INVESTMENT BANKING

Exit Stage Left

Your guide to family business succession planning.

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Introduction

No one goes through the work, risk, and sacrifice of starting a business without hoping it will last. Building value that endures is the dream that motivates entrepreneurs. Yet in many businesses, too little of that work goes into determining who will take over when the founders leave the stage.

This guide highlights the two stages you should consider for the long-term posterity of your business after your exit. You will also find the Succession Planning Toolkit with helpful checklists and questions outlining the various facets of a successful exit strategy.

For private, owner-managed, or family-owned businesses, a solid succession plan can drive the growth of the business and set the stage for retirement. Family-run businesses may benefit further by focusing on preserving harmony within the family.

This guide addresses the broad range of topics that business owners need to consider in order to facilitate an orderly transition of management and ownership. The information that follows is intended to help business owners measure their state of preparedness for their desired business succession.

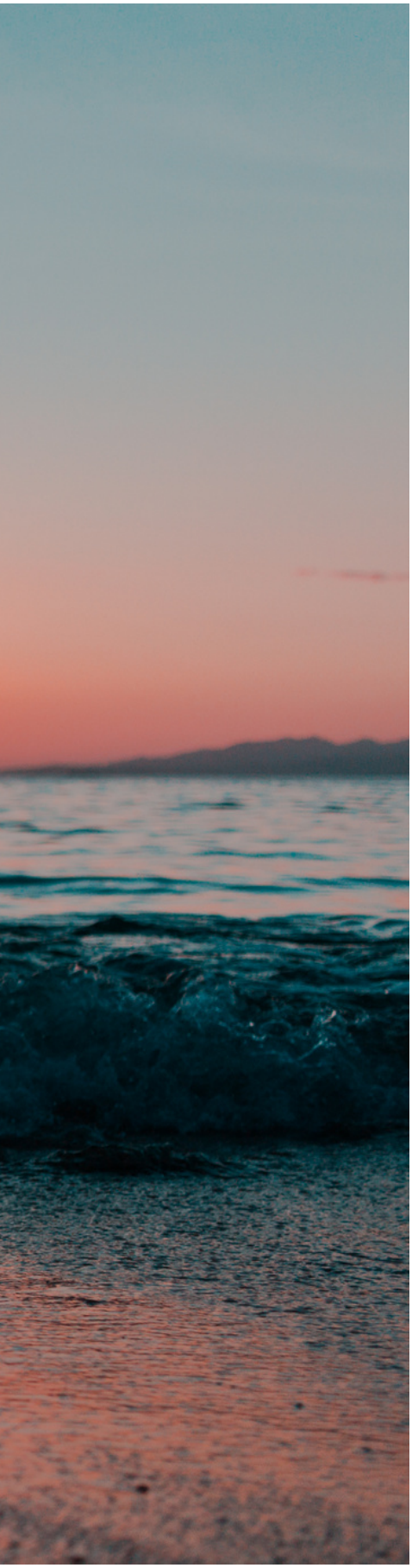
Not all questions will apply equally to every business and business owner. However, some elements of this guide may be relevant to every business owner.

Stage 1: Getting ready to exit

Pursuing the right exit strategy and delivering a smooth transition throughout the process.

Stage 2: Your Next Chapter

Embarking on a new journey



Stage 1: Getting ready to exit

Stage 2: Your Next Chapter

Which exit strategy is right for you?

In simple terms, Business Succession Planning refers to the process of determining how business ownership will be transferred and how the transition of its management control is handled.

Failure to create a succession plan for your business can invite disruption, uncertainty, conflict, and endangers future competitiveness. Even long-established businesses can risk failure without a succession plan that accounts for the transference of knowledge and/or managing power.

These issues may be further complicated in family-owned or controlled businesses where there are emotional ties. In these cases, the issue of succession also introduces deeply personal issues that can create tension. There is also the risk of having to widen the circle of stakeholders to include non-employee family members.

