SUCCESSION PLANNING AND EXIT STRATEGY

How to safeguard the future of your business

www.bcms.com
CONTRIBUTORS

Jonathan Dunn,
Managing Director,
Major Transactions Group

Anthony Flynn,
Financial Planning Director,
Chartered Financial Planner

Rebecca Leask,
Partner and Notary Public
EXECUTIVE SUMMARY

International mergers and acquisitions advisor BCMS, specialist wealth manager Investec Wealth & Investment, and law firm Harrison Clark Rickerbys have teamed up to provide business owners with this comprehensive study on handing over ownership of a company to a new team.

How should owners decide whether to sell to a trade buyer, organise a management buyout (MBO), or keep the business in the family?

In this white paper, business owners are presented with impartial advice on the many different options available, from how to identify a potential successor internally to designing an exit strategy.

Making these decisions early will help ensure that business owners can pass on their business without compromising its value.
INTRODUCTION

This white paper has been produced to help business owners protect the value of their company during a change of ownership.

The decision by an owner-manager to step back and hand over their business may seem simple, but the consequences of failing to plan can be severe – with family fallouts, feuding shareholders, or a staff exodus all common scenarios that can make a business unsellable and unmanageable.

Put simply, a succession plan identifies who will take the reins and when, and outline interim measures to ensure the successor is ready to take over. An exit strategy outlines how the business will be transferred to another third party such as an acquirer.

Family businesses face particular challenges in these areas. Handing the reins to the next generation is still the most popular option, and yet only half of current owners believe the next generation is capable of taking over 1.

Non-family businesses face their own dilemmas too. Many SMEs remain overly reliant on their founding entrepreneur – limiting internal succession options, while also making the business unattractive to potential buyers. This paper also details ways to address common challenges for entrepreneurs seeking an exit.

Whether the business is to be passed on to the next generation, sold to a third party, broken up, or even closed down takes careful planning to optimise the chances of success.

1. PwC Next Generation Survey – 2016
Succession planning has been around as long as family businesses themselves. Historically, the family firm was often passed down to the eldest child, even if they were sometimes reluctant to take on the responsibility.

However, in the last 20 years, succession issues have become more pronounced, due to several emerging realities:

- **Job mobility** – few people want a job for life, so finding and keeping key people is harder
- **Retirement** – babyboomers are retiring in record numbers, increasing demand for senior management expertise
- **Downsizing** – the trend for flat management structures has removed tiers of potential leaders from the business

Succession planning acknowledges that staff and shareholders will not be with a company indefinitely, and provides a process to address the changes that will occur when they leave.

While most planning focuses on CEO succession, all key positions should be included in a plan.
WHAT IS SUCCESSION PLANNING?

• Succession planning is a process to identify and develop internal people to fill leadership positions in a business.

• In practice, this amounts to holding on to a pool of talent, then planning replacements in key roles.

WHY IS SUCCESSION PLANNING IMPORTANT?

• **Continuity** – a means to ensure business continuity when key people leave

• **Retention** – a way of hiring and keeping talented people motivated to stay in the business

• **Motivation** - the accompanying commitment to develop career paths sends a message to employees that they are valuable

• **Value** – unplanned transitions typically reduce company revenues by 16% 

WHO IS RESPONSIBLE FOR SUCCESSION PLANNING?

• The board is responsible for the replacement of the CEO

• The CEO is responsible for planning replacements for other key positions

• If the HR manager lacks the skillsets for succession planning, assign external consultants

WHERE TO FIND REPLACEMENTS?

• **Existing senior staff** – but look beyond the exiting executives’ immediate deputies

• **New hires** - exceptional employees in other organisations may be looking for new challenges

• **Former staff** – perhaps a manager left to gain more skills and experience and can be re-hired

• **Consultants** – may be interested in working as an employee again in the right environment.

---

2. BCG Perspectives – Succession planning in family businesses – 2015
AFTER THE HANDOVER: WHAT DO BUSINESS OWNERS DO NEXT?

Many owner-managers are daunted by the prospect of having nothing to do after handing over control of their business. Anthony Flynn of Investec Wealth Management has advised many on their post-sale options. He says: “Typically, owners have given so much of themselves to the business that they struggle to let go and create some separation.”

