



Best Practices

California wine businesses and succession

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Report Outline

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California wine family businesses and succession: *What is working and what isn't.*

70% of family businesses do not make it to the second generation.¹ Only 10% of these pass into the hands of third generation family owners. If we translate these statistics into the California wine industry, this could mean that only 150 out of 500 first generation California wineries will transfer their legacies to the second generation; and of these, only fifteen will make it to the third generation.² We set out to find out how wine families are managing succession in their businesses.

During the first quarter of 2005, we surveyed 450 California wine family businesses leaders and this is what we found:

What is working!

Successful families manage their businesses against written long term strategic and financial plans, and usually have well-defined exit plans. These owners tend to make better use of a combination of advisors and advisory boards – frequently comprised of outsiders, and express above average satisfaction with the results around their businesses. These families also feel better prepared for family business succession.

What is not!

Many first generation business owners do not feel successful enough with their progress: most are within ten years of retirement, do not have exit strategies, do not manage their businesses against long term plans and frequently are not open to outside advice to help them with complex decision making concerning their families and their businesses. These owners tend to be less happy with their businesses' performance and, simultaneously, appear unprepared for successful generational transitions.

¹ 2002 United States Survey conducted by the Family Farm Institute

² Although there is no empirical evidence to support this, of the approximate 1,100 wineries registered in California, we are estimating that 300-500 hundred are now going through the first phase of succession.



Profiles of More Successful Transitions

The following three profiles define what practices are adopted by three generations of business owners who are successful in ensuring sustainable businesses and succession. We observe ample similarity in how these three generations run their family businesses.

Respondents By Generation	Succession Practices				
	Exit strategy	Management and business results ³	Professional Advisors	Board of advisors	<u>Written plans</u>
<p><u>First generation families</u></p> <p>Most are run by family leaders</p>	100% - Committed to next the generation	Very satisfied	All reach out to a variety of advisors to help them with succession	Most have outside boards; they are very happy with the impact these boards have on their businesses	A majority have long term strategic and financial plans
<p><u>Second generation families</u></p> <p>All are run by family leaders</p>	100% - Committed to next the generation	Very satisfied	All reach out to a variety of advisors to help them with succession; and have a <u>higher degree of satisfaction with these advisors typically than first generation</u>	90% have outside boards; they are extremely happy with the impact these boards have on their businesses	All have long term strategic and financial plans
<p><u>Third generation families</u></p> <p>Most are run by family leaders who are establishing policies supporting family continuity</p>	<p>90% - Committed to next the generation</p> <p>10% - Plan to sell to an outsider</p>	Very satisfied	All use a variety of advisors to help them with succession	10% have outside boards that are having positive impact on their businesses	All have long term strategic and financial plans

³ Note that respondents mostly comprise business leaders who are running the business



Profiles of Less Successful Transitions

The following two profiles describe the practices of business owners who typically feel less successful with the results they are achieving around their family businesses. These are conceivably ineffective models and we have observed similarities in how these family leaders run their businesses.

First generation families: who feel they are not prepared for succession and/or feel it is too soon to claim success.

- Most are run by family business leaders
 - o Two are professionally managed and one has an exit strategy in process
- Most are average-to-satisfied with management results around the business
- 20% have advisory boards (either family or outside) and are *generally* happier with management results than those that don't
- 50% don't have exit plans defined
- 80% don't have long term written strategic and financial plans
 - o 20% that have plans are *generally* are happier with the management results
- Most have professional advisors who are generating effective results for them

Second generation families: who feel they are not prepared for succession and/or feel it is too soon to claim success.

- Don't have long term written strategic and financial plans
- Don't have advisors or an advisory board
- Are unhappy with current management and the results around the business



Best Practices in Wine Family Succession

As professional advisors we work exclusively with family wine businesses and observe sharp contrasts between the practices of wineries who are quite successful in managing succession and those who are not. These practices appear to greatly decrease the risk and improve the sustainability and value of family businesses, even during transition. Our research results certainly substantiate our observations. We have been able to incorporate both our observations and our research findings to provide you with our perspective concerning the following issues:

- *How to maintain family continuity*
- *How to achieve succession in your family business*
- *How to develop a business that sustains future generations.*

The following six points are best practices distilled from families who claim success – either at making the transition or in being well prepared for succession.

