

ENJOY IT



Craig West

SUCCESSION+

Business Succession and Exit Planning

A Guide for Small and Medium Business Owners

SUCCESSION

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National Library of Australia Cataloguing-in-Publication data:

West, Craig, 1968 -

Enjoy It: Business Succession & Exit Planning.

ISBN 0-9922939-0-1

1. Executive succession -- Planning. 2. Small business - Management.
3. Small business -- Planning. I. Title.

658.022

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Editor: Nicola Wilson, Wordonomics Pty Ltd: www.wordonomics.com.au

Design and Artwork: Dean Taylor, Notions: www.iamnotions.com

Printed by Watson Ferguson & Company

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Introduction

As a CPA and strategic business advisor, I've been helping businesses for over 20 years. My boutique advisory practice, Succession Plus, helps small and medium business owners design and implement a business succession exit plan to maximise sale value on exit.

I am the president of the Australian Chapter of the Exit Planning Institute, and one of only twenty three accredited exit planning advisers in Australia. So I am well placed to help you realise the goals you set for your business sale or succession.

The baby boomer generation started to reach their 65th birthdays in 2011, and over 4,000 Australians per week will turn 65 in the next 17 years. The average age of small business owners in Australia is 58, and it is estimated that over 50,000 small business owners will be looking to 'exit' each year, that is to sell the business or pass it on to the next generation. Over 50%, unfortunately, will exit due to death, illness, divorce, dispute, financial distress, bankruptcy or other unforeseen events.

Many business owners expect the sale of their business to fund their retirement, with over 30% reliant on it as the primary source. Many are concerned about their level of superannuation following the GFC and the volatile markets of recent years.

With so many business owners in weak financial positions looking to sell, and a lack of cashed-up buyers in the market, it's more important than ever to plan your business exit to extract the highest possible value. You can't just start to think about it when you turn 64; if you don't plan, you get a poor price. But a good succession plan is a win-win for everyone – you get the best price, the buyer gets a good business and your customers and staff are looked after.

At Succession Plus we take a holistic view to succession planning, looking at your business and personal goals and putting processes and systems in place to help you reach the best outcome, offering expert advice in management, taxation, employee incentives and accounting issues.

We've identified a number of steps that you can take to dramatically improve the performance and preparedness of your business, and hence the value on exit. We take you through those steps over a number of years as you go through the gradual stages of transition.

If you've been working hard in your business for many years to create wealth for you and your family, this book will help you to realise the full potential of your efforts and investment, the rewards you set out to achieve. I don't try to give you a one size fits all or a 'do it yourself' manual, but you'll get an understanding of the scope and processes involved in successful succession and exit planning.

If you are close to retirement or need to exit quickly, you may not be able to go through all the steps. But I'll steer you towards some crucial quick fixes to help you get prepared.

Craig West

Prologue

"If you want to build a business you can sell for maximum value, Craig West is the best in the field. Whether it's through his books, courses or advisory programs, if you can get in front of him, do it."

Jack Delosa - Executive Director of The Entourage and MBE Education

"With an increasing number of business owners approaching retirement, it is so important that they have a way to maximise their exit. This book helps business owners to apply smart strategies to expand, acquire, merge or otherwise in order to maximise the exit.

The SME Association of Australia wants to see more education and awareness of how important this is for a healthy prosperous nation."

Dr Caroline Hong - CEO of SME Association of Australia

"Exit planning should be part of every business owner's strategic business plan. We should always be prepared to get hit by that proverbial truck. A functional exit plan must take a three pronged approach to maximise value, plan for tax, estate planning and financial planning, and create a blueprint for your business and personal life.

Don't put off establishing your exit plan till tomorrow. Start today to maximise the value of your life on this earth by reading this book."

**Peter G. Christman, CEPA - The Original Exit Planning Coach and Mentor;
CEO, The Christman Group - Value Enhancement**

"As the current President and CEO of the Exit Planning Institute I am often asked "How do I know if this is the right year to sell my company?" Timing the market perfectly is almost impossible. Exiting is not the end; it's the beginning of your next life. Plan for what you are going to do after the exit and make sure you have discussed the plan with trusted advisors, family, and friends.

If you are prepared, this may be your year. If you are not prepared, choose to take the next year or two to get prepared or risk ending up in the category of those who regretted selling. Succession Plus will help you to choose your time and maximise your results on exit."

**Christopher M. Snider, CEPA - Founder/President of Aspire Management;
CEO/President of the Exit Planning Institute**

WHAT IS SUCCESSION & EXIT PLANNING ALL ABOUT?

Most people go into business not only to earn an annual income but, more importantly, to ultimately extract the wealth created with a lump sum to fund their retirement or next venture. But many don't think about how to exit their business until it's nearly time to retire. Worse, many find they are forced to sell or leave their business suddenly due to illness, disability, debt, bankruptcy, legal disputes or divorce.

You can't just put up a 'for sale' price on your business and expect that someone will come along and pay you the price you want. And if you do just put an advertisement in the paper or online, don't think that the price you get represents the true value of your business.

For many Australians the family home is their greatest asset. For business owners, the business may be the largest asset with the family home second. Yet many business owners will spend more time and effort preparing the family home for sale than their business. Most of us wouldn't just do a quick tidy up two weeks before the auction of our home and hope for the best.

Selling a business, just like starting a business, requires a strategic succession plan, whether you plan to sell to family, employees or complete strangers. Otherwise you risk losing the long term value of the investment that you have worked hard to create.

A strategic succession plan is a vision of the future, broken into the steps you need to take to achieve that vision. To maximise the value of your business on exit, you have to plan your exit long before it happens. This will allow you time for a smooth transition, but also give you a much better state of play should anything unexpected happen to you, the other shareholders or your family members.

Succession Planning is a holistic process to help you align your personal and financial goals with your business performance and value. We help you to identify the current position and value of your business, the price you need for your business sale to meet your personal objectives, and then develop a strategy to help you breach the gap. The process from planning to exit may need five to ten years. Our aim is to have your business adequately prepared, and at peak performance to ensure you get the best return. If you are passing the business on to family members, we help you to put processes in place to make sure the business doesn't crumble the minute you hang up your keys.

We'll explain to you that WHO buys your business is a key factor in the price that you achieve, and help you to position your business so that you can attract the best buyer.

The most successful succession plans are those that have been carefully and slowly considered over a period of time, are implemented gradually, constantly monitored and reviewed, have realistic strategic outcomes and *"Begin with the end in mind"*.

This book takes you through 21 steps to exiting your business over five stages:

- 1 Identifying value
- 2 Protecting the value
- 3 Maximising value
- 4 Extracting value
- 5 Managing value.

Each stage may take months or years depending on your personal goals, your situation, your business readiness and your industry.

BUSINESS SUCCESSION AND EXIT PLAN	Stage One: Identify Value	STEP 1 :	Goals and Outcomes
		STEP 2 :	Fact Find
		STEP 3 :	Stage One Report – INSIGHTS
	Stage Two: Protect Value	STEP 4 :	Financial Planning
		STEP 5 :	Unplanned Events
		STEP 6 :	De-Risking
	Stage Three: Maximise Value	STEP 7 :	Exit Options
		STEP 8 :	Strategic Planning Business Model
		STEP 9 :	Strategic Financials
		STEP 10 :	Systems and Procedures
		STEP 11 :	Marketing and Sales
		STEP 12 :	Corporate Governance
		STEP 13 :	Ownership Thinking
		STEP 14 :	Peak Performance Trust
		STEP 15 :	Management Succession
	Stage Four: Extract Value	STEP 16 :	Tax Planning
		STEP 17 :	Documentation
		STEP 18 :	Liquidity Event
	Stage Five: Manage Value	STEP 19 :	Ongoing Investment Planning
		STEP 20 :	Asset Protection
		STEP 21 :	Estate Planning

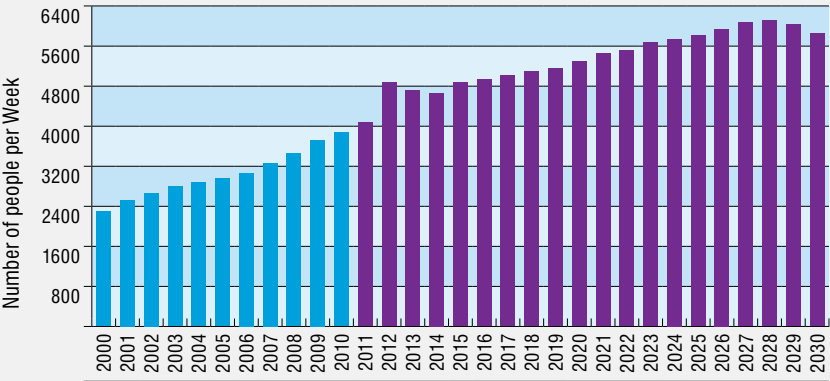
Why is now a good time to think about succession planning?

As any financial planner will tell you, the average amount needed to fund retirement in Australia is at least \$1 million. We are living longer than ever before, and life expectancy is constantly improving, so we need more money to fund a long retirement – unless of course we wish to rely on a government pension. Fifty year olds today can expect to live until they are 82; that's potentially around 20 years to fund in retirement.

According to the Australian Family and Private Business Survey 2010 (RMIT University), the average age of family business owners is 58 years. Almost half of business owners surveyed see themselves working in the business beyond 65 years of age, with over 30% saying they will be relying solely on the sale of their business to fund their retirement.

The baby boomer generation began turning 65 in 2011, and from now until 2030 over 4,000 Australians will hit retirement age each week. It is estimated that over the next decade the retirement of family business owners will see the transfer of approximately \$1.6 trillion in wealth, which surely must make succession planning one of the most significant issues facing small to medium enterprise (SME) owners. Yet incredibly, despite 61% of business owners surveyed admitting their businesses are not sale or succession ready, 52.2% do not intend to do anything about it over the next twelve months.

Australian Population Turning 65 Years of Age - Weekly



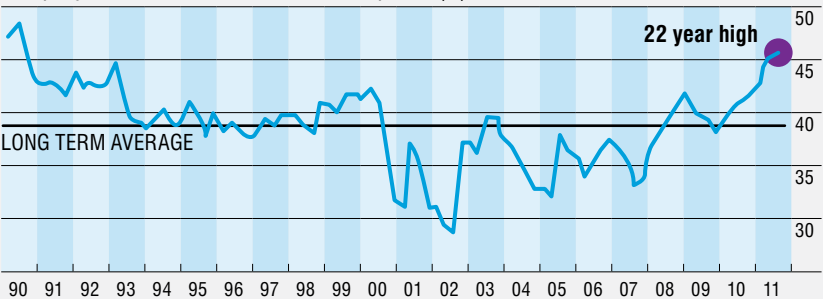
The Global Financial Crisis and the more recent European crisis has had a negative impact on market sentiment around the globe. Cash is harder to access, and potential buyers drive a harder bargain, putting pressure on valuation multiples (more about this later). Many baby boomers are delaying retirement because the value of their nest egg has diminished, whether that is in the

share market, superannuation, real estate or the value of their business. With estimates of 50,000 businesses for sale each year for the foreseeable future, the small business market may become flooded, which will put further pressure on business values. Many business owners will simply close the door.

At Succession Plus we are finding that there are some cashed up buyers and companies out there – as of June 2012 Australian listed companies have the highest cash to assets ratio in 22 years. So they are using that cash to fund growth through acquisition, making acquisitions of much smaller businesses than they might have ten years ago. But the competition in the market can mean that buyers are a little more particular about the businesses they buy, so the businesses need to be better prepared if they are to find the right buyer and the right price.

On the back foot

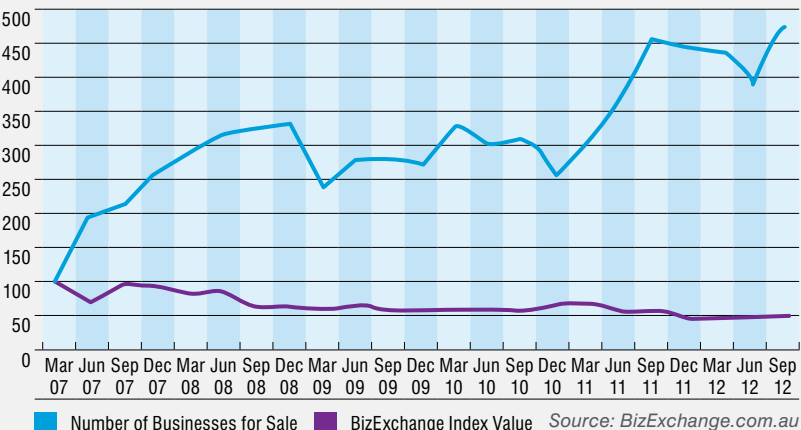
Company assets, shares held in cash & deposits (%)



Source: Commonwealth Bank

The following graph from Bizexchange shows that the number of businesses for sale grew rapidly in 2011, with some fluctuation in 2012, while relative business valuations have gradually declined over the last four years.

Volumes and values trend %



Source: BizExchange.com.au

As a responsible business owner, it makes sense to start your exit strategy when you are 'at your peak' – ideally when the business is doing well and you have the energy and enthusiasm to make the appropriate changes. Many business owners are finding it hard to keep up with technology and the new competitive environment that brings. If you feel defeated and lose market share your business value will diminish, so start the process when you still have some fight and passion for your business. You may need to grow your business to make it more attractive to a buyer, or you may need to transition client relationships gradually to a general manager.

In the current market the best chance of success is to be prepared and plan ahead. If you always *"Begin with the end in mind"*, you are much better prepared for making the right decisions along the way, following the steps towards your long term vision. If you start preparation early, you will get a deeper understanding of the potential value of your business, and have the time to make positive changes to increase your chances of a good sale.

On a financial level, a well-planned business exit will not only enable you to attract a higher sell price, it will also let you minimise tax on the proceeds, using staged payments, superannuation contributions and taking full advantage of tax concessions. If you put your business up for sale suddenly, you may be met with a tax bill just when you don't need it.

Twenty five percent of the business owners surveyed (the Australian Family and Private Business Survey 2010), had been approached by potential buyers in the last twelve months. If you have started to plan your exit from your business, have an understanding of its value and have been tidying up loose ends in readiness, you are much better positioned to take advantage of opportunistic offers like this.

And finally, if you do have to exit from your business unexpectedly due to poor health or other issues, the further you are down your exit plan, the better the outcome is likely to be for you and your loved ones. A poorly planned or poorly executed succession will often lead to dispute, poor customer experiences, business decline and financial pressure. Is that what you have worked all these years for?

Identifying Value

I'm going to take you through our unique 21 step process that will help you to reach a successful business exit. This is not a do it yourself process; you will need to get some help and advice along the way. But the better you understand the process the more you can get involved, take on the tasks that you can do, and have clear expectations of the people who advise you on the rest.

In the introduction I've focussed on why planning is important, and consistent with that, I'll go through the initial steps, in the Identifying Value stage in more detail. Once you are clear about where you are trying to head and why, getting there is a whole lot easier.

STEP 1

INITIAL INTERVIEW, GOALS AND OUTCOMES

The first step is deciding what outcome you want for your retirement from the business. It'll differ for everyone in terms of your financial and lifestyle goals, but there are a number of key factors to consider and discuss with your business advisors and financial planner. As we work through the steps in the book you'll get a better understanding of what is realistically achievable from your business, but we'll start by identifying the main drivers and influencers in your exit plan.

Ask yourself the following questions. It might be useful to jot down your responses to discuss with your advisor.

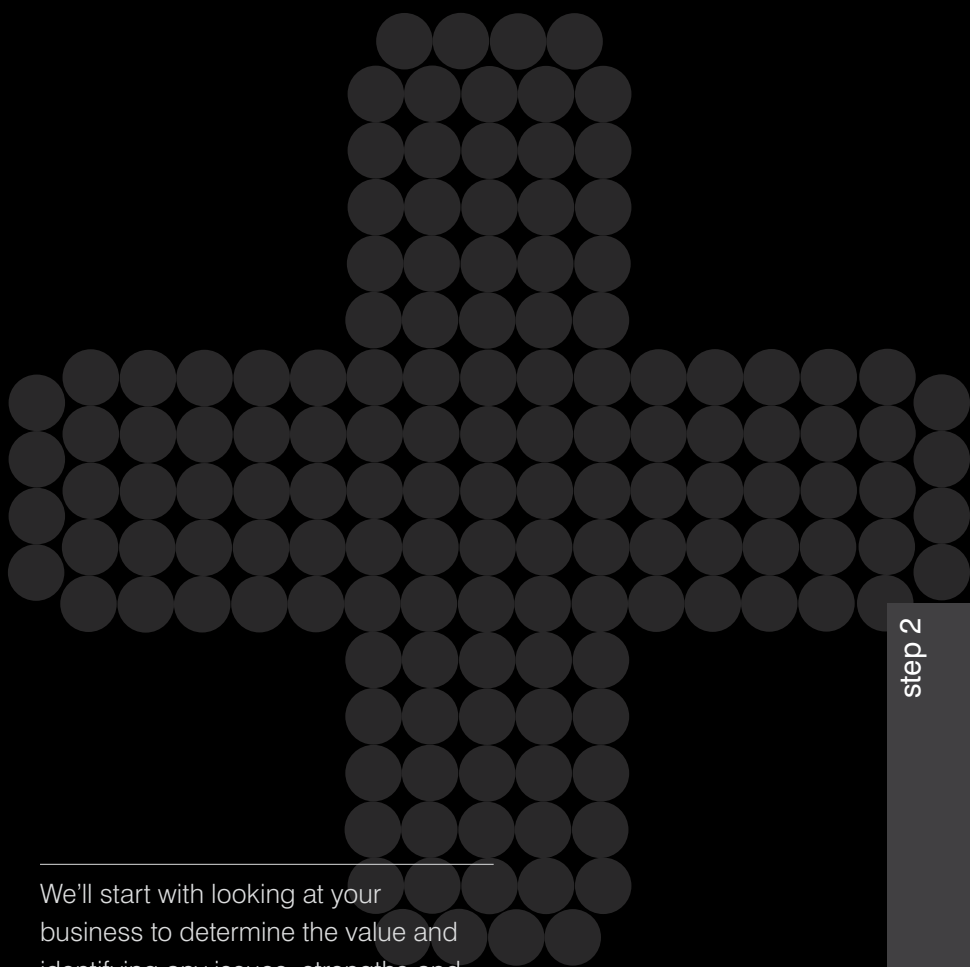
- 1 Do you have a valuation/sales price in mind for your business?
- 2 Do you have personal/financial goals that your business sale needs to fund or make time for?
- 3 When do you want to leave the business?
- 4 Are you happy to stage your exit over several years?
- 5 Do you want a lump sum to retire with, or could you work with several payments over time?
- 6 Do you want to retain any ownership in the business?
- 7 Do you want to transition the business to a family member?
- 8 Do you have any key members of staff that would be keen to take on the business?
- 9 Do you have a potential/interested buyer in mind?
- 10 Do you have a view of what the business will look like after you retire?
 - Are you interested in leaving a legacy?

Answering those questions honestly may make you feel quite ready and comfortable, or you may realise you have never really thought about these things before, let alone know how to make them happen. Some of these questions will prompt you to consider whether you have a strong preference for one form of action versus another. Going through the succession planning process will help you to aim for your preferred action, whilst also preparing you and making your business better able to adapt to alternative routes if needed.

Now that you have a big picture view of where you'd like to be, let's look a bit deeper into where you actually are.

STEP 2

FACT FIND



We'll start with looking at your business to determine the value and identifying any issues, strengths and opportunities.

With your exit planning advisor you'll go through the following questions:

- What does the business currently look like?
- What would it be worth in its current state?
- What are some of the risks in the business?
- What are the opportunities in the future?
- What profit is the business currently making, and are your financials up to date?
- What do you need to do to prepare for due diligence?

A business versus a job

An important part of this process is establishing what you have to sell - do you have a business, or are you self-employed?

In some cases business owners who have started or bought a business have simply bought themselves a job. They may have bought a database or a few customer contracts (common in trades such as plumbing, mechanics), but the income is essentially derived from the business owner directly servicing clients. Robert Kiyosaki's definition of a job is 'Just Over Broke' because there's no equity value. The day you stop, the money stops.

This type of business has little or no resale value, unless you can find a way to replace yourself in the business with at least the same results. A good way to determine whether or not you have 'a business' is to consider how long you could be removed from it without affecting operations. If you could take weeks off and the business would continue to survive and produce income, you have a business. If you've got a position where you have to be there all the time, you've got a job. The income stops when you stop.

It is important at this point to identify whether you have a 'job' so that you can spend time in your succession planning building a business, or making the most of what you have. An advisor will help determine the best path for you.

STEP 3

STAGE ONE REPORT INSIGHTS

The next step is comprehensive analysis and diagnosis - getting into the detail of your business, assessing it as it currently stands and identifying ways to increase the value. Then we'll prioritise the areas that need action.

3a Structural review

First we look at how your business has been set up and structured, for example whether you operate as a sole trader or have set up a limited company, partnership or family trust. We see many businesses that started 10 or more years ago that were set up as a shelf company, with husband and wife the only two shareholders. Husband and wife are probably also directors, which is fine when you first start out because it's quick, easy and cheap.

But over time the business grows, you purchase other assets such as equipment or real estate. Some companies buy the premises they operate out of, and the real estate is held in the trading entity, along with say a stake in another business or a significant piece of equipment, with no separation of risk and assets. Part of our job is to minimise the risks with the right ownership structure.

Too many people asset protection means being able to control assets or have access to assets which they do not actually own, so that if they are sued the assets are not at risk. Common examples are assets being owned by a family company or trust, or being placed in the spouse's name.

The key is separation; wherever possible, quarantine the assets from the risk, especially capital appreciating assets like property, by creating completely separate structures. And where husband and wife are both directors, they are both at risk individuals. So we need to find a way to protect them too. It's not that the wrong structure has been set up, but that the business has changed over the years, has increased in value and taken on assets and risks, and that the original structure is no longer appropriate.



Another aspect of asset protection is having adequate insurance cover, and good systems in place to prevent faulty goods, negligence or injury. We also look at where we want those assets to end up. Perhaps you want to keep the business premises and rent it to the new owners to create an ongoing income stream. If so, you won't want it sitting in a trading entity, but more likely in a self-managed superannuation fund, trust or other structure. Here we'll work closely with your financial planner to get the most benefit from your assets.

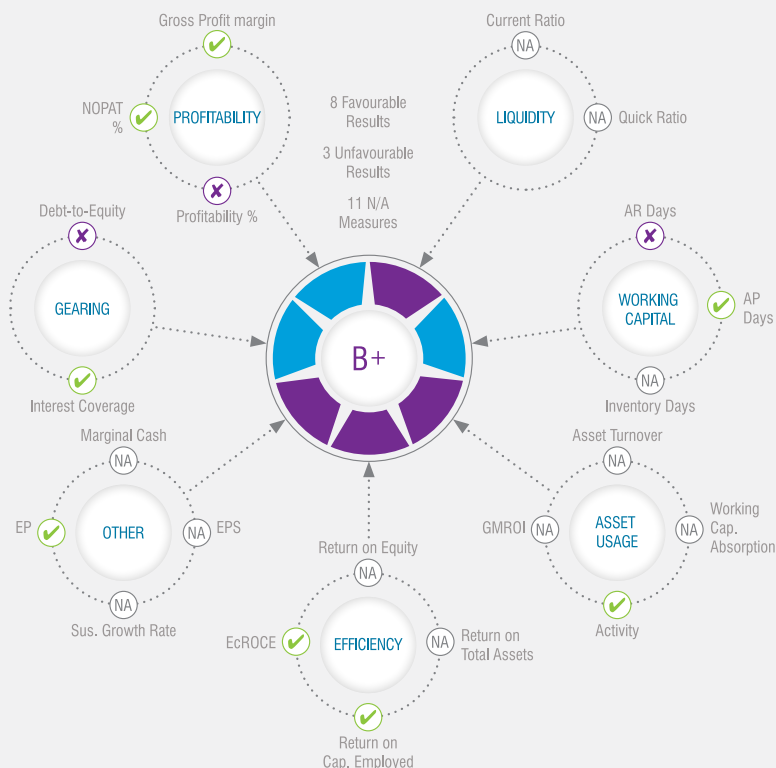
3b Financial analysis

As an accountant I tend to focus on the financial analysis next, but I'd also argue that it's actually not the most important area in determining value. But we do need to get a good understanding of how the business is performing. We use a financial analysis tool to show the business owners a snapshot of the financial performance and the areas for improvement.

The following diagram shows a typical overview of the financial position of a small business. It assesses the business's profitability, cashflow, debt levels, efficiency, and highlights the good and bad with green ticks or red crosses. The tool focuses on measurements that are relevant to your business – in this example eleven measures were deemed not applicable, and eight were favourable, so the business owner can see clearly that they need to focus attention on improving the three unfavourable measures – net profit margin, debt levels and collecting cash from customers more quickly. This business scored a B+, which is above average for a small to medium business.

It is important to know the key financial drivers and performance indicators at any stage of your business so that you can step in and make improvements. This is of course crucial when you are preparing your business for sale.

The potential buyer will look at the financial performance of your business, but also how well you manage the financial data, and how quickly you act on key financial indicators to improve performance.



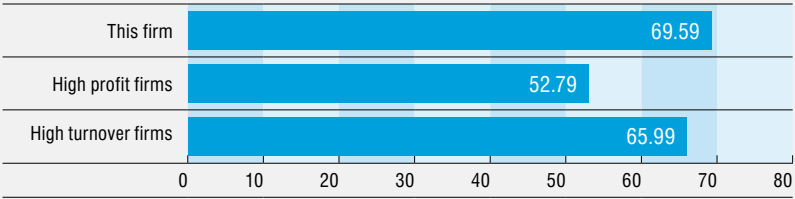
3c Benchmarking and profit gap

Benchmarking is a process of comparing your business metrics with other similar businesses. Not many business owners think of benchmarking their business, and most do not have access to data to be able to do this. At Succession Plus we identify the key performance indicators in your business and benchmark them against industry averages to identify areas of improvement, or 'the profit gap' between where you are and where you could be.

Benchmarking uses largely financial data but also uses statistics such as the number of employees, floor space utilised, total equipment or assets. Some of these measures of efficiency don't stand out from your management accounts. But a buyer will want to understand how you are positioned in the market to assess your relative value.

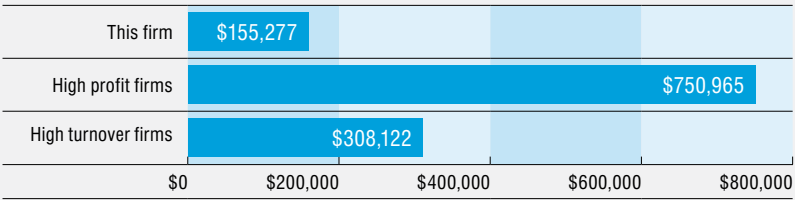
If, for example, you operate an accounting firm, where your profit depends on billing time for services, benchmarking would look at billable hours, total fees earned per full time employee (or equivalent) and overheads. The graphs below show benchmark reporting for a professional services firm versus industry averages.

Average debtor days



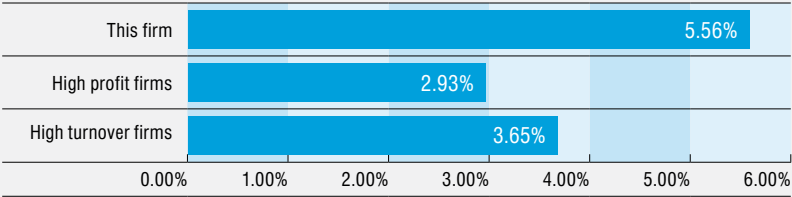
This firm's debt collection is slower than the industry average, which may lead to cashflow issues.

Average NPAT per principal



This firm's average net profit after tax (NPAT) per principal is much lower than the industry average. While this may be largely driven by the size and profile of the firm, it prompts additional analysis into pricing, volume of work, utilisation of staff and costs.

Minor overheads as % total income



This firm spends more of its total income on minor overheads than the industry average, which will put pressure on NPAT.

While the firm may be too small to reach the industry averages, benchmarking gives us a good starting point that highlights where we need to look deeper to improve the future performance of the business.

When we benchmarked one of our Sydney clients, a professional services firm, we found the IT costs were significantly higher than its industry competitors. Digging deeper, we saw that all of the firm's computers and systems were 15 years old, which meant the maintenance contractor was coming in almost every day to fix something. On the other hand, depreciation was much lower than the competitors as the assets were all fully written down long ago.

