Finding a successful exit solution for your client's business

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Research by Deloitte, an accountancy firm, in October 2008 found that 74 per cent of business owners had no concrete plans for handing over control, despite the fact that 72 per cent were actively involved in running their organisation. In 39 per cent of cases entrepreneurs had no plans at all, and 35 per cent of entrepreneurs said they were waiting for an opportunistic offer from a third party.

And yet for every business that outlives its founder there will be a change in ownership: it may happen when the owner dies, chooses to retire, sells the business or passes it to a family member. One thing is for sure – it will happen.

When we started to think about this, and the possibly catastrophic effects of not planning for succession - the worst case scenario for most small businesses isn't a global financial crisis, stock market crash or the loss of a major customer, it is the unexpected death or disability of the business owner (who hasn't prepared a succession plan) – we started asking two questions: why and what can be done to improve the chances of a business planning for succession?

<u>Let's look at why businesses owners don't plan for succession</u>

There is no shortage of literature, agencies or advisers that will advise you on how to plan for succession so there had to be another reason. Research amongst Mindshop facilitators revealed the problem is as widespread as the Deloitte findings show but few revealed why. So we started looking elsewhere.

What we found was that business owners were not, in general, ignorant of succession options or how to prepare a plan (most had prepared business or marketing plans) but rather they had ***chosen***, either consciously or unconsciously, not to prepare a succession plan. Reasons given included:

- I don't want to think about retirement/death – that's for old people.
- I don't want to think about what might happen to the business I founded, brought to life and built up.
- No one knows this business like I do; no one could possibly take it over.
- I'm just too busy right now to think about it.
- I know I should prepare a succession plan one day, but I've next year's product launch to plan.
- I'm sure someone will come along and make me an offer I can't refuse.
- I'll plan my retirement when I am ready to retire.

So is succession planning important if no one seems to want it?

What's all the fuss about?

We think so for three very good reasons.

1. An owner's wishes and his family responsibilities are an important aspect of a business's purpose; a succession plan secures the family's future not just the owners.
2. Nine out of ten UK businesses are family-owned. Only 30% are successfully passed to the second generation and less than 15% to the third generation. Many just sell up and close. Experts say this is because they do not have a clear succession plan.
3. Nearly 50% of UK businesses are owned by the 'baby-boomer' generation who are coming up to retirement. It is economically sensible that these businesses continue to flourish, create employment and wealth.

And even if the aim is for the business to be sold, rather than passed on to the next generation, a succession plan is still needed to determine the various exit options available and assess which is most attractive.

So how do we get all those reluctant owners to plan?

As Mindshop facilitators know raising *dissatisfaction* is the key to change. Nothing will happen until the incumbent owner gives more weight to what he will do ***after*** retirement than whilst he is running the business[1].

The catalyst for this can be ill health, death of a family member/colleague, loss of a major customer or any 'disaster' type reasons but preferably it should come out of the overall strategic planning process. Ideally a succession plan is simply part of a company's overall strategic business plan, which states the company's vision and specific strategies for achieving that vision, including the succession of the owner.

Interestingly research shows that business's that have a strategic plan are more likely to also:

- Have written agreements with major customers, suppliers, employees, agents and licensees;
- Hold board meetings regularly and take time to discuss strategy;
- Have training and development plans for key management and reward structures that recognise performance;
- Have lower staff turnover;
- Have higher sales growth.

So as the saying goes – you know it makes sense.

[1] I am grateful to Harry Kras who introduced me to this concept.

What should a succession plan contain?

Most of the time spent preparing a succession plan will be spent thinking through the options, what needs to be done to achieve the desired option, timing etc. There is no 'one size fits all' succession plan and it is important to be clear about the objectives of the owner.

We suggest these be documented under three headings:

1. Personal goals: lifestyle and life balance;
2. Financial goals: how much money do you need to retire; and
3. Business goals: what do you want the business to achieve?

The plan itself should address a number of questions:

- What are the business's vision, strategy and goals?
- Who will lead the business and take on leadership responsibilities?
- Will he/she be ready to take over by the time the owner retires?
- What is the financial strategy for transferring ownership;
- Should you consider selling the business?
- When does the owner want to retire?
- Is there an adequate retirement fund?
- How much does the owner need to live in retirement?

With a clear succession plan in place the owner can retire confident that the business will continue to function.

What are the options?

There are seven principal options for exiting from a business:

1. Trade sale.
2. Management or employee buyout.
3. Sale to a private equity firm.
4. Public flotation.
5. Transfer to a family member(s).
6. Asset sale and winding up the business.
7. Retain ownership but bring in outside management.

Whether the eventual goal is ownership succession (selling or transferring the business) or management succession (finding a new CEO but retaining ownership) there will be a need to structure the business so that it can function without the founder owner. At a minimum that means formal governance, well documented systems and processes, formal contracts with key customers, suppliers and staff and protected IP.

In a management succession it can take several years to recruit and train a new CEO even if that person is already part of the business.

