Dodge the pitfalls of family business transition

Middle-market business transitions are rarely simple, with family business transitions among the most complex. A business transition — whether an acquisition, sale of a business, restructuring, or leadership change — may generate the energy to grow a business's value, or it may allow an owner to start a new chapter. With the overhang of a global pandemic, the challenge of simultaneously maintaining business performance, handing over the management reins, and managing a transaction, especially one that affects both business and personal wealth, can test any family enterprise leader.

Family businesses layer family dynamics onto the challenges of a middle-market business transition. Combining family and business issues extends the list of transition items leaders need to address, increases the odds for goal divergence, complicates governance, and introduces family undercurrents into every decision. That makes transitions harder to plan, start, and execute.

Oddly, leaders of family businesses spend less time preparing for transactions – barely more than a year – than leaders of not family businesses.[1] Shortchanging this planning process may result in reduced financial proceeds, business disruption, and family squabbles.

Dodge these eight pitfalls as you prepare for a family business transition.

Family owned businesses expect fewer transitions and start planning later.

Percentage of businesses that expect a transition in the next five years[1]

- Family-owned businesses **65%**
- Not family owned businesses **69%**

Years before next transition when planning is expected to begin[1]

- Family-owned businesses **1.1 years**
- Not family owned businesses **1.5 years**

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Eight pitfalls of family business transitions

1. Skipping personal and business transition planning

Transition planning often seems to fall to the bottom of the "to-do" list. By not carving time out of their busy days to address transition, owners are foregoing important early planning and structure setup that can maximize owner value and ensure the ongoing business enjoys continued success.

Too often, family leaders assume they will continue running the business forever. David Herritt, head of Truist Wealth Center for Family Legacy says, "The senior generation just keeps going and going and going until one day they wake up with the epiphany, 'Hey, I can't do this anymore, I don't want to do this anymore, so I'm going to try to think of my succession plan now,' which is why a lot of these transitions happen very quickly. They're not thinking about it when they have the runway to think about it." Whether it is the pull of family and family business values or the fact that family businesses use fewer external advisors as counsel to better prepare for transition, owners wait until the last minute. (Only 19% of family businesses plan to use advisors for the next transition versus 29% of not family businesses.)[1]

2. Living the last generation's dream

It can be difficult for the senior generation, especially when in full control of the company, to remember that transition is not for them but is there to serve the subsequent generation(s) and those depending on the company (e.g., employees, business partners, the local community, etc.) "It's hard to live somebody else's dream, explains Herritt. "As the child, the business may not be your dream. It was your parent's or your grandparent's dream. Do the successors even have the same skill sets? Just because the parent or grandparent was an entrepreneurial sort and was good at running a business doesn't mean the next generation will be. Remember the business you or your parents have a passion for may mean nothing to your kids. Aren't you better cashing out and seeding them in businesses they love so they can enjoy the same business passion you've felt?"

3. Ignoring the generational math that complicates transition

Business longevity combines with family growth with each generation, which makes mature family businesses harder to manage than newer ones. Herritt elaborates, "I work with a family right now that was founded by the matriarch and patriarch. There were six children, four who worked in the business, two who didn't, but they were all on the board. And now, we're at the cousin consortium level, and there's three working in the business out of 17, and only two of them are sitting on the board. So, you have all these passive shareholders you didn't have with the other two generations and trying to keep them engaged is difficult. Transitioning to be professionally run going forward is pretty attractive." Understand the impact of generational math and add planning time for the stickier issues that come with a more developed family tree.

4. Taking the family to work and bringing the work into the family

"Leaving work at the office" is not a strategy with a family business. Conversely, going to work to get away from family stress is not an option either. Herritt says, "You're wearing your parent hat at the dinner table at Thanksgiving, and then you put on your CEO hat when you get back to the business on Friday. That's quite a stretch you have to consciously make." Russell Sanders, managing director, Business Transition Advisory Group at Truist Wealth, advises, "It's no simple task to set ground rules, handle business complications, and make decisions to run a family business and also be responsible for keeping the family peace during the holidays. It's dynamic and multidimensional. The moving pieces need to fit together so the family continues to function as a family, and the business continues to function as a business. As the family grows, the tension only gets worse."

