WE KNOW
BUSINESS STRATEGY

EXITING THE BUSINESS

QUICK GUIDE

INTRODUCTION

All business people have to exit their business eventually. The best-case scenario is a managed exit, where you spend a number of years planning a graceful retirement, such as by selling to an external buyer, passing it on to a family member, selling part of the business and ending day-to-day involvement, or even just closing the business and winding it down.

The worst-case scenarios are when the receivers come in, or you face an unplanned sale because of a crisis, illness or a change in circumstances and don't get full value for your business, or you get forced out by other shareholders.

Now is always the best time to start thinking about your end game tactics – even if it is your first year in business. Selling a business takes time; you must plan ahead and groom what is possibly your most valuable asset for re-sale.

WEIGHING UP THE BENEFITS

Before embarking on the process of business succession, it is essential that you understand your motivations for the process and what you hope to get out of it. Without a clear view of the intended outcome and the benefits of the process, it is unlikely that your objectives will be met. To help you understand your priorities and set objectives, ask yourself the following questions:

- Do I want an ongoing management involvement in the business?
- Do I want an ongoing financial involvement in the business?
- Have I determined what's really important to me? For example, do I wish to maximise the value I receive for my business, or are other issues (like safeguarding my employees) more important?
- Are there other motivating factors for me? Do I want the business to retain its name and identity following my exit? Is it important that my business retains its independence and/or kiwi ownership?

Understanding the answers to these and other questions will help you to be clear about your priorities and lead you to choose the most appropriate method of exiting the business.

While it is important to have a clear view of your objectives, it is also important to be clear about the priorities of your business. Having a clear view of your future strategy for the business and the critical success factors will impact on your chosen method of succession and exit. Questions you should ask yourself include:

- What are the opportunities available to my business and what is the strategy for taking advantage of them?
- What are the critical success factors in determining the future growth of my business?
- Does my business have all the necessary managerial expertise required to be successful in the future?
- Does the business have an appropriate capital structure and access to further funding to enable it to take advantage of the future opportunities?

Answering these questions requires a clear view of the future strategic direction of the business. If the future strategy requires significant changes to the current business model, the impact of these changes needs to be factored into your succession and exit planning.

For example, if your business has, to date, largely been focused on the New Zealand domestic market and your strategy dictates that it must exploit export markets to grow, this will have significant implications for the managerial and capital requirements of your business and hence, your succession and exit strategy. You may decide that the capital, resources and 'know how' of an existing overseas company are the best route for exploiting your company's export potential. Alternatively, you may decide that a stock market flotation provides the best option for raising the necessary capital and attracting the appropriate managerial talent. Whatever your decision, it is only by a clear understanding of your priorities and your business's priorities that you can choose the succession and exit options that best meet your needs

SUCCESSION PLANNING

Formal governance

Establishing a formal governance structure is one of the best ways of ensuring a successful transition when the time comes to transfer or sell part or all of the ownership of your business to someone else - the next generation, your management team or an external buyer. It also helps ensure you get the best possible price.

The benefits of planning include:

- Survival and growth of the business
- Retaining harmony within a family
- Minimisation of tax obligations
- Setting up the retirement you envisage

Like any other form of planning, deciding where you want to go and how you will get there is key. Working through the issues involved with a managed exit takes time, generally several years.

An effective board will ensure the best succession path for the individual business and its owners is chosen, and a realistic timeframe established within which to make it happen.

Companies with boards are more credible to buyers

Deciding that you're going to sell or transfer ownership of your business is not the same as actually doing it.

Common barriers include:

- For SMEs most of the company's knowledge resides with the owner and it can be hard to transfer successfully to a third party.
- Many owners have an unrealistic idea about the value of their business.
- There aren't that many buyers out there and connecting with them isn't necessarily that easy and when you do it may not be plain sailing.

