Do your small business clients have an exit plan?

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The answer is probably ‘no’ for financial planners whose small and family business owner clients are poised to retire within the next 10 years. However addressing the issue of succession planning before it is too late can be the difference between your clients retiring comfortably or struggling to make ends meet.

Research by KPMG and the Family Business Association Resource Centre, shows that 34 per cent of family businesses don’t have immediate plans for a succession plan, 32 per cent don’t have one but are ostensibly looking to implement one and 9 per cent don’t intend doing anything about a plan.

While many of these business owners may not necessarily be boomers (those aged 45-60), I suspect that many are, which makes the results especially chilling.

Middle aged executives and professionals often leave the corporate sector to begin their own businesses – something that was particularly prevalent during corporate downsizing activity in the 1990s. Also, there has been a trend away from younger people starting their own businesses and a preference for joining larger outfits.

Irrespective of age, succession planning is critical. Even young people face the risk of becoming seriously ill, having accidents and being laid up for months, leaving their businesses rudderless.

However, the biggest threat is to those facing imminent retirement.

It is vital that that they depart their business with enough money to retire on comfortably. All too often, the difference between having ‘enough’ money and ‘almost enough’ comes down to how well they manage the business succession planning process.

While small business proprietors often claim they are getting or have an exit strategy in place, far too many are piecemeal, addressing some but not all the issues.
GET YOUR HOUSE IN ORDER

Before preparing an exit plan business owners need to know that their businesses are robust and can function independently of the owner being there.

This is where due diligence is critical. Should a business have a board of directors, this would be the board’s responsibility. However where there isn’t one, the onus is on the owner. A due diligence would be done in consultation with key stakeholders such as board members, senior staff, suppliers or customers, trusted advisers (such as your lawyer, accountant or financial adviser) and spouses and family members.

Part of the due diligence process is putting together a working brief which will:

1. Establish the current legal and administrative structure of the business and how the parts of the business work together.

2. Establish areas of vulnerability such as product life cycle, emerging competition, global warming implications and so on.

3. Ensure all parts of the business (finance, IT, marketing, staffing, operations, health and safety, environmental, branding and marketing and corporate governance) are working effectively and where they aren’t, fix them.

4. Make sure that areas of command and control are clear – i.e. who has authority and responsibility for what.

5. Ensure all the necessary agreements are in place. These include:
   - The way the business is structured whether through companies, unit trusts or partnerships
   - Business succession planning agreements
   - Governance agreements
   - Insurance policies
   - Shareholder and unit holder agreements
   - Licensing and IP including trademark and copyright
   - Administrative law including professional registration
   - Supplier and customer agreements
   - Commercial and property agreements
   - Employment agreements for staff. Ensuring that all your staff have clear position descriptions and measurable performance indicators linked to any bonus schemes will help motivate employees, help you identify stand out performers and add value to your business. Such agreements can help you to identify those you might wish to target for retention and/or future equity holdings.

6. Ensure that everyone in the organization understands their job requirements, their entitlements, that lines of communication are clear, and that operations are transparent. It is critical that this information is available on paper and that it includes the owner’s children should they be involved in the business, in its ownership structure or if they have rights to acquire such interests.

7. Branding needs protection. Ensure that all trademarks, copyright and patents have been registered and confidential information and intellectual property protected. A contract will stipulate who owns what and on what basis it can be used while trademarks must be registered at the trademarks’ office and are available to be searched on public record.

8. To improve the value of the firm, business owners will need to dress up the value of the business by appointing a board of directors or a board of governance. Irrespective of the size of a business, a board is critical in that it separates the owner from the business, enabling the business to develop its own business “personality”, and in the process add value. It also forces the owner to be accountable to someone outside the organization. Having an independent chair does not mean that you lose control of your business. An independent chair does not make decisions but asks WHY and ensures that decisions are made for the right reasons, not done simply because that’s the way things have always been done.

10. Getting a business’s house in order also means reviewing strategy. If you’ve simply been reliant on the same client base for years, draw up a new strategy that will take you into new markets that would be appealing to a purchaser.

