Grant Thornton

An instinct for growth™

Succeeding at succession

A Grant Thornton series for privately held businesses

In this series we highlight key actions to help you achieve a smooth transition.

Forward planning is vital for the success of privately held businesses.

Whether in family or non-family firms, business succession has the potential to make or break a business. Managed effectively, it can help a business sustain its competitive advantage into the future. Managed poorly, it has the potential to see a business come undone rapidly.

Succession planning is not something that is done overnight. It is a complex process involving the thoughts and feelings of the owner's families, management and other senior staff, which should start long before the proposed transition date.

One of the main challenges is finding the right balance of participation, ownership and distribution of wealth in your transition process to ensure the continuity of the business and family harmony.

To achieve these goals, guidance, assurance and good planning are essential. Goals that are established before commencing will instruct and guide those participating in the process. Working through this process is both practical and emotional, often requiring an adjustment by all stakeholders in order to affect the full and successful implementation of the transition.

A key aspect of planning is to establish and understand in advance the financial requirements and growing needs of a combination of the following:

- the business
- the exiting generation
- the entering generation, and
- potential of additional generations

If there is a focus on continuity and ongoing jobs, this draws attention to the capital value drivers of the business, which will in turn support sale price if eventually there is a decision to sell.

Although there are no one-size-fits-all solutions when transitioning a private or family business, there are many tools that can be used to shape this transition. We can also assist business leaders to develop the communication skills that can help preserve family relations – and business wealth – for generations to come.

Grant Thornton's specialist advisers provide the best blend of succession expertise and knowledge for both business and family.

"Succession is the process of ensuring the successful continuity of a business beyond its current management and ownership."

Robert Scheiber
Melbourne

It took time to build the business. It takes time to pass it on.

After years of hard work and careful planning, many owners of successful businesses dream of transferring their company. This can be the most challenging stage in the lifecycle of the business while at the same time presenting the owner with the greatest opportunity to perpetuate the benefits and rewards of private ownership.

While each family business is unique, those that are successful across generations have much in common; a commitment to building a business that lasts beyond the tenure of its founders. This type of legacy is not created by accident. It requires you to carefully nurture your business value drivers, clearly articulate your personal and business goals, identify and groom qualified successors and engage the support of specialist advisers.

Working to establish a process, formalise it, timetable it, monitor it and commit the necessary resources sets the scene for success. Therefore, starting this process with readiness and the end in mind is no different to undertaking any other business project.

It is important to discuss the process openly before commencement, to identify and remove limitations and barriers.

There is often only one chance to get it right.

Answering the difficult questions

The first thing to determine is whether it is possible for the business to flourish after the transition of the founder. In certain circumstances this may not be the case. The business may be so dependent on a single individual that it has no life as a separate entity from the founder. However, this is unusual, and in most cases it is possible to pass the business on to a future generation, either family or non-family.

Although succession planning can be simply defined as the process of transferring the control and ownership of a business, developing and executing a succession plan is not nearly so simple. As the owner of, or investor in, a privately held business, you need to answer some hard questions. For instance:

- how long do you want to stay in the business?
- how sustainable is the business model?
- have you identified managers capable of growing the business into the future?
- how will these decisions affect key employees?

It is important to consider emotionally challenging issues that may call the skills of your family members into question or require you to creatively structure your transition to be fair to all those involved, understanding that fair and equal are not the same thing.

These issues may be complex, and sometimes uncomfortable to consider, but ignoring them is not an effective solution. While solutions exist to these quandaries, they won't appear overnight. If you want to ensure the long-term survival of the business, minimise taxes and – for family businesses – maintain healthy family relationships, it's never too early to put a succession plan in place.

"Succession planning can be overly complex if it is not approached in a rational and organised fashion. Owners, investors and managers must take the time required to both develop and implement a succession plan by putting processes in place to effect a successful transition."

Mark O'Hare
Brisbane

What could stop you getting out of the starting blocks?

A change of ownership is expected within the first ten years in approximately 25 per cent of private business. Yet only just over a half of these companies have a formal succession plan in place. This may explain why only 30 per cent of private enterprises survive into the second generation and only 12 per cent survive into the third.

Business owners cite many reasons for failing to develop a succession plan. They worry what will happen in their absence, who will be responsible and how the business will fare after their departure. They are concerned about meeting the needs of both managers and family members who are not in line for succession. They are uncomfortable about discussing personal and financial goals or about disclosing family issues to outsiders. They are afraid of compromising their personal relationships or creating irreconcilable rifts. Very often, they are simply hesitant to retire, concerned about their financial prospects or feel that any identified successors are not ready to take control.