1. **Define unambiguous family policies for family members participating in the business:** Family continuity planning is a practice adopted by many successful family businesses and culminates in specific guidelines addressing family participation in the business. The process incorporates ongoing family dialogue around issues critical to a family's future and helps family members communicate, refine and understand their legacy and vision of the future. This process benefits families that need to formalize how business owners and business participants will work together around the business; to reduce conflict on issues that become personalized and polarizing; to define how the family governs prized assets; and to smooth the progress of transitioning the older generation out and the newer generation in to the business. *Example:* One large vineyard owning family was concerned with keeping all their assets within the family. They developed a family policy that all spouses of future generations would sign prenuptial agreements, protecting these assets in the event of divorce. They side-stepped a potential crisis, when the family's advisors also recommended they adopt this policy while their children were young. Otherwise, this new policy would quickly become polarizing if instituted suddenly when the family's first young couple would be facing marriage.
2. **Get clear on your family ownership goals and values:** Business owners who understand and agree on the most important family goals usually are more successful at aligning their business to support family needs. The process of reviewing these objectives is particularly important for families in transition, principally when the new generation decides to participate in the family business. *Example:* The new generation business leader of a North Coast winery felt highly demotivated and burnt out after only several years into assuming leadership of his family business. When queried by a family advisor, he learned that he was operating without a clear set of family goals and, with a high degree of probability, was running a business that did not support his future needs or interests. After many months of working with his spouse, they succeeded in clearly articulating and quantifying family goals and responsibilities to the business.



These were then developed into a family continuity plan and a Family Council was set up with the mission to hold the business accountable to many of these goals.

3. **Set in place your long term business strategy and financial plan:** The plan you develop should be geared toward achieving your stated family and business goals. At a minimum, your plan must identify strategic goals against a timeline and address the key ingredients that are necessary to achieve these. This process ensures that family resources (assets, finances and people) are focused efficiently and effectively on achieving success. *Example:* The wisdom behind goal-setting is simple: “If you aim for the tree, there is a good chance you will hit the tree. But, did you really want to aim for the tree?” A well-defined set of goals also gives a business plan integrity and focus, and is the basis for evaluating performance and making decisions about the future. The family leader in the last example (business practice #2) developed a reality-based strategic and financial plan to support his family goals, and within 24 months became re-invigorated, felt he was running a company that was exciting, and had the potential to successfully support his family’s future dreams.
4. **Execute with excellent people, processes and systems:** Before you are ready to implement your plan, you will need to (re)consider your enterprise’s ability to support its execution and to identify important organization gaps. Companies that over-estimate leadership, organization and process/system readiness are frequently off dramatically from plan by years and by millions of dollars in revenues and expenses. *Example:* A 15 year, Oregon-based producer became consistently unprofitable over the last five years. Finally, their major investor sought the advice of a wine industry advisor. The advisor conducted a comprehensive situation assessment and the shareholders were encouraged to replace the original founder and most of his team with new management and a skill set better suited to their phase of growth and need to achieve sustained profitability. Leadership readiness, a large component of organization effectiveness, has been dramatically under-valued by many wine industry business owners. Many a winery struggles with the issues concerning hiring new, more professional staff, versus showing loyalty to employees through investing in their development needs. The cold reality is that some of these employees (and sometimes the founder) may take years to develop, or never actually acquires the important new skill set. The winery CEO ends up missing a critical window of opportunity and spending much more in soft and hard development dollars than if she had hired higher priced, qualified leadership.
5. **Hire the best and listen to objective, trusted advisors:** The most successful families have collaborative, long term, trusting and beneficial relationships with specialized advisors who sit in the wings until they are needed. These families make use of a variety of different types of advisors: boards of directors, professional advisors, and business advisors such as attorneys, CPAs, estate planners, and financial planners. Because of the knowledge these advisors gain through long term relationships with a family, they grow in value to these families as they transition their businesses. These advisors provide a unique perspective for objective decision making and some become an extension of winery executive teams. *Example:* A vineyard and winery owning family in a lesser-known wine appellation was struggling with making ends meet during the recent grape glut.



Most of their returns traditionally came from the family's 500 acres of farmed grapes, sold to large wineries throughout the state. The winery had never been run with a real plan, but had somehow generated, over three generations of family ownership, more than 15,000 direct to winery loyal customers.

Their advisors became quite concerned about the survival of this family's business, with the crisis accentuated by the prospective need of the business to support 12 grandchildren through college and, eventually, as participants in the business. 36 months later, with the help of advisors, the family refinanced and sold non strategic assets - streamlining their grape business and returning to profitability. They currently are implementing professional management practices around the existing winery, unleashing more value around the brand. The most critical counsel from their advisors was to wait for the right moment to launch a new brand the family had been planning for years. The family patiently waited for the foundation of their business to stabilize before launching a second winery brand – the hope for the future - an expansion capable of sustaining the family through several more generations.

