

# advisory

## DEALING WITH THE CHALLENGES OF A FAMILY-OWNED BUSINESS

Family businesses are a cornerstone of the U.S. economy by a number of metrics. According to FamilyBusiness.org, out of the 37 million businesses in the U.S., 87 percent - or 32.4 million - are family businesses.<sup>1</sup> Moreover, family businesses employ almost 59% of the private sector workforce and generate 54% of private sector gross domestic product (GPD). Notwithstanding the overall contribution of family-owned businesses, they face significant and constantly evolving challenges.

As a business lawyer, I have had the opportunity to assist family-owned businesses in confronting multiple legal and business issues inside and outside the business. One interesting dynamic is dealing with the differences in the values of the founders that sometimes do not correspond with that of the children who may feel entitled simply because of birth rights.

Keeping the business in the family should be a positive motive. However, when the owner's children are being paid for doing little or no work, the morale of non-family employees is negatively impacted. A family business must carefully establish salary and benefits in accordance with position, experience and performance vs. the relationship to its owners. In other words, to avoid conflict, it is important that compensation be aligned without regard to the family relationship, and it should be clear to all employees that everyone is evaluated on the same basis.



There are many positive outcomes when multiple generations work for the same family-owned business. Younger generations can bring new and innovative ideas to the operation when, often, the older generation resists change. Healthy businesses need to be open to new ideas to evolve and should not succumb to an attitude of "this is the way we have always done it." Listening and engaging the younger generation and being open to progressive change is important for morale and makes the younger generation engaged in moving the business forward.

It has been reported that only 30% of family-owned businesses survive from the first to the second generation, and only 12% from the second to the third generation.<sup>2</sup> It has also been determined that almost 50% of the founders who want to retire neglect to identify a successor and develop a transition plan. If the business is to remain in the family, it is critical that the next generation is prepared and capable to take the reins. Involving them early in the management of the operation and providing insight regarding financial matters is essential to future success.

Family-owned businesses share all the same concerns as non-family businesses, i.e., profitability, competitive forces, adapting modern technology, and management and personnel issues, to name a few. However, family-owned businesses also have unique challenges that are not experienced by non-family entities.

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When family business ownership is passed to the next generation by inheritance, there may be heirs actively involved in the business, as well as heirs who are employed in non-leadership positions or passive owners. A communal problem amongst the various categories of owners is that family members feel entitled to a return on their equity. They may also expect to be provided a job regardless of their qualifications or expect to be paid a salary without actually providing a useful service. Managing family members in a business is challenging, particularly if the leaders wish to use the profits to invest back in the business to further growth rather than rewarding shareholders/family. The effective leader works to avoid a culture of entitlement in favor of operating the family business without bias. Managing employees, and establishing and maintaining effective human resources practices are challenges in any business, and the issues do not disappear when a business is owned and managed by family members.

If the family business operates as if domestic relationships exempt them from the rules applicable to other businesses, non-family employees will become problematic and could negatively impact future success. Management and ownership succession in the family business carries with it the continuous challenge of answering the question, "Should management and ownership continue in the family?" In a non-family business, the question will be "How can the business continue to provide benefits to its stakeholders, including investment returns to its equity holders?"

It is an exceptional family business that survives and thrives through more than two generations. Factors like preserving the family name or culture, living up to the expectations of earlier generations, and providing business opportunities for future generations often take priority over investment returns to family members. Succession, in whatever form, is inevitable. It is a wise business leader who addresses family succession issues before they ripen into a crisis.

If you have questions pertaining to a family-owned business, please contact PLDO Managing Principal Gary R. Pannone at 401-824-5100 or email [gpannone@pldolaw.com](mailto:gpannone@pldolaw.com).

<sup>1</sup><https://familybusiness.org/content/measuring-the-financial-impact-of-family-businesses-on-the-US-ec>

<sup>2</sup><https://www.familybusinessmagazine.com/critical-look-survival-statistics>



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