Around 30% of BCMS entrepreneurs who have sold a business start another venture, or get into crowdfunding, for example. As the chart below demonstrates, the average age of shareholders who choose to sell with BCMS is just 52 at the point of sale.

“Most are hard-wired as entrepreneurs,” says Flynn, “and are looking for ways to make money in new and innovative ways, and that doesn’t just go away.”

Others use their new-found freedom to help their favourite charity, or pass on their experience to other business owners. Philanthropy is a growing trend, particularly for those in a wealthy position where perhaps their own childhood was not so privileged.

Investec’s Flynn continues: “There’s a growth in mentoring by people who have successfully built a business. Typically, this is motivated by altruism rather than profit making.”

Profiling owners who choose to sell – Data taken from 100 selected businesses sold through BCMS, 2014 – 2016

<table>
<thead>
<tr>
<th>Average age of business – approximately</th>
<th>Average number of shareholders</th>
<th>Average age of shareholder</th>
<th>Average post-sale involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 years</td>
<td>3.2</td>
<td>52</td>
<td>1.5 years</td>
</tr>
</tbody>
</table>
## SUMMARY

Businesses sell all the time without succession plans in place, but most acquirers want someone experienced in place. Succession planning ensures risks are reduced and value is maximised when the moment of handing on the business finally arrives, and is therefore highly recommended.

### SUCCESSION PLANNING CHECKLIST

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Set goals and objectives</td>
</tr>
<tr>
<td>2.</td>
<td>Identify preferred exit strategy</td>
</tr>
<tr>
<td>3.</td>
<td>Restructure shareholdings</td>
</tr>
<tr>
<td>4.</td>
<td>Tax and legal implications</td>
</tr>
<tr>
<td>5.</td>
<td>Estate planning</td>
</tr>
<tr>
<td>6.</td>
<td>Successor selection</td>
</tr>
<tr>
<td>7.</td>
<td>Successor training</td>
</tr>
<tr>
<td>8.</td>
<td>Contingency plan</td>
</tr>
<tr>
<td>9.</td>
<td>Conflict resolution</td>
</tr>
<tr>
<td>10.</td>
<td>Communications plan</td>
</tr>
<tr>
<td>11.</td>
<td>Timelines</td>
</tr>
</tbody>
</table>
IS A BUSINESS STILL SELLABLE WITHOUT RESOLVING SUCCESSION ISSUES?

• A study of 100 small businesses sold by BCMS found that 58 had no succession plan. Furthermore, these owners were not required to stay in the business after acquisition, any longer than those with successors in place.

• Conversely, a study of 200 ‘business transitions’ from 1995-2014 found that unplanned change of ownership or management caused a 16% drop in company revenues, and 4% drop in annual profits. ³

³ BGC Perspectives - Succession planning in family businesses - 2015

www.bcms.com
PART 2: EXIT STRATEGIES

As with succession planning, choosing the right exit strategy for business owners and shareholders takes careful planning and good advice.

While all businesses are unique to some extent, many share common characteristics which influence exit decisions.

HOW TO PREPARE FOR EXIT

• Assemble the best management team possible
• Owners step back gradually from the business
• Plan the tax situation with an expert
• Make the business as attractive and investable as possible – profitable, growing, and well-run
• Add as much substance to the business as possible – trademarks, contracts, R&D etc.

SHAREHOLDER OPTIONS

**IPO** – In an Initial Public Offering (IPO), a portion of the company is floated on the stock market, with public share trading. Typically, the owner and management team remain in place for a few years, and your company continues to operate much as it has in the past.

Most major financial centres have secondary stock markets designed for smaller businesses. There are no minimum size requirements and companies with as little as £20m (US$29m) annual sales are trading successfully and growing fast.

• **PROS:** straightforward exit for a shareholder or investor and capital injection for the company
• **CONS:** public companies are subject to additional regulations which can become prohibitive

<table>
<thead>
<tr>
<th>SHAREHOLDER OPTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IPO</td>
</tr>
<tr>
<td>2. Full company sale</td>
</tr>
<tr>
<td>3. Partial sale</td>
</tr>
<tr>
<td>4. Management buyout</td>
</tr>
<tr>
<td>5. Management buy in</td>
</tr>
<tr>
<td>6. Liquidation</td>
</tr>
</tbody>
</table>
MBO MYTH-BUSTER

How are MBO deals financed? Venture capital, private equity, business angels and asset-backed bank loans. The managers are expected to invest alongside these finance providers.

