

# Planning your getaway

Succession planning is about taking a considered, strategic approach to your business exit strategy. Without it, the value of your business may retire when you do, says **Craig West**.

**MOST BUSINESS OWNERS** go into business not only to earn an income, but (perhaps more importantly) to build the value of the business and sell it. In fact, more than half of all small business owners in Australia plan to use their business as the primary source of funding for their retirement. The average age of family business owners in NSW today is 56 years – so for many, retirement is not too far off.

For many owners, the value locked-up within their business is their second largest asset behind the family home, and in some cases it is even more valuable than the family home. Yet while most people will happily invest time, effort and money planning for the sale of their home, they don't do the same with their business. Choosing to invest the time and effort to develop a succession plan that ensures you realise the maximum value of your business when you retire may be one of the most important financial decisions you ever make.

I recommend a strategic nine-step process for implementing a succession plan within any business.

**Step One – Take a Strategic Approach.** The single biggest mistake that most business owners make is not allowing enough time to either plan or implement their exit strategy. In fact, the first time many business owners start thinking about a succession plan is when they turn 64, and decide to retire at age 65. This is no different to deciding to spruce up the house two weeks before auction, appointing a real estate agent and then heading

off overseas and leaving the sale to them – few of us would even consider such a hasty sales strategy for our properties, yet we do it for our businesses. The most successful succession plans are those that have been carefully and slowly considered over a period of time, are implemented gradually (over 10 years or more in some cases) and are constantly monitored and reviewed.

**Step Two – Maximise the Value of Your Business.** Maximising the value of your business takes time; it cannot be done overnight and it cannot be done without proper planning (which is one of the reasons why Step One is so important).

There are many different ways to increase the value of your business. I always start by having my clients identify where their business is positioned on the business spectrum, that is, to identify whether they are operating a boutique business, a scale-based business or whether they are somewhere in 'no man's land'.

In boutique businesses, the competitive advantage comes from offering a premium product or service at a premium price to a select clientele. The key growth strategy for boutique businesses is to further exploit this pricing advantage by becoming even more boutique – more premium and more selective. In scale-based businesses, the advantage comes from volume. The key growth strategy for these businesses is to increase volume even further – more clients, more distribution channels, more products and services. If your business is neither boutique nor scale-based, and it is not in transition between these two, then it is in 'no man's



land'. The only strategy that can add value to a business in this situation is getting out of no man's land quickly.

Working with a team of expert advisers that includes a qualified accountant will help you to understand the different methodologies available to place a value on your business. There are a variety of business valuation methodologies that can be used, depending on the business and sometimes even on the specific buyer that is interested in your business.

**Step Three – Choose Your Successors.** What people don't understand about succession planning is that it is not just an exit strategy, for the person buying the business it is an entry. At stake is the smooth transition of ownership, income and control of your business and the only way to make sure that this happens effectively is to identify and select the most suitable buyers.

There are a number of ways to sell your business, most people will be familiar with the idea of placing an ad in the newspaper and attracting potential buyers that way, but these sales are often fraught with difficulties; they are driven by the transaction with the seller trying to achieve the highest price, the buyer trying to pay the lowest price and there is often little consideration for the longevity of the business or the impact of the sale on staff and other key stakeholders. Other ways to sell your business include trade sales, mergers, listings and internal sales (or management buyouts).

For a host of reasons, I believe that management buy-outs are by far the most effective sales strategy for most small-to-medium

sized businesses. They give both the current and new owners a great level of certainty about the future of the business and it is often easier to identify potential successors from within the company and to transition the new owners in over a long period of time. In addition, there are few people who know more about your business and its strengths and weaknesses than the people who already work in the business, there is presumably already a good match between the business, staff, values and culture and this type of sale can also result in improvements in morale, loyalty and productivity as people begin to behave less like employees and more like business owners.

**Step Four – Implement an Equity Matrix.** Because an ideal succession plan involves the gradual transfer of ownership of a company over a long period of time (remember, it can take up to 10 years), it is important to ensure that everyone involved in the process is getting a 'win' at all stages.

An equity matrix maps the process for transferring equity and responsibility for management of the company from the current owners to the new owners over a period of time. When done correctly, the equity matrix ensures that the value received by both the existing and new owners is at all times greater than the cost. For the existing owners this may mean that even though their percentage of ownership is gradually decreasing, the value of their equity is increasing, in other words, over time they own a smaller piece of a larger pie. For the new owners, it may →

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→ mean that the amount they have paid for the equity is always less than the value of the shares they own, so they always have a gain on the equity they own. Again, the accountant in your succession planning team can work with you to develop an equity matrix that suits your needs.