Creating a succession plan requires realistic expectations regarding the current state of the business, viable successors and your desired post-exit lifestyle. The earlier this process starts the better, as this allows for thinking through all the key decisions that may need to be addressed and for considerations that may not have been initially envisioned to reveal themselves.

A closer look

Management succession is the transfer of leadership and responsibility for the day-to-day management of the business, including compliance, governance and commercial decisions.

Ownership succession is the transfer of the equity interest in the business entity, whether that be shareholding, partnership interest or beneficial interest in a trust. Owners do not necessarily have a say in management decisions.

Tip

While you can work on management and ownership succession at the same time, we recommend progressing management succession first as it may be easier to maintain control and gives persons the time to get accustomed to their new roles.

Methods of Transfer of Ownership

Family Succession

Passing a business on to the next generation is a lifelong dream for many entrepreneurs. But making that dream a reality requires careful planning. You should consider which family members will be involved, their current knowledge and skill within the business, the legal structure of the company, amongst other things.

There are different approaches to a family succession plan. You can opt for a gradual transfer of ownership by gifting or sale, a complete one-off transfer, total withdrawal from management by the current owners or a progressive and staged devolution of power.

Selling

This is an outright sale of the company to an outside party. This option requires careful preparation to allow you to 'put your best foot forward' and secure maximum value for your business. Potential buyers will be eager to see the 'ins and outs' of your business which means you should allow time to receive the best possible valuation.

Merging with another business

A merger is when two or more businesses agree that they want to combine as a single business. Mergers are often driven by the competitive landscape. One of the key objectives of a merger is that the combination of the businesses can allow for a greater market share as well as greater efficiencies.

Bringing in Private Investors

Inviting investors can allow for a full or partial exit from the business and can be a potential precursor to an Initial Public Offering (IPO) - a viable means of maximizing value for the founders/owners.

For the purposes of this guide, we will continue under the assumption that family succession is the preferred choice.

Selling / transferring your business to partners or employees

Selling to partners can seem straight forward with the only question being how the required capital will be raised. Establishing an employee share acquisition scheme, also be known as an employee share purchase plan or employee equity scheme, can be a start to this process. It is an arrangement whereby an employee or a related party is provided shares or other equity interests in a company in respect of their employment.

Orderly winding up

For some business owners, the best option is to finalise all contracts, sell the assets of the business, pay off the debts and retain any surplus cash. This may be the case where the business is intimately connected to you and without your skills, there is no ongoing business to sell. It may also be an option if you want to get out of a business quickly and there is very little goodwill or equity. Closing a business in this way should only be considered if you are able to pay off all your debts.

All in the family

Keeping the business in the family may be your ultimate goal, but there are numerous factors to consider in bringing this to fruition.

To ensure you cover all the necessary bases, consider the following categories and their components:

Family
- Goal articulation
- Family information and communication
- Estate and gift planning
- Life insurance analysis
- Investment advisory services
- Family offices

Shareholder
- Shareholder agreement
- Disability planning
- Compensation planning
- Stock transfer technique

Business
- Business strategy assessment
- Management talent assessment
- Corporate structuring
- Current business valuation
- Retirement planning

The owners of privately held businesses face complex planning issues. For some, the first order of business is the long-term success of business operations, which encompasses a host of distinct issues. For others, the priority is the preservation of family wealth through estate, retirement, insurance and investment planning — an equally complex challenge that may not always align perfectly with the aim of perpetuating the business.

Strategic succession planning becomes even more complicated when family issues such as legacy, birthright, communication, personalities, and interpersonal dynamics are added to the mix. Even an apparently simple succession scenario can become more complex when family interests mingle with business concerns.

These issues should be part of a long-term strategic plan that accounts for the needs of the business as well as the needs of the business owner. To formulate a plan, businesses can draw on the experiences of select advisors who can address critical needs and win acceptance from multiple stakeholders.

Is family succession planning right for you?