Aren’t these deals risky? A well-structured MBO takes account of any performance shortfalls while still meeting the funding obligations of external investors. However, with greater debt levels attached to the business, there is less margin for error.

My managers don’t have enough money to invest. Typically, a figure of one year’s salary will need to be personally invested by the management team, depending on the overall debt/equity mix of the business.

I am not sure whether I have the right team in place. An experienced and balanced team is not just critical to funding, but to the success of the business. The team should be led by a Managing Director/CEO, and have a clear strategic direction.

How long does it take? Typically four to six months – considerably shorter than most trade sales (which average 12 months-plus).

Tip: Some owners dismiss the MBO option early on because they don’t think their managers can afford – or have the experience – to buy them out. MBO investors bring vast business expertise as well as funding, to ensure that the management team get off to the best possible start.
FULL COMPANY SALE – selling the entire business is a very popular choice among family businesses and entrepreneurs, as evidenced by the 90,000 acquisitions worldwide in 2015. The acquiring company buys the assets and/or shares of the target business, and may or may not wish to keep the current owners or management team. Most buyers will structure the terms of a deal to keep the business owner on board for a handover period of 1-2 years (often attached to a deferred payment or ‘earnout’).

- **PROS:** realises significant cash to fund retirement, start another business, and safeguard staff jobs
- **CONS:** loss of control on future direction of the business, which may still have friends and family involved

PARTIAL SALE – offering a minority or majority stake in a business is particularly suited to fast-growing companies and industries. An investor or another company takes a stake, either indefinitely or for a fixed period, allowing for board-level exit while providing stability to the business.

- **PROS:** selling a minority stake may allow for an exit from running a business, while still maintaining control
- **CONS:** Some companies take minority stakes to prevent competitors buying them, and the business may become unsellable until that investor exits

MANAGEMENT BUYOUT

This provides an immediate cash payment to the existing shareholders, as the business is recapitalised and sold to the next generation of incoming management. A management buyout (MBO) is usually financed through a combination of private equity and debt collateralised against the assets.

Investors like MBOs because they provide consistency of management, less disruption to customers, staff and suppliers, and in-depth industry knowledge.

- **PROS:** buyer and seller already know each other, and ideal for businesses that can assume debt and may be stagnating
- **CONS:** occasional inability of financial partners to agree on how they will deal with each other
**MANAGEMENT BUY-IN**

A management buy-in (MBI) occurs when a manager or management team from outside the company raises the necessary finance, buys it, and becomes the new management.

Just 2% of business sales end up as an MBI, and the incoming team has to appeal to both the exiting shareholders and their investors to successfully complete a transaction.

In some cases, a combination of existing and incoming managers takes over a business. This is known as a buy-in management buyout (BIMBO).

- **PROS**: ideal when there’s no single succession plan and no obvious internal candidate left to run the business. MBI candidates have some profile in the industry, which can help unlock future potential
- **CONS**: occasional risk of a clash with the new management and company culture

**LIQUIDATION**

There are no current figures to calculate how many businesses are voluntarily wound down, but family business surveys in the UK, US and Europe suggest 9-15% of business owners will simply shut their business down.

Here, business owners may not appreciate the true value of their enterprise, and seek to sell off stock and assets piecemeal.

- **PROS**: an emergency plan if the other options fail
- **CONS**: significant loss in value from not monetising ‘soft’ assets such as brand reputation, specialist skills, and customer loyalty

---

4. Institute of Family Business – State of the Nation 2015-16
WHAT DO TODAY’S SELLERS LOOK LIKE?

PROFILING BUSINESS VENDORS BY SHAREHOLDING AND AGE

Source: Sample of 100 BCMS completions worldwide 2014-16

www.bcms.com
PART 3: REAL EXAMPLES OF EXIT CHALLENGES

SCENARIO 1: THE WRONG SUCCESSOR

Husband and wife John and Jane, both 50, set up their food logistics consultancy more than 20 years ago. They put in place some informal succession planning by offering a board position to a senior manager two years ago, but had doubts about his ability to run the entire operation.

