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Why family businesses should have a transition plan in place

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As the baby boomer generation continues to flood into retirement in large numbers, many business owners are looking at who will be the next in line to keep the family legacy alive.

To prepare to retire from the family business, the first item to consider is the value of the business. As advisors, we know this is a delicate subject. However, it is also essential to a successful transition of any business.

It's important to incorporate an outside perspective when assessing value. Given the personal time and energy most business owners invest in their companies, it is not uncommon to overestimate the value. It is vital to have a third-party voice in the conversation to help develop a fair, unbiased price tag.

Once the value of a business is determined, a full transition plan must be developed. A business transition plan is the written and agreed upon expectation and understanding of the value of the business. Once an owner has begun development of a plan, they can bring in others to determine if it is fully aligned with reality or if there are further considerations that need to be looked at.

In addition to business value, the transition plan should include who will own and manage the company moving forward. Alongside each of those items, it's essential to consider the rollout of the new leadership. A business transition plan should be created, at minimum, three years before a transition takes place. In a perfect world, a transition plan is created five to seven years before transition.

The majority of family-owned businesses transition to another family member. When a transition occurs within a family, there is often an emotional component that comes into play. Business owners should start early in discussing the transition, allowing time to communicate appropriately with the whole family as well as employees. A solid transition plan is a good place to direct anyone with questions or concerns, and can help to clearly manage expectations.

If the family member who will lead the business after transition does not have proper experience, it's essential to offer training programs to that individual well in advance. Research done by the National Bureau of Economic Research shows that 30% of family businesses make it to the second generation, while only 12% make it to the third generation — often because the person who takes over is not fully prepared for the transition. When planning and training takes place well in advance, companies are well-positioned for longevity.

There should also be a contingency plan in place in the event that the first in line to lead the business falls through. When developing a transition document there should be multiple contingencies to ensure that the business falls into capable hands.

Letting go of a company that an owner built from the ground up is not an easy feat. To make these tough but necessary decisions, having the trust of clients in order to lead them through each step of the process is key to a successful transition. ¦

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