How prepared are you? How prepared are your family members?

Toolkit

Here are some tools to check your level of preparedness. These tools are designed to help you, your family and non-family members work through key steps to ensure that your family business succession plan leads to the best possible outcome.

Family Succession Planning Quiz

Succession planning checklist

A means to an end

Corporate Finance

The simple vision of just handing over the keys is seldom realistic.

The way a business structures itself, assesses its value and goes about obtaining capital all sound like here-and-now concerns. And they are. Each of these disciplines are vital to the work of managing a business in the present day. It's not always easy to see how these decisions influence business succession plans that may not take effect for many years. But they form the foundation where those future plans will eventually rest.

The simple vision of handing over the keys is seldom realistic. Many ownership succession plans lead to the company's ownership being divided, transferred, or consolidated. Some closely held companies may be able to fund their succession plans on their own. But when the process requires a cash payout to existing shareholders that is more than a company has available, it has to turn to external funding sources.

There are two basic financing alternatives available to businesses: debt and equity. Debt is simply a loan, with a promise to repay the funds borrowed, plus interest, over a designated period of time. Equity financing involves the sale of an ownership share in the company to another party. There are advantages to using either form of financing. The appropriate answer for a company depends on the specific circumstances at hand and the way the choice interacts with other elements of the succession plan.

Two ways to raise capital for succession planning

You can raise the cash needed for your succession plan through debt financing or equity financing. Both have their advantages as outlined below.

Advantages of debt financing

- Debt financing is finite which means the company's obligation to the lender ends when the debt is repaid. As such, the owner retains control of the business.
- Depending on the strength of the business and the preferences of the owners, debt can be either secured or unsecured and have various levels of covenants to assist owners in navigating potential unexpected events.

Advantages of equity financing

- Money received by the company stays in the company. There is no commitment to make future repayments of cash.
- Financial flexibility is maximized in the event of a slowdown in operating performance.
- Multiple classes of stock (voting and nonvoting) may allow companies to receive an injection of cash from outside investors without giving up management control of the company.
- Some companies simply do not have the capacity to incur additional debt, which generally leaves equity financing as the most viable alternative.

Food for thought

Owners of closely-held businesses often rely on those with whom they have built client service relationships over many years, such as a banker, lawyer or insurance broker.

As a result, they may not always shop aggressively for a capital structure that gives them the greatest power and flexibility. Furthermore, when a succession plan calls for financing, or for shifts in financial structure (for example, through a leveraged dividend or a minority equity investment), companies may limit their options by relying solely on historical relationships that might have served them during an earlier phase of their company's evolution.

If owners determine that their ultimate goal is to sell the business, implementing the appropriate capital structure can help the business weather storms before, during, and after the eventual handoff. It's important to approach finance with a long-term view.

Remember, succession planning is a process, not an event. Whether you realise it or not, that process starts the moment a business first opens its doors. Without a doubt the day it's needed arrives sooner than most business owners expect.

The next act

The post-sale phase of ownership represents an opportunity for you to either move from 'business owner' to 'investor' or consider the next stage of your life if you are planning on retiring.

What many people fail to appreciate is that personal wealth management in a post-succession life stage is not always about complete independence from the business. Some financial ties may endure long after you sever the management ones.

The plan you make for your business can have significant and often surprising effects on the plans you make for yourself in retirement. The financial futures of other key stakeholders are in play as well.

A few options to consider:

Retirement
Your ideal version of enjoying the fruits of your labour.

Estate planning
You may decide that you want to transfer wealth to your family. This may include setting up a trust or a family investment company for your dependants and/or reallocating your property, assets and chattels to your dependants to manage your estates and succession planning requirements.

Start over
This could be a business you start from scratch or acquiring an existing business.

Other roles
You may be interested in sharing your knowledge via Director roles in other businesses.

Work with the new investor
You want to stay in the business and work closely with the new shareholders in a PE or an IPO scenario.