A buyer considering this business will need to factor in significant capital outlay to replace the IT assets, but can expect to spend less in maintenance costs as a result, therefore increasing profit.

When we benchmark a business we calculate the potential profit gap – the profit you could achieve if you were operating at industry average levels. On a simple level, if you produce a product at \$1 and sell it at \$2 you are making \$1 or 50% margin. If your competitor is selling the same thing for \$2 but it costs \$0.75 to produce, he is making \$1.25 or 62.5% margin. The profit gap is 12.5% or 25 cents. Benchmarking assumes that you should be able to operate at roughly the same level as industry averages.

Sometimes there is a significant gap between the current profitability and profitability that could be achieved at maximum efficiency. Once we work out where the business is over or underperforming or overspending, we focus on resolving individual issues to close the gap, improving profitability and value.

**Your Profit Gaps relative
to the Most Profitable firms:**

	This Business	High Profit Firms Average	Profit Gap Relative to High Profit Firms
If you could achieve the average level of fees per person		\$245,000	
then your firm's present fees of	\$3,800,000		
would need a total personnel of	15.51		
but you presently have total personnel of	19		
so you are overstaffed by			3.49
and at your average salary cost per employee of	\$65,000		
your salary-related Profit Gap is:			\$226,837
If you could achieve the average level of non-salary overheads	25.80%	24.00%	
you should reduce your overheads by			1.8%
then on your present turnover of	\$3,800,000		
you are over spending by			\$68,400
You asset turnover is presently	1.90	2	
but your current revenue of	\$3,800,000		
suggests you should have assets of			\$1,900,000
Currently you have assets (net of any loans to owners) of	\$2,100,000		
So you could look to reduce total assets by			\$200,000
If this could save you interest at, say,	9.00%		
Then you'd close a Profit Gap of:			\$18,000

Your total Profit Gap:

	Relative to high profit firms
1. Bringing your personnel numbers back could yield	\$226,837
2. Reducing non-salary overheads could yield	\$68,400
3. Reducing your investment in the firm could yield	\$18,000
So your total Profit Gap is	\$313,237
Which is ... of your current profit level	43%

3d Non-financial analysis

Our non-financial evaluation is basically an interview process where we look at the operations of the business and determine where there is risk. We use a similar tool to score various areas of the business. It will be these areas that ultimately affect the multiple you can achieve on sale. But these are also the areas that are largely in your control, and some can be improved relatively easily. Some of the interview questions are as follows;

- 1 Do you have an up to date company profile and website?
- 2 Do you have all of your intellectual property registered and up to date?
For example business name registrations, trademarks, patents
- 3 Are your financial statements, BAS, payroll and tax returns in order?
- 4 Do you have monthly or quarterly management accounts?
- 5 Do you have an annual budget for the current year?
- 6 Do you have monthly management meetings, and do you have minutes of those meetings?
- 7 Do you have robust accounting systems that allow you to run reports on top customers, top suppliers, debtors, creditors, KPIs?
- 8 Do you have employee agreements in place for all your employees?
- 9 Are you meeting your obligations re employees – leave balances, superannuation contribution, award rates, payroll tax, workers compensation?
- 10 Are all your vehicles registered, insured and lease payments up to date?
- 11 Do you have the lease agreements for your premises?
- 12 Are your company registration documents up to date? e.g articles of association, shareholder agreements etc.
- 13 Have you documented key processes, job descriptions and procedures (such as a safety manual, induction manual) in your business?
- 14 Do you have a board of directors or advisory board and do you communicate regularly?
- 15 Has your IT system been reviewed lately to ensure it meets your needs?
Do you have back-up facilities in place and a disaster recovery plan?

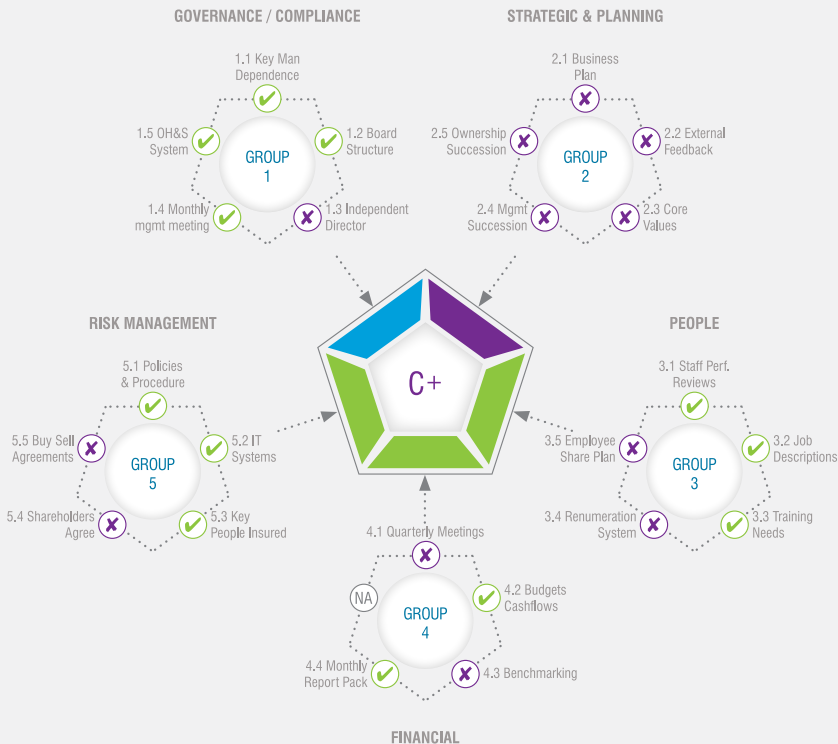
A prospective buyer will see the non-financial measures of your business as a reflection of how you manage your business – your attention to detail and compliance, your ability to plan and execute, how easily the business can operate without you, the quality of your staff, and whether they are locked into the business. They will also look not just at your financial performance, but how well you manage and use financial information.

The diagram below shows an architecture business with a C- rating. In the top left we have governance and compliance, and this business has a tick for key man dependence. This is quite unusual in small to medium businesses, which are usually very dependent on the founders. In this business there are four architects, which means the business could continue to operate if one left. This company is doing well in all areas of compliance except that it doesn't have an independent director, which would be an advantage to have further down the track to reduce perceived risk.

The company is performing less well in risk management and strategy. They have no shareholders or buy/sell agreement, which could cause quite significant issues if one partner leaves the business, gets sick or is hit by the proverbial bus.

Like many small companies this business has no business plan and no succession plan and they haven't had the business benchmarked. So they don't really have a strong direction to determine the future value of the business. They also don't have a clear remuneration strategy or an employee share plan, which does expose some risk of staff turnover despite some good HR practices.

This diagram clearly shows the risks in the business and helps us to prioritise action – for example we would certainly recommend having a shareholders agreement and buy/sell agreement prepared above appointing an independent director.



3e Valuation

Once we've gone through all of this analysis we arrive at a valuation figure, and we'll hit the pause button to protect the wealth that's already been created before we think about growing that value in order to reach your retirement goals. A major part of that protection involves decreasing business risk.

But first a look at the mechanics behind valuations and some of the jargon that comes with it.

Financial valuations

There are several ways to value a business in a largely mathematical way, arriving at a financial valuation. No matter which method is used (with the exception of liquidation), and who prepares the valuation (be it an accountant, potential buyer, advisor or valuation expert), the various outcomes of a financial valuation will be largely consistent. The financial value should reflect the market value of the business, and what it would be worth to someone who takes it on and continues to run it in much the same way, capitalising on the potential identified.

A strategic valuation on the other hand, does not necessarily represent the market value of the business, but what that business is worth to the acquirer for strategic reasons. A strategic buyer is likely to pay well above the financial valuation of the business.

The following are examples of financial valuations.

EBIT multiple

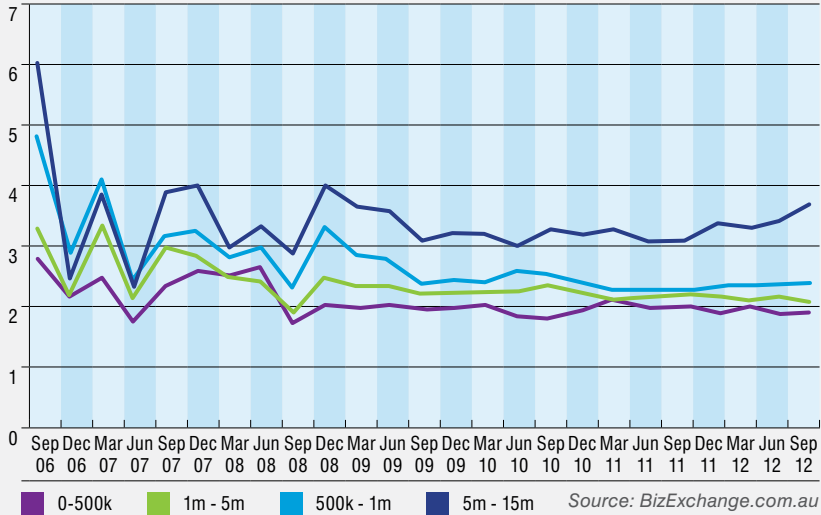
An EBIT multiple valuation is derived by multiplying the annual ongoing profit of a business by a multiple. For example, a business that generates \$500,000 per year and is valued at a multiple of 2 should achieve a sales price of \$1 million. Despite being a mathematical calculation, many non-financial drivers impact the multiple, while the main financial driver is the profit figure.

The main drivers affecting the multiple are risk and potential. A business with low risk and high potential can achieve a high multiple, while a business with high risk and limited potential will achieve a low multiple.

Small businesses in Australia generally sell for multiples of around 2, but in recent times many businesses have been sold for multiples of less than 1; that is the business owner takes less than a year's profit to have the business taken off their hands.

The following graph shows that business multiples generally increase the larger the business. This becomes important when we look at maximising business value.

Business value as multiple of EBIT



Risk and potential – key indicators

- Industry in which the business operates – some industries, such as hospitality and retail, attract a low multiple while professional services firms and medical practices can demand higher multiple (this is due to the relative predictability of future income)
- Quality of governance, compliance and reporting
- Quality of the management team and staff
- Extent to which future revenue and costs are secured by contracts
- Levels of debts and management of cash
- Quality of customers and cash collection history
- Past track record in achieving goals set
- Quality of business assets, in particular intellectual property
- Barriers to entry for competitors and relative competitor strength
- Quality of the product or service and relative price points
- Ability to expand – reaching more customers with the same product, or the same customers with additional products
- Profitability, cash flow and financial position of the business
- Multiples achieved for other similar businesses.

Liquidation or net realisable value

The liquidation value, sometimes referred to as a 'fire sale' reflects the price that could be achieved if the individual assets of the business were sold. This method is generally only used for a business that is in distress.

If the business will continue to operate, this method provides an indication of 'minimum value' since it does not take into account actual or potential earnings. This can be a helpful benchmark to assess valuations by other methods, or offers you might receive.

Discounted Cash Flow

A discounted cash flow calculation, or DCF, models the present day value of the business's projected future net cash flows. It is a relatively complex calculation analysing future cash flows, capital structure and the costs of capital. Future cash flows are derived using past performance and future assumptions, many of which may be beyond the control of the management team (for example purchases in US\$ at a forecast exchange rate).

This method is not popular due to the risk and uncertainty in the assumptions, but it is often used to estimate the value of start-up businesses, which are built on assumptions about the future.

Capitalisation of future maintainable earnings

Similar to the DCF, this method determines a valuation range using future expected earnings divided by a capitalisation rate (usually determined by reference to similar risk profile investments). It is appropriate for businesses that:

- are a going concern
- have been in existence for a number of years
- are not undergoing any significant transformation
- have historically stable profitability
- are not likely to experience significant growth or decline
- have products that do not face technological obsolescence.

More about this in the Maximising Value stage.

3f Reverse due diligence

An important step in the preparation process is reverse due diligence, a process that is very similar to the due diligence a buyer or an investor would undertake when looking at your business, so it will help you to start to get prepared. We give you a comprehensive list of all the things that we need to get together in terms of documentation, to identify any areas where we've got gaps, where we've got information that's out of date or where we can't find original documents.

It's surprising how many business owners come to us asking us to sell their business quickly, yet when we give them a list of the information we need it will take them six to eight weeks to collect it all. The information we ask for is basic stuff – balance sheets, profit and loss statements, and a breakdown of clients, leases, contracts and agreements. They often don't have it, can't get it or have to wait for their accountant to prepare it. Once we do get it, it can be impossible to reconcile the management accounts with the BAS statements already submitted. So it is important to be on top of this early on; it will make your business look much more professional and much less risky once you are asked to provide information.

Focus on getting the following up to date and ready for inspection:

- Financial statements and management accounts
- Trend analysis for the last 12 months
- Top 10 customers – spend, margins, terms
- Legal documentation – shareholders certificates up to date, all licences and IP current
- Employee contracts up to date and entitlements properly accounted for.

For an expanded list:



STEP 4

FINANCIAL PLANNING

One of our favourite themes is
“Begin with the end in mind.”

In financial planning terms this means understanding exactly what your retirement looks like, what funding you will require to live the lifestyle you choose and who should own those assets after you sell your business, considering issues like asset protection, simplicity of operation, tax effectiveness and estate planning and the myriad of other complex issues that require professional financial planning advice.

Many retirees greatly underestimate the amount of money they need to fund their retirement lifestyle, and there are two key statistics I regularly quote that show the importance of getting this part right.

A typical Australian male who turned age 50 in 2012 is expected, on average, to live until 82, a remaining life expectancy of 32 years. This has serious implications in terms of funding retirement. It is much longer than retirees 50 years ago, who had to fund a fairly short life expectancy after work, and while medical science and technology are improving to increase our life span, our health costs increase.

The second important thing to remember is that on average business owners spend far more money in retirement than they typically spent while running the business. Recent research studies suggest retirees spend up to 160% of pre-retirement spending, all due to one key factor – time. As a business owner you invariably find it difficult to take long holidays or travel overseas, but after exiting the business successfully you'll have the time to take trips and do the things that have been on your bucket list.

So we start with working out how much you need to fund your retirement, and then work backwards to see how we can get there. This will involve maximising the value of your business, looking at ways to release lump sums or ongoing income streams, and investment strategies for any other assets that you have – for example real estate, share portfolios, superannuation. So we work with your financial planner to design an overall wealth plan. If you don't have a financial planner we can also help you find one.

Now is also a good time to get some tax advice to understand the whole picture. Ask your accountant - if you sold your business tomorrow at its current valuation, how much CGT would I have to pay? And secondly, can I improve on that?

Tax advice is a crucial part of the financial planning process. Your business may be worth say \$6 million, and you may have decided you need \$4 million to fund your retirement. But after tax and transaction costs you may only walk away with \$3 million.

There are a number of small business concessions, but you need good advice to make sure your exit is managed correctly to meet the various thresholds and conditions. We'll look at those in Step 16.

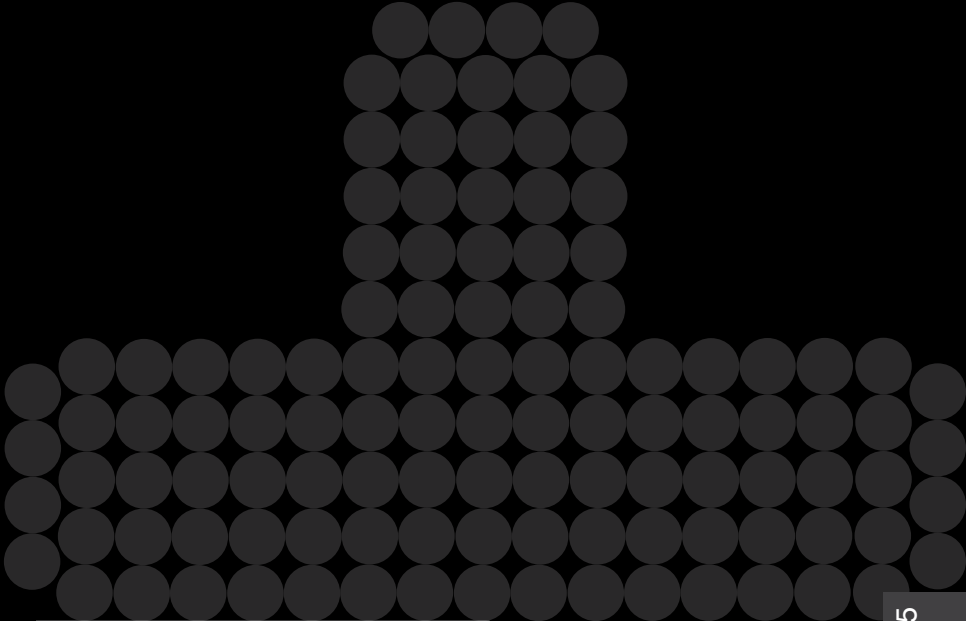
You may also think about a self managed superannuation fund as a tax effective way to invest the proceeds from your business.

Protect Value

The next steps involve protecting the value that is already there through asset protection strategies, some insurances, preparing for unplanned events and de-risking the business.

STEP 5

UNPLANNED EVENTS



The average age of Australian business owners is 55, and sadly many business owners in their 60s can't afford to retire. Post GFC, around 50% of business owners are delaying retirement due to financial necessity. But these business owners, due to their age and potentially high stress levels, are in high risk categories for heart disease, cancers and age-related conditions.

Many people avoid talking about death, wills or selling their business. And many families are left inheriting a burden. With no succession plan in place they are left with a business that can't survive without the owner. So they close the doors, or get the best price they can under the circumstances, selling off machinery or a few contracts. Some are left with an administrative nightmare because nothing is documented, compliance isn't up to date, there are debts outstanding or simply no one can log in to the business systems.

In the event of your death or serious illness, what would happen to your business? Do you have plans in place to ensure that control or ownership of the business is passed on to the successor of your choosing? And would your family be taken care of in the event of the business being sold? Is your will up to date, or would your estate be inherited by a previous spouse?

If you have worked hard to provide for your family, don't risk it by not protecting your assets. Develop a succession plan and talk to your loved ones about it so that they have somewhere to start if you are incapacitated. Think about a best case and worst case position; the best case will be a fully developed and executed succession plan that ends in a long, healthy and financially secure retirement! The worst would be what your family would need to do in an emergency to manage or sell your business – the location of key documents, names of key people etcetera. Both will need a degree of effort on your part to get everything in order, but much less effort than it would be for a grieving family member with no previous involvement in your business.

Ideally you will need to formulate plans to ensure that your business can survive an unplanned event such as an accident or illness. Part of this will be making sure you have a shareholders' agreement that clearly states who will manage and/or own the business in the case of your death or incapacitation.

Buy/sell agreements

If a buy/sell agreement is to be formed, then the Shareholders Agreement will usually state that both agreements must be executed at the same time.

Buy/sell agreements generally come into play in the event of an insurance 'trigger' event – that is, death, illness, accident or disablement. They allow business principals to plan for the future of the business by specifying whether the business should continue, be sold, transferred or liquidated in the event of their death or incapacitation.

The agreement may provide for the transfer of equity interests to the continuing owners by the payment of fair market value to the owner's estate (funded through life insurance) and deal with key person issues such as the elimination of debt, the extinguishment of personal guarantees and the replacement of lost revenue.

A properly drafted buy/sell agreement can ensure that:

- the business value is preserved, and possibly even strengthened
- there is business stability for the continuing owners

- funds are available for the continuing owners to buy-out the departing owner's share without putting the business in jeopardy
- funds are available for the payment of expenses such as CGT and stamp duties
- a fair price is paid to the outgoing owner or to his or her estate
- financiers, suppliers and customers are given certainty about the business's future
- the value of the business is preserved even with the departure of a principal
- business liabilities are repaid to reduce the financial burden on the business
- the risk of disputes between business owners is reduced should a trigger event ever occur.

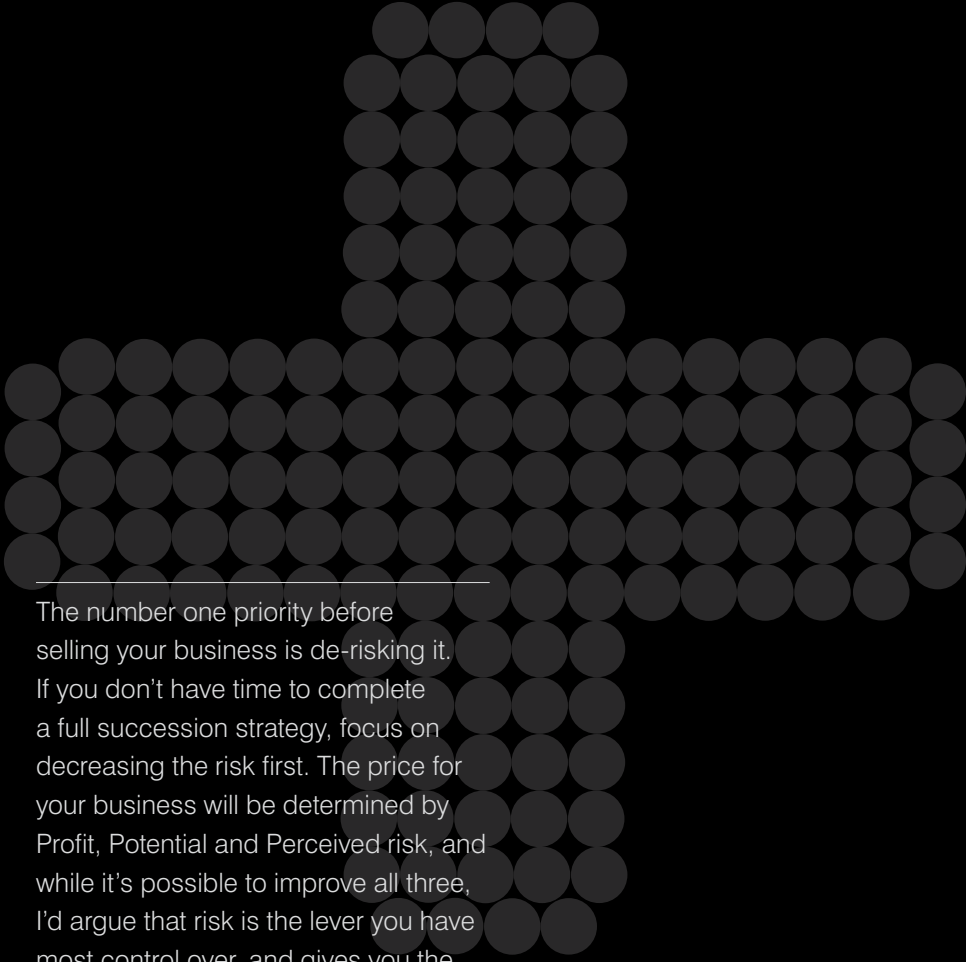
Generally, there are two key aspects to any business succession agreement: a correct transfer arrangement and a correct funding arrangement. In any agreement it is important to establish:

- How the interests of the business will be valued, and using what methodology
- Which events will trigger the agreement. These could include death, disability, resignation, bankruptcy, retirement or even criminal charges
- What the succession obligations of the various business owners will be
- Whether life insurance can and should be used to fund the payment of all or part of the purchase price.

When these considerations have been established, the documentation will specify the terms and conditions of the agreement and how it is to be funded.

STEP 6

DE-RISKING



The number one priority before selling your business is de-risking it. If you don't have time to complete a full succession strategy, focus on decreasing the risk first. The price for your business will be determined by Profit, Potential and Perceived risk, and while it's possible to improve all three, I'd argue that risk is the lever you have most control over, and gives you the greatest return.



Risk and its effect on valuations

As we said in Step 3e, in valuation, there's a whole stock of methodologies and ways to value a business, but at the end of the day it comes down to two things: reward and risk. The reward is obviously the profit or the return on the business, but the risk in achieving that return is at the heart of valuations. That's true of BHP and Rio Tinto and Westpac Bank, and also the small business down the road.

Most small business owners we see don't have a handle on the risk element. They generally understand that their profit contributes to their valuation. But if we can identify all of those risks, we can show them the match between risk and the valuation multiple. If we can improve the risk, the valuation will increase. So that's an area we work on significantly with business owners. We also focus on WHO will buy the business to ensure the highest possible price.

6a Owner dependence

Many small businesses are owner managed, meaning the business is completely dependent on the owner. If the owner becomes sick or takes a holiday, the business can't survive. Many business owners simply walk away because they have no one to sell the business to; they didn't have a succession plan, and therefore no succession happens. A Sydney aquarium closed down in November 2011, with the business owners saying they didn't look for a buyer as they assumed a new owner wouldn't be able to meet the rental payments. Yet customers were upset at the loss of a valued local service.

While this business would not have been big enough to support a management team, a succession plan would have allowed the owners to investigate potential buyers, and ensure a well trained staff member was on hand to help with a transition.

6b Non-financial analysis

We looked at non-financial analysis in Step 3, where we identified and prioritised the weak points in the business. Non-financial analysis is all about finding and prioritising action on risk areas in the business. Now is the time to implement improvements in governance and compliance, strategy and planning, human resources, risk management and financial management.

FREE DOWNLOAD



For a detailed example of a client implementation plan, identifying the various workstreams taken on by different experts over the succession plan timeframe.

Based on our analysis of the non-financial risk items in Step 3 we now need to prioritise all those items where the business is underperforming in order to reduce risk. As the valuation is directly related to the level of risk within our business, each item identified in the scorecard needs to be prioritised according to importance and urgency. In the example earlier I'd suggest that the absence of a shareholders agreements/buy-sell agreement could lead to a major financial disaster if one of the shareholders becomes ill, while having an independent director on the board is less urgent or important to business survival.

The analysis highlighted that the business does not have a fixed remuneration system or employee share plan. Implementing either of these strategies involves several considerations, for example if a business does not have job descriptions and staff performance reviews in place there is little value in adding a formal remuneration review system.

The succession plan often spans 18 months to two years but in managing its implementation we need to ensure that in each step of the process one of two key outcomes is achieved - either reducing risk in the business or improving performance/profitability.

6c Key person risk

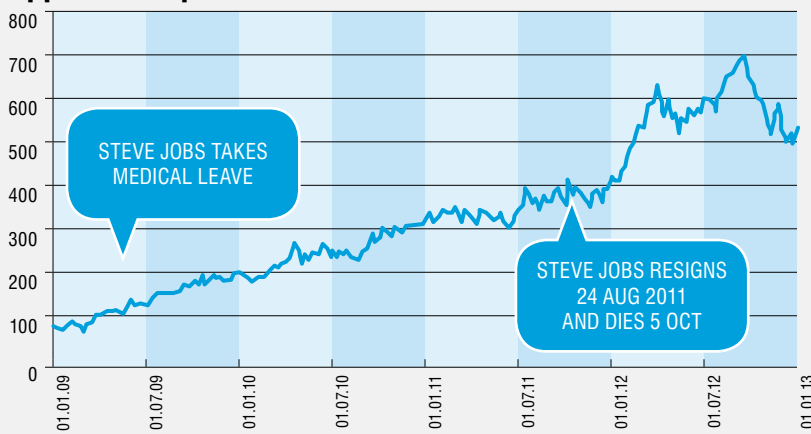
"Steve Jobs may well be one in a billion, but he is not immortal. The company's share price has got the wobbles more than once when investors have become concerned about his health and the lack of a successor"

(Emma Connors)



Remember when Steve Jobs retired from Apple? Already battling cancer, Steve Jobs put in place a new management team and stood down as CEO. While the market's reaction was at first a little wobbly, Apple survived, and in fact following his subsequent death, the valuation of Apple saw unprecedented levels, becoming the most valuable company in history as at August 2012.

Apple share price



While Apple as a business may be an unusual case, Steve Jobs' situation unfortunately is not. But he managed his succession well, developing a strong and able team around him that were able to take the reins when he no longer could. He also instilled such a strong sense of culture in the business that Apple employees were able to continue on as if he were still there, asking themselves: "What would Steve do?" Customers already loved the Apple brand and innovative product line, and would keep on buying whether Steve was there or not.

In this case Steve Jobs was the CEO. In your business you may have a key person that you really can't do without – a sales manager who holds all the relationships with clients, a technical programmer or developer who manages your business systems, or a scientist who holds all of your research and development IP. Or the key person may be you.

In any size business if you have the right management team in place, loyal staff who understand your business philosophy, and ensure your customers will enjoy the same experience with or without you or your key people, you are well on the way to a successful exit. But many business owners are the key person in the business, and without them the business will fail.

If you are currently the key person in your business, how do we help you to gradually extract yourself? That will depend on the type and size of the business, but we will work with you to work out the key relationships and knowledge that you hold and develop transition steps. A key task will be to document as much as you can about your business.

