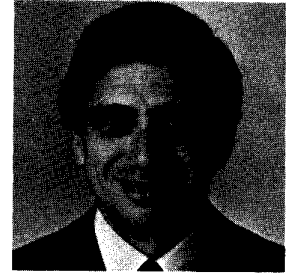


By Daniel M. Morris



Why Family Businesses Fail

Warning Signs A Credit Manager Should Watch For

The Bechtel Corporation. The William Wrigley Jr. Company. S.C. Johnson. These successful family-run companies started as small operations and grew to become major players in U.S. business. They also overcame the problems unique to family-owned and run businesses, as well as the usual obstacles that any developing concern would face.

Unfortunately, the successful family-owned company is not always the rule. Typical family businesses are more susceptible to financial crises than comparable firms guided by professional managers. For example, nearly half the clients referred to my company, which is a turnaround consulting firm, are family businesses.

Why? In eight out of 10 cases, family-owned companies court financial problems by failing to plan realistically for the succession of management, and suffer from cloudy financial vision caused by the emotion of working with family members and relatives. Characteristically, there also is a tendency to ignore financial warning signs, and a reluctance to acknowledge when the company might be in trouble and need help.

Finally, there is the inability to deal with a crisis as it develops. Here, the business credit manager is in a unique position to help spot the first warning signs of financial problems and to alert management regarding trouble.

Ownership Vs. Management

The root cause of failure in many family businesses is that ownership and management are not dealt with separately as they are in public concerns. Inherited wealth does not automatically qualify heirs to manage a company. Most often, family members have different skills and talents than the owner and lack the same vision he or she had when the business was founded. The owner and chief executive might resist training or expect far too much from a son or daughter as a successor on the one hand, and refuse to hire a competent manager from outside the family on the other.

In another scenario, the heir-apparent to the business might be kept under wraps until the owner retires, without ample training or day-to-day transfer of responsibility. When the transfer finally takes place, the new chief executive might immediately implement drastic measures such as adding or dropping product lines or moving a plant. Whether or not such actions are appropriate in theory, the company is likely to flounder because it is unprepared to operate efficiently in a rapidly changing environment.

Growing Pains

A financial crisis frequently occurs when the family-owned business grows and no longer is a "big small business," but

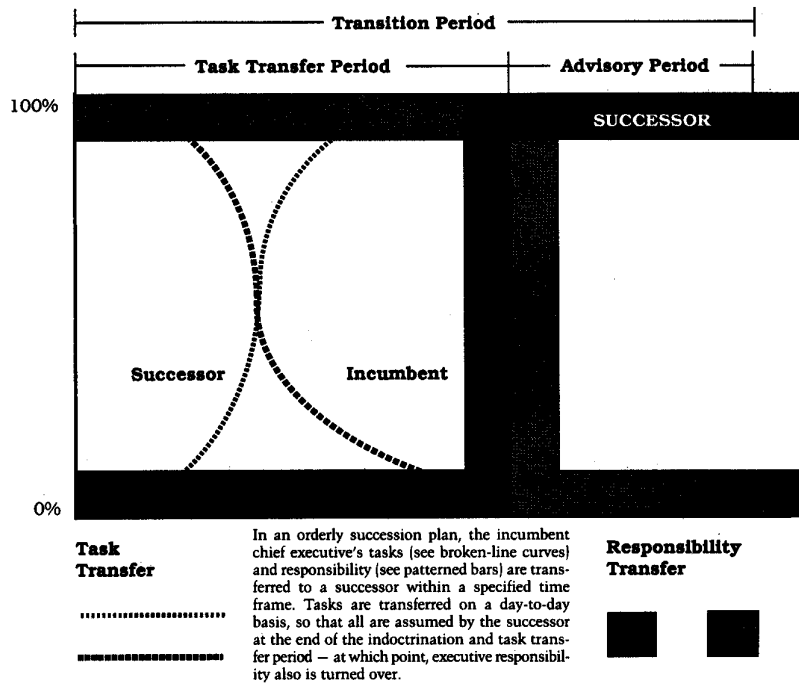
rather a "small big business." In other words, a transition must be made from entrepreneurial to professional management.