In an ownership succession it will take a similar period of time to prepare a business to stand up to legal and financial due diligence. Purchasers are very aware that in small businesses most of the goodwill sits with the owner. Unless your business can run without you a purchaser may only pay what the business is worth without you – which may be a lot less than you think!

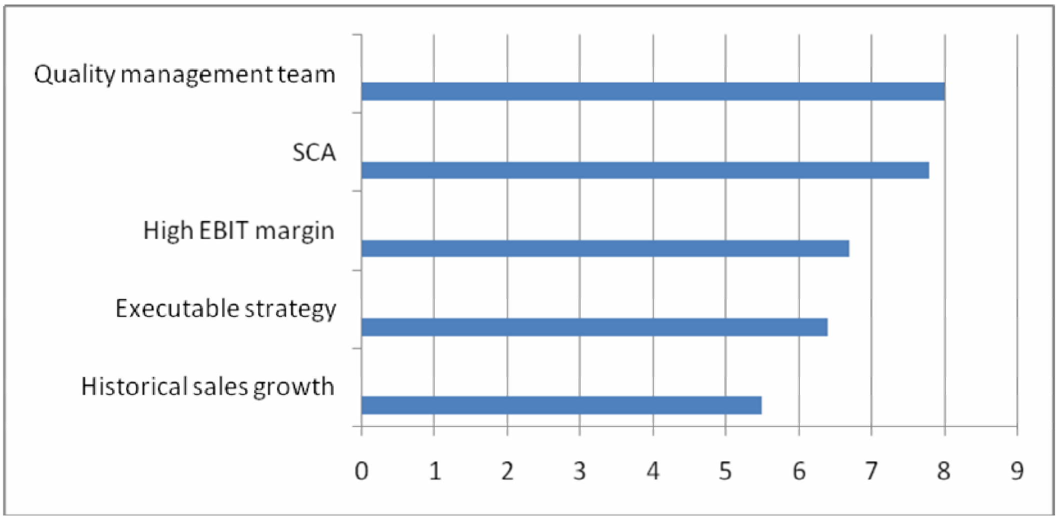
You should also consider that to get the best price you may need to choose your timing carefully; business sales are like house sales: you don't want to sell at the bottom of the market[2].

For more information on the available options we recommend the UK government websitehttp://www.businesslink.gov.uk/bdotg/action/layer?topicId=1078303641 where you can use an interactive tool that will give you a detailed report of the succession options most suitable to your situation and explain what to do next in each case.

What is my business worth?

Our research, reinforced by Mindshop facilitators, shows that most business owners have little or no idea what their business is really worth and that those who do usually overvalue it.

There is also considerable misunderstanding of what drives value as this graph[3] of the top five factors affecting a business's valuation shows:



Too often value is determined by using multiples of historical accounting profit (EBIT, profit before tax etc.). This is misleading, at best because it distorts or ignores several factors that have a major influence on value such as:

- Most small businesses produce accounts for tax purposes with often very conservative accounting policies which may understate profit;
- All value is in the future: a business is worth what a purchaser will pay for it, not what you have generated in the past; and

[2] With thanks to Rod Willers of Ernst & Young in his article Plan to Succeed.
[3] Increase your company's market value – Pegasus Partners June 2007

- Competition: of all the factors that will influence price upwardly the greatest is creating a market of bidders.

We advise never discussing price until a number of prospective purchasers have expressed interest. It's a bit like offering a car for sale at '£2000 or nearest offer'. Guess what offer you won't receive?

Retirement

One of the reasons, we discovered, that owners put off succession planning is that they are so absorbed in the business they don't spend any time thinking about what they are going to next. Retirement is not ***from*** work but ***to*** the next stage in your life. Vague ideas about travel or seeing more of the grandchildren don't do it. These plans need to be as thorough and researched as the original business plan 30 years ago.

As essential first step must be how much does the owner and his dependent family need to live comfortably in retirement: the answer is not for this paper but can be found from financial planning advisers.

Next it's about creating a vision and a plan to achieve it: sound familiar? Maybe a one page retirement plan!

Summary

We have not attempted in this paper to cover the succession planning process in detail, although that will be available as a workbook from Guilford Consulting in Spring 2009. Rather we have concentrated on those elements in the process which in our experience get too little attention (such as overcoming barriers) and are not well understood (such a business valuations). We have also kept away from some of the operational aspects of succession planning such as preparing sales memoranda, identifying prospective purchasers, tax planning etc., all of which whilst important – and will be covered in the workbook - are already well documented in the literature.

Good succession planning helps ensure you have the funds you need to retire, takes care of your family and provides longevity for the community that relies on your business.

We suggest three strategies:

1. Start today – planning should start 5-10 years before you want to retire. The more time you give yourself the more you have to train your successor, find a purchaser and hand over the reins.
2. Involve senior management and family members – businesses that develop a team work approach in which everyone can contribute to the plan have better outcomes. Pay attention to the ambitions, feeling and goals of everyone.
3. Use outside help – have an independent professional facilitate the succession planning process for your business.

Good succession planning is done early, regularly reviewed and based on sound professional advice.