**Step Five – Secure Funding.** If not handled correctly the funding aspect of succession can jeopardise the entire plan. And securing funding for the purchase is not just the buyer's problem. If you are proactively identifying successors for your business, perhaps from within the business, then the most likely candidates will be young and upcoming. They will be at a stage of life where they are perhaps starting a family, getting married or buying a home – circumstances that don't lend themselves to people having large sums of money readily available to invest in buying your business. There are commercial funding products available through financial institutions as well as any number of ways that the business may choose to fund the purchase itself.

Many business owners overlook the option of funding the purchase themselves, and it may initially seem counterintuitive to fund the purchase of your own business. However, if the appropriate successors have been identified there's no need

to let an issue such as them not having the cash to finance the purchase get in the way of an ideal business outcome. The business could choose to use its existing overdraft facility, to borrow money specifically to enable the purchaser to buy shares from the current shareholders, or to allow the new owners to sacrifice part of their salary to fund the purchase.

A key issue in funding the purchase is matching the size of equity parcels with the income generated by the equity so that the purchaser is not placed under financial stress. Many of my clients have been able to structure the purchase of shares so that the income that flows from the equity funds the borrowings, making the purchase effectively self-funding. The benefit of this is that the new owners of your business are able to focus on operating the business at an optimal level, rather than worrying about their own financial exposure.

**Step Six – Smooth Transition.** With any transfer of ownership there will be a skills gap between the outgoing owners and the incoming owners. Allowing sufficient time for the new owners to be appropriately up-skilled across all areas of the business is the only way to ensure the smooth transition of ownership.

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→ can help to address the skills and experience gap, and working with a business coach or consultant can be invaluable in identifying these issues and developing effective strategies (thus driving the gap together). I also recommend developing a comprehensive transition management plan that sees the new owners spending an appropriate period of time getting to understand all aspects of the businesses' operations, especially the accounting and financial. I always include these two areas in any transition management plan that I develop for my clients. I firmly believe that a CEO cannot be effective without a good understanding of these functions and of the financial drivers of the business. There are a number of books and even software solutions that can help smaller businesses to manage this transition stage. The most popular of the software tools is Succession Wizard, a trial version of which can be downloaded for free from [www.successionwizard.com](http://www.successionwizard.com).

**Step Seven – Tax Benefits.** Albert Einstein once said, "The hardest thing in the world to understand is income tax!" And that's not to mention capital gains tax, small business tax concessions, retirement concessions, rollovers and so on. I cannot even begin to address the topic here, suffice it to say that there are tax benefits that can be achieved if you start early enough and work with an expert team to put a proper succession plan in place. My advice is to get the best advice you can on the tax implications from someone who understands your business and the objectives of your succession plan.

**Step Eight – Communicate and implement the plan.** As with any major business strategy, developing and documenting the plan is ultimately only a small component of success. Long-term success is found in communicating and implementing the plan effectively and consistently over a period of time. One of my clients recently demonstrated how to handle the communication and implementation phase exceptionally well. An abbreviated version of the plan document was provided to all staff and regular meetings were held to discuss the plan, why it was being

implemented, its key features, how it would affect people and what the benefits were for current and new shareholders as well as staff. This company's investment in communication was repaid with a high level of acceptance for the plan among staff. They have also used their succession plan to greatly improve staff retention as well as their recruitment offering, which means that they now attract a higher calibre of employees.

**Step Nine – Get the Best Advice.** A key to success for any small business owner is to surround yourself with the right advisers. Unfortunately, many small business owners skimp on paying for good advice in an effort to reduce costs, but it's a false economy and in the long run they end up losing money, good staff, valuable resources and time. Surrounding yourself with the right advisers is vitally important in the succession planning process.

As you've seen, there are many different business functions involved in effective succession planning, including maximising the value of your business, managing the equity extraction, funding the purchase, transferring control and management of the business, taxation as well as several other issues. All of these processes can be greatly enhanced with the involvement of a team of quality advisers that specialise in succession planning. Your team would be headed by a project manager who understands succession planning and is able to coordinate all of the technical experts, while taking a holistic view of your business and personal requirements. Other members of the team would include an accountant, lawyer, insurance expert and business coach.

Most small business owners invest years (and blood, sweat and tears) building value into their businesses, but because they lack a strategic succession plan, they never get to extract it. The time to start planning your exit strategy from your business is today. Make sure that you reap the rewards from your business and that the business you've created becomes a legacy to a lifetime of hard work by living on in the hands of the right new owners. □

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