5. The generation-in-waiting running out of patience

"Great news that people are living longer," says Sanders. "But they're staying in control of the business longer. The next generation is blocked by them." In the healthiest situations, that pressure is the catalyst for a succession and transition. In other cases, it's another family flashpoint that can delay transition and weaken the company when talented family members run out of patience. Herritt explains, "The next generation says, 'I just can't wait. If you're not ready to elevate me, I need to do something else, otherwise I'll get to a point where I'm not going to be able to transition to another career if I wait too much longer."

6. Downplaying the role of family shared values

While growth in family numbers can lead to a divergence in goals as a business matures, some family businesses coalesce around a set of values that binds the family and business.

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Sanders elaborates, "There's a mysterious glue for family businesses around values. For some, the business itself is the family and for others, excelling at entrepreneurship or being a core community business with strong employee ties are really the family values at work."

Such shared values frame transition considerations. Herritt says, "Just as leaders need to stay anchored in long-term goals, it's no different in these families, and it's important for them to understand what those shared values are. They have to use those shared values as a springboard to every decision they're going to make around their vision for the future, whether it's creating their corporate mission statement or their family mission statement."

7. Aversion to advisors

Running a private business in today's world takes a good measure of self-reliance and confidence in one's problem-solving abilities. Family leaders can carry this same attitude into transition. "Family leaders have an independent mindset with a 'can-do' attitude," says Sanders. "But as you're beginning a transition, you need to understand there are many facets to it, on both the personal and the business side, and that it requires a certain amount of expertise. Appreciate that complexity and understand it's okay to reach out to outside advisors to supplement existing advisors. You get one shot to do this right, and you don't want it to spin into a direction you didn't expect. You need to build a team of advisors that's deal savvy and has transition experience for what lies ahead." Four out of five family business owners eventually recognize their transition expertise shortcomings and turn to outside advisors for help.[1]

8. Forgetting the world will change when you are no longer here

In any family, the departure of the senior generation kickstarts the reordering of the survivors' relationships. When family and business are intertwined, the reset can be even more dramatic. "The sudden death of a senior leader can leave the family totally unprepared to work together and make decisions," Herritt says. "While there may be someone who can manage the business, they can't find someone to lead the family." Owners who want to direct the path of the business and family into the future need to do so while they are still in control.

73% Family owned businesses need help with transition[1]

73% are lacking in critical areas of expertise:

1. M&A
2. Legal
3. Capital management

Families and Transitions

Family businesses are usually a means to personal and family goals. Transition in a family business can be planned and carried out to further those family goals. "It's the family component that matters, including what the transition is going to mean to the family and how they're going to co-exist, be happy, and get together for holidays," Sanders says. "Transition planning needs to incorporate expert family and personal preparation, and M&A industry knowledge with extensive market relationships. The Business Transition Advisory Group brings together Truist Securities, SunTrust Commercial Banking, and Truist Wealth teams to support business transitions.

Start planning at least two to three years before you want to transition so you can prepare and set up the structures you'll need. "If you're looking at transitioning this business within the family and you want to keep the family together, there are unique structures you'll need," Sanders elaborates. "You'll consider trusts and family managed entities like partnerships. You'll take the time to look at all the usual estate planning techniques. Additionally, there are family specific strategies, like family councils and structures that provide a safe forum for dealing with issues when mom and dad may not be around any longer."

Herritt adds, "Those same competencies and activities that you used to run a successful business will help you run a successful enterprise that just oversees liquid assets. You still need to figure out how to find talent, assign roles and responsibilities, and put a framework around it. Most importantly, remember that those family values will continue to guide even after the business is gone."

[1] National Center for the Middle Market Report, 2019.

Prepare early for the challenges of family transitions. Talk to your relationship manager or wealth advisor to get your family on the right track.

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