6. **Establish effective governance practices around your family and business:** The most successful wine families uphold long term relationships with trusted advisors AND maintain professional governance practices. Family wineries are increasingly embracing advisory boards or even more formalized boards of directors, progressively hiring outside directors to participate on these boards. *Example:* A mid-sized North Coast producer with major real estate holdings was preparing for the family's third generation succession. Their profits had been lagging on both sides of their business, grape farming and wine sales, and they realized they had a gap in family leadership. The second generation was ready to exit and the third generation was still developing professional skills outside the family business. The Board of Directors voted in several, new outside members and then recommended hiring a professional CEO to transform the business by executing a five-year growth plan. The Board was instrumental in helping the family and the CEO achieve their stated goals, and then facilitated the successful 'transitioning in' of the third generation. The Board had a key role in five important aspects of this family's business:
 - a. Represented, protected and reported to shareholders
 - b. Encouraged accountability in management and monitored implementation
 - c. Acted as a sounding board to assist the business owners through the transformation and helped the professional CEO to be fully effective, by providing confidential and empathetic counsel
 - d. Provided an objective, broader perspective on compensation, performance, strategy, creative thinking and critical decision-making
 - e. Acted as an arbitrator and provided essential advice during several crises to ensuring survival during the final 'transitioning-in' period of the eventual, next generation family business leader



What our Survey Analysis tells us about Wine Family Succession

During the first quarter of 2005, Scion Advisors conducted a study of 450 California family wine businesses, generating an 8% response rate to a mailed survey. 60% of these respondents indicated a strong sense of preparedness for succession or satisfaction with their phase of succession. The results of this survey point to clear differences between wineries that are satisfied and those that are not satisfied with their transitions.

- **A majority is first generation families:** 64% of our respondents are first generation families transitioning to 2nd, 21% are 2nd generation transitioning to 3rd, and 10% of these respondents are third generation wine business owners.
- **A majority have been running the business for more than 10 years:** 65% have been running the business for more than 10 years; 17% under 5 years
- **Most families are planning on transferring their business to the next generation:** 66% expect to transfer their legacy to the next generation; a resounding 31% of business owners have not yet started planning their exit; and 3% expect to sell their businesses
- **30% consider that they have been successful with succession:** 30% believe it is too soon to know and 10% do not feel succession is happening successfully
 - o 42% of respondents are 1st generation families who feel prepared for succession
 - o 18% of respondents are 2nd generation families who feel well prepared for succession
 - o 10% of respondents are 3rd generation families are satisfied with succession
- **50% feel they are/were prepared for achieving succession:** 45% feel they are/were not well prepared; and 5% are not at all prepared
 - o 23% of respondents are 1st generation families who feel they are not prepared for succession or feel it is too soon to claim success
 - o 5% of respondents are 2nd generation families who feel they are not prepared for succession or feel it is too soon to claim success
- **A majority hire professional advisors to help with family issues and succession:** 66% hire advisors; and 34% do not
 - o 42% hire attorneys
 - o 33% hire accountants
 - o 40% hire other advisors (trusted family advisors, outside board members)
 - o Less than 5% hire psychologists
 - o These numbers add up to more than 100% due since many families hire multiple advisors
- **A small majority have advisory boards:** 44% operate without advisory boards; 30% have out side board of advisors; 26% have all family-comprised boards
- **Many are less satisfied with the succession results achieved with the help from their attorneys and accountants:** 27% are quite satisfied; 73% are less satisfied
 - o Second generation families who feel prepared for succession have a higher degree of satisfaction with their advisors than first generation who feel prepared for succession
- **Families with boards are mostly very satisfied with them:** 66% express above average satisfaction; and 34% are not happy with the results from their advisory boards
- **A small majority have formally written long term strategic and financial plans:** 55% have plans; 45% do not



- **Most wineries are run by family business leaders:** 93% are run day to day by family leaders; 7% have hired professional general management
- **A majority are happy with the results achieved by their business leaders:** 80% are satisfied with the results; and 20% are not as satisfied⁴
- **A majority have 1-3 family participants in the business:** 80% have 1-3 family business participants; 20% have 4-7 family participants
- **Profitable growth in sales and distribution is the top issue in 2005**
 - o 70% - sales and marketing; more leverage with distribution and market attention; export market competition; profitable sales with chains and other large retailers
 - o 30% Other – compliance, family policy for next generation, good grape supply, launching new businesses, pursuing opportunity, keeping fresh, funding growth

Who is Scion Advisors

Trusted advisors to family wine business owners, we work side by side with our clients to build stronger businesses for future generations.

Applying our extensive management expertise to the wine industry, we improve business fundamentals.

- o More professional teams
- o Disciplined financial and business practices
- o Innovative go-to market strategies.

We have designed a distinctive approach.

- o Driving higher quality decision making
- o Delivering faster results
- o Developing capability rather than dependency

Our clients achieve more enduring profitability, growth in brand equity, more effective ownership transitions.

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⁴ Note that respondents mostly comprise business owners who are running the business