An effective governance structure will play a large part in breaking down these barriers:

- A board or independent directors will understand the need to capture institutional knowledge, one of a company's principal assets, so that the risk if anything happens to the company's owner(s) or founder is minimised and the company can continue independently of the owners.
- Valuing a company is a difficult discipline. Experienced directors will enable owners to strike a realistic value that is based on a range of indicators, rather than wishful thinking. In addition, effective board's add value to the company's bottom line making them more attractive to prospective buyers than those without, but also giving them greater credibility with financial institutions and professional advisors, possible sources of buyers.
- The networks that independent directors bring will also be invaluable in identifying and connecting with prospective buyers.

Taking the emotion out of the process

The reality is that many small business owners simply shut up shop when they're ready to retire or sell. Of the above survey group, only 47% had any sort of exit plan and few of these were formal ones. Common reasons given for not having a plan were 'It's too early to be thinking about it', 'There's never enough time' and 'I don't know where to start'.

Some of the reluctance to discuss or plan is psychological; fear of death, envy of the younger generation to whom the power is passing, facing up to leaving a business that has encompassed your hopes and dreams, and being worried about loss of status are a few of the barriers. In family-owned businesses where there might be more than one generation involved, with different aspirations and expectations, there are also likely to be complex relationships to take into consideration.

Establishing a board or including independent directors in your governance structure will bring much needed objectivity to the discussion and minimise the emotions.

Questions you need to ask:

- Do you want to be able to walk away and be done with it? *(In which case you need a cash sale with no strings.)*
- Would you consider leaving some of your equity in the business while the new owner gets up to speed?
- Do you want to sell to someone who will carry on your vision?
- Is there a minimum price you can afford to accept?
- If you are retiring or selling in order to do something else, how much is enough?
- Is selling the only option - perhaps you should consider keeping your investment but bringing in a suitably qualified manager so you have no day-to-day involvement.

A board can help you find the answers

Consider this:

- Fewer than 15% of family firms survive under family control after the third generation.

Source: Study by Harvard and Wharton Business Schools.

- Many owner-managers have an ultimate vision to retire and sell their businesses, but have not adequately considered the steps needed to make that vision a reality. Even those who never plan to retire will need to plan to ensure that the intrinsic value of their business is retained to benefit their heirs. Unless the owner is prepared to let the business expire, a long-term program to identify and groom future company executives must be undertaken.

Deloitte - The Art of Business Succession

Conclusion

Succession planning is a complex and often emotionally fraught business.
A Board will help you to:

- Take the emotion out of the process
- Ask the right questions
- Address the right issues
- Define what it is you want
- Involve the right people
- Communicate effectively to those who will be affected
- Be fair
- Put a realistic value on your business
- Commit adequate resources
- Set an achievable timeframe for your plan
- Have credibility with buyers and other key stakeholders
- Make your vision a reality

SMALL BUSINESS OWNER

An owner forced to exit a business or sell to a shareholder to keep their business going or growing it can be very hard. They can feel that they have lost control of a business that was part of them. And they would be right.

It is important that you are made aware of the different options, and their financial, legal and tax implications. This can be a highly specialised area and if your legal and accounting advisors are not experienced in this area and aware of the options you will not have the opportunity to select the best ones.

Consider the basics for succession planning below before going to your lawyer or accountant;

The Plan
There is no perfect template or model for a succession plan, because each plan will vary. Having said this, there are three basic steps to creating a succession plan:
Step 1: evaluate the business assets;
Step 2: evaluate the management of the business; and
Step 3: collate the information from Steps 1 and 2 into a written plan.

The Review
A crucial part of ensuring the “success” of your succession plan is to subject it to constant review. This is so you can update it, if necessary, to reflect both the currency of the forecast assumptions and also changes in the wider market.
Your plan should also be reviewed if something unexpected happens, such as a crisis, a relationship upheaval (personal or business) or the loss of a key customer or supplier, or if your own succession objectives change.

The End
Succession is generally all about ending your involvement in your business. As a result it is very focused on what you are going to end up with. It makes sense then to think, as early as possible in the life of your business, about what you want out of your business.

Please refer to our other resources Planning for a Crisis and Managing a Business following a Crisis.