or ownership will usually pass to the next generation. Statistics show that most successor managers will lose their inherited stake much like most lottery winners squander their wealth in a short period of time. To beat the odds, business owners should transfer their values before they transfer the value of what they own.

To guide this process, it is prudent to use reports like the one at www.TrainingHeirs.com. Even if Generation 1 has a clear vision and mission that unites a team in diligent work, it is important to use assessments when equipping Generation 2 and 3 to follow the business vision faithfully. This process is guided by reports like the one at www.FaithfulHeirs.com.

Conclusion:

A business owner may be overwhelmed when considering all of the ways that ill-prepared successor managers can undermine years or decades of hard work. Fortunately, experience and technology now equip advisers to help business owners find hope and develop clear plans for prosperity in even the most challenging situations.

Assessment tests can efficiently and effectively identify areas where additional planning is needed. Once business leaders clarify "what is," they need to unite decision-makers in clarifying how the organization can most effectively exploit its resources and take full advantage of stewardship opportunities.

Taxes are one of the biggest obstacles to stewardship. Fortunately, modern tax planning instruments afford myriad creative solutions for improving after-tax cash flow and/or after tax transfers of equity to successor managers. Wise business owners know how to fund tax-efficient risk management plans that help protect the business even before comprehensive business succession plans are in place.

Have your clients established business succession plans for the seamless transfer of family business assets at the right time to the best people? If you struggle to answer this question with clear and positive responses, you should look beyond common legal tools and help your clients think about the stewardship process.

The stewardship process can encourage family members to pass on proven spiritual and emotional values before they pass on the value of what they own. The process can integrate wealth transfer wisdom with tax and financial planning instruments.

As a professional, you can find new joy and meaning in your calling while helping clients transfer both a relational inheritance and financial inheritance to their heirs. Following the example of Solomon, you can inspire future generations to leave a legacy of time-tested values.

Endnotes:

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5 Perry L. Cochell & Rodney C. Zeeb, *Beating the Midas Curse,* 44-45.
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7 Perry L. Cochell & Rodney C. Zeeb, *Beating the Midas Curse,* 158.
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12 Russ Crosson*, A Life Well Spent (*Tennessee: Thomas Nelson Inc., 1994), 167.
13 George W. Hester et al, *Family Wealth Counseling : Getting to the Heart of the Matter*, Professional Mentoring Program, 1999, vi.
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16 Roy O. Williams, *For Love & Money: A Comprehensive Guide to the Successful Generational Transfer of Wealth* (Oregon: Robert D. Reed, 1997), 13-15.
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