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Too many mouths to feed in 2nd generation family businesses

The challenges in multi-generational family businesses are well-known. The statistics bear out the number of failures when transferred from Generation #1 to Generation #2. So, how can we break this cycle? This article talks about best practices and provides some key areas for business owners to consider when looking ahead to plan their exit.

I love small business owners. They epitomize the American dream and the cowboy spirit. They “went west” with nothing more than what their horses and wagons could carry. They started small businesses with less than \$5,000, and they have built them into \$1.5 to \$4 million dollar annual revenue businesses. However, there is a crucial prob-

lem that happens when these business founders turn over their businesses to the next generation.

The problem is, that which provided a perfectly comfortable (or even extraordinary) lifestyle for a single fam-

ily cannot do the same for four grown children with families. Let’s look at the math. For purposes of our example, we’ll use a \$3 million dollar business with 30 employees. We’ll assume that Dad takes a \$75,000 salary and then

takes home a 10% distribution (see “Generation #1”).

Even if we back off the annual salaries to \$50,000 instead of \$75,000, you quickly see how fast the money goes. You can first argue that \$93,750/year is

land and building? Since that is not readily accessible, that could mean that if Son #1 takes over the business, he immediately has to either:

Sell the land and building(s) and move the business to a new location so that he can pay off his siblings, or

Take out a loan to buy out the siblings of their part of the estate, and then he pays himself back through

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a great income, and you would be correct. However, when you compare it to what “Dad” was bringing home before, their lifestyles are nowhere near as nice as “Dad’s” was (see “Generation #2”).

The spiral continues downward from here. Let’s take it out one more generation, and assume that just three of the

Generation #1	
\$3,000,000	Gross revenue
\$75,000	Salary
\$300,000	Distribution
\$375,000	Total annual compensation

Generation #2	
\$3,000,000	Gross revenue
\$50,000	Child #1 salary
\$50,000	Child #2 salary
\$50,000	Child #3 salary
\$50,000	Child #4 salary
\$200,000	Total salaries
\$43,750	Distribution per child
\$93,750	Total annual comp per child

kids have three kids of their own ((see “Generation #3”).

Now each annual income is below the average median income in the US. The kids could likely do better financially to go work elsewhere than to join the family business. What do we do about this?

There are really only three options.

First, Dad can decide to structure the business in a way to pass on his legacy. This can create all manner of infighting among the kids. Which child will run the business and receive the monthly cash flow? Will all the kids share in the equity that resides in the

Generation #3	
\$3,000,000	
\$40,000	Child #1 - Child#1
\$40,000	Child #1 - Child#2
\$40,000	Child #1 - Child#3
\$40,000	Child #2 - Child#1
\$40,000	Child #2 - Child#2
\$40,000	Child #2 - Child#3
\$40,000	Child #3 - Child#1
\$40,000	Child #3 - Child#2
\$40,000	Child #3 - Child#3
\$360,000	Total salaries
\$1,667	Distribution per child
\$41,667	Total annual comp per child

cash flow of the business.

Second option, Dad can simply ignore the problem, fail to provide a comprehensive will and let the kids sort out the mess after him and mom pass on. This is incredibly irresponsible of Dad, and yet we see this type of thing happen every day. Worse yet, Dad dies before Mom, and Mom simply inherits everything (such as in Texas where estates are community property). Now Mom, who was never really involved in the business decisions, but is reliant on the cash flow, has to be the arbiter between her children on who should get what. If Mom fails to put all the proper legal documents in place, then the kids have to go through Probate to work it all out. In Texas, if everything is in order, you can be through with this entire process in less than six months, and the cost can be \$3,000 or less. However, if the documents are not up-to-date and in order, then you can spend a year or more. If a will is contested, it can stretch out the litigation to several years. A famous

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Too many mouths in 2nd gen businesses

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case was Anna Nicole Smith's contest of Howard Marshall's \$1.6 billion will. He died in 1995 and supposedly left everything to his stepson. Anna Nicole Smith and her son were both left out of the will, and they battled it until her death. As of a couple years ago, the US Circuit Court had still not made a final ruling on the case, some 18 years later...