Retirement

In addition to savings, retiring owners may work to create sustainable cash flows that continue to flow from the businesses they've left. In some cases, they may also rely on instalment proceeds from the sale that ended their tenures.

Retiring owners who set up these income streams and plan to depend on them need to confirm that the source of cash flow is adequate and protected. Retirement planning for closely-held business owners can be especially challenging in the frequent cases when a closely held business owner's retirement plan is linked to other critical issues like developing the next generation of leaders, estate and gift tax planning, stock transfer techniques, valuation, and corporate finance.

A retirement strategy starts with goal setting. What is your vision of retirement? Do you envision spending any time at work, or will you withdraw completely from managing the business? What sort of lifestyle does 'retirement' mean in your view — and how much money will it take to make that vision come true? Once you have established a retirement plan, do not set it in stone. Review it periodically to make sure it's tracking with reality. Think of retirement not as the absence of a job but as a new job — safeguarding and enjoying the rewards you've worked hard to accumulate.

Tip

In addition to managing any corporate finance needs, RF can assist with all the faucets of advising and executing retirement strategies, trust and estate planning and general investment management.

Trust & Estate Planning

Trusts are widely used in estate planning, largely because they're very flexible. You can create and fund a trust during a lifetime (inter vivos trusts) or create one by the terms of a will or trust at death (testamentary trusts). The terms of some trusts may allow it to be changed or even revoked by the grantor. Other trusts may be fixed or irrevocable at the date of creation.

In estate and financial planning, there are several common purposes for using trusts:

- Protecting assets - In certain situations, a properly drafted trust can protect the assets from the creditors of a beneficiary. In addition, the assets may be protected from a spouse in the event of the divorce of the beneficiary.
- Providing privacy - The assets, terms, and conditions of a trust are generally not subject to public inspection.
- Managing assets - The responsibility for making investment decisions and maintaining adequate records can be transferred to either a corporate or an individual trustee.
- Avoiding probate - The assets that are held in a trust created and funded during the grantor's lifetime are controlled by the terms of the trust, not by the terms of probate. Avoiding probate can save time and reduce administrative expenses.
- Providing for multiple beneficiaries - A trust can be created for the benefit of multiple beneficiaries and can allow the trustee to use discretion in making distributions.
- Providing for special needs - A beneficiary may have a special need relating to education, health, and so on. A trust can be used to address those special needs.

Investment Strategy

As a business owner, you may face special challenges in managing family wealth. It takes so much time and energy to stay on top of business operations that it may seem like there's little bandwidth left to manage personal investments. In this case, you may want to defer investment decisions to a broker or money manager.

Experienced help definitely has its benefits, but your personal attention is still a necessary ingredient for your investment portfolio to reach its potential. No one knows better than you how to make sure your investment strategy aligns with your family's goals or those of your business.

Managing wealth should be an integral part of any comprehensive succession planning process. To successfully anticipate and plan for future needs, investment advisors should understand clients' attitudes and competencies including:

- Overall investment goals and objectives
- Personal risk tolerance
- Level of knowledge relating to investing
- Current investment strategy
- Current investment portfolio

An investment advisor who understands all of the components of the succession plan may better account for income and estate tax complications, retirement needs, or other special cash requirements.

The hope for every retiring business owner is to experience seamless coordination of the plan by an investment advisor who is independent, tax-sensitive, and understands the succession plan.

"No one knows better than you how to make sure your investment strategy align with your family's goals or those of the business."

In Summary

Neither succession planning nor retirement planning happens quickly.

People may plan for retirement, but the process is different for business owners. You can and should rely on professional counsel for both the succession process and the retirement process. You should certainly insist that the advisors you use in each case pays attention to the other side of the equation and work toward alignment.

Family business succession can be complex. Through personal commitment, planning, open communication and application of proven practices, families will find the succession journey enriching and worthwhile.

As a family, you can successfully 'pass the baton' and your legacy to the next generation.

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