Ten Rules of Transition Management

The issue of family business generational transition is a major topic of discussion as farm businesses position themselves for success. Growth is the primary reason why businesses fail, and this is because of under-capitalization, inadequate preparation in human relations and communications, and insufficient income generation. Sixty percent of all farm and small businesses that enter bankruptcy were profitable in previous years. The following are some rules that are generally used in successful business transitions.

Rule 1: Revenue/Net Income
Bringing in a new partner takes an estimated $150,000 to $250,000 in gross revenue, or $40,000 to $70,000 of net profit for a successful business transition. Violate this rule and you set yourself up for guerilla warfare, where family members or partners fight over scarce resources (including net income) to meet their standard of living.

Rule 2: Three-to-Five-Year Rule
Agricultural business transitions are twice as likely to be successful when the family member or potential business partner works for someone else for three to five years. Allow them to make mistakes with someone else's money! A recent study found that the farm businesses that allowed entering partners to work for others for three to five years found their business to be four times more profitable. A college education is not part of this experience; however, military and summer work experiences are part of the experience base.

Rule 3: Six-Year Rule
If a new partner is brought into the business, make sure you allow him/her to move into management and decision-making within six years. Farms and businesses that fail to do so are twice as likely to have an unsuccessful business transition and are less profitable. This past winter in a seminar in Wytheville, an 85-year-old gentleman, after the seminar, indicated that he needed to turn the books over to his boy. Well, his boy was 65 years old! The old adage is you either teach or share with the younger generation, or you destroy the business.

Rule 4: Ripple Effect
When making changes to a growing business, you should over-estimate capital needs by at least 25 percent to avoid being short on working capital due to unexpected costs. For example, if you need $200,000 to expand the business, then $250,000 should be estimated and used to determine whether or not the growth is financially feasible. It is also wise to over-estimate the time needed to complete the change by 25 percent.

Rule 5: Don Shula Rule
Many managers and owners stay too long before turning over the business. The optimal time for ownership and management of a business is 30 to 35 years. Owners and managers who fail to heed this rule run into the trap of continuing to do "business as usual" without changing for the times. In order for managers to maintain the cutting edge, they must either follow this rule or surround themselves with new members who will bring renewed energy and new resources into the business.

Rule 6: You Can't Treat All Children Equally, But You Can Treat Them Fairly and Equitably
One of the most profound challenges in estate planning and transition management for farm businesses today is what to do with children who move away from the business. Usually, they have little interest in the operation. When the parents die, the business interests of the children who have moved intensify because proceeds from the estate can be used to pay off mortgages or fund their children's college educations. The most successful transition plans have the business assets transferred to the child managing the business, and insurance policies to cover estate settlement costs and cash settlements for children who are not interested in the business. This strategy allows the children involved with the farm to continue to function without requiring them to buy out the non-farm children's shares, and also have sufficient cash to pay estate settlement taxes. This strategy is simple and objective.

Rule 7: Non-Business Spouse
An increasing challenge in businesses is incorporating the non-business spouse into the family and business management process. Many more families are finding this incorporation a challenge because there are more non-business or non-agricultural spouses, and that these spouses frequently do not understand erratic business schedules, time management, and prioritization problems that can occur. An operations agreement including time expectations, goals, responsibilities, and accountably can resolve many of these issues.

Rule 8: Getting Out of Business
A plan that covers dissolution of the business is critical in establishing a family business transition. Included in such a plan is an operations agreement, a buy/sell agreement, and a time line for an orderly transition. Partners who are not willing to discuss these issues often find that getting out of business is more difficult than getting into business.

Rule 9: Transition Team
All businesses need to have a list of advisors or a transition team. This team includes a lender, a lawyer, an accountant, a financial planner, both spouses, and all partners. Annual team meetings with all members present are critical. Outside professionals need to be placed on retainer rather than on an hourly fee structure.

Rule 10: The Nike Principle
Just do it! The biggest concern with family business transition plans is procrastination. Day-to-day matters frequently take priority over the planning process. A transition plan often takes two to three years to formulate, and must be updated at least twice a decade.

Written by David M. Kohl, Alex White, Dixie Reaves, and Amanda Wilson, Farm Management Update, June 1996
Visit Virginia Cooperative Extension "Ten Rules of Transition Management," http://www.ext.vt.edu/news/periodicals/fmu/aaec-310.html

Succession Planning Workshop Slated

Few challenges facing family forestland owners, farmers, wine-makers, and other land-based family businesses are more important than the issue of passing the business and its supporting land base on to the next generation. As part of the Farm and Ranch Survival Kit Project, OSU Wasco County Extension Serivce, WSU Klickitat County Extension Service and Columbia Gorge Community College are sponsoring a workshop on February 2, 2006 to help families dealing with the challenges of passing the farming baton to the next generation.

Today, 95% of Oregon's small landowners are 65 or older making family succession planning all the more critical.

"Based on the average age of farmers and ranchers right now, the next decade is going to see a huge transfer of land resources to the next generation," says project coordinator, Cheryl Williams-Cosner. "Passing property from one generation to the next can be an emotional experience."

For families, the real challenge may not be technical issues, but communication. Lawyers and accountants are skilled at dealing with the technical aspects of moving assets between Mom and Dad and Son or Daughter through the use of business and legal tools. But without informed decision makers, family emotions may prevent honest, open communication. This alone can prevent families from being able to pass their land on to the next generation intact.

The OSU Wasco County Extension, WSU Klickitat County Extension, OSU Austin Family Business Program and Columbia Gorge Community College jointly host this forum to explore the human side of estate planning, focusing on ways to maintain family ties to the land from generation to generation. Practical exercises will teach families necessary tools to address tough issues.

Passing the Baton: The Art of Handing Over the Farm to the Next Generation" will be held on Thursday, February 2 from 1-4 pm at Columbia Gorge Community College, Building 2, Room 2.384. Participant costs are $29 per person. To insure your seat, **please pre-register by Tuesday, January 31st with Columbia Gorge Community at 541-506-6011** , 400 East Scenic Dr., The Dalles, Oregon 97058. For more information, contact (541)296-5494 or e-mail Brian.Tuck@oregonstate.edu.