McDonalds is a good example of a systemised business. What makes McDonalds so successful is that it is easily duplicated, with every McDonalds franchise running pretty much the same. The franchises run on a 'turnkey' system – the operations manuals and the procedures and systems for the running of a store are so comprehensive and logical that a new owner can literally turn the key and open the doors for trading.

Unfortunately this is often far from the case for the typical family owned business. Much of the knowhow is in the business owner's head, making it very difficult for anyone new to come in and get started. But buyers are prepared to pay more for businesses that have documented systems, policies and procedures. You might pay a multiple of one or two times for a local burger bar, but around 6 times to buy into a McDonalds franchise.

Break down the areas of the business into its key functions and areas and then keep drilling a level deeper to identify all the processes in your business. For a retail outlet or workshop, you might start with the procedures to open and close up the shop. As you write each step, keep asking yourself 'how' to make sure you are not just assuming that a staff member would know how to complete each step, for example setting the alarm system or switching on the air conditioning. Make sure you are not expecting them to get from A to C without first guiding them through step B. A good way to test this is to get someone not involved in the business to try to perform each task as they have been written (properly supervised if there is any safety risk!).

Documentation of processes requires balance between being detailed and comprehensive while not being so long that no-one will bother to read it. Number each step so that it is easy to follow and gives the reader a sense that they are progressing through the task.

Next, put the processes where everyone can access them. For larger companies this may be an intranet site, or it may just be a folder on a shared network drive. You might print them in a book on site. Whichever way you choose, make sure each process or set of instructions is easy to find – clearly titled and in a logical order. Then assign staff members to update the processes regularly, or as changes occur.

Here are some examples of documentation that you will need to create or update when implementing your succession plan;

- General instruction manuals on operating systems, opening and closing, contact details for management team, security staff
- Shareholders plan, company constitution
- Sales processes – document each step in the sales process from adding customers to your database, dealing with an order, through to invoicing, returns policy, credit policies and ongoing relationships
- Procurement – document how you go about finding suppliers, any due diligence you do on them, purchase order process, dealing with invoices

- IT systems – document which systems deal with which processes and any software licences, expiry dates etc. Now is also a good time to get someone to overhaul your systems to look for efficiencies
- Staff procedures – document processes from recruitment and induction to job descriptions, performance management processes, leave policies, workplace behaviour policies, OH&S policies and termination.

Documentation can be a laborious task, but it helps the business to run smoothly without you, allows staff to take ownership and accountability of tasks without too much one-on-one training time, and of course helps to add value to your business. You can ask each staff member to get involved in the workload by documenting the processes they are involved in, and then switching with other employees to test the procedures. Or, you can take on a contractor to take full responsibility, although note they will still need access to your team and their time.

Of course implementing this plan early is recommended because transitioning your role to other team members takes time, but there are other important factors at play. I mentioned earlier that it is better to start the exit process when you still have a passion, drive, and energy for your business, not when you have become stale or the business is in decline. It's also important to have time to ride the waves of the capital markets – transitioning yourself out of the business as the manager means you can start to enjoy some time off before you actually sell, and means you can wait for the right buyer and the right price.

In Steps 13 and 14 we look at ways to make sure the business does not lose its key people, with various incentive plans.

Maximise Value

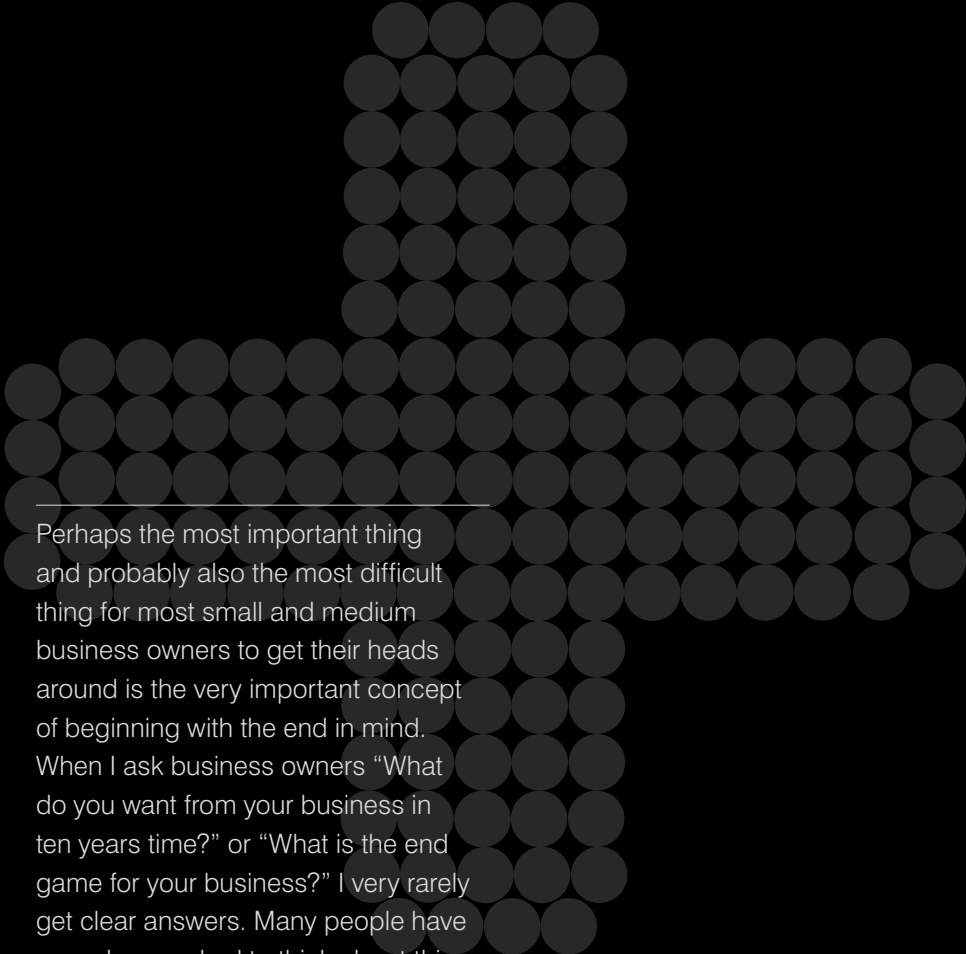
The next stage is usually quite an extended one where we look at maximising the value. Your plan is in place, you have worked on de-risking your business and reducing your operational involvement, and now it's time to make the business as attractive as possible to a potential buyer.

When we first arrive at a valuation of a business very few owners say "I'm happy with that, let's sell." They generally want and need to improve the value to fund their retirement.

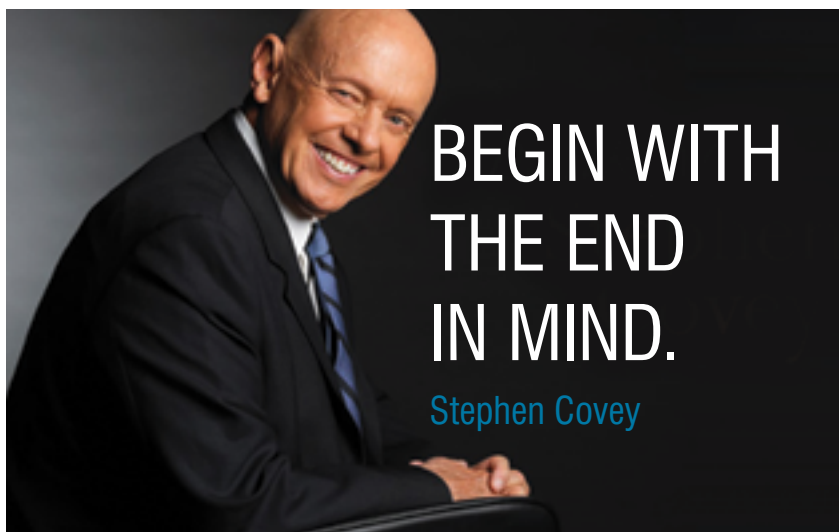
The next steps show the strategies we implement to increase your valuation multiple. Note that larger businesses tend to achieve a higher multiple than small businesses, partly because the perceived risk is lower – larger businesses are expected to have a strong management team, more people to cover each other's roles, more governance, better systems and processes and less reliance on a small number of clients. Significantly growing your business may add to its ultimate value on exit. But first, we look at the different options in actually exiting your business.

STEP 7

EXIT OPTIONS



Perhaps the most important thing and probably also the most difficult thing for most small and medium business owners to get their heads around is the very important concept of beginning with the end in mind. When I ask business owners “What do you want from your business in ten years time?” or “What is the end game for your business?” I very rarely get clear answers. Many people have never been asked to think about this important aspect.



A simple analogy is I jump into a taxi outside Sydney airport. The driver asks “Where do you want me to take you, Sir?” and I reply “Not really sure, drive around for a while and we’ll see what happens.”

Unfortunately many business owners operate their business using exactly this model day-to-day, driving around without really having a very clear destination in their head, and even more importantly, that is documented and clearly communicated with key stakeholders, employees and family.

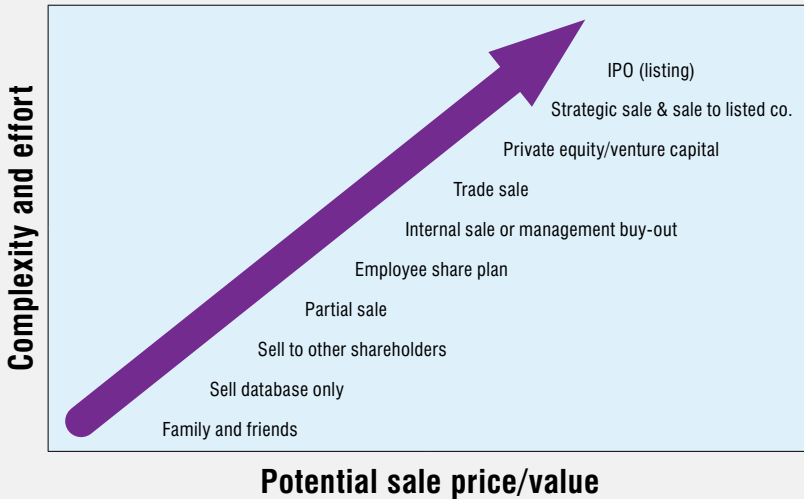
The ‘Simple sale’

Many business owners come to Succession Plus saying they need help through a ‘simple sale’ process. Unfortunately there is no such thing as a ‘simple’ sale. There are sales in which the owners put in limited preparation, put an advertisement in the local paper and have a few meetings with prospective buyers ending in a contract of sale, but these sales lead to big problems during the transaction or shortly after. Typically they will be because the sale process did not allow sufficient time for the transition of the business to be managed well.

These transactions are usually based on the seller trying to achieve the maximum possible price (or in some cases of desperation, the quickest possible sale), and the buyer trying to pay the minimum possible price. The business usually transfers quickly because the previous owner wants to take their money and get out without regard for the new owner’s ability to run the business profitably, effectively and efficiently.

Obviously, we don’t recommend such a sale. A good succession plan is a win-win situation for the exiting and incoming shareholders. You get a good sale value to fund your retirement, and the buyer(s) get a good stable business with future potential.

There are a number of ways to exit your business that can achieve a win-win situation. The graph below shows the options available to you and their relative time, complexity and effort to achieve. As a general rule of thumb, as the complexity and effort increases, you are rewarded with a higher price. With all options you will need to plan to reach the best outcome, and all options will require you to get tax advice well in advance.



Transfer of ownership between family members or friends

A business owner may transfer or sell part or all shares in the business to family members or friends. This is the least complex in terms of documentation, legal requirements and process, but certainly has its own challenges.

Transferring ownership of a business from one generation to the next within a family is the ultimate management challenge, but the Australian Family and Private Business Survey 2010 (RMIT University), reported over half of business owners intended to keep the business in continuous family ownership.

But unfortunately barely 30 per cent of family businesses survive into the second generation, and fewer than 15 per cent endure into the third (Planning for Succession, HRManager.com.au).

Effective succession planning is especially important within family businesses since they come with additional challenges and stressors particular to the family. When developing a succession plan to family members, we take account factors such as;

- relationships between family members
- health of family members
- each family member's interests and skill levels

- the degree of influence family members have over each other
- competition between family members
- the degree to which various family members are involved in the business.

Succession within a family business usually involves the transfer of control and ownership – each of which should be considered separately.

Often, the succession of control happens by default – there will usually be one member of the next generation more active, qualified and interested in the business than his or her siblings, and usually the founder will have already spent a great deal of time grooming the likely successor over a number of years. Dividing control of the business between different successors is rarely successful, unless there are well-defined functions or business units that different family members can assume control of, or they have very defined skill sets (example finance versus marketing).

If there is competition between family members for the position, and a successor hasn't already been identified by interest, proximity or birth order, it can be useful to convene a transition team made up of senior staff (including non-family members) to choose the successor without adversely affecting the business. Giving key, non-family employees the opportunity to participate in the transition team can mean that there is increased support for the successor, which will benefit the continuity of the organisation over the long term.

While transition of control may happen organically over time, transition of ownership requires the same careful planning and documentation as a trade sale process to minimise tax implications, and ensure that the legal reality reflects the informal intentions. A family succession plan should allow for contingency plans should a key stakeholder be incapacitated, and also be consistent with the business owner's will. In particular it should deal with future events such as divorce, partners or any step children that would not automatically inherit a share of the business, but may well be actively involved.

While this may be the least complex method in terms of documentation, make sure you get a business valuation to lock in the value of the shares at the time of transfer. This will help to minimise family dispute later, and determine the capital gains tax and stamp duty on this transfer and future capital gains tax for the new shareholders.

Selling the database

If you are self-employed rather than 'running a business,' or your business has little resale value for whatever reason, you may be able to extract some value from selling your database, usually to a competitor. Some businesses have a large email database that has a high conversion rate, or are in industries that tend to have a high level of repeat businesses. Financial planners and mortgage brokers sell their 'book' of trail income on existing clients, whereas the trades and service industries (plumbers, electricians, hairdressers, beauticians etc) may be able to onsell their client list.

As there are no shares changing hands, the process can be much quicker and less complex than selling the whole business, but you will need advice to make sure the sale of client information is handled within legal requirements, and again to maximise the value on sale.

Sell to other shareholders

Similar to a transfer to family members, a sale to existing shareholders is less complicated than some other exit options since you already have a relationship with the buyers, and they have a good understanding of the business. Again, you will need assistance in drafting the legal documentation to make the sale process smooth, and will need a formal valuation of the business to assign a value to the shares, that will also be used to determine your tax on sale.

In this scenario your succession plan will focus on transition of control and management if the shareholders are not actively involved in the business, and as in the family transfer you will need to identify a transition team to minimise business interruption.

Partial Sale

A partial sale involves selling some of your shares to a third party, and is somewhere between a sale to existing shareholders/family and a trade sale, depending on the buyer. If the buyer is already involved with your business or in the same industry, the process may be similar to the family transfer.

A partial sale may be the first step to a trade sale or private equity sale, that is the buyer makes a partial acquisition to start to build a relationship with the business, with a view to buying out the existing shares at a later date. Additional legal agreements may be required to document future milestones that will be reached, or to give the buyer the right to buy future shares using a call option. A partial sale can be a good way to free up some cash and create future options while developing the full succession and transition plan.

Employee share plan

An employee share plan allows employees to own shares in the company. This is a great way to motivate employees (since shares can be awarded in place of cash bonuses) and encourage loyalty. Once staff members are shareholders in the business it often changes their behaviour – they talk about ‘we’ instead of ‘they’ and are much more conscious of performance and decisions hitting the bottom line.

Employee share plans are usually operated using a trust, which can help to fund the share purchase for employees. This is covered in more detail in Steps 13 and 14. It is also the subject of my recently revised book ‘build it’ which will be released late 2013, and can be downloaded for free.

Transferring ownership to employees is a way to ensure succession of control as well as ownership; the key employees needed to run the business are incentivised to stay and step up (see MBO below). Benefits such as equity participation can be powerful tools in recruitment and retention.

Again you will need a formal valuation of the business to determine the value of shares, and legal advice in drafting an employee share plan and setting up a trust.

Internal Sale or Management Buy-out

In my opinion, a management buy-out (MBO) can be one of the most successful transactions. The current management team buys you out of your business, and continues to operate the business.

An MBO gives business owners a greater sense of certainty about the ongoing potential of their business. In most cases ownership is transferred to people that the existing owners know and have worked with. The transition can be planned over a much longer period and successors can be groomed according to the specific needs of the business and each individual's skill set.

Very few people know more about your business than those who already work in it, and will invariably have their own suggestions as to how the business can be improved. And assuming the staff are willing to participate in a management buy-out, we can assume there is a reasonable match between the business, staff, values, culture and the existing owners.

Staff members who buy equity in the business and participate as an employee and a shareholder or owner are more likely to stay with the business. They are more motivated, more dedicated, loyal and focused – behaving less like employees and more like business owners. This also helps to attract other like-minded people to the business.

Trade Sale

A trade sale is the process of selling your business to another company, which may be a private company or a public listed company. You may sell to a competitor, supplier or customer that can see strategic and cost advantages in bolting the businesses together.

In many ways a trade sale can be an easier and more successful option because in most cases the people buying your business will have experience and knowledge in the industry, and have their own way of operating a business. A trade buyer is also likely to be a 'strategic buyer' which means that they may pay a higher price for the business.

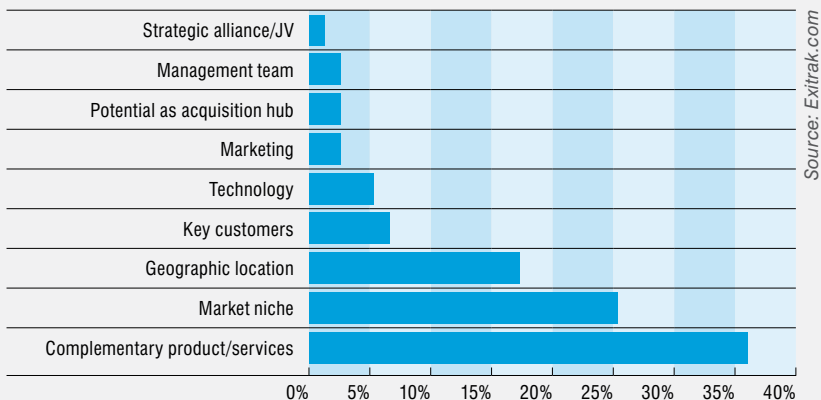
Strategic Value

Strategic value refers to the price a particular buyer is willing to pay for a business above and beyond its financial value. There are many reasons that a business may hold more future value for a particular buyer. Here are some examples;

- you own a valuable piece of technology or asset
- you have penetrated a market that they want access to, or have a contract with a key client
- you have employees that they want
- they want to prevent their competitor from buying you
- having your business combined with theirs will give them the highest market share or a unique offering
- the combined businesses will bring significant economies of scale (beyond an average trade sale).

ExiTrak surveyed business brokers in 2011 about the top reasons buyers acquire a business. The results were as follows:

Buyer motivation



To maximise the value of a business on sale there are three things to focus on;

- 1 Increase profit
- 2 Increase the multiple (by decreasing risk and increasing potential)
- 3 Sell to a strategic buyer.

A good example of a strategic purchase is Instagram. Despite not making any revenue and not having much future potential to make revenue, Facebook bought Instagram for \$1 billion, largely to knock a competitive threat out of the market. The attraction for Facebook was Instagram's momentum, fast ascension and almost cultlike following with over 30 million users, and helped cement Facebook's product offering in mobile technology.

Sale to listed company

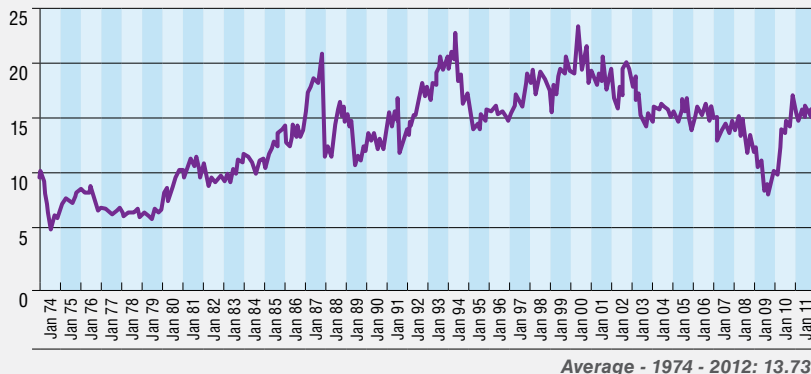
The long term price earnings average for companies listed on the ASX is 13.73. This is the valuation of the business divided by its annual earnings, which is equivalent to an earnings multiple. Obviously it varies across industries and sizes of business but let's use the average of 13.73. The long term average for private companies is 2.5.

If a private company makes \$1 million dollars a year, its value, using the 2.5 average multiple, would be \$2.5 million. If it was instantly listed on the ASX (which is not going to happen) we could expect a valuation of something close to \$13.73 million. The gap between is called arbitrage. So we have to look into how we as small business owners can take advantage of that.

If a listed company buys a private company it benefits from that arbitrage. So it may pay say \$4 million to \$5 million (a multiple of four or five times) to secure the company, in the knowledge that the acquired business instantly becomes revalued at \$13.73 million once added into the listed company's assets.

Selling to a listed company isn't simple - you have to position yourself for the purchase. But if you're prepared to take the time and effort to do that, the valuation difference could be significant. Our aim at Succession Plus is to attract this type of buyer.

Australian All Ordinaries P/E ratio (Jan 74 – Feb 11)



Merger

A merger is a joining of two entities where neither entity is deemed to control the other (conversely in a trade sale the acquiring company usually controls the new business and absorbs it into existing operations or operates it as a subsidiary).

Mergers are about matching, and it is very difficult to match two businesses successfully to form a merged entity due to;

- financial disparity between the two businesses and/or their owners
- ethical and values-based clashes between the owners
- operational differences
- a poorly matched client base, for example one business might be looking for premium clients while the other is attracting low budget clients.

Typically, the synergies anticipated from merging the two businesses are not as great as originally thought. The owners can underestimate the level of involvement required in the merger or the quirks and specialties in the new business. In the meantime, they may take their focus off their existing business, with the effect of decreased profitability.

Often, the employees become confused about the business strategy, new lines of reporting and ultimately who is controlling or managing the business day-to-day. In many cases, merged businesses lose staff shortly after the merger takes place. But there are many examples of successfully merged businesses, particularly among professional practices. Mergers work best where there is a strong match between the businesses, the owners, the client bases, the systems and the internal cultures.

Private Equity/Venture Capital

Private Equity and Venture capital firms are institutional investors that invest in or acquire businesses with strong growth potential. Their aim is usually to grow the business and exit within three to five years, often through an IPO. If you have private equity or venture capitalists interested in your business you will need to be extremely well prepared for the negotiation and due diligence processes. As professionals, they demand a thorough process and drive a hard bargain.

Professional investors may invest into your business in the growth stage to take a minority equity stake, while giving them the option to buy out 100% at a later date. This fits in well with long term succession planning.

IPO (Listing)

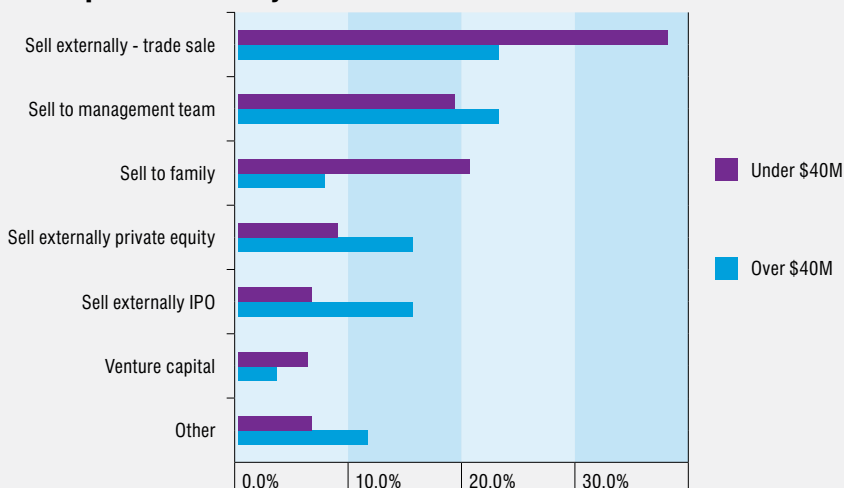
An initial public offering or IPO is generally a fund raising exercise rather than an exit strategy, since the business founders will usually retain some equity post listing. However it does allow you to reduce your shareholding and can be a way to achieve maximum value.

Listing on an exchange such as the ASX is an expensive, time-consuming process that rarely produces the results that business owners expect.

Once listed on a publicly traded exchange the company is bound by compliance and reporting requirements to protect current and prospective shareholders, who are not involved in the day to day running of the business. Exchanges require detailed and regular reporting and disclosure, which can be costly and consume valuable resources without delivering anything of substantial value to the owners.

Listing is obviously only available to a certain size of business, and is not appropriate for all business owners.

Exit options used by SME business owners



Funding the transaction

When a business owner starts to sell the family business they don't often think about how the buyer will fund the business; they don't see it as their problem. And that may be true in the case of a business owner who is looking for a quick sale and who has no real interest in who buys their business, or in the new owner's ability to continue to grow the business. Business owners who want to ensure their business is transferred into the hands of the right successors may need to consider how the ideal new owners will afford to buy into the business, and this should form part of the succession planning strategy.

Understanding the various funding options will help you to understand your buyer's motivation, and therefore be more responsive in the negotiating period. Business sales, unlike houses, rarely involve simply exchanging cash for the keys on one day. Some of the more creative methods can lead to a good outcome for all parties, and most importantly facilitate the deal getting done in a tough market. Here we explore some innovative methods for funding your business sale/acquisition, and offer some insights into the benefits of buy-in through equity participation.

In many businesses, your ideal buyer may be a young entrepreneur who is also starting a new family, buying a new house or getting married – a range of life circumstances that do not lend themselves particularly well to having surplus cash available. In some cases, it may be possible for the new owners to finance a business purchase through a home mortgage. But the downside is that if something were to happen to the value of their shares in the business their home is at risk.

Macquarie Bank, for example, offers a product called Goodwill Funding to professional practices such as legal firms and accounting practices, and businesses such as veterinary surgeries, pharmacies and real estate agencies where there is a reasonably predictable and maintainable stream of income. This funding is secured by the goodwill of the business based on its ongoing maintainable earnings and profit. It does not require property as security, but it may require directors' guarantees and security over the business assets.

Other lenders such as Investec (an investment bank) and ANZ have developed products specifically to fund management buy-outs and buy-ins and internal succession. In successful businesses these products rely mainly on the business repaying the debt through its cash flow, sometimes without the need for external security. The lender will register a charge over the assets (a type of mortgage granting priority over the assets if anything goes wrong) and may even introduce some converting preference shares. These are a special type of share that basically act as a debt facility and on certain events convert to equity – so, if things are not going so well the debt converts to equity and ownership of some of the company transfers to the lender. In October 2012 Australia's Channel 9 just avoided administration by converting almost \$1 billion into equity.

Another alternative is for the business itself to arrange finance for the new purchaser. This is called vendor financing, and can be arranged through business cash flow, an extension of the existing business overdraft or a new loan taken out and secured by the business for the express purpose of enabling the new purchaser to buy shares from the existing shareholders. Under this method the buyer takes ownership (or part ownership) immediately, and therefore responsibility for operating the company, but can pay for the purchase over time from the business profits. Effectively, the new owner forgoes dividends or sacrifices part of their salary until the debt is repaid.

When setting up a vendor finance agreement it is important to make sure the value of the equity and terms are matched well so that the income generated should largely fund the annual repayments.

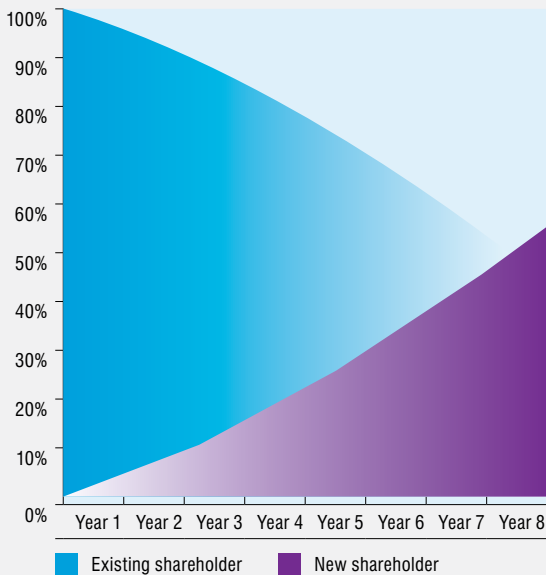
There are some tax benefits for the purchaser when borrowing money for investment purposes, and these can make the purchase more affordable in most cases. Equally, there are some tax benefits to the vendor when cash received is staged over several years.

