

Succession Planning

“It’s not just about selling it’s about creating options”

What is it?

It is assisting you in

- The transition of your business to the new owner and
- Maximising the value realisation and capital extracted through the process

It is a process not an event and ideally the process could take 3—5 years to maximise the value and capital extraction for you while it can be achieved in a shorter time frame it usually results in a lower value being extracted.

The issue

New Zealand is a country of small to medium sized enterprises (SME). Some key facts are:

- There are more than 380,000 SME’s
- They make up 95% of all New Zealand businesses.
- They employ 650,000 people, representing over 40% of the workforce.
- They create 40% of New Zealand’s GDP.

These may not seem interesting in themselves until you realise that SME’s have another important common statistic—small business owners are getting older at an alarming rate—evidence indicates the average age of business owners is mid 40’s to early 60’s.

The ‘generational crisis’

Over the next 5 to 10 years, a consequence of this aging SME community is that we will see a significant number of businesses during the current decade in preparation for retirement. Whilst this is a general trend across all industries it will be more pronounced in some areas.

Many owners see their business as a significant contributor towards their retirement capital. Some have managed to build retirement savings outside of their businesses, however many have only limited retirement savings. Without realising the assumed capital value of their business they will be forced to:

- Stay within the business for much longer than planned
- Accept a significant reduction in their standard of living; or
- Seek to position them in a way that maximises their welfare entitlement



The increasing supply of businesses coming on to the market over the decade is unlikely to be met by an equivalent demand.

As a result, the focus of the sale of the businesses will be either price or value. However, many small business operators are not in that position, nor have the skill set, to maximise the value of their assets. This will leave many to negotiate on price alone.

The likelihood is that most will be forced to achieve a sale through discounting.

As the supply increases there will be a widening gap between good business, which will continue to sell and command their price, and poor performing ones that will be under price pressure or be unsaleable.

“Succession is a lot like selling a house. The key is presenting a well-managed business which even after the “key scrape test”, will measure up to a purchaser’s expectation.”

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The changing business model (Market Convergence)

Historically, the majority of sales of SME's have been

Effects on the SME community

The combination of the demographic and market convergence trends will have a major impact on the SME community.

The capital invested in the SME sector will come under threat. Capital in the form of investment in plant and goodwill has been sustained over the years on the proposition that it will be returned through income and profits, or ultimately realised through a sale. If realisable incomes are placed under pressure, and the ability to on-sell at par or better is substantially compromised, then the willingness to invest will be challenged.

The changes anticipated cannot be prevented. It is a factor of market and demographic conditions. An understanding of these conditions will allow SME owners to consider a range of issues including:

- The increasing number of businesses for sale coming onto the market;
- For SME owners who are looking to exit, a shift in thinking from 'how much does my business produce' (income) to 'how much is my business worth' (asset value);
- The changing nature of market competition levels and business models;

- Business owners are staying in their businesses longer because they can't sell their business for a price that will sustain them in retirement.
- Owners having to allow more time to prepare their businesses for sale. Value needs to be built into their businesses or they will only be able to trade on price when they come to sell;
- The need for a greater emphasis on business and management skills; and
- A contraction in the number of businesses in the small business segment.

“Buyers want one thing - success! How does your business scrub up when seen through a buyer's eyes”

Shifting from 'reactive' to 'proactive'

The emerging trends clearly identify that succession is an issue that needs to be planned and given a reasonable level of forward consideration to maximise the results. Timeframes of 1 to 3 years are not unreasonable.

If you are considering selling/exiting your business in the coming years, you must shift your focus from being reactive to being proactive through succession planning, especially if you are to protect your business's value and wealth.

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Where to start

The first step is to undertake a business diagnostic.

This has two primary objectives:

- To identify any issues or obstacles that may impede the succession process: and
- To identify areas where improvement will likely cause a superior succession outcome.

The following steps are then recommended:

- Valuation – this step can be skipped where some form of external market data supports price expectation. Where there is no ready market by which to compare and assess the business, a valuation should always be undertaken.
- Succession plan – this step should always be completed. It is important to document the expectations, steps to be completed, and who is responsible for the various steps.
- Business improvement programme – this is the area that requires the most significant time to complete.
- Balance sheet review and tax structuring.
- Financial reporting structure – implement a system that provides a clear history of the business trends, sources of income, and key expense areas. This step will assist in explaining the business to a potential buyer and support their understanding of key business trends.
- Preparation of information memorandum – this step is highly recommended. In almost all cases it will assist the process of a sale, unless the potential buyer knows the business well.

How can Business Advice assist you?

To assist clients with their succession planning we have developed the following tools:

- **Selection of Succession Options checklist**
- **21 Step Business and Sales Advisory Service**
- **Business Diagnostic/Due Diligence review**
- **Business Development Questionnaire and Programmes**
- **Client and Employee surveys and checklists**
- **Variety of other related business tools and processes**

You may think the phrase ‘succession planning’ only refers to planning for the transfer of ownership of a business in readiness for retirement. In reality, succession planning should also take into account the planned transfer of the ownership and management of a business under a wide range of circumstances, including a general business sale, generational succession, management/employee buy-out, realisation (liquidation) of assets, or even a public listing.

Also, it’s not unusual for an unplanned event to occur that requires the transfer of the ownership of a business at a less desirable time or under less than ideal circumstances. It’s at these times that a good succession plan will be particularly useful. For example, what happens if a business owner suddenly suffers a

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What are your options?

Usually you will do one of the following six options:

1. Sale of the business (externally)
2. Generational Succession (internally to family)
3. Employee / management buy-out.
4. Retain ownership and appoint a new CEO
5. Structured realisation of assets (closure)
6. Public listing

The majority of succession activity will occur in the first three options, with the external sale of the business being the dominant outcome.

By working through each option and discussing your motivations and arising issues will assist in clarifying the option most suited to you.

By following a formal process such as our “Selection of Succession Options” checklist can be an excellent way to explore and discuss your options. This process helps educate you while also identifying which option may best suit you.

In our experience in this area, the path followed often takes turns along the way with the final outcome not being the same as initially envisaged. Therefore it is important that you are aware of the main options, the process and some of the implications of both of these factors.

Some Succession Tips

1. Succession isn't just a retirement issue
2. Develop your business with its succession in mind
3. Plan out your succession—adequate time will produce best results
4. Understand the concept of “windows of opportunity” - you may not be able to choose your exact time
5. If your option is to sell the business, allow a minimum 3 to 6 month time frame to achieve the sale
6. Never take a business to market if you are not succession ready
7. Take advice on your business structure and tax position in advance
8. Understand all of the contract terms you enter into, particularly any warranties or indemnities.

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