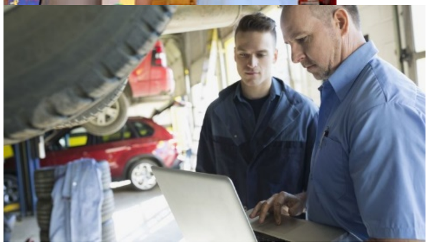
The 3 Ts of a Successful Family Business Transfer

Find out how training, transaction and transition can all help smooth the process so each side is pleased with the results.



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The following excerpt is from Mark J. Kohler and Randall A. Luebke's book The Business Owner's Guide to Financial Freedom.

Selling your business to family is similar to selling to a third party, but typically, it's a more simplified process that happens over time. I actually don't recommend a long, drawn-out process. Please understand that your family member(s) buying the business have lives and dreams, too. If you're going to sell the business, make a plan and stick to it. I've seen children leave the business because mom and dad made promise after promise to sell the business and step away from management, but it never came to fruition.

So get serious! Have a plan and a timeline agreed upon in writing. Maybe it's five years, 10 or 15, but be clear about what you want and all your expectations. Respect your family member enough to treat them like a third-party buyer. That means providing them with the preparation you'd afford any other buyer.

Many family business consultants have summarized a successful family business transfer as the Three T's: Training, transaction and transition.

Training your successor

Hopefully it's obvious who has the skills, personality and temperament to step up and run the business. However, this doesn't mean they're automatically ready for the job or could handle it in the near future. This business is something you've built from the ground up, and you need to make sure you've chosen the right person. Make sure the person you're passing it down to is not only ready and interested but also competent. This is where training comes into the equation, something that could take years.

Document the training plan and set benchmarks for achievement and a date for when official ownership transfer documentation will be signed and put into motion. The family member needs to certainly earn the right to buy the business, but they also don't want to feel the carpet may be pulled out from under them or the training process continues to be an endless process of jumping through hoops and no official paperwork is ever signed.

Transaction

Family transactions tend to be a little more relaxed on the topics of the nondisclosure agreement, valuation and negotiation. This is understandable, but it can also lead to other corners being cut in the documentation process as well. A family should do their best to keep the transaction process professional.

Involve a lawyer in the process and maybe even a legitimate business appraiser to provide an outside voice as to the true value of the business. In almost every situation, it's typical that the owner thinks the business is worth far more than it really is, and they believe the family member should simply be grateful they're getting the business -- even though they expect them to pay for every red cent. This can require the family to have an intervention or reality check with the owner as to the real value of the business. Thus, an appraiser can be a good idea even in a family transfer.

However, the reason the valuation tends to not be as critical is that it's something you typically back into in a family sale. For example, it's not the value of the business that matters; it's how much Mom and Dad need to retire on. Thus, once you find the monthly income needed to support the seller, you can work backwards to arrive at a price. Sometimes, the price ends up being under market value; other times, it's a price that a third party would never pay in exchange for the business.

Bottom line: The goal is that the buying family member can carry on the business, and in turn, Mom and Dad get a payment every month for life. Again, this can sometimes be unrealistic, but other times, it's a good fit. It really comes down to the numbers and lots of conversations around the kitchen table.

Transition

If you as the seller want to stay involved in the business, that's great. But, if it's not handled very carefully and the relationship isn't clearly defined, it can end up in a case of the seller stepping on the toes of the buying family member.

Typically, I encourage the seller to just do their new job, keep their head down and don't stick their nose into everything. You're getting paid under a purchase contract and may have a consulting or employment contract -- but only for a specific job. Now, I know this is difficult to do, but stick to your assignment and stay out of the way.

The family member taking over the business may have a new vision or direction and as long as it doesn't risk profits or your Note, then give them the latitude they deserve and paid for. Something I recommend strongly is having the prior owner (oftentimes Mom and Dad) serve on the board of directors or board of advisors.

This isn't just a figurehead position. During the training phase, there should have been a focus on regular meetings and trainings to help the upcoming family member take over the reins properly. Oftentimes, when the baton is handed over, a whole new set of problems occurs and usually with unexpected challenges. More than ever, those regular board meetings help in the transition.

It's certainly common to also have the prior owner work with specific customers that could leave if the owner completely disappears. I really believe that setting up meetings and experiences for the new owner to meet key customers is critical. For example, golf outings are a classic example where the "old boys" bring the new owner into their fold through relationship building -- an important part of the transition.

This also goes for vendor relationships. Sometimes, the business has been given great pricing by vendors, deals on delivery or accounts payable terms, and the new owner needs to strengthen these bonds through the help of the seller. Plan for this, and expect these types of meetings and activities.