Equity Matrix

"If you think of life as like a big pie, you can try to hold the whole pie and kill yourself trying to keep it, or you can slice it up and give some to the people around you, and you still have plenty left for yourself."

Jay Leno

You don't have to sell off all of the shares in your business in one go; you can stage your exit over time. In vendor financing control and ownership changes on the transaction date, but the cash is staged over time. An alternative is to match cashflow with equity in a gradual sell down of your shares. This works especially well with succession to family members, or to a competitor who wants you to reach a few milestones before they take on the full risk. If you do a deal with a buyer that wants a gradual acquisition, you need to get started early since this process works best over five to ten years.



The idea is that you gradually own fewer shares in a business that is increasing in value, so the dollar value of your shareholding doesn't really fall. At the same time the buyer acquires increments of shares in a business that is increasing in value, so with each purchase they increase ownership, but pay a higher price per share.

Let's look at an example where a business owner, who owns 80% of the company, gradually sells down his equity to the 20% shareholder, his son. Over the eight year exit plan the business increases in value at 10% per year because of various value maximisation strategies.

Year	Business Value	Shareholder 1		Shareholder 2		Buy/Sell Value
		Equity	Value	Equity	Value	
	\$000					\$000
1	\$1,000	80%	\$800	20%	\$200	\$100
2	\$1,100	70%	\$770	30%	\$330	\$110
3	\$1,210	60%	\$726	40%	\$484	\$121
4	\$1,331	50%	\$665	50%	\$666	\$133
5	\$1,464	40%	\$586	60%	\$878	\$146
6	\$1,611	30%	\$483	70%	\$1,128	\$161
7	\$1,772	20%	\$354	80%	\$1,418	

Shareholder 1 reduces his shareholding from 80% to 20%, yet the value of that 20% is only just less than half the original value. In the meantime he has received cash payments each year at 10% of the current business value (a total of \$771,000). So if he sold the additional 20% now he would have achieved \$1.125m for a shareholding that was originally worth \$800,000.

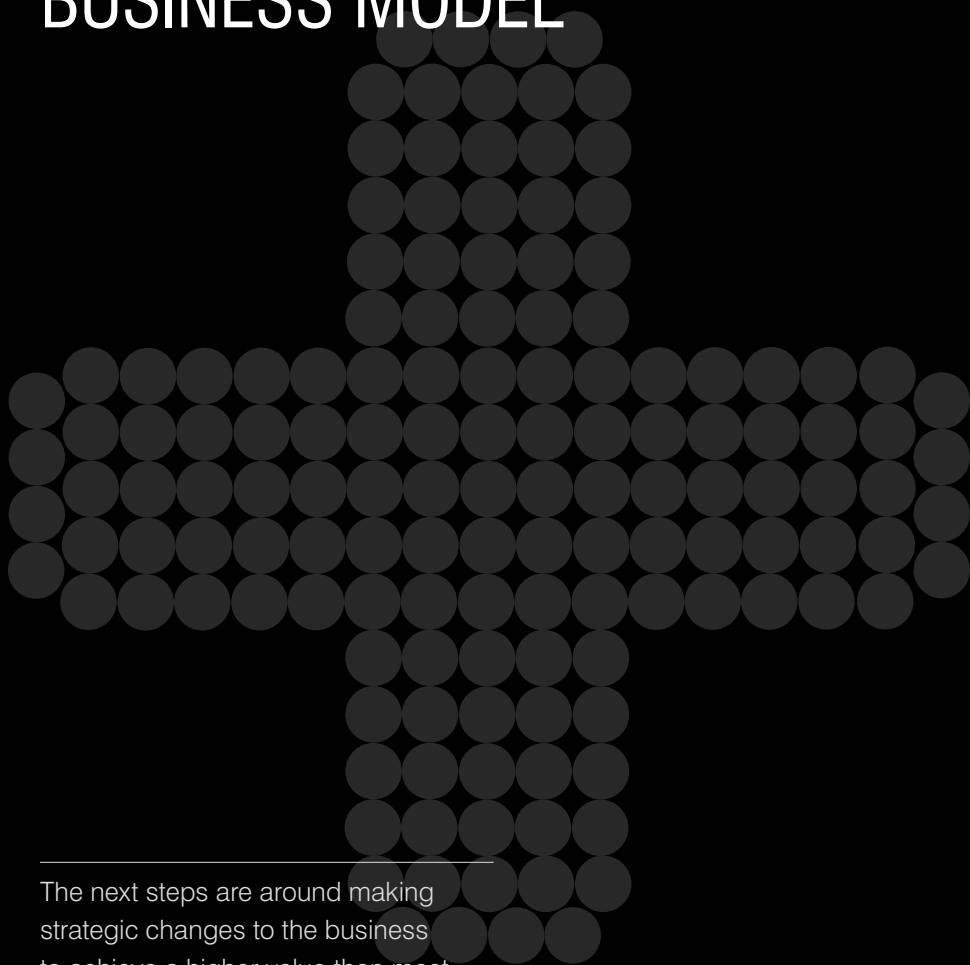
As the business grows in value Shareholder 2 owns 80% of a \$1.8m business, but has benefited from buying those shares at a lower rate over the years. During the succession plan he has paid \$771,000 for an additional 60% of the equity, now valued at \$1,062,000.

As an extreme example, the early angel investors in Amazon were eventually diluted to a minuscule fraction of ownership of the company, yet they enjoyed a 4,000 times return on their invested money.

Of course this doesn't work for everyone but if you don't need a big lump sum in the next few years a gradual divestment can be a win-win situation and gives you time to reduce your involvement in the business while taking some cash out to achieve your personal financial goals - be it pay off the mortgage, help out the kids, fund medical bills or travel. Your time or effort in the business should follow a similar pattern – you train and develop shareholder two so that his knowledge gap lessens and value to the business increases over time.

STEP 8

STRATEGIC PLANNING BUSINESS MODEL



The next steps are around making strategic changes to the business to achieve a higher value than most similar businesses.

All businesses need to have a defined business model which governs the way they operate, the pricing they charge and the level of service they provide to customers.

8a Boutique versus scale

A factor to consider in determining your business position and its potential value, is whether you have a scale business or a boutique business, or somewhere in between in no man's land.

Boutique ❖❖❖ No Man's Land ❖❖❖ Scale

Boutique businesses are typically small and offer a service or product at a premium price to a relatively small client base. The value in a boutique business is typically related to its premium pricing, since if correctly managed and planned, a boutique business will be able to generate higher margins. The business can add value by developing this price advantage, becoming even more exclusive.

Here are two examples of very different boutique businesses that operate on very different models:

- The Rockpool restaurant in Sydney has a famous owner/chef, fantastic food, excellent service and a serious price list – it caters to a discerning clientele that appreciates the value of the boutique dining experience, and can afford to pay.
- Lexus is a brand of luxury vehicles that represent prestige and wealth. Made by Toyota, they are quite distinct from the rest of the Toyota range. Lexus drivers are prepared to pay more for the Lexus experience.

Scale businesses on the other hand are larger and offer a wider range of services or products. They are often differentiated by lower prices and value for money. In a scale business volume is key to increasing value - more clients, more distribution, more products and/or more services in a business model that is cheap and easy to replicate.

Here are two examples of scale businesses using the restaurant and motor vehicle industries:

- McDonalds is the ultimate example of a restaurant built on the scale model. Its business relies on a large number of people spending a relatively small amount of money on a standard range of products across many locations.
- The Toyota Camry has been the best-selling mid-size car in Australia for the last 18 years. It is reliable, efficient and priced at the low end of the market, again combining high volumes with relatively low-priced vehicles.

When I first started my accounting firm, I left a large chartered firm and set up on my own. I had one large client giving me around \$50,000 in fees which was really high end, international tax advice on foreign exchange trading. A very boutique, specialised, technical service. My other clients were the teacher up the road and the plumber across the road who wanted help with basic tax returns. So suddenly I was in no man's land, and it's a very difficult place to operate and a difficult offer to market. If I wanted to go and recruit a staff member, I would need someone who understands the basic PAYG rules for the school teacher, and someone who understands foreign exchange trading and capital gains tax issues.

Lots of businesses end up in no man's land so the key is to work out which end you're at and stick with it. You'll add much more value this way. Look for more clients like the ones you already have and as your service becomes clearer you will attract the right customers and staff more easily.

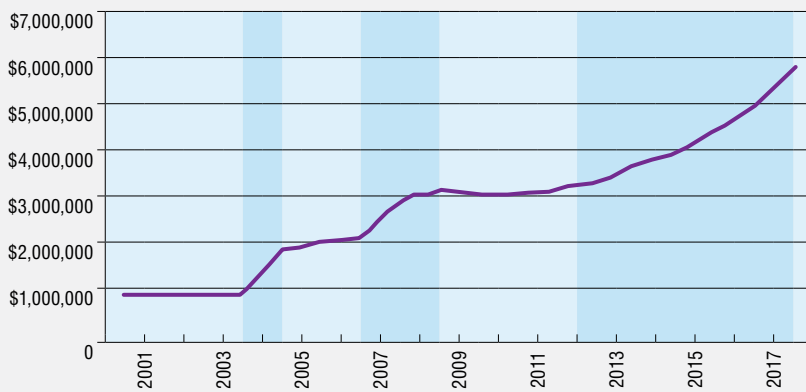
A potential buyer will see value in a clearly boutique or clearly scale (or scalable) business, however if your business is in no man's land it will be harder to justify that the business can differentiate itself in the market. If your business is somewhere in transition between boutique and scale, or doesn't have a strong strategy that aligns product or service with the target market, you will need to focus on this early in your succession plan.

That may mean getting some advice from a marketing expert to help you find your point of differentiation.

8b Efficiency or expansion

If you have been happy ticking along as a small but profitable business, and are now ready to contemplate an easy life on the golf course or a cruise ship, you may not be comfortable with the idea of now pursuing significant growth. But protecting the value of your business may require you to expand or become more efficient.

Revenue



If you ask most business owners what they want to do with their business they will answer: "I want to grow it". It's an almost manic need to grow, whether or not we know why. Sometimes continual growth isn't right for the business. Often we work with clients who are unclear whether their business is in the expansion or efficiency stage. In my view, businesses simply can't do both effectively – that is you can't successfully grow and expand whilst building systemised processes and efficiencies. The two require a different mindset, different focus from team members and deliver vastly different business outcomes. A good strategic succession plan must combine and manage the timing of the stages between expansion and efficiency and ensure the business is never doing both at the same time.

In many cases, where businesses have been able to focus only on expansion they find customer complaints increase or staff turnover becomes an issue simply because they haven't built any efficiency into the system - there are no structured or documented policies and procedures. As the business grows it becomes more and more inefficient.

We had a client whose revenue reached a plateau of about \$1 million for two or three years in a row. Their production capacity was about a million dollars. They were flat strapped, their warehouse was full, and their people were really busy working lots of hours. They were striving to increase revenue but were really struggling. So we explained the model of efficiency. They needed to improve their ability to perform the same \$1 million more easily while, more importantly, building the capacity to increase production to \$2 or \$3 million.

What do we mean by efficiency? Train your people, take on a trainee or a new person to do the everyday tasks, upgrade your software, expand your premises if warehousing is an issue. Whilst you're doing that you're building the capacity to turn over \$3 million. Then, you can go into growth stage. When you get to \$3 million, we press the pause button again and we build the capacity again.

Managing our growth on that basis allows us to do two things: manage the cash flow that goes with it (because growth costs money) and allow us to maintain a level of service and product quality without compromise. If you manage your business on this basis, you can control that growth rather than letting it control you.

A Sydney client of ours was run by two brothers – one an accountant and one a sales guy. They took turns at the CEO role depending on what phase the business was in. In the efficiency phases the accountant ran the business, while in the growth phases the sales guy was in charge. This allowed them to manage the needs of the business and focus in the right place at the right time.

Another client has an entirely different management style (for example changing the agenda at monthly management meetings) depending on which phase the business is in.

The board's role is to advise the CEO and management team on which phase they should be in and how to transition between the phases over time to dramatically improve the business outcome and value. Managing this well will increase your valuation multiple.

Here are some ways to drive expansion in your business without having to reinvent the wheel.

New market or product

Look for ways to expand what you are doing even just a little. You might add a new product or service, add a premium version of your current product or service, or find ways to reach new customers in your existing market with your existing product or service. Alternatively you might try to enter a new but similar market. If you currently don't market your business online, now might be the time to start (although do get some advice before spending any money on this).

Expand your database with a campaign

A low cost way to try to increase sales is to send out a newsletter or offer to your existing database to remind your customers what you can do for them, and give them a reason to come back. You could also offer a referral reward, which will help to increase your customer numbers.

To reach a new set of target customers, try a strategic partnership with a business that has similar customers to you; for example if you have a beauty salon, you might agree with a local hairdressing salon to join forces on a special offer or mail out. A social media campaign will boost your profile, although again get advice first to ensure that your business lends itself to 'followers'.

Make acquisitions

Acquiring another business just as you are about to exit may sound crazy or complicated, but it can instantly add scale and value. If you are able to buy a business similar to your own but in another location, you will be able to grow revenue and gross margin, potentially add some valuable skills, assets or methods, while reducing costs by taking out duplicate overheads.

Remember there will be thousands of businesses for sale over the next decade. Some business owners will be desperate to get out and will not have a succession plan in place. So there may be some solid businesses out there that you can buy at a low multiple, de-risk and improve profitability along with your own business, and then generate a higher multiple on sale.

There are several ways to fund an acquisition. Remember the seller will have the same sort of options as you do on exit, which we cover later.

One of our clients is taking advantage of the baby boomer wave and advertising to attract potential acquisition targets as part of a growth strategy.



Q: What's your succession plan?

A: Moody Kiddell & Partners

For over 30 years Moody Kiddell & Partners have been providing experienced, ongoing finance advice and we work as our clients' partner. Thanks to our unrivalled reputation in the Finance market, we are the recipients of numerous awards:

- ★ CAPFINS FINANCE National Broker of the Year (2012)
- ★ CAPFINS FINANCE 100th Broker of the Year (2013, 2015)
- ★ Money Management Finance Top Ten Brokerage (2012 - 2016)
- ★ RQS OF 1001 - ACT Finance Broker of the Year (2012)
- ★ Success Outstanding Performance & Commitment to Excellence (2012)

We're looking to continue our success and grow our business through quality acquisitions and would welcome a confidential conversation.

If you're interested in finding out more, contact us at 01454 660000 or email info@moodykiddell.com

Moody Kiddell & Partners
Finance Succession
moodykiddell.com

8c Strategic succession plan document

No matter how far ahead you are planning, you should have a plan that leads you from now until your successful exit. Keeping your mind on the end game will help you to stay focussed. Here are some points to keep in mind when developing your plan;

- As a business owner you should always be focussed on growth – even if you want to keep your business small with a limited number of customers, you need to find ways to grow profitability; adjust pricing, cut costs, add higher margin products or services. Once you make the decision to leave your business, don't take your eye off the ball. Make your business as attractive to a buyer as possible.
- The plan should let your business keep growing in whatever way is feasible, while letting you gradually withdraw. That could mean bringing in a new manager to drive growth at the same time as learning your role and gradually taking over the day to day management. If you gradually sell down shares in a growing business, your percentage of equity in the business will decrease, but the value of those shares will increase. This is achieved by implementing an equity matrix (see previous section).
- While focussing on the big picture and your ultimate exit from the business, the plan should detail the steps along the way with clear accountability, dates and milestones. This will help you to feel a sense of achievement along the way, while ensuring that your business continues to flourish, and that you are delegating important tasks and processes.

At Succession Plus we spend a good deal of time developing your plan with you to make it work for you and your business. There is no one size fits all, with so many variables between businesses, individual needs, families, and financial goals.

Once your plan is in place we recommend that you tell your staff members what is happening. Many business owners try to hide their planned exit from their staff, but this is usually a mistake; employees can sense something is happening, start to talk amongst themselves and jump to incorrect assumptions, and get anxious that they will lose their jobs (which causes some good people to leave).

FREE DOWNLOAD



In our experience telling employees about your succession plan means they will feel their jobs are more secure, have a chance to make suggestions in the process, and get a chance to step up to more senior roles. Undoubtedly some will resist change, but the more you keep them involved generally the easier it is to avoid business disruption, and get on with achieving the tasks on your plan.

Firstly, communicate the plan in a positive and inclusive way. You may tell a select group of people first, but ideally you should get the message out to the general staff at the same time. You don't have to release full details all in one go, as you are unlikely to know yourself, but start with the overall facts, timeframe and what this means for the team and ongoing operations.

Let them know that you'll give them regular updates, and then deliver on this. Don't risk losing people because they perceive the organisation to be unstable, or because they feel threatened.

Make sure you have enough time to implement the plan so that staff members don't feel 'put upon' by the extra work. And encourage feedback and ideas. Depending on the size of your business you might hold some workshops to get input from various divisions of the business. If you have a small team, it is important to include everybody.

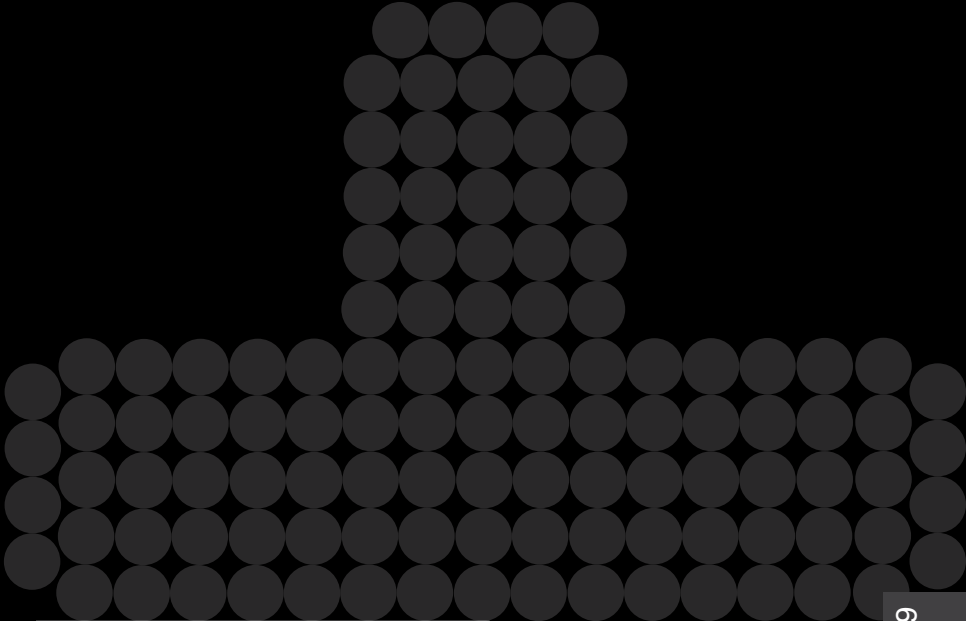
Be consistent in your message to employees, customers and the general public. You don't need a huge announcement or press release, just a brief message that says you plan to retire in the next few years and are starting a transition process to make sure the business remains a success, with the priorities being employee and customer welfare. You can then add some key dates and activities that they need to be aware of. Give them a contact to direct any questions to (you may need to appoint a specific person for this, particularly with a lot of staff), and let them know when to expect the next update.

Of course at this point it is unlikely you will know who will buy your business, and the buyer will determine their own operational structure. The main aim at this stage is to keep the staff that you need to help you reduce your own involvement in the business in the lead up to the actual sale. The next step will be to negotiate with the buyer to take on all of the staff. This will be an easier negotiation to have if the employees are engaged and hitting business goals.

Often if managed and communicated properly employees may see increased opportunities with a larger buyer.

STEP 9

STRATEGIC FINANCIALS



In the early stages of your succession plan we look at the financial health of your business and other factors such as how well you manage financial information. As we maximise value we start to focus on improving financial results and reporting, which helps to improve the business valuation (i.e increasing profit and decreasing perceived risk).

First we look at the recent profit and loss account for the business to establish financial stability and potential issues. Then we look for ways to quickly and easily improve profits.

9a Capacity Planning

Business capacity planning is all about proactively managing the business in terms of utilisation of resources and how efficiently they are used. Every business has a capacity, in other words a maximum level of turnover that can be achieved with the employees, equipment, resources and tools available. However in the real world nothing is ever run at 100% efficiency: employees will have sick days, machines will break down or there will be delays due to inefficient operations.

Most business owners don't bother to calculate their capacity or measure the rate at which their business is performing. Let's look at an example in a professional services firm, for example an accounting practice. Let's say that with one partner, one manager, four accountants and two admin people I have the capacity to turn over \$2 million, and at that level the business would be extremely profitable. But we will never be able to work at 100% of capacity and this accounting practice may well turn over 60 or 70% (our ideal target should be around 80% running rate).

Businesses that don't manage this capacity and running rate effectively may be pushed to the limit and turning over 90 or 95% of their capacity. But this is when other issues start - clients complain that you don't return calls, customer service levels drop, tax returns get lodged late. In a manufacturing company you might see product defaults, late deliveries or the wrong order shipped to the wrong customer. This is a symptom that the business simply doesn't have the resources to deliver its turnover.

On the other hand if we were to run our mythical accounting practice in the running rate of 25%, quality and customer service is really good, our clients are very happy, we are probably able to over-service, however we are not making any money, invoicing only \$500,000 which would not cover the costs to run the business.

There are two key things we can do to manage capacity. Firstly in the accounting practice, to improve or grow capacity we would invest in new resources, perhaps introducing new products or employing a new staff member to concentrate on larger clients. Capacity might be able to grow from \$2 million to \$2.4 million.

The other variable we can adjust is the running rate - how much we actually turn over as a percentage of total capacity. To improve that we need to go into efficiency mode - systemise the business, train people, automate processes and ensure everybody is clear on the role that they play. Going back to the example of our accounting practice, we don't want fully qualified, experienced professional accountants opening the mail or sending tax assessments to clients as this is an admin task.

If we understand capacity and whether our business should be in expansion mode or efficiency mode we develop a focus for the entire business and a clear area of attention for our management team.

To help you in determining your business capacity we have created a calculation tool, which is free to download.

FREE DOWNLOAD



9b 5 x 5 x 5

This model we call 5 x 5 x 5 because it's really simple. If you went to a CEO and said "I need you to grow your profit by 25%" chances are they wouldn't be sure how to do that, or they'd already be doing it. They'll probably focus first on trying to save costs. We look at three key areas generally. Sometimes the benchmarking might identify more, but usually three is a good place to start.

Three small manageable steps can deliver quite significant results, especially if you do this every year. In most businesses the following is usually achievable, and the CEO will feel comfortable aiming for small improvement targets, and can allocate responsibility for them to different parts of the business;

- 1 Increase revenue by 5% - whether through volume or pricing (although pricing is preferable!)
- 2 Increase gross margin by 5% - reducing cost to produce or serve
- 3 Decrease overheads by 5% - look for quick wins in underutilised space, paying out retainers unnecessarily, travel that could be replaced with conference calls, etc.

With real clients we have increased profit by 33% using this model. The key here is looking for quick wins, just sharpening what you are already doing, or adding obvious high margin services that add customer value. The well-known McDonalds' approach to increasing revenue is "Want fries with that?" At McDonalds staff members can actually be sacked for not asking that crucial question because the sale of fries is such a huge revenue and profit driver in the business.

Here's an example:

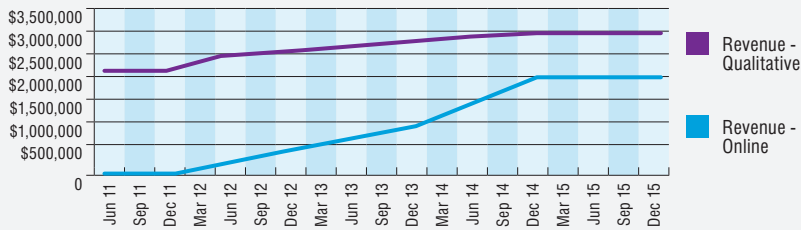
Profit and loss statement	2013 \$	Current %	Improvements	Planned 2017 (3 years later) \$	Plan %
Sales	3,000,000	100	5% Increase	3,150,000	100
COGS	2,250,000	75	5% Decrease	2,205,000	70
Gross profit	750,000	25		945,000	30
Fixed overheads	112,500	15	5% Decrease	94,500	00
NET PROFIT	637,500	21		850,500	27
NET PROFIT IMPROVEMENT				\$213,000	
PERCENTAGE IMPROVEMENT				33.41%	



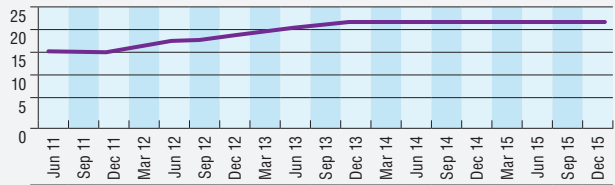
No matter what stage you are at in your business or exit strategy, it is always worth a review to see where you may be able to increase profits in the business. It sounds obvious, and you may think you do this all the time, but chances are you can always find more. This is where an advisory board can be really useful; as the board members are not as close to the business they can challenge the status quo objectively.

As a result of designing our strategic financials we should be managing the business with a big picture (strategic) financial model that is focused in getting us closer to our ultimate exit strategy – this business exit target was to get the business to produce \$600,000 in dividends (\$300,000 per family) whilst reducing their hands on involvement in the business.

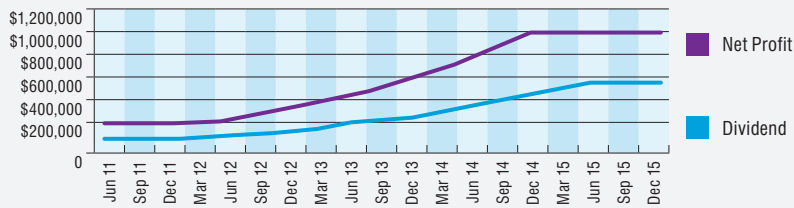
Revenue



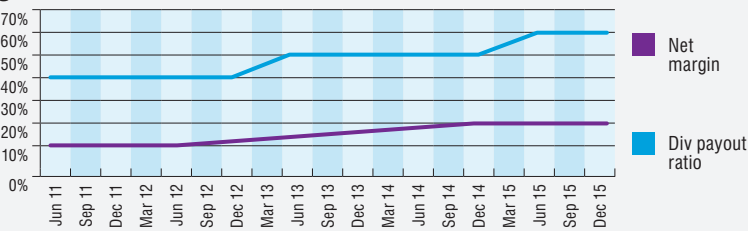
Headcount



Profit / Dividend



Margin / Div ratio



9c Financial reporting package

If you do not already produce or receive a monthly financial reporting pack, this is a crucial tool to implement and ensure you are on top of all the key financial and operational drivers in your business. Getting information often and promptly gives you a chance to act on any surprising results and improve profitability or efficiency. If you have started an advertising campaign over three months and can see after two weeks that it is not generating the expected outcome, you have time to change or cancel the campaign. If you only look at your financials every six to twelve months you have no way of being proactive and flexible.

A monthly reporting pack will generally include at least a profit and loss statement comparing the current month to the previous month, to budget and the same period last year to be able to easily spot trends. You may also produce a balance sheet, or a cashflow. You will at least need a working capital breakdown to monitor cash, outstanding debtors, payables and inventory levels (if appropriate to your business).

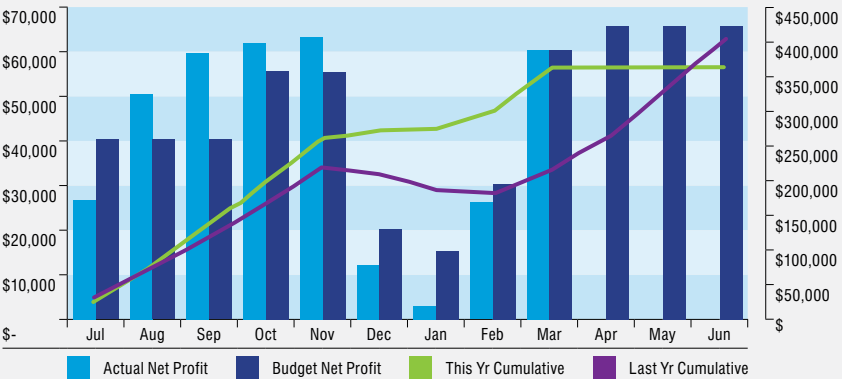
Good packs start with a dashboard that highlights all of the key drivers or key performance indicators in the business in an easy to read format that is consistent each month. This allows you to hone in on the most important figures instantly and take action, be that gross margin of a particular product or division, staff turnover, debtor days, website traffic, units sold. Even the basic off the shelf accounting packages (such as Xero) can produce most of this data at the click of a mouse. Here's an example for a manufacturing company that is focussed on cashflow, sales conversion and safety (see over).