That difference could be subtle in terms of total sales, but quite significant when it comes to company structure, accountability by function, planning, financing, operations and marketing strategy. The entrepreneur can no longer manage three or four key functions single-handedly, handle finances out of his or her back pocket, and close every deal with a handshake. He needs to rely on others, and those key people must operate effectively as a team for the overall good of the organization.

For all of the above reasons, an orderly succession plan, in which leadership is delegated and gradually transferred over a prescribed time span, is basic to the ongoing success of a family-owned business. The first step in the plan is to perform a thorough qualifications review to identify the requisite functions within the business, and the availability of managerial talent to fulfill them.

Sometimes it is necessary to admit that: the son or daughter does not have the potential to run the company; the son-in-law must first prove himself as a field salesman, or income or company cars must be taken away from children who are not playing any role in the business. It might even be that a professional manager should eventually be

SUCCESSION FLOW CHART



SOURCE: Morris Anderson & Associates

A Bright Future For Small Business

SMALL BUSINESSES should enjoy 1989, thanks to the economy and President George Bush, according to the results of a survey of entrepreneurs conducted by Arthur Young, the accounting and consulting firm. Almost all (95%) of the 120 business owners who were surveyed predict a favorable economic climate in 1989 for small company growth. A total of 83 percent believe that small business is a moderate or high priority for President Bush. Eight out of 10 (80%) foresee an increase in profits, and more than half (54%) believe that increase will be 10 percent or more.

"These results are more optimistic than we expected," says Dan Garner, national director of the Entrepreneurial Services Group of Arthur Young, which conducted the survey at the second annual conference of the Institute of American Entrepreneurs in Scottsdale, AZ, in November 1988. "This may be an exciting indicator of small business growth."

Company expansion will indeed be popular, with 89 percent of the respondents expecting to create new jobs in the next year. One-third maintain they will hire more than 20 new employees. More than half (52%) of the entrepreneurs reported that their company is international now, or will be within two years — a reflection of the increasing importance of selling products overseas. "This number is much higher than it would have been five years ago, and is probably lower than it will be in another five years," Garner comments.

The entrepreneurs did have concerns. A total of 52 percent chose "reduce the federal deficit" as the one charge they would give Congress and the President. When asked about their biggest concern as entrepreneurs, 34 percent reported it is retaining and motivating good employees, followed by financing their business (27%) and maintaining their profitability (25%). — Sara M. Silberman

brought in to replace the founder.

Warning Signs

Most troubled family-owned companies are referred to turnaround consultants by lenders and attorneys. Loan officers recommend a consultant when they suspect their loans are in jeopardy, whereas legal counsel usually can observe that a company is experiencing difficulty from its legal activity and financial statements.

Failures of many family businesses can be averted or turned around if management heeds the warning signals of potential problems. Otherwise, a temporary cash squeeze can escalate into a full-blown cash crisis. The credit manager of a family-owned business, whether a family member or not, is in a unique position to recognize the warning signals of a financial crisis as it develops.

Two of the most common red flags are a decline in operating margins and a loss of working capital. In some instances, the company's volume might remain constant or even increase. Among other warning signs are:

- * over-optimistic sales forecasts that are viewed as a cure-all to solve current business problems.
- * inadequate internal accounting controls, such as the absence of an inventory or cost accounting system.
- * increased need for working capital during non-peak periods, indicating that the company might be exhausting the equity in its assets.
- * inability to generate financial and other operating statements accurately or on time.
- * unbalanced inventory problems, or unmanageable trade debt.
- * failure to keep pace with the times, including changes in customer preferences, new technologies, government regulations or fluctuating prices of raw materials.

Most severe financial problems occur in family businesses within a year after the initial cash flow squeeze develops. Therefore, warning signs of a financial downturn demand decisive action based on an objective appraisal of the situation. Calling in a turnaround consultant usually is the fastest way for a family business to pinpoint problems and help arrive at the most advantageous solutions. And the best time to seek help is when the first telltale symptoms appear.

Daniel M. Morris is the founder and partner, Morris-Anderson & Associates, Glenview, IL. The company specializes in turnarounds, corporate reorganization, crisis management and financing transactions.