

FOR IMMEDIATE RELEASE

FROM: WAYNE UNZE (797-1100)

RE: THE RIGHT (RITE?) OF SUCCESSION

Clyde and Irma (not their real names) had built a prosperous and growing retail business in one of NE Albuquerque's busy strip malls.

Like most entrepreneurs, they had weathered the tough times by spending countless hours tending the store and reinvesting profits until they had the right combination of inventory, marketing and personal service.

On their 45th anniversary in business, Clyde decided it was time to turn the store over to their son Greg, who had worked in the business since his graduation from UNM business school. Like his father, Greg was a likeable sort, easy-going and quick to flash a smile or share a joke with a customer. Unfortunately, Greg had not inherited his parents' work ethic or conservatism.

Clyde and Irma struck an agreement with Greg whereby he would pay them off over a ten-year period, offering Greg a comfortable payment program while

providing them a retirement income and the satisfaction of knowing their business would remain “in the family.”

Once vested with control of the company, Greg initiated an aggressive expansion program to add another major product line. The investment in new inventory was significant and required his parents’ be co-guarantors on a \$300,000 line of credit. The large investment in inventory also required more staff, an additional investment in parts, and the expansion and remodeling of the existing facility.

Because it was a new product line, Greg hired and relied upon a new department manager who was a college chum with self-proclaimed experience and ability.

Together they would forge a glorious future. Unfortunately, the new product line fizzled rather than sizzled, the high debt service siphoned all the profits from the established lines and Clyde and Irma stopped receiving their monthly checks.

I’d like to say that everything worked out, but it didn’t. Clyde stepped back into the business too late to turn it around. Clyde and Irma were forced to liquidate the remaining inventory, fixtures and equipment, and spent a sizable portion of their retirement savings on legal fees in a futile attempt to avoid bankruptcy.

Meanwhile, Greg secured a middle management position in another state.

What went wrong with Clyde and Irma's retirement plan and why didn't the succession work? One of the prime motivating factors behind an entrepreneur's drive to succeed is the desire to turn over a dynamic enterprise to the next generation. Nearly one-third of the business owners I consult with contemplate turning their businesses over to one or more of their kids at retirement. It seems to be a natural progression...almost a ritual.

But I also frequently meet the Clydes and Irmas of Albuquerque - often when it's too late to attract either a buyer or investor. They are usually devastated by the collapse of their business and the loss of vital retirement income. They feel angry, confused and betrayed, and their plight compels me to describe what I believe are the root causes of these failures.

1. **Little or no vested interest.** Greg had no stake in his acquisition so he had nothing to lose other than his credit rating. If he had invested at least ten percent of the value of the business, he would likely have been more cautious and frugal in his expansion plans. Parents can help their kids acquire a down payment by withholding a portion of their pay in the years preceding the sale.

2. **Too fast of a transition.** In their haste to retire, Clyde and Irma gave up

control of their business far too quickly. The ownership transition should have taken at least a year or two so they could have observed Greg in his new role as chief decision maker and assessed his ability to manage the company.

3. **Too much change too soon.** My best advice for those purchasing a going and profitable business is to operate the business for at least six months before making any changes, especially dramatic and costly ones.

4. **Good money after bad.** Clyde and Irma should never have co-signed Greg's line of credit. They increased their risk without any offsetting reward or control over how the money would be spent. Making Greg finance his own expansion might have forced him to be more conservative and test the market with a smaller inventory purchase.

It has been my experience that more than half of the businesses turned over to children end up in failure. Maybe by taking the steps outlined above, this rate can be improved. In any event, knowing the pitfalls may help owners avoid a pratfall.