Many small businesses focus on compliance – the BAS statement, PAYG and tax returns. While these are all important they don't help you in managing the operational and financial performance of the business, and they don't help a potential buyer to understand the potential value in your business.

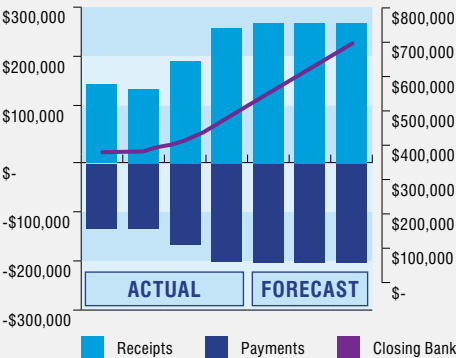
Your tax accountant may have been giving you some great advice over the years about reducing profits and therefore tax. When it comes to a business sale however, a business showing losses or low profits has low resale value. A quality monthly reporting pack lets you and your potential buyer see your true operating results and cashflow.

Profitability

Monthly Profit and Loss, Budget vs Actual



Cash Flow



Operations

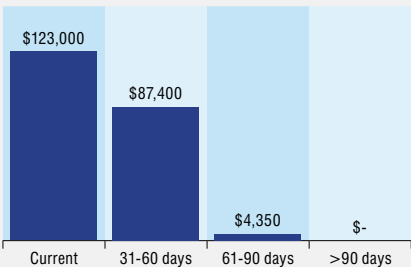
	Target	Actual
#Enquiries	525	575
Conversion rate	42%	35%
#Active customers	200	195
Average sale value \$	\$1050	1100
Orders shipped	245	220
Shipping errors	10	6

Safety

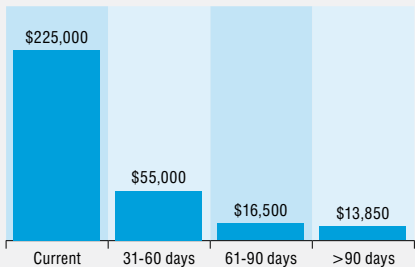
	Target	Actual
#Lost time injuries	1	-
#Hours to injuries	10	5
#Inspections scheduled	3	4
#Inspections completed	2	3

Working Capital

Aged Creditors



Aged Debtors



STEP 10

SYSTEMS AND PROCEDURES

The benefit of systems and procedures is efficiency. Having key business tasks systemised and documented will mean the business runs smoothly no matter who is in charge. An efficient business decreases risk and therefore increases the business valuation. So first let's look at what we would describe as an inefficient business, and then how we turn it into an efficient, lower risk business.

Symptoms of an inefficient business

Key Person Reliance: The ongoing operation of the business relies heavily on an individual; even worse is the situation where key people are the business owners who are looking to exit the business.

Management Mismatch: The skills and experience of the management team aren't suited to the business direction (for growth), and there is nothing in place to assist management succession; this is especially the case where the business owners wishing to leave the business are also the only people on the company board and in key management roles.

Un-systemised: When business systems are not documented, are ineffective or unproven the business is usually inefficient, experiences losses and strained client relations due to poor quality work. Typically the management team and owners of un-systemised businesses complain about having to micro-manage and find it time consuming and expensive to train replacement staff.

Lack of Documentation: We realise that putting a plan in place doesn't guarantee success in its own right, but it does help team alignment to common goals, and when external or internal changes trigger a change in business direction, the plan needs to be the blue print that is referred to and checked before deciding to switch courses. Other important documentation – for compliance and strategic reasons – includes key relationships (clients, suppliers and employees) and due-diligence documentation.

Generating Revenue is Costly or Time Consuming: A lack of repeat or referred business is a classic indicator of the revenue generation model being ill considered or ineffective; if there is a scatter gun approach to getting sales instead of a strategic approach, it will be costing the business dearly to get new business through the door. A heavy reliance on key customers is also a risk when it comes to reliability of future revenue.

Lack of Reporting: If a business can't show a track record of reporting and forecasting across all areas of the business, then how can it operate autonomously? Who is making decisions and on what basis? We know that 'gut feel' is a culmination of experience, and it often does result in good decision making, but this is a very risky basis for continuing to make decisions in a business if it is to be robust against industry, market or internal 'surprises', or if it is to achieve growth or ownership succession.

Poor Technology: Outdated or underutilised plant and equipment poses risks to business sustainability. It creates competitive vulnerability, and breeds complacency. Even if the business is doing well financially without striving for optimal efficiency and utilisation, it sure helps buffer against external changes (such as the GFC) if efficiency is a habit and valued in the business. Also relating to technology, ineffective intellectual property management presents risks and can undermine the value of a business, particularly where the intellectual property is one of the assets that give the business a competitive edge.

Sick Finances: Personal finances mixed with business may bring short term gains in personal wealth, but these can come at a much higher long term cost.

Remember that if you're looking to sell the business or have it valued for any reason, each dollar that's missing from the bottom line can be worth many times more dollars when it comes time to value the business. In terms of reliability of future revenue, basic business sustainability and capacity to finance growth, other risks are inconsistent cash flow, poor or inconsistent profit margins, and carrying unprofitable products/services.

Each of these inefficiencies need specific action, but the two we usually recommend as priorities are HR tools and templates and documented policies and procedures. These are key to keeping staff on track and making sure you stay compliant with the various laws and regulations.

10a HR tools and templates

Again the most important aspect is documentation. Has everyone got employee contracts and job descriptions, for example? Do you do performance reviews? How do you work out remuneration planning and employee reward?

I've got a client who mentioned to me that some of his employees have been with him 12 or 15 years and he's never updated their employment agreements from the day they started. Which means the agreements are probably not legal. The number of changes to HR and OH&S in that period of time would be significant. So that's what we mean by looking for gaps and out of date documents.

To start, get them all together in a lever arch folder. If you want to do it at an advanced level, get a secure area on a server and get all these scanned in, updated and recorded so everyone knows where they are.

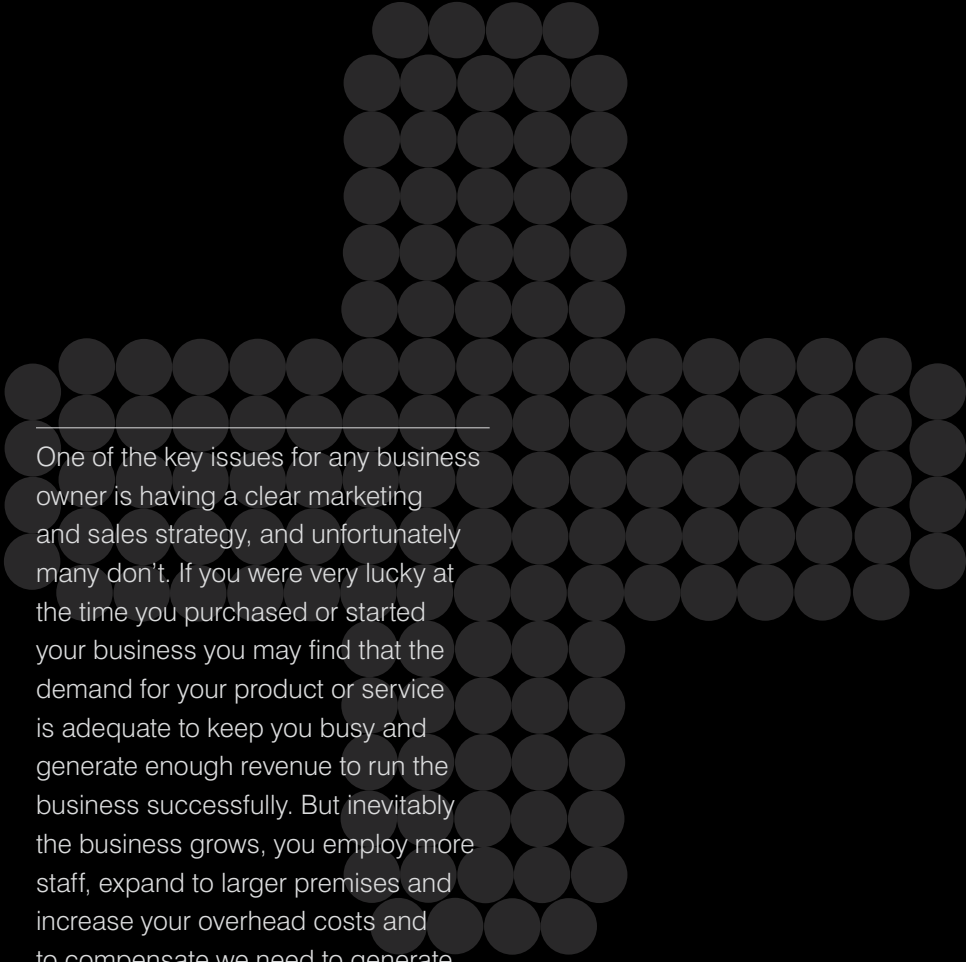
10b Policies and procedures

Ideally you have a policies and procedures manual covering each aspect of your business. They will mostly be people related but can also relate to systems and operating machinery. The standard ones are;

- Workplace behaviour
- OH&S or health and safety
- Expense claims
- Food preparation and storage
- Operating equipment and machinery
- IT policies – for example what employees can access in the workplace
- Security procedures and after-hours access
- Company car policy
- Staff travel
- Entertainment and after hours events.

STEP 11

MARKETING & SALES



One of the key issues for any business owner is having a clear marketing and sales strategy, and unfortunately many don't. If you were very lucky at the time you purchased or started your business you may find that the demand for your product or service is adequate to keep you busy and generate enough revenue to run the business successfully. But inevitably the business grows, you employ more staff, expand to larger premises and increase your overhead costs and to compensate we need to generate additional sales.

Most people who go into business are very good at what they do, be it as an air conditioning mechanic, process improvement specialist, or architect, but don't necessarily have marketing and sales skills.

Like so many other areas of business management, business owners often take the DIY approach and run advertisements in local papers in the hope of generating sales. But to maximise the value of the business, partly on the basis of our profitability, and partly on the basis of our professionalism, we recommend engaging some experts to design a marketing plan. This will identify accurately who the target customers are, what they like or dislike about your product, how and where they are searching for similar products or a competitor's product, and how best to communicate your message to them.

Simply getting this aspect right can dramatically change the performance of your business. A question I always ask business owners is "if I could magically generate a ridiculous amount of sales far in excess of anything you could imagine at the moment, what could you then do in your business? What potential would there be to expand, open a second location, bring in additional products or services to generate extra profits?"

Obviously, a key aspect of the marketing and sales approach would be to match every aspect of the business to the business model - a boutique accountancy practice would be expected to provide premium service, a 'luxurious' reception area, high end marketing materials as opposed to a scale based business - which should look and feel like a highly efficient factory.

In 2012 Succession Plus undertook a client survey (thanks to our friends at Stable Research) to find out the key things our clients thought about our business, didn't know about our business or would like to see improved or added to our business. The results were largely what we expected, but we did learn that many of our clients were unaware of the breadth of our product offering, having only used Succession Plus for a specific service, for example to introduce an employee share plan.

As a result of this survey we modified our marketing materials to include different content in our monthly newsletter and add several case studies to our website to show our clients some of the other things we offer to business owners.

We typically see business owners using their own skill, talent and personality to achieve sales, and whilst this might be okay for a small business it is certainly not the way larger more professional and more valuable businesses should operate. When investors or buyers interview business owners they tend to focus on questions around how the business generates sales. The crux of these questions is to find out if there are sales systems, processes or models that generate sales, or whether sales are dependent on the owner's relationships.

A sales system/process/pipeline to generate reliable ongoing new customers is far more valuable than a talented salesperson or the owner generating all the business.

STEP 12

CORPORATE GOVERNANCE

"The best executive is the one who has sense enough to pick good men to do what he wants done, and the self-restraint to keep from meddling with them while they do it."

Theodore Roosevelt

This section covers the practical side of governance. Legal requirements under the Corporations Act are very specific and apply differently to public and private companies. Some items discussed below as recommended practices are in fact a requirement in public companies.

12a Review business advisers

A key to success for any small business is to surround yourself with the right advisers. Unfortunately, many small business owners skimp on paying for good advice in an effort to reduce costs, but it's a false economy and in the long run ends up costing you more. With bad advice you can lose money, staff, valuable resources and time. Surrounding yourself with the right advisers is vitally important in the succession planning process.

There are many different business functions involved in effective succession planning as you go through each of the five stages. All of these processes can be greatly enhanced with the involvement of a team of quality advisers that specialise in succession planning. In my role as a project manager I work with business owners to coordinate the various advisers required in the development and implementation of their succession plan, bringing in the right expertise and experience at the right time. Typically these will include:

Tax consultant – Tax advice is crucial in succession planning. If you take action without tax advice you may end up with a higher tax bill than was necessary, and once a tax event takes place, it can't be undone. A tax advisor will help you to determine the appropriate structure for your transaction and ensure you can take advantage of all the available tax relief and concessions. Your buyer may also request certain conditions to be in place to minimise tax implications or stamp duty on their side. Be aware that once you put any arrangements in writing they can be used to determine the tax impact, even if you later change the agreement. So, again, planning upfront is key.

Accountant – An accountant or corporate finance advisor will be involved in valuing the business, mapping the transfer of equity over time (ownership/shares), and funding the purchase.

Lawyer – A number of agreements are required in order to correctly record everyone's understanding of how the succession plan is to work, and to ultimately sell equity. These include:

- a shareholders' agreement, which every business should have in any case
- a buy/sell agreement, or sale of business/shares agreement, which outlines the arrangements that would come into play if one shareholder is no longer able to continue in the business
- a funding agreement which would outline the funding options available to the shareholders in the event of various circumstances, for example the death of one of the parties.

Insurance expert – It is important to have insurance not only for the business and its assets, but for key shareholders, particularly to determine what would happen in the event of trauma or death. An insurance expert will ensure the correct policies are in place, are correctly structured and regularly reviewed to ensure that the needs of the business and the individual shareholders are being met.

Business coach – To get the best result from the business it is useful to have an objective person to help you through the process, especially if you are aiming to reach certain business goals during your succession plan. Business succession planning can be an emotional time, so a business coach can be a key player in the advisory team to keep perspective and drive accountability. One of my family-owned business clients recently found that the emotional issues were far more difficult, complicated and time-consuming than the technical aspects of the transfer from father to sons.

Project manager – This is the role that coordinates the various technical experts. Designing the succession strategy and coordinating its implementation is vital to ensuring that the plan works effectively for everyone involved and requires a holistic perspective from someone who understands the entire process.

Documentation experts – If you are putting your business up for sale you will need an information memorandum (IM) that outlines the business opportunity to a potential buyer. Some corporate finance advisors will offer this service, or should be able to refer you to someone who specialises in this field. Look for someone who understands the financial content of the IM as well as possessing good writing skills.

Your network – Don't be afraid to ask for help from those around you. If you belong to any industry groups, business networking groups or have access to consultants and advisors, get the benefit of their experience.

Advisory Board – You should have an advisory board throughout your business's life, but if you don't already have one it is a good idea to get one in place in the succession planning stage to help in the overall plan of maximising value. The advisory board will guide you and keep you accountable. It will also give a potential buyer comfort that you have governance and process in place.

Advisory boards help to guide the strategic direction of the business and overall business philosophy and are involved in the bigger picture decisions. They usually don't have legal standing in decision making, but continually challenge the management team to make sure you don't make dumb or costly mistakes. They also make sure you don't become complacent, or take shortcuts, for example not having an up to date business plan and targets.

An advisory board gives you access to serious executive input without paying for top-notch consultants. One of my clients set about recruiting an advisory board from a local network of business associates, offering selected candidates a generous amount of shares as compensation.

The selections from the talent pool were based on the fact that they identified several 'holes' to fill; financial expertise and strategy to keep them from getting bogged down in the minutiae of running the business. They also wanted an expert in the digital media environment, one of their target markets. The advisory board for this business concluded the business was undercharging customers, which led to improved profitability. The more you charge, the more clients value what you say and do, provided that your basic offering is of real value.

Being in business can be like riding a rollercoaster. There are some great highs, but there are also some terrible lows; these are times when advisors should act as cheerleaders. Although some advisors will only work on a fee for service, an experienced and seasoned advisor may agree to be compensated by shares and options, which may suit the business owners if cash is not readily available until after exit.

12b Board composition & guidelines

When asked about their board of directors, many owners of small and medium sized businesses frequently respond along the lines of:

"All of the owners of our business are also directors and all of us work in the business. We know the business inside-out, so we don't really need formal board meetings."

or

"As the single shareholder, director and senior executive of the business, I AM the board of directors and I know everything that matters about this business. We're really not big enough to worry about having a formal board. I deal with the formal stuff when the accountant gives me the forms to sign each year."

In our experience, having a formal board adds value to the business throughout the business life cycle, and gives a potential buyer assurance when you are looking to exit. The purpose of the board is to drive strategy, monitor performance, provide accountability, set and monitor risk and manage the senior executive (CEO or General Manager). Boards also bring fresh ideas, insights and outlook to steer business strategy and remain objective, with the ability to step in and prevent a hindrance or complete disaster. Well chosen board members have experience from a range of industries and situations and can use that experience to maximise returns in your business.

If you are a director, or are considering appointment as a director of any entity, it is well worth educating yourself on the legal duties and responsibilities. The Australian Institute of Company Directors (AICD) runs highly respected courses in this area. Below is a concise summary of the functions of the board, taken from the AICD Company Directors Course:

- Strategy formulation and approval
- CEO selection, monitoring, evaluation, remuneration and, when necessary, removal
- Ensuring that effective governance processes are in place
- Setting and monitoring corporate culture
- Control and monitoring of organisational performance
- Ensuring that appropriate risk management is in place.

- Compliance with the law and the requirements of regulators
- Big picture policy formulation
- Communication with key stakeholder groups
- Crisis control
- Networking.

Characteristics of an Effective Board

An effective board will have full understanding of roles and responsibilities, both at a board level and individual director level, cover a range of skills and experience, and have formal processes in place to facilitate timely, efficient and relevant communication and decision making. This includes clearly documented and consistently implemented processes, policies and guidelines around board meetings, reporting, selection and removal of directors and board evaluation.

Board meetings should operate to a standard agenda, with reporting packs provided in advance of each meeting and minutes issued within 48 hours afterwards. Reporting packs include operational and financial metrics to keep the board members informed on performance, trends and any issues in advance of the meeting. At the meeting, time can be more productively focussed on tackling the issues. Below is a standard board meeting agenda.

- Minutes of Previous Meeting
- Actions Arising from Previous Meeting
- Managing Director's Report
- CEO's/General Manager's Report
- CFO's/Financial Controller's Report
- Sales Pipeline Update
- Other Business
- Future Board Meeting Schedule
- Special Items (e.g budget)
- Evaluation of Meeting.

An annual board program ensures all of the ‘big items’ are scheduled time in the appropriate months, for example to deal with strategy development, adoption and review, budget development, adoption and review, board performance review, annual account sign off, shareholder meetings and general compliance. A typical board meeting calendar may look as follows:

Item	Time and location	20XX						20XX					
		Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
	9am - 12pm boardroom, head office	18 th	15 th	19 th	17 th	21 st	19 th	16 th	20 th	20 th	17 th	15 th	19 th
Strategy													
Develop	8am - 5pm seaside retreat, pretty beach							17 th					
Adopt												X	
Review													X
Budget													
Develop											X		
Adopt												X	
Review	1pm - 5pm												X
Board performance													
Evaluation		X						X					
Feedback			X						X				
Planning				X						X			
Finance													
Draft accounts				X									
Final accounts					X								
Shareholders													
AGM					X								
Report					X								

Example board calendar

There are a great deal of discussion, recommendations and guidelines on what makes an effective board composition. Ultimately it comes down to what makes sense for the present and anticipated needs of the business. The number of directors on the board generally relates to the size of the company: smaller companies operate well with three to four while large public companies typically have upwards of eight. The board needs to give consideration to composition at appropriate intervals, looking at the mix of existing directors and then working out how to fill any gaps as the business develops or undergoes significant change.

As a minimum, we usually recommend our small business clients have two non-executive directors or board advisors. A non-executive director or board advisor can add significant value in terms of industry or business expertise, experience or contacts. An independent director or advisor should also be able to strengthen strategic planning, decision making and corporate governance.

In larger businesses or those with complexity or particular risks the board will form committees to focus relevant board members' time on those areas. Examples are:

- Audit Committee
- Remuneration Committee
- Risk Committee
- Nomination Committee.

These committees are then governance focused and guided by their own specific Charters.

12c Family council/communications

In many family owned businesses the complexities of having family members who might be shareholders, employees and managers (and obviously family members) can substantially interfere with the operations and strategic direction of the business (rarely in a good way).

I have seen many businesses where the inability to effectively manage this complex web of relationships has greatly reduced the value and performance of the business.

One of the best solutions is to introduce some sense of corporate style governance - in the case of the family business a family council can be introduced to represent the wishes, goals and strategy of the family (assumed to be major shareholders). This can avoid the issues of individuals within the family making representations to management and even directly to employees.

In many cases the discipline and structure of this type of arrangement will provide a forum for open communication and a structure to allow two-way feedback, and ultimately a better result in terms of stakeholder outcomes.

12d Director Succession

In the same way that a business owner must look at ownership succession as part of an exit strategy, the board also needs to look at management succession of its directors as a key part of the puzzle.

There are several recent and well publicised cases of public company succession issues involving directors - some quite good examples where the plan has been outlined and communicated for some time and the successor well prepared, others not so good where succession was not managed and an unplanned event forced a rapid change on the business, which was ill equipped and badly prepared to handle it.

In smaller businesses owners need to carefully separate ownership succession and management succession and ensure they have the most suitable successors for both as they are often not the same person despite the founder traditionally fulfilling both roles.

Richard Pratt – Visy Packaging Succession Plan

Richard Pratt died in 2009 after a long battle with prostate cancer. Pratt spent five years carefully planning his succession to ease himself out of the day-to-day running of Visy and leave his family well looked after.

Pratt's son Anthony assumed the role of leader of the Visy empire, and inherited Pratt Industries USA. The family investment vehicle, Thorney Holdings, went to daughter Heloise and her husband, Alex Waislitz, while Visy Industrial Packaging was left to daughter Fiona and her husband, Raphael Geminder. Each business had been managed by the successors for the past few years. Visy's \$3 billion Australian manufacturing group, was split equally between the three oldest children, while Pratt's youngest daughter Paula had a Sydney mansion and cash held in trust until she turns 18.

Pratt and his family also brought in a team of non-family board members, led by former Foster's boss John Murphy as chief executive and another Foster's boss, Ted Kunkel, as chairman.

12e Decision rights and authorities

Between the directors, owners, management team and shareholders it is important to know who makes what decisions, and what happens when a shareholding changes or there is a dispute between shareholders.

Shareholders' Agreements

The Shareholders Agreement is really like a corporate rulebook that sets out issues such as:

- how the company will run
- how the profits of the company will be divided
- how decisions will be made
- what happens in a deadlock if the directors or shareholders can't agree.

When playing a game you may not need to refer to the rulebook from play to play, but when you don't agree with a call, the rulebook has the final word – and it is the same with a Shareholders' Agreement. You and your fellow shareholders/directors make the day-to-day decisions about the company and its business, but if at some point you don't agree with each other, then you can refer to the agreement for a ruling.

The Shareholders' Agreement should cover the most important aspects of running a company, including:

Directors

How many directors should there be? Who may be a director? How are they nominated, appointed or removed? What quorum of directors is needed to make a decision? Does the chairperson have a casting vote? How is a managing director appointed?

Who makes the decisions?

Should it be the directors, who are appointed by the shareholders? Should it be the shareholders themselves? If so, will they have different classes of shares that entitle them to different voting rights? Or will it be a combination of both depending on the particular decisions that need to be made?

When the shareholders are also the directors it is practical for the directors to make the decisions on a day-to-day basis. A directors' meeting can be called quickly and most questions (or motions as they are properly called) can be passed by simple majority vote. The types of decisions that could be made based on a majority vote include:

- removing a director or appointing a new director
- appointing a manager to the business
- buying low-value equipment, for example, equipment under \$10,000.

When the decisions are more important, particularly when they involve a major or ongoing financial commitment, or a change in the direction of the business, it may be wise to require an absolute consensus in order to make the decision. Examples of decisions that might require a consensus include:

- decisions to expand the business by buying another business
- decisions to expand the business by taking on additional funding.

These voting rules can apply to directors, shareholders or partly to shareholders and partly to directors, depending on the decisions under consideration.

How do you break a deadlock?

When the relationship between shareholders breaks down to the extent that the company cannot be run effectively, you have a deadlock. This is when the Shareholders' Agreement is invaluable.

In a deadlock situation, the Shareholders' Agreement will set out the rules under which a shareholder can request the other shareholders buy his or her shares to allow him or her to leave the company. This may be a mandatory provision so that the other shareholders must buy him out. If none of the shareholders wants to remain involved in the company, and they want to get out of the relationship altogether, they can apply to the court for a winding up order and the company will be wound up and deregistered. A liquidator is usually appointed to make sure all the debts are paid and then any surplus is distributed to the shareholders in accordance with the Shareholders' Agreement.

How Do You Break Up?

A Shareholders' Agreement should always set out the rules for what happens when a shareholder wants to sell their shares, whether or not there is a deadlock.

Usually the Shareholders Agreement contains pre-emptive rights, which means the exiting shareholder must first offer his/her shares to the other shareholders. If the remaining shareholders don't want to buy the shares, the outgoing shareholder can sell them to a third party.

Remember the shareholders of a company are the owners. They can make decisions every day without ever having to look to the Shareholders' Agreement. And, if they all agree, they can even make decisions that contradict the Shareholders' Agreement. It is only when there is a disagreement that you need to refer back to the rulebook – and if things have reached that point, you had better be sure that the rules work.

Dividend Policy

Including the basis for dividend distribution and how it is calculated.

Matters Requiring Unanimous Approval, Special Resolution or Ordinary Resolution.

Decisions made have varying degrees of importance in terms of how the outcomes of those decisions may impact the shareholders and/or the wellbeing of the business. Some decisions can only be made at a meeting of shareholders, while others are delegated to the Board of Directors. Usually reflecting the degree of importance, the Shareholders Agreement will set out how these decisions are made and can be.

- Unanimous means everyone must agree
- A Special Resolution is defined in the agreement, typically falls in the range of 60 – 75% e.g a resolution passed by more than 74% of directors/shareholders
- An Ordinary Resolution is also defined in the agreement, typically this is a resolution passed by more than 50% of directors/shareholders.

Examples of decisions that may require unanimous approval of shareholders:

- Amending the company constitution
- Entering into a scheme of arrangement with creditors
- Giving a guarantee or other form of security by the company.

Decisions that would usually require either Special or Ordinary resolution of shareholders:

- Change in issued share capital
- Securing debt finance above a set threshold
- Amending the dividend policy
- Acquisition of other businesses.

The Business

- Purpose of the business (usually to make profit)
- Usually includes special terms given that shareholders are also often key people in the business e.g may include a requirement to contribute skills to the benefit and advantage of the business, and non-compete clause
- Right to examine financial accounts
- Nominated Accountant
- Nominated Banker
- Registered Office
- Frequency and Notice Period of Board Meetings
- Requirement and Frequency of updated Business Plan and Budget.

Transfer of Shares and Pre-Emption

How shares may be transferred under a range of different circumstances

- Planned exits
- Unplanned exits
- Who shares can be transferred to
- Whether shares are to first be offered to remaining shareholders
- Basis of valuation of shares
- What happens concurrent with the transfer of shares e.g resignation as director, returning company records
- Repayments and guarantees
- What happens with any amount owed by the Company to the Shareholder
- What happens with personal guarantees given by the Shareholder.

Breach Exit

Sets out the circumstances that warrant expulsion of a shareholder. Typically:

- Breach of the Shareholder Agreement
- Criminal conviction involving fraud, dishonesty or serious harm to another person
- Bankruptcy
- Action or negligence resulting in harm to the business
- How the expulsion takes effect
- Basis of valuation of shares in the event of breach exit.