While these challenges are not as acute for investors in privately held businesses, owners of non-family businesses, or managers of professional services firms, they still grapple with the complexities of identifying appropriate successors, defining clear exit strategies and laying the foundation for future growth. Often, the day-to-day realities of running a business hamper efforts at this type of long-term planning.

As a result, many privately held businesses find themselves making succession-related decisions under pressure, rather than planning in advance. Additionally, many businesses now point to recent economic volatility as a reason to defer succession planning. Arranging to sell or merge a business amid historically low valuations can be daunting. In the worst case scenario, without a sustainable strategy for the future and a viable business model, planning for succession becomes a moot point.

Although many of these reasons appear valid, failure to act can result in a host of unintended consequences. Without taking time to maximise the value of the company or adopt a structure that supports future growth, it may be difficult to attract buyers or investors. This may also compromise the company's ability to continue compensating owners following their exit, putting their financial welfare at risk.

Without developing an appropriate leadership structure or properly preparing successors, the business may flounder and ultimately fail – compromising investors' ability to realise a sufficient return on their investment. Proceeding without gaining buy-in from all the key stakeholders can result in losing essential staff or alienating family members - a major risk in a family-owned business. Without planning for contingencies and considering your alternatives, you can face a forced sale, higher tax payments and the potential dissolution of the business you worked so hard to build.

For these reasons and many more, succession planning is not a process that can be put off. By laying the groundwork in advance, you can position the business to capitalise on opportunities as they emerge, regardless of economic conditions. It's critical not to underestimate the challenges that can arise as you begin to plan for transition.

To improve your odds of success, you need to approach succession planning as an ongoing process, taking steps to overcome the psychological barriers and consider your options from all angles.

"Transitioning a business is no small item to plan around. If you don't do this right, it can scuttle the successful transfer of the business from one generation to the next."

Andrew Steer
Melbourne

Following a structured approach.

To get a handle on the complexities associated with succession planning, it helps to start by taking one step at a time. Although different approaches to succession planning exist, private businesses are more likely to reach their goals by following a proven process. The following process, recommended by Grant Thornton firms, is designed to help you uncover your real goals and objectives:

Collect and analyse information

In this first phase, you (or your advisers) conduct a series of confidential interviews with business owners, key management and/or family members to uncover both your immediate and long-term objectives. From an operational perspective, this allows you to identify potential obstacles to your intended succession plan and put processes in place to resolve them. From a personal perspective, it ensures that current wills, enduring powers of attorney, shareholder agreements and financial resources reflect your aims. This phase also affords you the opportunity to uncover the factors that truly underpin your business philosophy, family relationships and personal concerns.

Assess strategic and wealth enhancement opportunities

The second phase involves brainstorming a range of potential solutions with your advisers to address your transition goals. Through strategic planning sessions with your key personnel and/or the creation of a family council, you can solicit input from all stakeholders to ensure your plans take everyone's varying needs into account. This second phase also helps you consider opportunities to improve the value of the business over the short, medium and long terms by identifying the actions needed to improve cash flow and reduce perceived or actual business risk.

Design, develop and implement your plan

Having considered the various options, you will have the information you need to begin plotting your succession strategy or building a "blueprint" of the plan you are going to implement. At this stage, the steps you take will depend on the structure you've selected for your succession.

For family-owned businesses, if you plan to pass the business on to a family member, this is the time to identify your successor and help them develop the expertise they need to assume control of the business.

For owners or investors who plan to sell the business, this is the time to put processes in place. It is important to ensure you maximise business value, benchmark against your peers, rationalise business lines, identify service gaps, shore up your balance sheets, extract personal assets from the business, and generate competing bids.

If you intend to sell internally to management or other family members, make arrangements for the financing required to affect a successful transfer.

If you've given yourself a long enough timeframe, you can enhance the odds of reaching your succession planning goals by developing parallel succession plans – one that can be implemented immediately in the event of an unforeseen emergency, a second that you can implement in the mid-term (within one year) to begin closing any identified gaps, and a third that lays out your long-term intentions (five to 10 years) and contemplates a variety of financial models that account for different contingencies or scenarios. Here is where a proven process is invaluable. Many strategic plans, business models and succession plans never make it from concept to reality.