11. The key to business longevity is client retention. By gradually introducing smaller equity partners into the business, you can create an environment where clients will develop relationships with other staff members and potential equity partners. This can act as insurance against losing a client who is heavily reliant on one personal relationship and can act as a retention tool by exposing selected staff to greater responsibility. Some examples of how businesses address this include: holding weekly kick-off meetings, cc-ing colleagues on key client communications, regularly introducing colleagues to clients and friends of the business, and engaging in team building activities to build corporate memory and optimise resource capacity.

12. Finally, establish the value of the company and what price it could fetch. Because many businesses don’t declare all their earnings up front, they are often forced to sell below value. Don’t fall into this trap.

PREPARE YOUR SUCCESSION PLAN

Once the due diligence process is over and owners have addressed areas of weakness, the next process is getting a succession plan in place. While ideally most business owners should have a plan in place from Day 1, those who don’t, make sure you get one before you begin losing interest in your business and the value begins dropping off.

Once the business’s value has been established, the owner or board must begin identifying buyers and whether or not they have the money to buy the business outright.

The entire business can be sold to one purchaser or alternatively partners or shareholders can be brought in. You might also consider bringing in your children as shareholders. However don’t fall into the trap of giving away shares to them. They need to pay a fair price and on suitable terms to ensure they understand that business is business. Your estate planning decisions can then be based on a solid foundation.
Should a shareholder arrangement be brought in, owners could also consider selling off parcels of shares to employees. Initially you might like to give them a combined minority shareholding but in time and once you’re convinced you have eligible candidates to step in and run the business, you may begin selling down your shares. Again, consider how this might apply if your children are interested.

One way to begin the process of passing your business on to the next generation is to develop a formal plan to give employees equity in the business. Properly drafted, these plans can provide tax benefits when allocating minuscule shareholdings to large numbers of employees. Allowing key staff to buy into the business or issuing small shareholdings to staff is the best way to give staff an understanding of what it is like to run a business. Business owners may have to accept they won’t get much from selling shares to staff or to competitors. Investigate selling to a group of investors on a small stock exchange. You could well end up securing better value for your business by going down this path.

Preparing a succession plan should be done in conjunction with solicitors, accountants and financial planners where applicable. The lawyer’s role is to provide the preliminary overview of planning issues before decisions are made about documentation. The accountant’s role is to assist with the wider structuring plan dealing with the establishment, growth, succession, sale or merger of business and investments. The financial planner’s role is to assist with the wider financial plan identifying estate planning issues as part of the financial plan.

The lawyer will also prepare a letter of advice accompanying wills, beneficiary nominations, powers of attorney and other documentation.

Although every business is unique and every plan is different, there are some common themes in every succession planning process.

○ You need to identify the characteristics of possible successors and establish appropriate mechanisms for attracting, selecting and developing suitable candidates.

○ The timing and manner of any handover needs to support the personal aspirations of the directors and the current business climate.

○ The roles and needs of all the participants (including spouses and children) should be recognized.

○ The succession plan must be in line with the strategic direction of the business.

○ Maintaining good relationships and open communication is crucial.

○ It is important to source solid, independent, experienced advice to help you navigate the complexities of the process.

### THE EXIT STRATEGY CHECKLIST

The questions below are indicative of the process you need to follow to develop your exit strategy. Asking these questions each time you review your succession plan will go some way to ensuring its effectiveness.

#### Trade sale

- Can my current partner(s) or staff manage the business or is it beyond them?

#### Sale to the next generation

- Are there any suitable candidates in my business who would be in a position to buy it?
- Are they fully prepared for my exit?
- Do they have enough training, finance and the other basics to manage my exit?

#### Sale to partners

- Is the timing right for selling to my partners – are they at the right age and stage to take over?
- Have I considered the timing of other partners’ departures?
- Can this transition be made as efficiently as possible?

#### Merger/Acquisition

- What is the defining reason for this merger?
- What is the best way to set up this merger?
- How much do we want in advance? What are the likely costs and when do we have to pay them?
- Is there a potential benefit to us having an earn-out provision?

#### Public float

- Is my business large enough to meet minimum listing standards, to float shares on the stock exchange;
- If so, would it provide me with a better chance of achieving higher multiples?

An effective succession plan should be able to address any negative response to these questions.