

# Services

## **Don't Underestimate the Importance of Succession and Exit Strategy Planning for the Business Owner**

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by Allen R. Stott

Privately-owned family businesses account for over 90% of all businesses in the U.S., and the same percentage or greater exists for the Building Services industry. According to independent sources, however, only about 30% of family businesses survive the transition to the second generation; only 10% survive to the third generation. A primary reason for these statistics are that most business owners have committed their life's work to building a successful company, but only a relatively small percentage of owners make the time and effort necessary to fully prepare an exit strategy or succession plan for their company.

It's important to distinguish between these two related terms - exit strategy and succession plan. Exit strategy is the broader term, referring to a range of alternatives for a business owner to exit his/her business. The primary alternatives include:

- Sell the business to a strategic or financial buyer
- Sell or give the business to family
- Sell the business to employees (ESOP)
- Leveraged Recapitalization
- Go public (IPO)
- Close the business

The phrase succession planning typically refers more specifically to keeping control of the business primarily within the family or among some collection of existing related shareholders. While expert opinion varies on the exact timing, it is widely agreed that in order to build a comprehensive plan, business owners should initiate the planning process at least three to five years before they wish to retire.

### **Why Plan?**

For many business owners, their company represents a large portion of their total net worth. Without proper planning, the value of their business will not be maximized, while federal, estate and gift taxes can erode the wealth and income created by the business. A variety of strategies and tools exist to maximize and preserve wealth created by the company, and planning will identify the most appropriate strategy and tools for your specific situation. Frequently, owners wait too long to begin to relinquish control. They react only after an unforeseen negative event occurs, and find themselves without the energy or desire to effectively transfer management and ownership.

The planning process begins with a comprehensive assessment of the business and the objectives of its principal owner. The following represents a list of the key elements of the planning process:

### **Key Elements of the Planning Process:**

1. define the owner's objective,
2. perform a complete analysis of the financial and qualitative factors of the business,
3. determine the current value of the of the business,
4. define the current and future role of family members in the business,
5. evaluate management talent,
6. select a successor if appropriate,
7. develop a strategy, through estate and financial planning, for the successful and timely transfer of assets.

### **Exit Strategies**

Numerous exit strategy alternatives exist to business owners. They may decide to sell to a strategic buyer or a financial buyer not active in the industry. An owner may want to sell the company to the existing management team and other employees through an employee stock option plan (ESOP), which has significant tax benefits. Some middle market business owners may have the desire to go public. However, in most cases, an IPO is not practical, and greatly restricts their freedom.

Another lesser known strategy is a recapitalization, or recap. A recap is where the owner sells majority ownership of the company to a strong financial partner. Through the use of leverage, the owner would receive a significant portion of the total value, while retaining a meaningful minority ownership and full operating control. The founder will have a "second bite of the apple" by subsequently selling the remaining equity, typically in three to seven years.

Taking the time to plan now and position the company for maximum value will ensure that an owner will not be surprised or disappointed when they do exit. The exit strategy process will provide a road map for the company's future direction. A critical step is to determine what the company is worth today, thus providing the starting point for long-term planning. Planning for your exit entails many of the same steps as if you were developing a succession plan.

## **Family Succession**

Some owners who have family in the business have a strong desire to see the next generation take ownership control. One requirement is that a qualified and capable successor be present. An important part of succession planning is to train the successor and build a strong management team. It is likely that the successor has been active in the business for an extended period of time. His or her knowledge of the business and its employees can be a major benefit. The shift in power can be gradual, and employees will accept the change over time.

Balancing the financial impact between the successor and other siblings, both active and inactive, is a complicated, timely process. Some situations can arise that can actually be detrimental to the business. Personal issues, tensions, sibling rivalries, and lack of a qualified successor can all cause problems. Conflicts of interest can arise out of loyalties. Key non-family management may feel that they've been treated unfairly and leave. Sometimes, the founder has made all the key decisions for the life of the company, and relinquishing power and ownership becomes a difficult emotional and financial hardship.

## **Start Planning**

The objective of exit strategy planning is to determine how to maximize value at the time the owner is ready to exit. Those who have not planned for their exit may suddenly find themselves at the point where they want to or are forced to sell the business, and may be disappointed with the results of their life's work. Taking the time to plan, prepare, and maximize value will bring much greater financial rewards. It is a complicated process, and the use of such professionals as an attorney, CPA, financial planner, and M&A advisor to provide objective, expert advice is well worth the effort.

*Allen Stott is Managing Director and Principal of Executive Sounding Board, LLC, a Baltimore-based firm specializing in mergers, acquisitions, and divestitures with 26 years experience representing buyers and sellers in the Building Services Industry. He can be reached at 410-243-5551 or via email at [stott@esbltd.com](mailto:stott@esbltd.com)*