Drag Along

This clause mainly prevents minority shareholders from blocking the sale of the business. This clause basically gives the majority shareholder the right to force other shareholders to sell to a buyer. Of course, the basis for valuing shares must also be set and agreed here, and the buyer must pay no less than that price.

Tag Along

This clause protects shareholders in two ways:

- From all of sudden finding themselves in business with someone they don't want to be in business with!
- If a partial sale, giving all shareholders the opportunity to sell some of their shares.

If a shareholder finds a buyer, then under this clause, the other shareholders have the right to 'tag along' i.e to force the buyer to buy their shares as well, in full or in part, as the case may be. The shares must be purchased on the same terms as agreed with the original selling shareholder.

Other 'standard' clauses

- Confidentiality
- Governing law and jurisdiction
- Variations to the Deed of Agreement
- Successors and Assigns
- Termination
- Duration
- Notices
- Stamp Duty and Costs
- Inconsistency
- Waiver
- Cumulative Rights
- Execution by Counterparts
- Non-Solicitation
- Not Induce Breach
- Entering into Competition
- Dispute Resolution
- Entire Understanding.

Shares in the Company

Entitlement of Shareholders to the capital of the company, and their voting 'voice', usually proportionate to the number of shares held, the issue of new shares, quorum of shareholders and basis for changes to Company Constitution, which must usually be unanimous.

Types of Buy/Sell Agreement Structures:

Heads of Agreement

This is an agreement rather than a legal contract and the legal enforceability of these types of agreements is doubtful. However it does show a level of intent.

Mutual Wills

Mutual wills are between two parties (usually spouses) who bequeath their business assets to the surviving party in the event of either of their deaths.

Conditional Contracts

This is a contract conditional on a particular trigger event. Caution should be taken with these types of agreements; if poorly drafted there can be stamp duty payable on the full value of the business. In addition, the signing of a conditional contract may in itself trigger a CGT event, or establish the timing for the occurrence of a CGT event.

Share Buy-backs and Redemption Agreements

Under this type of arrangement the company redeems the shares held by the shareholder when a trigger event occurs. The source of funds under this arrangement is the company. The share buy-back arrangement must cater specifically for Corporations Act requirements and tax implications, which includes the proceeds being treated as an unfranked dividend and the CGT cost base being affected.

Put and Call Options

'Put' and 'call' options are widely recognised as the most efficient way of structuring a buy/sell agreement. A put option allows the executor of the estate to 'put' the business interest to the surviving party (or a nominated party to the agreement) and legally binds that person to buy. A call option allows the surviving party to 'call' upon the ceasing owner (or the executor of his/her estate) to transfer the business interest and legally binds them to sell. The transfer is always carried out at a price predetermined under the agreement.

The use of put and call options ensures the CGT liability in respect of the transfer is triggered on the actual transfer, not when the agreement is entered into. It overcomes a CGT issue that can arise with conditional contracts. The use of put and call options provides increased flexibility and tax effectiveness of the arrangement for the business partners and beneficiaries.

Funding Arrangements

There are a number of ways to provide funding for a buy/sell agreement, including the use of a Peak Performance Trust. Generally, life insurance can provide all or at least part of the funds required to allow business owners to satisfy their obligations under a buy/sell agreement should an insurance related trigger event occur, and this should prevent the continuing owners from having to borrow money, liquidate assets or deplete the reserves of the business or their personal wealth. Once the type of life insurance policy required has been determined, the requirements of the buy/sell agreement establish how the policy should be held. The methods of ownership typically include:

Cross ownership – Under a cross-ownership agreement, each of the business owners holds a policy on the life of each of the other business owners, with the proceeds being payable to the continuing owners. The proceeds are used to purchase the departing owner's interest in the business from his or her estate. With cross-ownership it is important to recognise that without a legal agreement in place the surviving owners cannot force the estate to sell their share of the business in most cases.

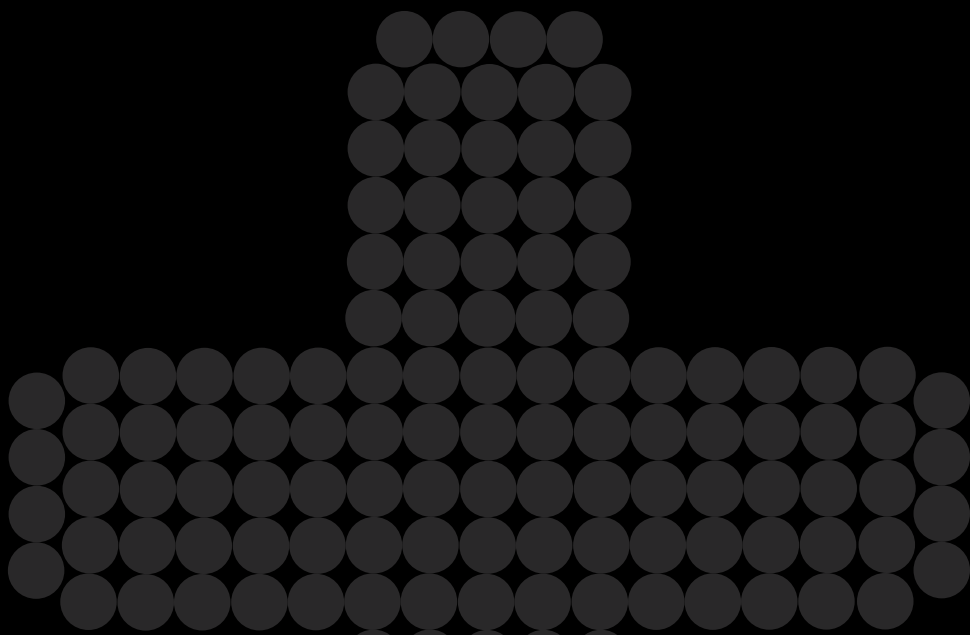
Company ownership – This can only occur within a company entity and should be considered as a funding arrangement where the legal agreement is the share buy-back or corporate entity redemption agreement. There are several adverse tax consequences with this approach, and as a result it is not used very often.

Insurance trust – In this scenario the trustee owns the policies on behalf of the business owners. This may be a suitable option in circumstances where the owners enter and leave the business regularly. However, there are also several adverse tax consequences with this approach.

Self-ownership – Self-ownership is generally considered to be the most practical funding method due to its portability, tax effectiveness, ease of administration and simplicity in engaging new business partners in the agreement. Each of the business principals owns a policy on his or her own life with the proceeds payable to the estate of the deceased principal. The agreement entails the insurance funding the purchase price, so as to give the continuing owners a market value cost and the deceased owner's estate a market value proceed from the sale. This option is only available where a buy/sell agreement is used as a legal arrangement.

STEP 13

OWNERSHIP THINKING

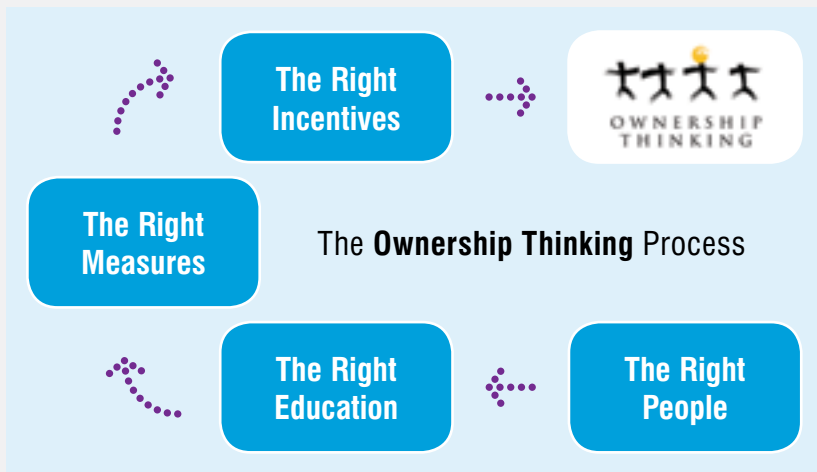


One of the biggest issues for most business owners is people - and whilst we have all heard the quotes about our people being our biggest asset I often speak to business owners who consider their people to be their biggest issue or liability.

In December 2011 I listened to Brad Hams of Ownership Thinking speak at the Exit Planning Institute conference in Florida. His presentation was about getting your people to 'think and act like business owners' by finding better ways to attract, retain and motivate your key people (the by-line of my book on employee share plans).

Ownership Thinking is a business model which provides design, advice and consulting to businesses who wish to engage employees and create a 'culture of accountability and purpose'. The goal of Ownership Thinking (OT) is to create an organisation of employees who think and act like owners. It's not only about making money, however. OT is also an excellent cultural model and retention strategy. Companies practicing OT retain employees at a 200% better rate than companies that don't.

There are four components of Ownership Thinking, shown in the diagram below:



The Right People

Ownership Thinking creates an environment that promotes learning and development, while increasing visibility and accountability. Your best people will excel, and your poorest performers are generally self-selected out by their peers.

The Right Education

Employees are taught the fundamentals of business and finance, so that they are better equipped to make decisions that are financially sound.

The Right Measures

Rather than focusing only on lagging financial measures, an emphasis is placed on identifying the most critical leading, activity based measures (Key Performance Indicators, or KPIs), and utilising those KPIs to forecast results on a regular, formal basis.

The Right Incentives

The process of employee education and focusing on the right measures in an environment of high visibility and accountability will increase your organisation's profitability, guaranteed. We can now design and implement a broad based incentive plan, because it is self-funding.

In the succession and exit planning process, better engaging your team to drive performance within the business will always add value. Most buyers are far more attracted to businesses that are run by motivated and incentivised employees than those that need to be run by owners.

Case Study - NPG

The best way to demonstrate how Ownership Thinking works is to follow an example of a company that has successfully implemented the strategy.

In August 2011 NPG was facing a few major issues. It was heavily reliant on the three owners, the staff were disengaged, which frustrated the owners, and nobody was clear about the vision and future of the business. The owners had some clear personal goals. They wanted to continue receiving solid income from the business without having to be there every day. They wanted to be able to semi retire and take a few months off or work part time, while continuing to build value in the business. And finally they wanted to reduce their personal risk and liability.

The owners recognised that they had some business challenges that would make it difficult to achieve their personal goals. Firstly they were having difficulty attracting and retaining staff with the right skills and right attitude/cultural fit, and could not get staff to think about the company's wellbeing as well as their own. They found it tough to find the right remuneration and incentives strategy for their disengaged, blue collar work environment. This was exacerbated by disharmony between two departments of the business and cashflow restraints.

The owners needed to take significant action, and with the help of Ownership Thinking they began with four major steps.

- 1 Defined the overall strategy and vision
- 2 Improved people management and communication
- 3 Implemented ownership thinking to move the company towards a business of 'business people'
- 4 Appointed an independent General Manager to reduce the reliance on owners and move the company forwards.

With these four actions, the business became cohesive and productive. Staff members understood the vision and strategy of the business and the owners and were clearer about what was expected of them. They felt more included and informed through monthly company-wide information sessions. All employees were educated in business ownership and began receiving information about the performance of the business. A self-funded incentive plan will replace their Christmas bonus.

There is more 'we' than 'me' thinking in the culture, and a greater sense of purpose, visibility and accountability.

The two owners closest to retirement appointed and began grooming their successors..

In 2012 we reviewed progress with Bob, one of the owners. He had the following list of achievements:

- Insurance coverage improvements underway
- Resourcing gaps filled
- Accountant appointed
- Sales and resourcing 3 year forecast prepared
- Shareholders arrangements worked through
- Goals clarified
- Monthly staff meetings in place
- Monthly management meetings in place.

"Just three months on from implementing Ownership Thinking in our business, we are thrilled to see that our employees are shifting from indifference and a sense of entitlement, to a team who are really engaged and proactive. Before Ownership Thinking, absenteeism was a massive problem for us. Not only were staff using up all of their sick leave, but often they just wouldn't show up, leaving us understaffed and unable to meet our customers' deadlines. If they didn't need the cash, they would just take leave without pay. We were losing a lot of money because of it!

Since kicking off our Ownership Thinking program, absenteeism has already dropped by at least one third! Overall, productivity is higher and our employees are taking more interest in the financial wellbeing of the business. Instead of the all the responsibility falling to the owners, our leadership team are really on top of what's going on in their areas of the business: they understand their numbers and are sharing the issues and challenges we face in running the business.

Overall, it's a great sense of relief for us as owners. We really feel like we're 'sharing the insomnia' that comes with running the business. We're positive that, by doing business the Ownership Thinking way, our profit is going to soar and we'll all be having more fun working together as a result!"

The benefits of Ownership Thinking can be seen almost immediately, and the best part is that they last. And it's not just about money. The culture of accountability, winning and team alignment drives staff to achieve long term goals. Once they are engaged and understand how they can affect the performance of the business, they are motivated to keep on making improvements. There are many other success stories. One US IT consulting and managed services business doubled its 2011 profit in 2012, months just 1.5 years after implementing Ownership Thinking.

A cabinetry business recovered \$21,000 in its first 3 months after implementing a Rapid Improvement Plan.

Many owners that have implemented an Ownership Thinking strategy have reported a 'natural shedding of dead wood', typically employees who weren't willing to be held accountable. Their departure was normally to the great relief of their hardworking, culturally-aligned co-workers.

Case Study—Garrett Sullivan, Kaikor Construction Associates, Inc.

In 1985, Garrett Sullivan and his business partner started a construction company, Kaikor Construction Associates, Inc. Seven years later, his business partner retired. Garrett built the business to annual revenue of \$20-25 million per year, predominantly working on government contracts such as bridges, concrete buildings, parking structures and parking lots. He found success when he benchmarked the business against heavy highway contractors in the less than \$50 million category and worked hard to get results in the top 25% (a Best in Class ranking in the construction industry).

In 2009, Garrett went to the Annual Ownership Thinking conference. Although he had already been sharing some financial information with his staff, had a bonus plan in place, regularly looked at Key Performance Indicators (KPIs) and was consistently benchmarking, he found that the Ownership Thinking Management System put a structure and organisation around those activities. He believed Ownership Thinking promoted a deeper understanding of the financial information being shared with the employees and helped his team understand how they could impact the bottom line.

Garrett set a stretch profit target of 35% in January and began implementing an Ownership Thinking Plan, with staff receiving training and full financial information. By May, the financial results indicated that they were on track and remained strong as the year progressed. By November, the Senior Management Team decided to award a 50% 'deposit' on the incentive payout the week before Christmas, emphasising that the payment was the result of the employees' continuous efforts, and not a Christmas bonus. The company closed out the year achieving their stretch profit target.

As the Ownership Thinking culture continued to grow, Garrett held a quarterly meeting with all employees to review the financials. He also introduced activities such as a financial planner to talk about personal wealth management and financial boot camp for the non-financial employee. Ownership Thinking topics were also encouraged in business communication, for example the weekly foreman's meeting and the company's bi-monthly newsletter.

In the second year, the company doubled its profit and continued to do well for the next three years. Around this time, Garrett found that he had fulfilled all of his goals for the business. He had built the company to a standalone business no longer dependent on him, and he had invested in his employees' development to help them realise personal and professional dreams. It was time to move on and allow other team members the opportunity to step up in

the business by taking real equity ownership. The senior managers were very clear: they wanted to buy it. However, they didn't have the cash to buy the business outright.

A concept called 'New Company/Old Company Buy Out' was structured, which enabled the business to be sold gradually, over an agreed five year period. First, a new company was formed with the senior managers having a minority stake and Garrett having a controlling interest. New and existing contracts were assigned to the new company, while the new company paid the 'old' company for use of all business assets and premises. After the third year, the new company had enough retained earnings and cash to buy all of the equipment. And when one of the new employee-owners needed to cash out for personal reasons, the other senior manager bought his interest out.

The buyout plan worked extremely well and was accelerated in the fourth year. Only one issue remained to be solved; the unearned profit on the outstanding \$34 million of uncompleted contracts. It was agreed that one-third of this profit would be paid to Garrett in quarterly payments if he continued to work as an employee for a year (at his current rate of pay with all benefits).

Once Garrett's employment ended he maintained ownership of the building and parking lot and rented it to the business. The structure enabled him to 'cut ties' without any future liabilities beyond his direct control and ownership of the company's activities.

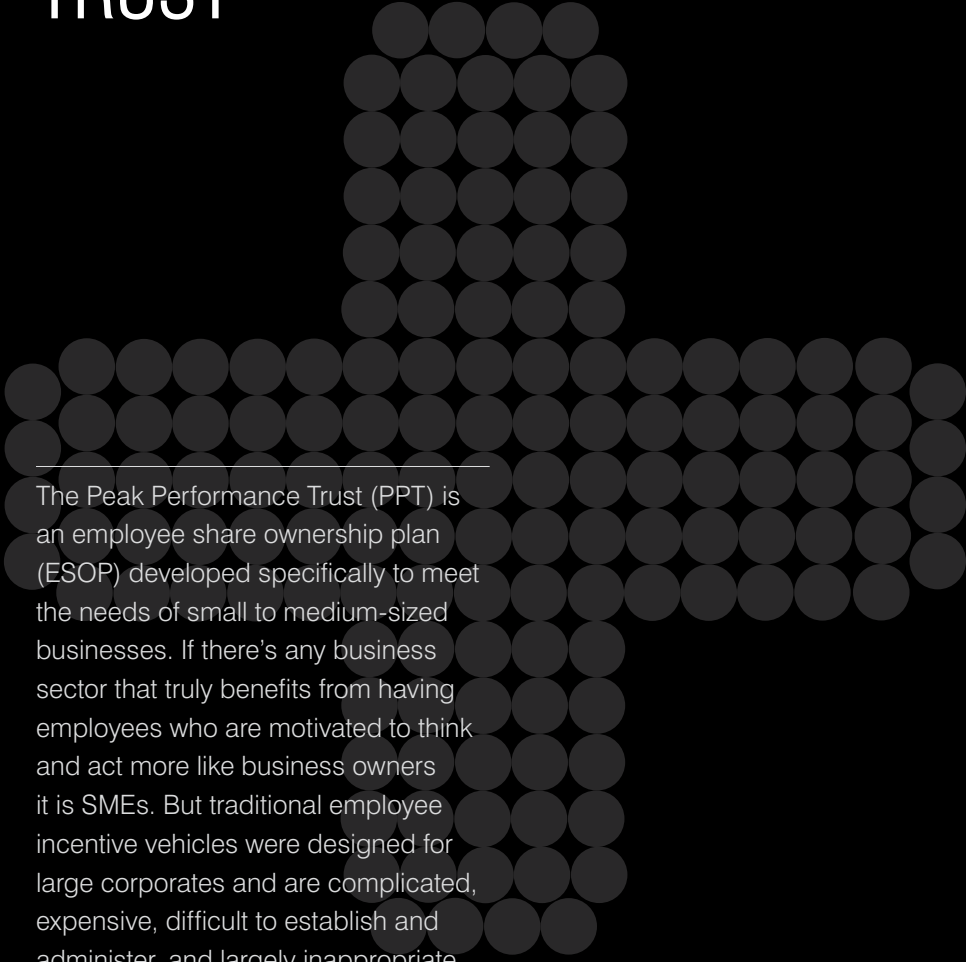
The combined payments included three years of office and equipment rental charges, building and parking lot rental fees (still ongoing), and the final equity payout. Garrett estimates this was equivalent to achieving at least 3-4 times earnings value, typical of the construction industry. However, he is quick to point out that earnings were higher than previously due to the success of the Ownership Thinking Management System program.

Garrett still sits on the board and consults with the business, while the old company holds his real estate investments. He has one reflection on what he could have done differently:

"I wish I had acted sooner on implementing Ownership Thinking, as even though we were in the top 25% in our industry class in net income and return on equity, I think we could have been much higher."

STEP 14

PEAK PERFORMANCE TRUST



The Peak Performance Trust (PPT) is an employee share ownership plan (ESOP) developed specifically to meet the needs of small to medium-sized businesses. If there's any business sector that truly benefits from having employees who are motivated to think and act more like business owners it is SMEs. But traditional employee incentive vehicles were designed for large corporates and are complicated, expensive, difficult to establish and administer, and largely inappropriate for smaller privately-owned companies.

The PPT was developed to offer smaller companies a tool that delivers all the benefits of a sophisticated employee incentive scheme, but without the expense or complexity. The PPT is simple, effective and good value.

Described by CPA Australia's In the Black magazine as an 'ingenious funding mechanism' for exit strategies, the PPT links increased profits to performance payments made into a trust on behalf of employees, building an employee's stake in the business.

Background to Employee Share Ownership Plans - International

Employee share ownership plans (ESOPs) are very popular in the United States, UK and Europe but have not yet gained momentum in Australia despite legislative changes and evolution since the 1970s. ESOPs benefit private businesses by:

- Funding an exit
- Delivering improvements in performance
- Achieving business continuity after the owners exit
- Allowing a tax effective transfer of ownership.

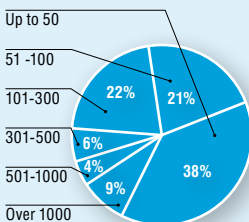
In the United States nearly half of all ESOPs are used by private firms to buy out an owner. It also positions the business as a more competitive employer and therefore attracts and retains key staff. Half of business owners surveyed said securing the right talent/finding competent staff was the number one issue while retaining them was ranked at 16%.

The following diagram shows statistics on ESOPs in the USA and the growth in number of ESOPs since they were introduced around the 1980s.

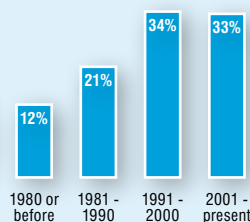
What do ESOPs look like?

Currently, there are about 10,900 ESOPs and equivalent plans employing more than 11 million U.S. employees. ESOP companies are incredibly diverse: there are ESOPs in almost every industry, ranging from just a few employees to over 150,000, spread throughout the nation. This infographic provides a brief summary of what the ESOP community looks like.

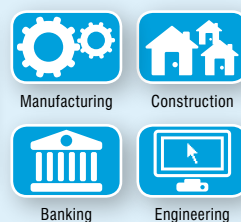
NUMBER OF EMPLOYEES



YEAR THE ESOP STARTED



MOST COMMON INDUSTRIES



ESOPs are particularly suited to a business exit because they allow more flexibility in the exit timeline, offer a structured and smooth transition and are an attractive alternative to selling on the open market.

Employee Share Ownership Plans in Australia

Employee share plans have been operating in Australia since the mid-1960s with both IBM and Ajax Fasteners operating schemes with varying success. The plans were first embodied in legislation in 1974 and have led to evolving significance and increasing support amongst business, and the gradual evolution of the legislation.

Support for employee share plans continued when in 1996 The Hon John Howard MP delivered a policy statement, Employee Shares Ownership Plans Initiatives. The subsequent Howard government increased tax concessions for employees in ESOPs and also relaxed the conditions to allow more companies to launch an employee share plan.

Implementing an employee share plan to facilitate an exit strategy is gaining popularity in Australia and especially small to medium enterprises. There are potentially great benefits to the business owner, the employees and the business due to improved retention, motivation, performance, productivity and profitability.

In a sale situation the PPT is also a clear demonstrator of the company's performance and the health of its financial assets since it shows the company's ability to pay funds over a period of time based on performance targets being achieved.

There is no single model or hard and fast rules, but ESOPs generally fall into two broad categories – giving benefits to executives or benefits to general employees. To facilitate a business exit, we will look in more detail at transferring ownership to employees through a Peak Performance Trust.

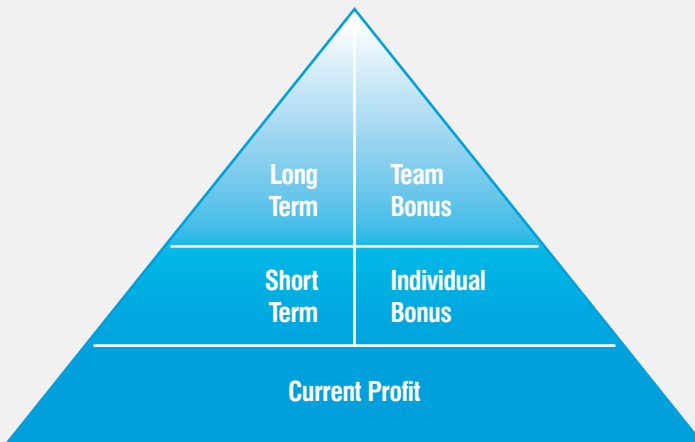
A Strategic Approach to Remuneration

Transforming employees into committed shareholders of your business involves developing a remuneration system that reflects your organisation's philosophy, objectives and values. The way that you reward your staff members influences their thinking, behaviour and performance.

For example, a company that pays bonuses or commissions to individuals for monthly or quarterly results encourage employees to focus on short term individual results, and not on the longer term business strategy. If the reward is capped, staff may hold and roll over sales from one period to the next rather than doing more than is necessary to achieve each bonus.

Employee remuneration is about more than just money – it is about motivation and reward, which contribute to increased levels of productivity and morale. A strategically planned remuneration system helps to align your employees' personal and financial goals with your business goals and encourages ownership thinking.

A good plan will combine a competitive base salary package with a short term bonus based on individual performance, and a component that relies on long term performance and team work.



Using a PPT in your remuneration strategy

As an employer you make contributions on behalf of, and for the benefit of, your employees into your PPT. Your business makes a commitment to investing a predetermined amount of money into the trust on a regular basis, contingent upon participating employees achieving predetermined performance targets. As the profits increase, so too does the percentage share that employees can benefit from, and vice versa.

The benefits of a PPT are considerable for employees and employers, ensuring complete alignment between financial and lifestyle goals. The PPT is the ultimate 'golden handcuff' for staff as it links financial reward to achieving long term results.

The following simple rules will help you to make the most of your PPT and motivate your staff:

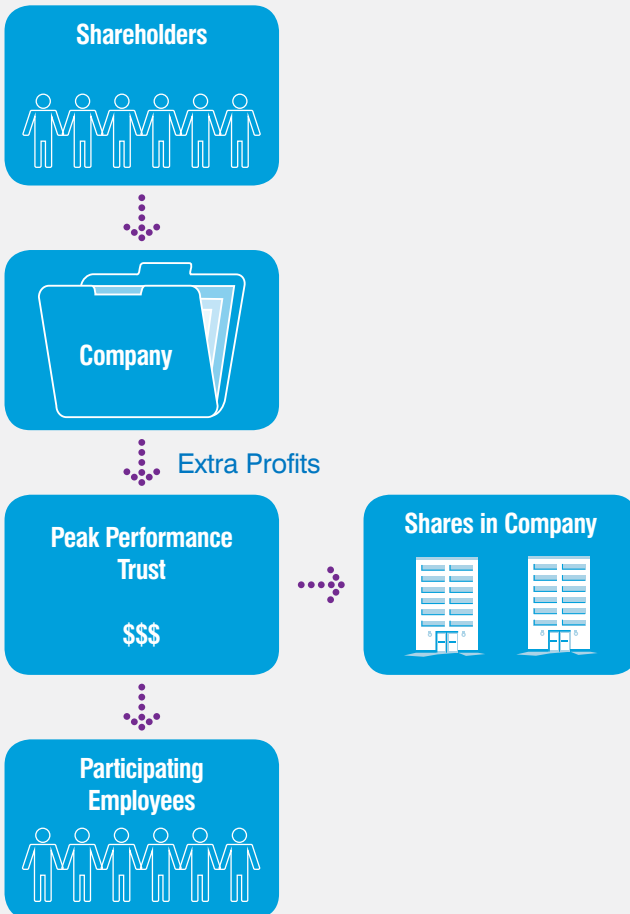
- **Simple** – well thought out and easy for all staff to understand
- **Applicable** – applies to all staff consistently (although you can choose to offer greater reward to particular levels or for particular relevant outcomes for which employees have control)
- **Reliable** – once communicated does not change often
- **Transparent** – communicated clearly and without ambiguity.
All performance indicators must be able to be measured objectively and progress communicated regularly
- **Supported** – the system must be supported by all company owners, board and management.

