IMPACT OF A LIFE-CHANGING EVENT ON THE FAMILY BUSINESS

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ABSTRACT

The tenuous nature of the ownership structure of most small and family businesses causes only one in three family businesses succeeds in making it from the first to the second generation. In addition to issues and problems they encounter when they try to undertake expected and natural transitions (e.g. retirement, etc.), these businesses are particularly vulnerable to the impact of unexpected, life-altering events that affect the business owner and often the business itself. We used real life cases and events published in numerous business publications and from our personal experiences to categorize and summarize these incidents to develop a preliminary perspective of the various impacts such changes can have on these businesses.

INTRODUCTION

According to the Small Business Administration's Office of Advocacy, 580,900 new businesses were launched in 2004, the most recent date available for data, while 576,200 closed. Family businesses have their own inherent risks, beyond the financial and legal pressures which all businesses face, because of their ownership structure and their failure to transition leadership and/or ownership of the business to new generations. Even though effective succession planning can prepare these organizations for change and transition, unfortunately majority of these businesses do not necessarily avail themselves to such planning. As a result, they encounter problems when they try to undertake expected and natural transitions (e.g. retirement, etc.) and become particularly vulnerable to the impact of unexpected, life-altering events that affect the business owner and often the business itself, severely undermining the successful transition of leadership and/or ownership and the long-term survival of the business. Unfortunately, evidence suggests that the succession process in family businesses is fraught with troubles and very few of these businesses survive beyond the first generation and, even if they do, the incidence of survival diminishes with each attempted transfer. [2] [3]

In addition to a natural and, hopefully, a planned transition or succession of leadership, a family business may also have to go through and experience transition (succession of leadership) due to some “unexpected life altering event”. The impact of such an event (e.g. death, sudden major illness, and divorce) which forces an unplanned transition upon the business enterprise, will have a much greater impact, and in most cases, a negative impact. The sensitivity of the topic (death, sudden major illness, and divorce) and lack of reliable data (especially financial) makes it almost impossible to conduct primary research on this specific sub-segment of small businesses. Our extensive searches have resulted with only one study that addresses one of our selected “life altering events”. It was published in 2003 and utilized a proprietary database from a large National business valuation and appraisal firm. It included fifty-two family businesses which experienced a “life altering event” (divorce) between 1990 and 1999. The study compared the financial characteristics of these multiple industry family businesses before and the year after the “divorce”. They found that the event had a major negative impact on the business’ finances (revenues down 58%, gross profit down 56%, profitability down 65%, working capital down 65%, and total equity down 68%). [1]

RESEARCH AND DISCUSSION OF FINDINGS

Because of the lack of availability of research studies in this area, we decided to review real life cases and events published in numerous business publications and use our personal experiences. We were able to identify thirty family businesses and looked at the impact of an unexpected "*life altering event*" on these businesses. Even though we did not have any concrete measures we could use in our analysis (e.g. before and after financials), we were able to evaluate the impact of the "*event*" by looking at the characteristics of these businesses during the transition (the turbulence and changes) and the final outcome (new steady-state after the event). We found that, in all but one of these businesses, these events had a very negative impact on the family business, even bankrupting some of them. Following summarizes our findings.

The "*death*" event has different implications for the business based on its ownership structure and on whom the event happens to. In businesses which we have classified as "single family", the family business is so much dependent on the characteristics the owner brings to the business that the untimely and unexpected demise of the owner had a devastating impact and in most of the cases the business ceased to exist. Even if there were co-owners, the loss of one created a similar impact and, even though the business may continue to exist, its value and vitality was significantly and negatively impacted. In businesses we have classified as "multiple family" (where there are more than one family member involved partially or fully in the family business), the death of the owner presented yet another set of transitional problems. In these cases, the final status of the family business seemed to depend upon two major factors: the transferability of the type of expertise brought to the business by the "owner/manager" and the remaining participant business owners' willingness or interest to continue with the business. Our findings show that their absences make the positive outcome (continuation of the family business) very unlikely. Findings of an earlier study show that 20 percent of the younger generation respondents expressing no interest in joining the family business. [4]

The second life-altering event we identified was "*divorce*". With the "*divorce*" event, there is some-what longer time frame with significant discord and contentiousness among the family members who have a financial stake in the business and demands on the value of its assets. In "multiple family" businesses, a husband and wife team who own and operate the family business, divorce invariably breaks up the business and can create competitors vying for the same client base and existing employees. Even though there is a significant financial impact of divorce, impacting size of operations and related diseconomies (e.g. reduced asset availability due to distribution, etc.), most of the damage is done to the business during the time while divorce process is in place. The findings of the Galbraith's study [1], the only prior research which identifies and reports the "impact of divorce as it relates to post-divorce profitability of the business", show that there are significant reductions in revenues (down 58%), gross profit (down 56%), profitability (down 65%), working capital (down 65%), and total equity (down 68%). Our findings show that, in addition to possible significant financial consequences (e.g. smaller operations, changing revenue streams, legal expenses, etc.); there are also some competitive issues that arise when a "multiple family" experiences a "*divorce*" of its partners. Because neither of the two partners generally wants to relocate to a completely new geographical area and acquire a brand new customer base, each pursues a predatory business practice to undermine the success and the viability of the other ex-partner (now a competitor). As the "war of roses" moves from the bedroom to the marketplace, it eventually ends up hurting both businesses. Finally, the complimentary benefits of the previously married partners will be lost, putting each of the new businesses at a competitive disadvantage against other competitors in the same market space.

The third life-altering event, a serious "*illness*" of the owner or illness of family member of the owner, brings with it yet even more challenges, some of which are similar to the previously identified impacts and others which are unique. When an unexpected accident happens to the owner of a family business or a serious illness strikes the owner or someone in the owner's family, two major outcomes can be a significant loss of assets (funds expanded to overcome the tragedy) and the impact on business caused by the damage to owner's psyche. Whether it is the owner who gets disabled (due to an accident or serious illness) or someone in his/her family, the family will try to expand all the resources they can gather (including personal and business assets) to bring hospitalization, treatments, and overall relief to the disabled/injured/ill person. This impact is very clear and is a very highly probable outcome. However, what is not so clear and easily anticipated is the impact of such an event on the owners' psyche and its implications for the family business. This event's physical human consequences (e.g. long hospital stays, debilitating medications and treatments, etc.) can be long lasting and consume complete thoughts and activities of all the family members, significantly impacting the time and effort put forth for the operational activities of the business. Either of these outcomes (financial or psychological) can threaten the survival of the business on the long run, if not immediately. Our study shows that, even under the best conditions and efforts of the business owner (e.g. one owner tried to continue to manage the business after becoming blind), the success of these efforts are tenuous at best and just end up delaying the final demise of the business.

SUMMARY AND CONCLUSIONS

Our research shows that small family businesses face extraordinary risks and are not necessarily prepared for life-changing events. Of course, these events (sudden death in the family, divorce, and major illness or a disabling accident) are major enough that they will have a significant impact on our lives, whether we are part of a family business or not. However, when these events happen to owners of family businesses, their impacts are amplified and endanger the viability of these businesses, with implications for our economic system. Therefore, as academicians and researchers, we should make every effort to study and understand the broad implications of these events and the characteristics of these businesses to find ways and educate the owners so that they can be somewhat prepared to tackle these challenges. Unfortunately, because of the ownership characteristics, daily business demands, and the unpleasantness of the subject matter make it a great challenge for us to accomplish these objectives.

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