And the third option, Dad can set the business on a path for growth, that way it can grow both top line revenue and bottom line net profit, thereby providing an excellent living for all the kids and grandkids. Unfortunately, this is easier said than done.

See, Dad built the business around something that he was very good at. Some technical skill, be it a mechanic, plumber, A/C technician, or other. However, he is not good at "managing and leading people." Most small business owners would be fired if they took a corporate job. They don't have the requisite ability to shut their mouth and take orders, they don't have the ability to play politics, and they are likely not that good at being part of a team. Hence the reason they went into business for themselves. The question becomes, how does a Chief Technical Officer change his attitude and behavior in order to recruit, motivate, inspire, and lead a group of people to

do (hopefully) a better job at his technical skill than he ever did?

The first challenge is mental because Dad's ego says that he is the

sets. Get a Master Plumber, an Excellent Executive Coach, a Financial Whiz, an IT expert, and a Rockstar Sales individual, and you are well on

people in the right seats on the bus. If Dad can do that correctly, then everything else will take care of itself. **G**

The other option for Dad is to build a Senior Management Team of folks that compliment each other's skill sets.

"best (insert technical skill here)" that he knows. That may be true. However, it doesn't always have to be true. Dad could choose to hire young talent, someone humble, hungry, and highly motivated, and teach them how to become a great plumber, for example. In addition to teaching him that crucial technical skill, he could ensure that he grows into a successful business executive, by having him take business courses at the local community college, a management training program, and other outside learning opportunities. Perhaps most importantly, have him read a number of leadership and business books and then be prepared to discuss them. Dad's first and foremost goal has to be, that his young mentee becomes more successful than he ever was.

The other option for Dad is to build a Senior Management Team of folks that complement each other's skill

your way to creating a winning team. If you can get each of those individuals to see the vision of building this company to a \$5 million, \$10 million, \$20 million company, then you can unleash their creative talents, and they can drive the bus. Recall Jim Collins' Good to Great, "first who, then what." You have got to get the right

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Apps assist biz functions, detailed 'menu' pricing, and refrigerant calculations

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dressing issues of concern about which the technician, but not necessarily the customer, is aware.

The HVAC, plumbing and electrical versions cover a full range of service repair tasks up to equipment replacements. The pricing system is customized and consolidated to match each contractor's needs and prices are easily changed and updated.

The ability of the customer to select from among the various options enables decision-making based on budget as well as immediate and future needs.

Once a customer chooses one or more options, invoice and payment processing can be handled within the application or using the contractor's existing invoicing program. Daily invoices and sales are easily tracked by technician.

HVAC Buddy (<https://hvac-buddy.com>) is a refrigerant charging and diagnostic HVAC app designed to help for technicians servicing equipment begin diagnosis and determine proper re-

frigerant. The user, armed with a set of gauges and a thermometer, enters the refrigerant, temperature, and pressure and the app does the math to display superheat, subcooling, and airflow target, actual and difference. A line graph shows readings and updates on value changes or in time increments from seconds to minutes. An out-of-tolerance indicator uses distinguishing colors for high and low conditions,

The readings can be emailed from the app in a personalized report, utilizing user-created defaults for email addresses, subject and system status report introductory text.

The app can calculate for over 100 refrigerants including R-22, R-134, R-404A, R-410A, and newer zeotropic refrigerants. A standard pressure temperature chart is included. **G**

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Success or Failure

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ing to be faced with the reality that a portion of the required business profits will need to be tied to the hourly labor rate.

Overhead is anything that costs the business money you cannot sell. Either you or your accountant must perform a break-even cost analysis to accurately know how much you need to charge per hour to customers over and above the hourly labor rate you will be paying the employees whose time is billable.

Have an exit strategy? Want to retire comfortably without money problems? Best factor that into your hourly billing

rate too. If you think your overhead is lower because you work out of your home and/or your own garage, think again. Yes, you can fly by the seat of your pants, but after three years, you're liable to end up with your rear-end exposed and deeply in debt. As Taco says: Do it Once; Do it Right! **G**

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