After hiring an advisor, the couple decided to see if they could find a trade buyer to speed up their exit, with a possible management buyout as a fall-back position.

They sold for £5.6m ($8.2m) to a multinational logistics group, who have put one of their own managers in to work alongside the previously identified successor.

SCENARIO 2: AN UNEXPECTED BREAK-UP

Bill and his wife Barbara had run their retail business together for 15 years, and were getting divorced. They had agreed to split everything 50/50, but the break-up had taken its toll on the business, and sales were underperforming.

After looking locally for a possible investor to buy out Barbara’s share, Bill and Barbara decided to sell the entire business.

They had no succession plan, and were in a hurry to sell, but their advisor still found them a major retail group keen to expand geographically in their part of the world. The £1m ($1.5m) offer was accepted by both, and as a cash-on-completion deal, both parties were able to walk away and start a new chapter in their lives.
SCENARIO 3: THE RELUCTANT ENTREPRENEUR

David started working for himself as an IT consultant after the recession in 2008, taking a few of his former employers’ customers to get the business going.

Regarding himself as a ‘techie’ rather than an entrepreneur, David hired two managers to take on the commercial and operational aspects of the business, but after six years, he found he wasn’t enjoying his work and wanted to start a new venture in an exciting new field.

Despite his apparent reluctance, the business was growing at 15% a year, and attracted multiple buyers and offers. He sold to a private equity house, who wanted to combine his company with a similar IT consultancy they bought the year before.

David has already started up a new venture in a new non-competing field, and is busy developing a new suite of products.

SCENARIO 4: SELLING A CASH COW

Brothers Andrew and Adrian set up their software business in 2010, and it’s been a runaway success generating double-digit growth. The pair awarded themselves generous salaries and dividends, and sales were robust, attracting private equity investors.

They worked out what the business was worth, and believed it was time to cash in. But on closer inspection, the investors dropped out when they saw how much money had already been removed from the business.

Eventually, Andrew and Adrian found a trade buyer and accepted a £10m ($15m) offer. The buyer told them afterwards that they would have paid twice that if the brothers had reinvested half of what they took out of the business.
PART 4: CONCLUSION

Succession planning and business exits are two equally important elements of deciding when a business should change hands.

Succession planning is an ongoing process to identify and replace key people (not just the owner-manager).

An exit strategy can also be open-ended, but is more often fixed by a range of factors such as market conditions, and the age or health of those exiting.

As illustrated, there are many different deal types to deliver the goal of a succession plan or business exit. While some are more popular than others, it is important that owners enter the process of transitioning their business with an open mind.
ABOUT BCMS

BCMS is a specialist lead advisor to shareholders of private companies. The company is a market leader in its chosen area of expertise, having completed over 500 deals in the last decade alone. BCMS is the world’s leading advisor to privately owned companies by deal volume, according to data disclosed to Bureau van Dijk’s Zephyr database.*

A family business, professionally run, BCMS has grown substantially since it was first established in 1989. Much of its international expansion has taken place in the last five years: BCMS has established offices across five continents and the company now employs 260+ staff.

* Source: BvD/Zephyr. BCMS tops the ranking search that includes completed deals in all value ranges by volume in the period 1 January to 31 December 2015, and specifies completed acquisitions, Management Buy-Outs (MBOs), and Management Buy Ins (MBIs) for private (non-publicly listed) companies. Search date: Jan 7 2016.

PUBLICATION DATE: July 2016

© BCMS 2016

Reproduction in whole or part without written permission is strictly prohibited. Whilst every care has been taken during the preparation of this publication, BCMS cannot be held responsible for the accuracy of the information herein or for any consequence arising from it. Opinions expressed do not necessarily reflect BCMS policies. The information published here is intended to be for general information only and should not be used as the basis for divestment decisions. BCMS, its staff and contributors do not accept any liability for any loss suffered by readers as a result of decisions made purely on the basis of the contents of this publication. Professional advice should be taken in relation to all divestment decisions. BCMS is a trading style of BCMS Corporate Limited.