Review and monitor

As the business and/or family dynamics change over time, your succession plan must change with them. Be sure to schedule regular reviews of your plan to ensure it remains current and continues to reflect your evolving wishes. Be sure to communicate any change of plans to your key stakeholders to ensure no one is blindsided when the business is transitioned.

Taking action is the most important first step.

Although there is no definitive "how to" manual for developing an effective succession plan, our experience shows that the following actions can help the business survive – and thrive – into the future.

1 Start early

Succession planning cannot be approached as a one-time event. It is a process that should begin long before the owners plan to exit the business. Starting early ensures you can select from the widest range of options available to you.

2 Commit your time

Getting the business to its current level took time and commitment. A succession plan needs the same attention.

3 Identify your business value drivers

By understanding which parts of the business will be most valuable to a purchaser or other potential successor, you can maximise the value of those assets in advance.

4 Articulate your core values

One way to ensure the business maintains its focus and follows the path you envision is by clearly articulating your core values and instilling them as part of the culture of the organisation.

5 Rely on decision-making frameworks

These can help strip the emotion out of your decisions and provide a roadmap for your successors to follow.

6 Involve your successors in your planning

When key employees, family members and potential investors understand your intentions, they are more likely to support your decisions.

7 Separate your business and family assets

This involves more than adopting internal control processes and performance management practices. It may also mean introducing more formal operating processes – from the establishment of shareholder agreements and employment agreements to holding regular board meetings and family meetings.

"Many private business owners loathe spending money on a succession plan they feel they won't need for many years. However, by exploring the various options available, a succession plan often provides owners with a preferred blueprint. Consequently, it needs to be viewed as an investment capable of delivering significant benefits – such as increasing the value of the business, being nimble enough to contemplate a sale if the opportunity arises and gaining the ability to deal with any other shareholders or family members in a more proactive and responsible way."

Dale Ryan
Adelaide

A step–by–step guide.

At Grant Thornton Australia, we can work with you to address each step of the succession planning process as part of a structured approach. These steps are discussed in greater detail in our succession planning series, and include:

Establishing the value of your company

As you begin planning it's imperative to ensure the business is sustainable into the future. This goes beyond cleaning up your balance sheet or strengthening your internal controls. In today's economic climate, businesses need a clearly articulated plan for long-term growth. This is particularly true for privately held businesses contemplating the viability of creating an organisation capable of surviving over time. These issues all play a role in helping to determine the value of the company.

Establishing your goals and objectives

When setting goals, it's important to consider not only your staff's and/or family's needs, but also your personal objectives for wealth preservation and optimisation. Working with unbiased external advisers can be especially important given the highly emotional challenges that often arise, particularly among first generation owners.

Identifying and incentivising potential successors

Whether you are considering family members for succession, promoting internal staff members or seeking external management, develop a plan that works in your business' best interests while keeping emotions in check. This encompasses identifying successors with appropriate skill sets, communicating these roles and responsibilities to all stakeholders and providing your selected successors with sufficient training to support continued business growth. Designing a compensation package to reward performance is also appropriate at this stage.

Selecting an appropriate structure for the succession

The structure you select for your business transfer will depend on the objectives you are trying to achieve. For instance, if you transfer control while retaining ownership, you may provide management, investors and other stakeholders with confidence that the organisation's vision will remain on track.

Contingency planning

Your succession plan must be flexible so as to change when circumstances shift. This involves preparing for a wide range of contingencies – from a loss of leadership or unanticipated illness, to ensuring you retain continuous access to the cash flow you need following the transition.

Minimising taxes

The tax implications that can arise on the transfer of shares or the business assets can be significant. By structuring your transition in a tax effective manner at the outset, you can minimise both corporate and personal taxes. Family-owned businesses can also use this stage to provide for the family's needs after they exit the business.

Don't leave things to chance

Although planning for succession can be complex and daunting, no matter what your personal situation, your Grant Thornton adviser can help you develop an effective business transition plan.

Our extensive succession planning experience also means we have the know-how to propose a huge range of options that can deliver creative solutions to the most intractable problems. By working with you and your family, we can assist with the development of communication skills that can help you preserve family relations and business wealth for generations to come.

When it comes to something as important as succession planning, you can't afford to leave things to chance.

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Key contacts

We design exit strategies for business owners to meet their lifestyle, income, wealth and security objectives. Whether the exit horizon is near or far, the best exit outcomes require careful planning and preparation. We are here to help.

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