Using a PPT for your Succession Plan

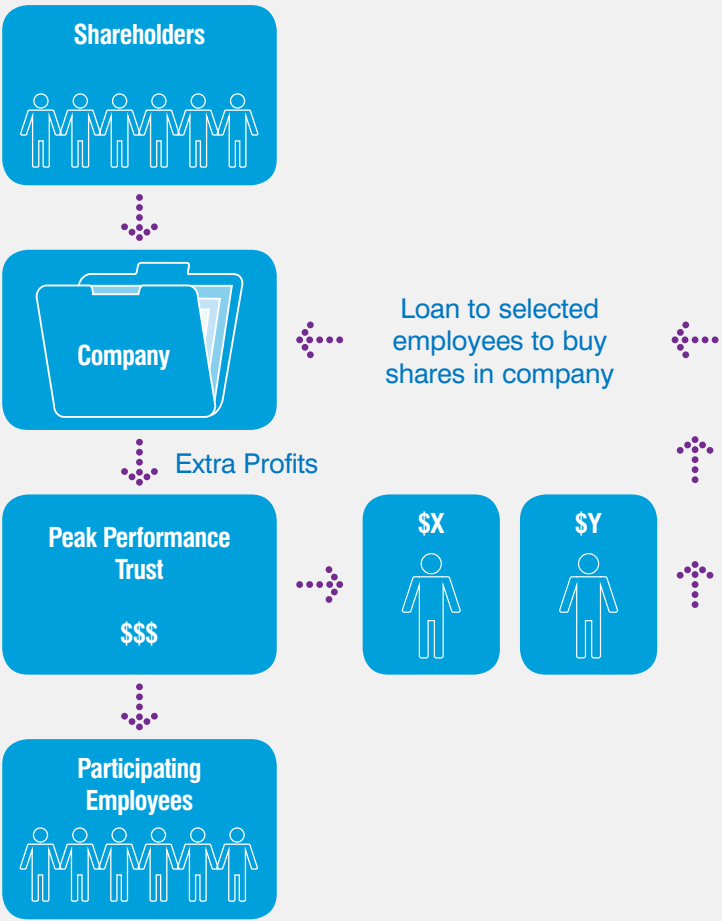
A PPT can provide a facility to fund an ongoing succession planning arrangement where money set aside in the trust is used to fund the purchase of a proportion of the business. In this way, the purchase is directly linked to the performance of the business and becomes largely self-funding.

There are two options when using a PPT in a succession plan. The first allows indirect ownership in the company. Qualifying company profits are transferred to the PPT, which then buys shares in the company. The employees own units in the PPT, making them indirect equity holders in the company.

This option has the benefit of involving all staff in ownership of the trust and can greatly simplify the business ownership structure. The trust becomes the majority shareholder without complicated ownership structures or the compliance burden of dealing with many minority shareholders.



The second option allows individuals to become direct shareholders in the company. The profits directed into the PPT are used to make loans to employees so that they can buy shares.



The inner workings of a PPT

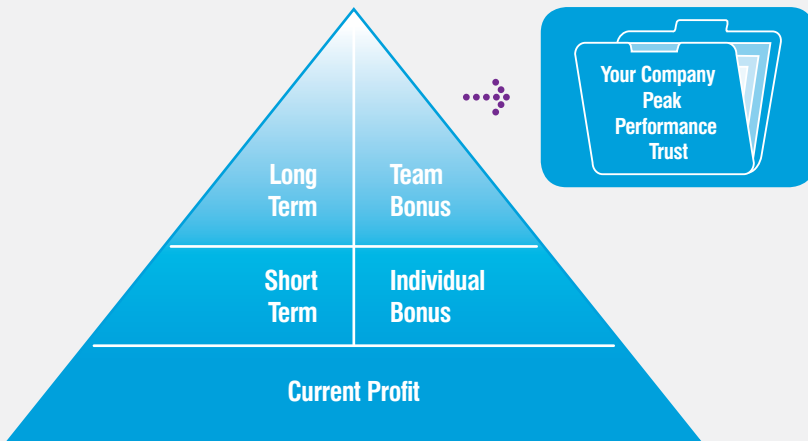
The principle of the PPT is to reward profit-increasing performance, meaning bonus payments are only made into the trust where performance criteria has been met. The most common use of a PPT is a bonus reward scheme in which a minimum net profit target is determined, based on financial projections for your business. Once the minimum target is achieved, the company contributes a predetermined amount of additional profits to the bonus pool.

The PPT is managed by a corporate trustee with specific investment powers and is restricted to only investing in shares in the employer company. We recommend that the directors of the corporate trustee include:

- two employee representatives (employees that are participating in the plan)
- one employer representative (a director or owner of the company) and an independent adviser (accountant, lawyer or representative of Succession Plus).

Eligibility

It is preferable to include as many people in the organisation as possible, within predetermined criteria. This should specify a minimum period of employment, vesting arrangements (i.e how long shares are held before the benefits can be realised) and what happens if an employee leaves the company. One of the benefits of the PPT is that eligibility and vesting periods are completely up to you, however you must ensure these are decided upfront, documented clearly and communicated clearly to all employees.



Being a flexible structure the PPT can be customised to measure and reward different performance criteria in different businesses, so it is important to determine which aspects of individual and overall performance you want to reward.

Income in a PPT is distributed to participating employees annually, based on the number of units held at the beginning of each financial year, and on how much those contributions have earned during the year. It is usual for employees to have served a minimum period of employment before being invited to participate in a PPT, and to remain with the company for a specified period of time before they are able to extract the maximum benefit.

Generally, the minimum period of service will be twelve months, but at times you may want to waive this condition for certain individuals, for example an employee to extend an under-performing employee's probationary period or to attract or retain a particularly high-performing member of staff.

Disqualifying Discount

We recommend implementing a minimum period, based on a sliding scale, to be served before employees are entitled to draw benefit from the PPT, for example:

- End of Years 1 to 3 – no benefit
- End of Year 4 – access to Year 1 benefit
- End of Year 5 – access to Years 2 and 3 benefit.

Under this scenario, an employee who leaves will miss out on the balance of the last two years' contributions, but the penalty might be reduced after five years and eliminated altogether after ten years of service.

There is virtually no limit to the way these conditions can be managed within a PPT, so it is possible to create some very innovative scenarios. One of our clients decided to offer 20 per cent of the employee's account within the first five years from the fifth year, and 100 per cent from year six.

Establishing Targets

In order to transfer funds into the PPT you will need to set targets for your employees to meet. This involves having a good understanding of the potential future performance of your business, and the areas that employees can influence to drive performance.

We start by looking at current profit drivers, and where the business should focus to motivate improvement. If you don't identify the key profit drivers and include them in the PPT, you may incentivise staff to focus on the wrong outcomes. For example, many businesses nominate sales volume as a KPI, but this can motivate staff to lower unit price, which ultimately decreases margin and affects bottom line profit.

Unit Allocation

Participating employees are allocated units in the PPT based on the contributions directly made by, or apportioned to, each person. The proportion of bonus allocated to individuals is determined using a points system, which can be calculated in a number of ways. Most commonly points are allocated based on the employee's total remuneration for the year (including short-term incentive payments), and their length of service.

Example

An employee has been with the company for five years and is on a current salary of \$60,000

1 point for every \$1,000 = 60 points

1 point for each year of service = 5 points

Total points = 65.

For example, an employee might be allocated one point for every \$1,000 in earnings (including incentives) and one additional point for each year of service.

This method of points' allocation takes into consideration seniority (based on salary) and loyalty to the company (based on length of service). But there are many other ways that points can be calculated, depending on the needs of the organisation.

For some clients we have created allocation methodologies based solely on salary. For others we have created allocations based on multiple considerations, and one client uses three measures: overall business profitability, team sales and individual sales. This rewards individual, intra-team and inter-team performance and sends a very clear signal to employees about the types of behaviours and results expected and valued by the organisation, driving a culture where everyone works together for mutual benefit. In other cases, clients have elected to allocate units equally amongst all employees.

Information and Systems

It is essential to launch the PPT with clear communication and then have the appropriate systems to manage, monitor and communicate results. Staff seminars are ideal to introduce the PPT, along with a handbook and legal documentation. If employees don't understand the plan or what they can do to influence its outcome, they will be discouraged and demotivated.

Once launched, information about the performance of the organisation and the PPT should be communicated to employee shareholders regularly, along with communication from management explaining where improvements can be made. Employees should receive quarterly statements outlining the fund's performance, contributions they have received and the investments the fund has made on their behalf.

A common misconception among business owners is that they need to provide extensive information. It is actually far more effective for staff to understand and focus on improving the business's key financial drivers. One of my clients, a sales-based business, simply reports on sales versus targets, which is enough to lead staff to achieve the targets.

We often discover that companies do not have the necessary systems in place to manage a PPT. Managing your business and the PPT's performance reporting may need some investment in infrastructure to allow thorough budgeting, costing, financial modelling and identifying KPIs. A simple MYOB system can be all that is needed to ensure the PPT is integrated with the business, and allows easy tracking and reporting of the trust's performance.

Additional Investments

Employees can make contributions to the PPT over and above the employee contributions. Because the PPT is designed to earn income on its assets, investments into the trust are considered to be capital, and are therefore not taxable in the hands of the trustee. Examples are salary sacrifice and savings.

Benefits of a PPT in Succession Planning

- Affordable for the business
- Encourages ongoing profit improvement through rewards linked to performance
- Tax effective for both the business and participating employees
- Supports employee development
- Rewards employees who make a substantial contribution to the business
- Easily understood, controlled and managed
- Appropriate for both the long and short term
- Complies with all current and likely Australian taxation and legal requirements
- Gives the company a competitive advantage in recruiting, motivating and retaining high performance staff
- Assists employees to achieve their financial and lifestyle goals
- Improves the attractiveness and value of the business to prospective new third-party owners by demonstrating that key employees are likely to remain with the company and are committed to achieving results
- A useful and accurate measure of a company's financial performance.

"The succession plan offers another dimension and long term outlook for key staff that often they never get. The result is truly a WIN/WIN outcome for exiting owners who want the best for the business and to achieve the best sale price for the asset, and for their employees – the people they need to make the results consistently improve."

LJ Hooker Commercial Central Coast has had an Employee Share Option Plan in place for several years and was awarded 2010 Employee Share Plan of the Year by the Australian Employee Ownership Association. This plan operates over an extended period and has had considerable success in attracting, retaining and motivating key staff within the business who now have a vested financial interest in maximising the value of the business for the owners and the staff.

ESOPs and Gen Y

A workshop on generation Y in the workplace raised an interesting statistic; 72% of the Generation Y population want to own their own business. Back in my dad's generation less than 12% of school leavers wanted to run their own business - most people wanted to go and work for a big bank or a corporate and stay there till they were 65 then retire on a good retirement plan.

If you have Generation Y employees this is an important fact to know. Because it means they are likely to leave. However, another interesting statistic was that over 90% of those wanting to own a business said **they didn't want to own it on their own**. Generation Y workers look for freedom and flexibility and the opportunity to have three months off to travel to Europe.

Most baby boomers look at that and think it's all too hard, they get it too easy or they are too much risk. But the fact is this is the way our workforce is heading, and rather than fight it we need to look for ways to accommodate it so that we can retain good people.

Most 30 year olds can't afford to start their own business or buy one. So an employee share plan gives younger employees the opportunity to part own a business while enjoying the security and lifestyle that comes with being an employee. And over the next five to ten years, that employee has an opportunity to build equity and gradually take over ownership of the business, if they want it.

In 2011 one of our clients, an LJ Hooker real estate office (referred to earlier), won the Employee Share Plan of the Year award for two reasons. Firstly, their sick days went down by 84%. Secondly not one person had left the business in the five years. For real estate agents that's ridiculous, it just doesn't happen. But this was all down to the ESOP. Everyone on the team was in it for the long haul. It will most likely take around 14 years for the eight team members to completely own the business. But no one is in a hurry; they are mostly in their 40s and are comfortable with a slow, long term plan that will deliver value because everyone is set on the same performance goals.

C-Mac GM Steve Grylak was presented with the national award for best SME employee share plan in 2012. The C-Mac engineering plant in Girraween, Western Sydney offered an employee owned share plan (ESOP) to all employees. As a result, the business has seen an increase in employee engagement and an 18% hike in productivity at the plant. And longer term the risk of losing skilled employees will significantly decrease.

"Being a board member has definitely given me a much different perspective on the way the business runs. I now have a lot more respect for the decision makers and have found that a lot of the day to day issues aren't as clear cut as they seem." an employee remarked.

"Being on the board has also given me some new found confidence in the business. Now I see all the measures and processes that are set up to make sure the business doesn't fail. I've found it quite interesting so far and can only imagine it will get more exciting."

"It has definitely made people think about their futures with the company and not just the next week or day. Most people understand it is a long term process and aren't expecting to 'get rich quick' or anything like that ... I will be constantly on the lookout to improve the business. I will also carry a sense of pride when representing the company during or even after work hours."

TO LEARN MORE
ABOUT HOW AN
ESOP COULD BE
PART OF AN EXIT
OR SUCCESSION
STRATEGY:

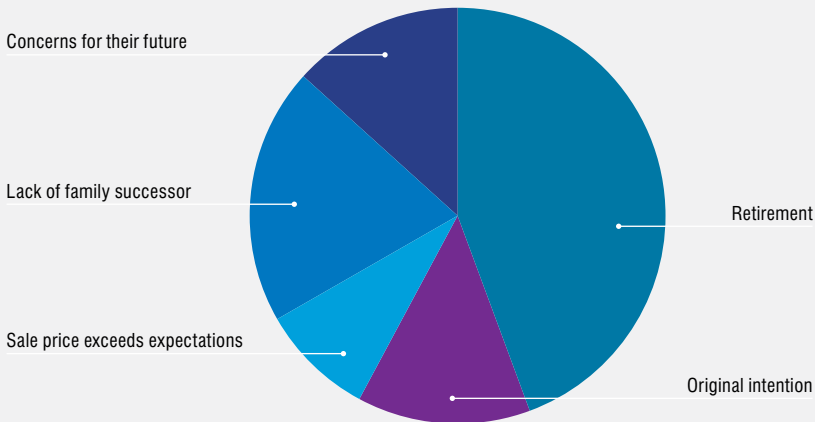


STEP 15

MANAGEMENT SUCCESSION

When you are ready to sell your business, a buyer is not likely to appear in a puff of smoke. You will need to do some groundwork well in advance to identify potential interested parties.

While for many family businesses succession to family members is an obvious choice, the 44% of surveyed respondents who expected to sell their business now or later, gave the following reasons:



15a Identify/recruit potential successors

The survey also showed that many business owners worry more about who will run the business, rather than who will buy it.

Many business owners who planned to pass the business down to their children find that their children are not interested in the business, have followed alternative career paths, or choose to live inter-state or overseas. So the business owner has to look at existing staff members or external hires as the future CEO. However many of the exit options in Step 7 allow transfer of control as well as management, which may influence how you identify potential buyers.

An important concept to understand about succession planning is that it is not just an exit strategy – for the person assuming responsibility or buying into the business it is an entry. Therefore the transition will need to be handled carefully to ensure that not only do you get a smooth exit, but that the business continues to operate well for the new owner, whether that is your existing management team or a former competitor.

The most suitable buyer for your business is not simply the person prepared to pay the most money, or with the financial capacity at the time you want to sell. It should also be the person that presents the best long-term potential for maximising the value of the business and ensuring a win/win transaction.

Make a list of your key successor attributes to clarify what you are looking for before you approach anyone.

Successor Checklist

I advise clients to prepare a checklist of all the important qualities that the future owners of their business must have, and to rank prospective successors against this criteria. The checklist should include specific skills and areas of expertise as well as values, financial capacity and other measures that are important in achieving a successful match between the prospective buyer, the current owners and the business. This process helps to deliver an unbiased view of each potential successor and the likelihood of them being successful in the role of new business owner. It also highlights those areas where the existing business owners should be focusing their attention in training potential successors.

To prepare an effective successor checklist, list the required attributes of potential new owners. At a summary level your checklist may look like this, although you would actually assess each assessor on many detailed areas:

	Candidate 1	Candidate 2	Candidate 3
Sales skills and experience	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Technical knowledge	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Financial management knowledge	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Service history (length of employment)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Qualifications and experience	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Other skills / experience / characteristics	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

15b Management development and performance

Clearly a key factor of transitioning yourself out of the business relies on having strong team members to take over. This may mean bringing on additional staff, but a good succession plan will seek to promote from within where possible, rewarding loyalty and making the most of people who already know your business well.

As part of your succession plan you may need a Human Resources advisor to help you plan the ideal organisation chart for the future, the key roles you need to fill, and then assess your current talent pool. Again it is important not to alienate or worry staff during this process, but instead give staff a chance to be rewarded, and potentially uncover skills or ambition that you didn't know about. Even employees you thought were unhappy or underperforming may suddenly show an interest in being trained and groomed for a new role, particularly in conjunction with a share or reward scheme.

The staff members that you identify as important to your current team do not have to tick all the boxes right now, but they should show some or all of the following characteristics, depending on their proposed role;

- Willingness and ability to learn
- Aligned to business culture and values
- Good customer service ethic
- Open to new ideas, and able to contribute ideas
- Able to manage staff well (if applicable)
- Reliable in terms of attendance and productivity
- Team player.

It is also useful to have a good mix of skills in the team, for example at least one person who is good at administration, process and compliance, and another who takes a creative approach to problem solving to generate more income for the business.

Once you have identified your key team members you will need to give them some incentive to stay throughout the transition period. The incentive you offer will depend on factors such as how far ahead your exit is planned, the nature of the business and industry norms, the availability of other job offers for your key people and the range of people you want to keep in terms of seniority, skills and pay levels. Some of your staff may be close to retirement themselves but will be willing to work for a few extra years if they have job security and the prospect of earning additional reward.

Don't be afraid to ask your staff what would motivate them. That doesn't mean you have to give them everything they ask for, but at least you can design a package that is attractive to them. Most employees will ask for something relatively simple – usually worth the cost when comparing that with the knowledge lost if that person leaves, and the time and cost to recruit and train a replacement.

Common incentive plans that we have seen are:

- Bonus payments awarded at key milestones in the transition period
- Bonus payments for achieving target results along the transition plan (this could be for example in achieving increased revenue, or for each task completed on the non-financial preparation, such as getting the legal documents up to date or writing key process documents)
- Employee share plan awarding company shares instead of cash bonuses
- Non-financial rewards for achievements such as time off or gifts (for example each month of the succession plan the person contributing most to the combined effort receives a dinner voucher or a weekend away)

- Training programs to help staff get to the next level, or to develop an area of interest, for example online marketing, advanced IT skills, sales training, or networking events to learn and share ideas
- Flexible working hours – employees with families in particular may be willing to commit to several years with the business if you are able to accommodate their personal commitments.

For bonus and share schemes and the more formal rewards listed above, you may need new or amended employee contracts, with the help of an employment lawyer. Again, you can't make any promises to staff beyond the date that you lose control of the business, but you can make a contractual agreement regarding their terms of employment up to that date.

The more of a team effort you make your succession plan, the more the team will get on board and make it happen. A happy and engaged team will only add value to your business.

Extract Value

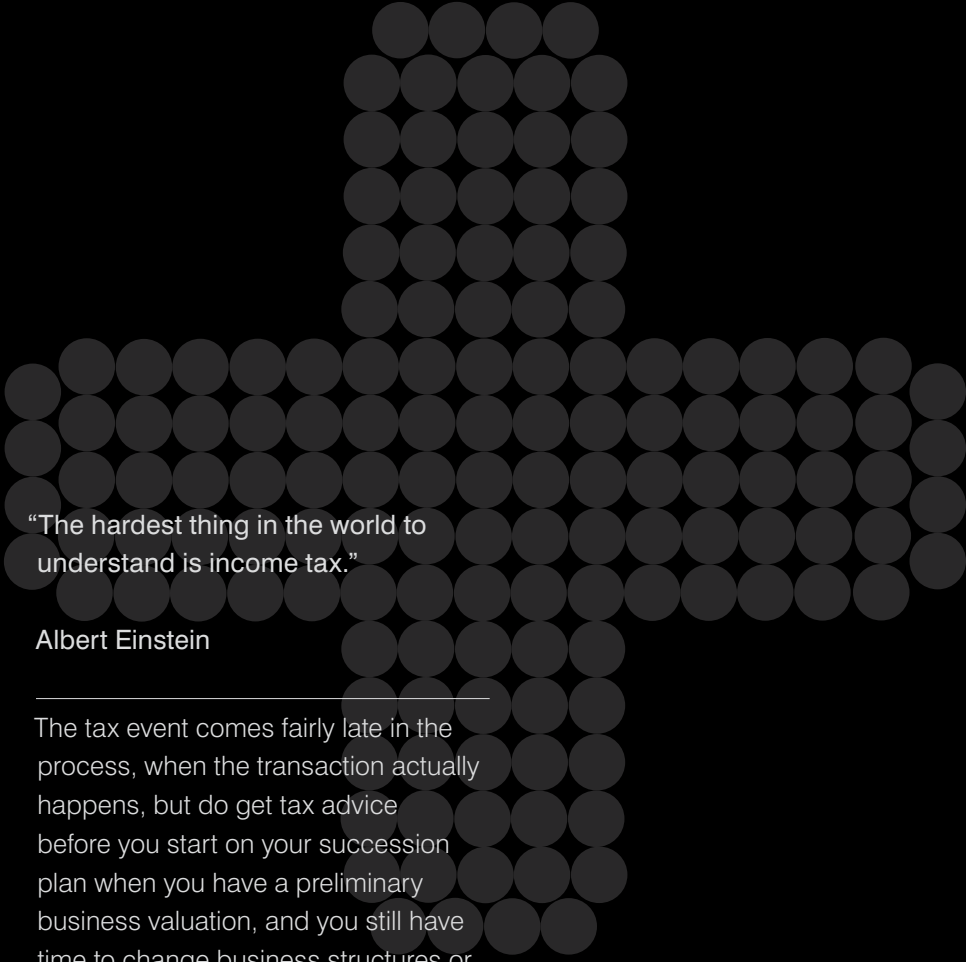
The fourth stage is the actual transaction, or the liquidity event. We've built up value and maximised it, and now we actually get it out. That is what will fund retirement. So we look at the options to exit and how we actually execute them. We start to set the wheels in motion for the change in control and/or ownership. This may happen anything from a few months after preparing your succession plan to several years later, with the business looking very different.

Throughout your succession plan you will have been on the look-out for potential buyers and potentially engaging them along the way to get a feel for their propensity to buy. They may even have given you some tips on what they would look for in a business investment. You may not have one specific buyer in mind, but plan to approach a few companies in your industry. The further removed the potential buyer is from your current business, the more thorough and impressive your marketing needs to be. A potential buyer will expect to see detailed information that articulates the value of the investment opportunity, and stands up to scrutiny. Likewise, in most cases, the higher your target sales price, the more information you are expected to provide.

Finding buyers may be a targeted face to face approach, you might use a business broker or corporate finance advisor, or you might advertise your business for sale on line.

STEP 16

TAX PLANNING



“The hardest thing in the world to understand is income tax.”

Albert Einstein

The tax event comes fairly late in the process, when the transaction actually happens, but do get tax advice before you start on your succession plan when you have a preliminary business valuation, and you still have time to change business structures or quarantine assets.

The most important taxation issue in succession planning is capital gains tax (CGT). Tax has been payable on most capital gains since 1985 in Australia, and the sale of equity in a business falls into this category (in most cases). If the shares or business were first owned prior to 1985, then they may be CGT exempt.

CGT is probably the most complicated area of taxation law in Australia and the issues are many and varied. Unfortunately this means that CGT advice is generally based on 'if, then' scenarios – so until you get into the specifics of your individual situation, there's little generic advice that will apply.

Tax rules also change often. The good news is that there are some reliefs and exemptions available when selling your own business.

50 per cent CGT discount for individuals

When calculating the taxable gain on the sale of shares in a business the individuals can choose between two methods;

- 1 the indexation method (indexed to September 1999)
- 2 50 per cent discount on the nominal capital gain on assets that have been held for at least twelve months.

The CGT exemption is only available to individuals, so where a person operates a business through a company and that company sells the business assets, the 50 per cent CGT discount is not available. Where the shares are owned by a trust, special rules apply.

Certain events do not qualify for the CGT discount, including:

- granting rights or options
- creating contractual rights
- creation of trusts
- granting or changing leases.

Where the discount does apply, it can work in conjunction with other exemptions.

Small business tax concessions

Small business tax concessions are available if the following conditions are met;

- 1 The net value of the assets of the business and its connected entities must not exceed \$6 million
 - 2 The asset must be an 'active' asset
 - 3 If the asset is a share in a company or an interest in a trust, there are two further basic conditions that must be satisfied:
 - there must be a controlling individual shareholder; and
 - the individual disposing of the share, or the interest in
- the trust, must also satisfy the CGT concession stakeholder test.

A capital gain is reduced by 50 per cent if these three basic conditions are satisfied. If the capital gain has already been reduced by the 50 per cent discount that applies to individuals, the small business concession reduction applies to that reduced gain; only 25 per cent of the original nominal gain is taxed. The capital gain can be further reduced by the small business retirement exemption, a small business rollover, or both. The 15-year exemption has priority over this concession.

15 year exemption

A small business entity can disregard a capital gain arising from a CGT asset that it has owned for at least 15 years if certain conditions are met, including;

Small business retirement exemption

A taxpayer can choose to disregard a capital gain from a CGT asset of a small business if the capital proceeds from its disposal are used in connection with retirement. Again, there are a series of conditions and requirements to be met and they also relate to some of the other concessions.

Small business rollover

A small business rollover allows taxpayers to defer a capital gain from active small business assets if a replacement asset is acquired within a period starting one-year before and ending two years after the disposal of a rollover asset in an income year, and if several other conditions are also met.

Using the CGT concessions

In practice, a combination of these CGT concessions could be used to enhance a business succession outcome, although the outcomes will vary according to individual circumstances. No wonder even Einstein was confused.

GST and business succession

The disposal of business assets may attract GST. The GST Act requires that for the supply to be GST free it must comprise all of the things necessary for the continued operation of the enterprise, which may be arguable if, for example, certain assets used in the enterprise are retained by the existing entity. Other requirements for agreements and registrations should also be noted.

Stamp duty

Stamp duty issues tend to go hand-in-glove with succession planning. Some of the basic stamp duty issues arise where:

- there is a transfer of assets between one entity/person and another entity/person
- there is a declaration of trust or transfer of property to a trust

- resettlement occurs, that is, where the assets held in one trust are transferred into a newly created trust
- there is a transfer of assets on the death of a person
- buy/sell agreements are entered into.

Tax for the acquirer

The purchaser will also have to deal with tax implications when acquiring the business. These include;

Dividend franking

The Australian system allows some relief from double taxation on dividends; that is if a company has paid tax on its profits and it distributes those profits to shareholders as dividends, Australian shareholders will only pay the difference (if any) between the company tax rate and their marginal tax rate.

Deductible interest

The interest incurred on loans used to fund business investments is a deductible income tax expense and can be offset against salary/wages or dividends ('other income').

Capital gains

The purchase price of the shares on acquisition (and each parcel of equity in a staged acquisition) will be used to determine the cost base for a future capital gain on a future sale or transfer.

Superannuation

There is much debate about the benefit of superannuation for business owners, but it is well worth considering using superannuation as a way to protect your assets and minimise tax.

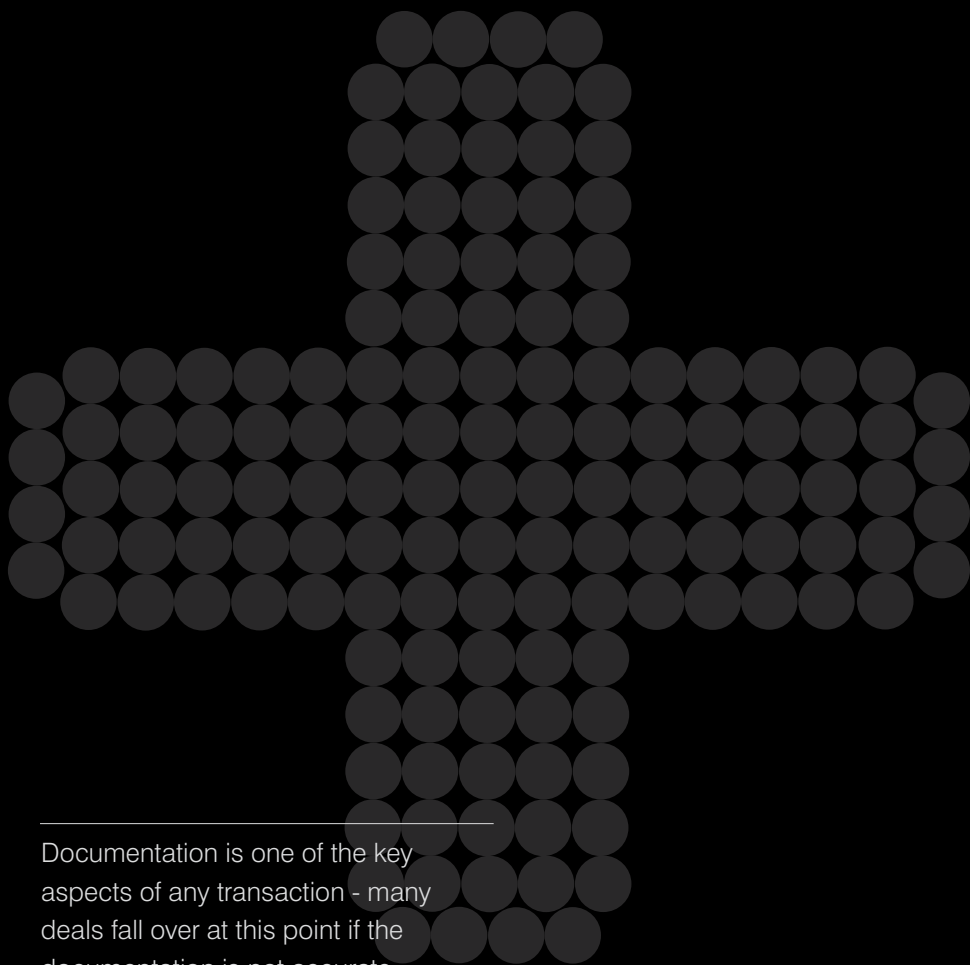
Many business owners back themselves to the hilt in building their business, believing that the value of the business will mean superannuation contributions pale into insignificance. Of course research also tells us that less than half of business owners extract enough value from their business to fund retirement.

Many business owners are scared of the legal and compliance complexities of owning and running a self-managed super fund, but with the right advice this is a manageable investment vehicle and the benefits far outweigh the increased effort, time and cost.

Contribution caps have made it difficult to get large sums into superannuation to generate a tax-effective income stream in retirement. With many family businesses owned and run jointly by husband and wife, the CGT cap contribution is a welcome opportunity available to both parties. When combined with the general contribution caps, a CGT cap contribution may allow a retiring couple to sell the family business, make contributions to superannuation in excess of \$3.3 million and start a tax-free income stream.

STEP 17

DOCUMENTATION



Documentation is one of the key aspects of any transaction - many deals fall over at this point if the documentation is not accurate, up to date and efficiently organised.

Once you have a buyer interested in your business, they will undertake due diligence to make sure everything that you have represented so far is true, and that there are no hidden liabilities or problems in the business. Although it may sound scary due diligence is good; the prospective buyer would not go to the effort and expense of going through this process unless they were committed to making the purchase. Either way, the best way to prepare for due diligence is to do reverse or vendor due diligence on yourself (or engage a DD expert to help you). This is an important step because many deals fall over in the due diligence phase if the buyer uncovers something in the business that detracts from the value. In the formal due diligence process, anything the buyer finds that you haven't disclosed or doesn't stack up against what you've said so far gives them grounds to re-negotiate the price.

17a Due diligence

Reverse DD gives you a chance to make sure everything is in order and consistent and tidy up any loose ends in time, such as expired licences, out of date software, leases on premises. The more prepared you are, the less painful the process will be.

We use an online due diligence package called Ansarada which allows us to upload a carefully organised package of documents, indexed and cross referenced, holding all of the vital information about the business.

A free download of our due diligence checklist is available, (a list of information a potential buyer is likely to ask for).

FREE DOWNLOAD



17b Information Memorandum

When you first approach a potential buyer you are likely to use a one page document to summarise your business and present it as an attractive investment opportunity. Interested parties are likely to ask for your financial information, and some other critical operational details. The standard documentation is an 'Information Memorandum' (IM).

An IM is similar to a business plan, but is written to the potential buyer – it is more about the benefits of the business as an investment opportunity than a path to achieving business goals. While you may be able to write the IM yourself using a standard template, it is well worth the investment getting this done professionally to make your business as attractive as possible. A poor IM will end up in the rubbish bin, and that potential buyer will be lost. Look for experts in transactions, finance and writing (as with any type of advisor we've mentioned, we are happy to recommend people). The cost of this expertise will be more than recovered in your sale price.

The IM is largely a sale brochure outlining the business, its advantage in the market place, strategic position and why a buyer would want to buy this business. In most cases this is the main criteria for decision making by the buyer - at least in the initial filtering stage of selecting companies worthy of further investigation/work.

Typically the IM will contain an overview of your business, the market you operate in, the market you currently reach and your business model. It will also contain summaries of your team, your product or services and the advantages you offer to your customers compared with the competition. It will show your historical financial results, typically for three years, and may also include projected results for the next one to two years to give the buyer a sense of the potential in the business. The IM then gives instructions for any interested parties to take action, which we'll look at in the next section.

17c – Legal Documentation

As with all commercial or business contracts there are obviously lots of key areas that need to be addressed, and much of this is an aspect of agreement between a vendor and a buyer. In most cases there are two stages of documentation - pre sale or exit and transactional.

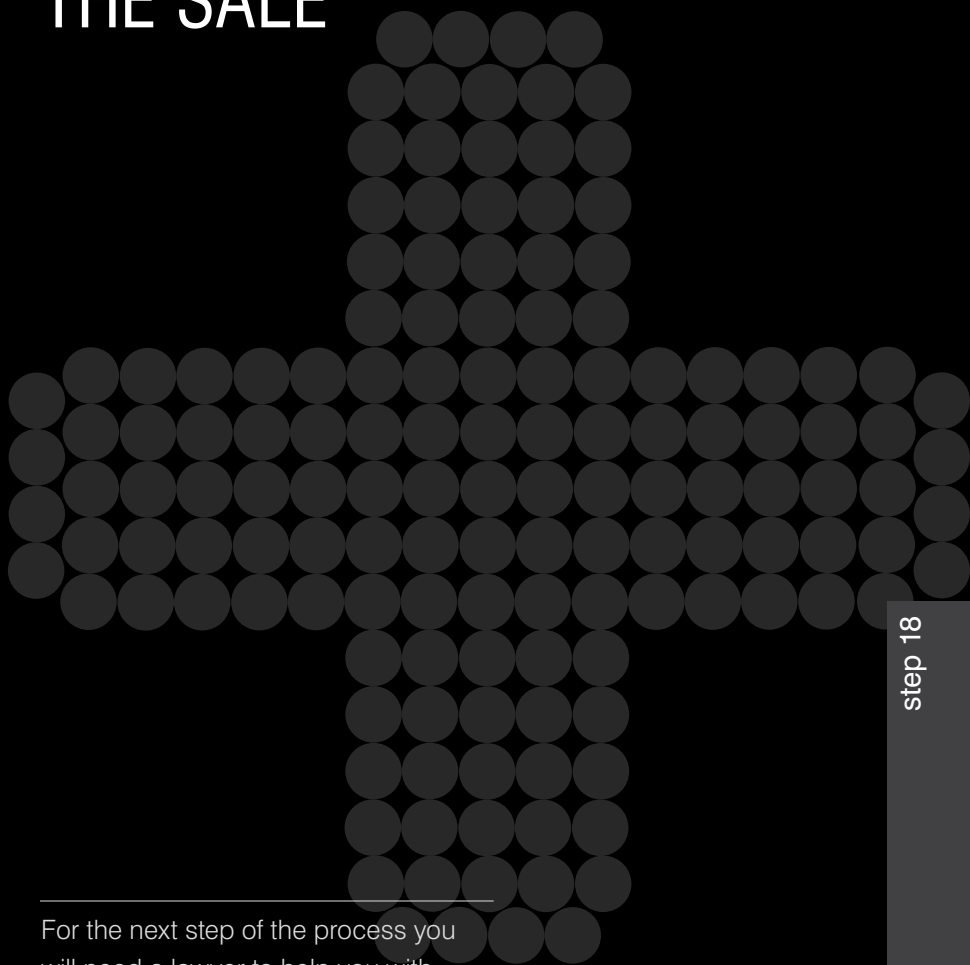
Prior to sale we work closely with clients to prepare an IM (as above), which is the starting point in attracting potential buyers to the business.

Once discussions start, all parties to a potential sale sign a non disclosure agreement (NDA) which prevents them from disclosing confidential information or, for example, approaching the business's customers, suppliers or employees.

Next we will generally enter into a non binding indicative offer (NBIO), basically an exchange of letters which confirms the proposed terms of the transaction. This is also often referred to as a 'term sheet'. At this stage it is important that the agreements are conditional and therefore fairly easy to walk away from. Due diligence is typically a condition – i.e an agreement is made subject to the buyer undertaking a far more detailed review of the business. The agreement may specify the items the buyer wishes to review, for example contracts, historical financials, agreements with suppliers, licences and leases.

STEP 18

LIQUIDITY EVENT – THE SALE



For the next step of the process you will need a lawyer to help you with various agreements.

Finding a buyer

Your potential buyer will likely be in your current network. We've already covered the possibility of a management buy-out or employee share scheme to transfer ownership to people who already know your business well, care about the business and probably have ideas to improve it. This is an option well worth considering as it allows you to gradually work your way out of the business, dealing only with people you already know and trust.

If that isn't an option, the next most likely group of buyers are your competitors, who will be able to combine your business with theirs to achieve a bigger overall business, grow market share and decrease costs, removing duplicated staff or systems. Your suppliers are also potential buyers, particularly if you are a key customer they don't want to lose. By buying your business they instead get access to your customers, cut out the middle man and increase profits. Similarly your customer may buy you because your product or service is crucial to their business and they can't risk losing supply, for example you manufacture patented packaging materials that they use for a high profile product.

Trade buyers may be bigger businesses than yours, but likely to be in the same or related industry. It is worth doing some research to find out which companies in your business are 'acquisitive' – a Google search should be enough to get you started. Most companies issue a press release after an acquisition, which will usually tell you what they paid for it. Find out what sort of multiples the company is prepared to pay, and how your business compares to any recent acquisitions.

Most importantly, think strategic – who is your business most useful or valuable to?

Approaching a buyer

One of the key differences with the Succession Plus approach, compared to a 'typical business broker', is that we never advertise our businesses for sale. Our key benefit is being able to attract the 'right' buyer for a business by buyer research and building relationships with businesses in acquisition mode, ideally a listed company or a strategic buyer (see Step 7) to attract a higher price. We may approach a private equity firm we have previously worked with or an international investor.

This buyer approach is significant and substantial differentiator in our business so we need to get it right. Firstly, this is about research and understanding very carefully what the buyer is looking for - in some of our most successful cases we have been able to 'build' the business to match almost exactly what the buyer is looking for!

In today's market buyers are plentiful but they are fussy - they are all looking for growth. One valid option is an acquisition, but unlike in 2006 buyers are more discerning and far more focused on the exact match they require to grow their business.

Legal agreements

Once you have marketed your opportunity and used your information memorandum to get interest in your business, the aim is to form an agreement with your preferred buyer, or potentially several buyers. You will also probably enter into a confidentiality or non-disclosure agreement (since you are potentially giving competitors insights into your business), and/or an exclusivity agreement.

You or your advisors will then usually meet with the buyer or their representatives to talk further about the opportunity and negotiate a price. This is your chance to shine and give the buyer comfort that yours is a low risk opportunity, pushing up the valuation multiple. You might sign a heads of agreement at this stage, in which the buyer states an intention to purchase shares in the business at an agreed price, subject to the findings of the due diligence.

You'll then have to make information available to the buyer and their advisors. This can be quite a formal process, depending on your business and the sort of buyer you are dealing with. You might just prepare some files for the buyer to access, or you may set up a data room with strict access levels. More commonly, you will have all the documents online in a virtual data room, using software such as Ansarada, an excellent custom-designed solution to manage the sale process.

Once you reach an agreement on price and terms you will need to effect the sale in a buy/sell agreement, detailing how and when the shares will change ownership, the sale price, how and when the funds will change hands, and any conditions upon which the agreement is made. You will need this agreement for all types of sale including for MBOs, employee share schemes and sales to existing shareholders and family members. It may seem like a very formal way to pass your business on to your children, particularly if they already work in the business, but ultimately you are selling shares in the business, and this does need to be recorded correctly to ensure future proof of ownership, and for tax purposes. The agreement may be requested for stamp duty purposes, so do make sure you get advice well in advance.

Project Timeline

The sale process will typically take around six months to complete, with the first two months spent in preparation.

Sale of business project timeline

			QUARTER 1												QUARTER 2													
Step	Project	Duration	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10	Week 11	Week 12	Week 13	Week 14	Week 15	Week 16	Week 17	Week 18	Week 19	Week 20	Week 21	Week 22	Week 23	Week 24	Week 25	Week 26
1 Exit options	1a Buyer profile	1w																										
2 Tax planning	2a Tax analysis	1w																										
	2b Tax advice	1w																										
	2c Restructuring (if appropriate)	1w																										
3 Due diligence	3a Request & compile information	2w																										
	3b Reverse due diligence	2w																										
	3c Issues & gap resolution	2w																										
	3d Finalise compilation	2w																										
	3e Set up online due diligence room	1w																										
	3f Upload documents	1w																										
	3g Set up access permissions	1w																										
4 Liquidity memorandum event	4a Prepare information memorandum	6w																										
	4b Identify strategic buyer	3w																										
	4c Approach buyer/s	2w																										
	4d Sign NDA	1w																										
	4e Negotiate & sign term sheet	1w																										
	4f Buyer due diligence	2w																										
	4g Draft & finalise sales contracts	2w																										
5 Pre-settlement	5a Stock take	2w																										
	5b Employment contracts	1w																										
	5c Leave liabilities	1w																										
	5d Other settlement items	2w																										
6 Settlement		1d																										

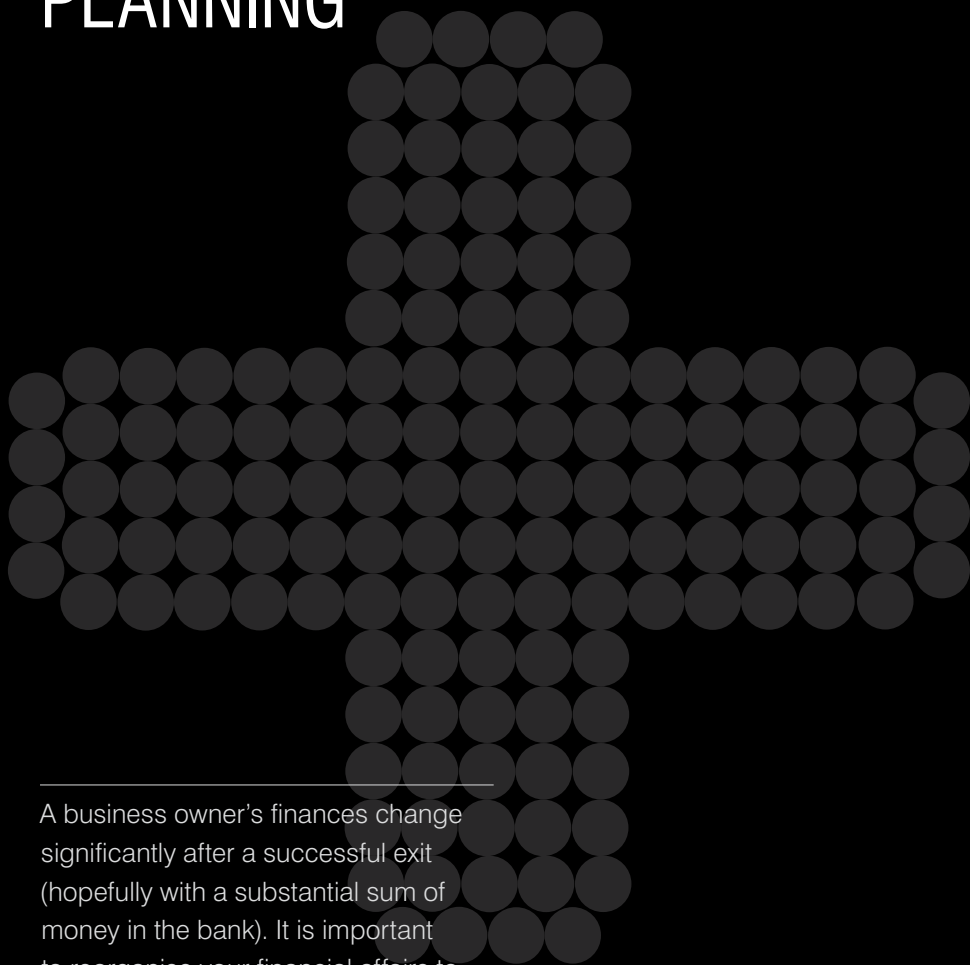
Manage Value

The last stage after your business sale is to take a brief look at how you manage the cash that you have extracted. You are now an investor rather than a business owner, with potentially a significant sum to invest and provide for a long retirement.

So we look at asset protection, estate planning and investment strategies to ensure you have the ongoing income stream that you need.

STEP 19

ONGOING INVESTMENT PLANNING



A business owner's finances change significantly after a successful exit (hopefully with a substantial sum of money in the bank). It is important to reorganise your financial affairs to maximise your future income.

The average 50-year-old in 2013 can expect to live until 82 so if you retire at the typical age of 65 you can expect to live another 17 years and need substantial capital to fund your retirement, particularly in an environment of low interest rate returns and fluctuating markets.

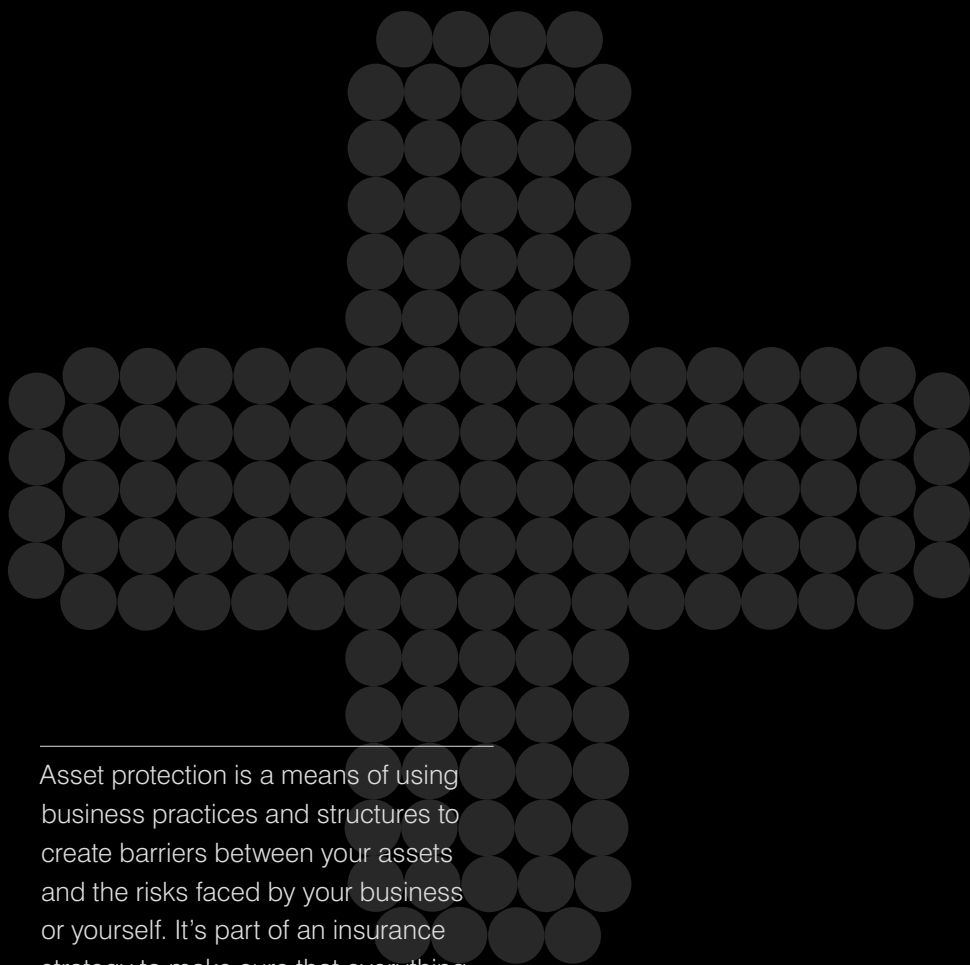
The reality is most business owners have been used to using their business cashflow to prop up personal income as and when required, and in many cases vice versa. This is no longer possible as we no longer own the business.

So we need to think about engaging the help of an expert in the area of financial planning to ensure our assets are owned in the right entity (see next Step on asset protection), and that the assets are reasonably capital secured. For example we don't want our entire investment portfolio in high-risk growth stocks such as gold exploration stocks (which may well quadruple in value if gold is found, but may also achieve zero value) but stocks that are able to supply a reliable income to fund your retirement going forward to the next 10 or 20 years.

In many cases using a self-managed super fund (not just at retirement but throughout business ownership and leading up to retirement) can produce significant advantages in terms of asset protection and taxation.

STEP 20

ASSET PROTECTION



Asset protection is a means of using business practices and structures to create barriers between your assets and the risks faced by your business or yourself. It's part of an insurance strategy to make sure that everything you build is protected.

While you may have set up an effective structure for your business, your divestment or retirement is the time to review your assets to see whether your structure is still appropriate. Your assets may be in jeopardy in retirement because of the way they are invested or owned. The decisions we make in estate planning will also affect the ownership of assets and therefore our ability to protect them, and will also affect your retirement income in terms of investment planning. Because these are all interrelated it is important to get good advice to balance the needs of tax planning, investment planning and asset protection.

When you are in business your asset protection strategy aims to protect your assets from risk and, most importantly from being sued. One way to protect yourself is to take out insurance policies. A key component of the legal aspects of selling a business is to minimise the potential future threat to those assets in the event of, for example, a claim against an indemnity, warranty or guarantee provided as part of a seller business contract.

Another crucial strategy is quarantining your assets so that you can enjoy the benefits of controlling your assets without the risk of ownership. This involves building an ownership structure where you own nothing but still easily access the assets and the income they generate. One way to do this is by transferring the assets to someone who has a lower risk of being sued and who is isolated from your business. Commonly this is the business owner's spouse.

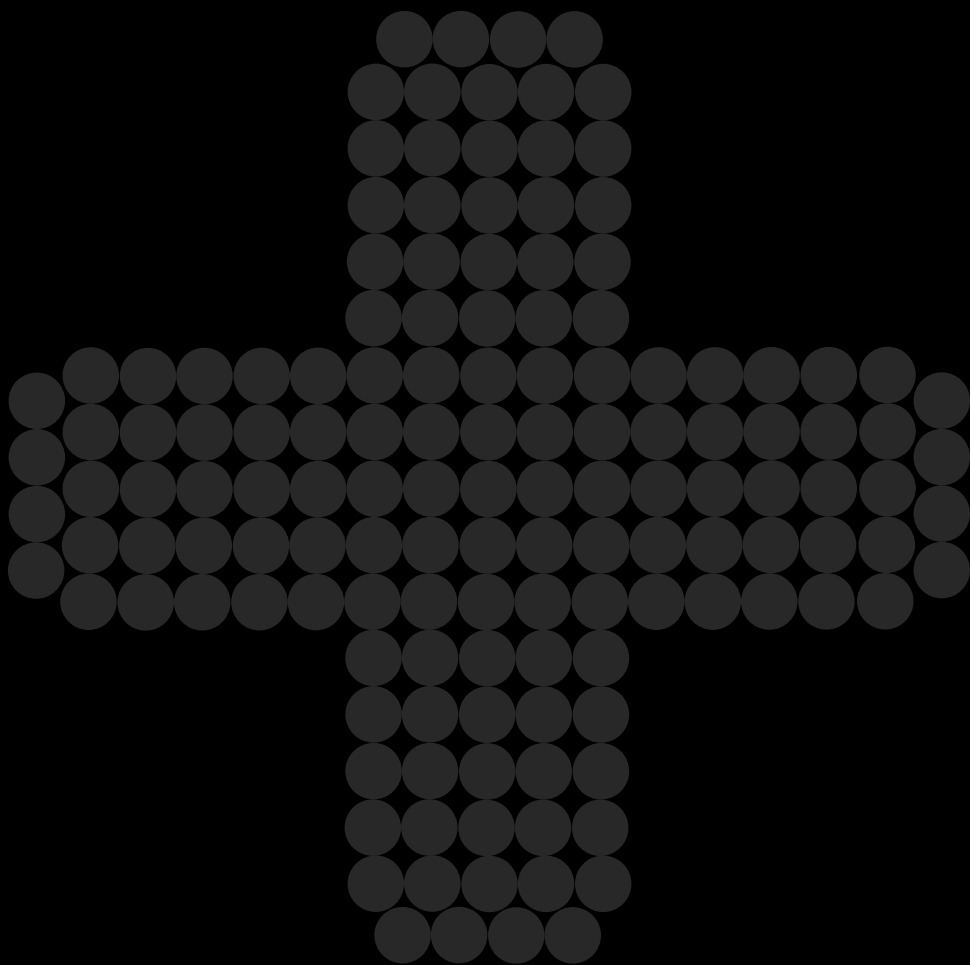
Gearing against your assets is an effective way to limit your ownership and therefore risk. So rather than paying off your mortgage on the sale of your business, you maintain some debt and free up equity to invest in other assets through structures that make investments for your benefit, in another name.

Trusts are one of the most flexible yet misunderstood and under-utilised structures available. The primary difference between a trust and a company is that trusts don't pay tax on their income, but all income must be distributed to the beneficiaries, who will pay tax on the earnings. Trusts offer excellent asset protection because assets are held for the benefit of the beneficiaries, without real ownership of the asset. Self managed superannuation funds are also a form of trust and offer some excellent asset protection and tax advantages for retirement income. A testamentary trust can also be established to take ownership of your assets in the event of your death.

One final way of protecting your assets is through your will. In many cases a strategic direction can be established and then given to your accountants and lawyers to implement and manage on your behalf.

STEP 21

ESTATE PLANNING



When I talk to most business owners the two key outcomes they are looking for from an exit strategy are:

- Firstly that the business continues successfully after they leave, and
- Secondly that somehow the exit strategy can provide a financial mechanism not only to fund their retirement but to provide for their children and, in many cases, grandchildren.

It is very common for business owners to have goals like paying for the grandchildren's private school education, or to fund a daughter or son into their first investment property.

One of the key issues with estate planning becomes the ownership of assets given the tax advantages of self managed super funds previously described. It may be that we can use a self managed super fund as a family wealth vehicle, providing benefits in terms of asset protection, simplicity and efficiency of operation as well as estate planning aspects where the underlying ownership of the assets can provide benefits to family members and subsequent generations.

We also commonly see business owners purchase related assets, for example the commercial premises the business operates from, in a property trust, family trust or self managed super fund. Again that asset can be left for the benefit of family members into the future, long after the business exit has been completed.

This area is often ignored by many business owners who may have had a will drawn up when they owned the business, but haven't changed it once their position has changed. After the exit the mix of assets and the risk profile is substantially different, and this needs to be factored into account as well as personal and financial goals for the family.

WHAT IF IT'S TOO LATE?

what if it's too late?

While we recommend a full succession plan that progresses over several years, we also see a lot of clients who are close to retirement age or have hit poor health who may not have time to follow the ideal plan. It's not too late to take steps to maximise the investment you've made in your business and achieve a positive outcome whatever your circumstances.

Think of it like trying to sell your house quickly – there are simple things you can do to increase the value of your house which don't require you to spend a lot of time or money, for example clearing out clutter, cleaning up the yard, a quick coat of paint. Likewise there are some things you can do to improve the value of your business in the short term. They won't have the same impact as a strategic succession plan, but they will improve the buyer's perception of your business.

Buyers use information as a means of assessing the value of your business, for example ensuring that your financial, operational and marketing information is well organised, presented and up to date. Poorly managed information can raise doubt or fear in a potential buyer's mind. Key areas a potential buyer will look at are:

- Your accounts, financial statements, tax and GST returns
- Management accounting and financial information that the buyer can verify
- Contracts in place with suppliers
- Details of key client arrangements. Where no formal contracts are in place a document outlining the strength and length of key relationships will help
- Current staff employment agreements and assurances that staff will stay with the business
- Website and other marketing and promotional materials are current
- Documented business systems, processes, policies and procedures, including operating manuals.

You may also be able to identify intangible assets that add to your business value, for example customer database, proprietary software, a unique staff incentive that attracts and retains employees, or documented intellectual property.

If you don't have all of this information in place or up to date, outsourcing is a way of tidying up the business quickly and efficiently. With the help of professional advisors you can develop quality information in a short period of time to set you up for success.

Try out our free new App which assesses the business readiness for sale or exit.



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notes

ENJOY IT

Succession Plus

Most people go into business not only to earn an income but also to build the value of their equity and to sell, but many business owners do not develop a strategic plan for exiting their businesses – without one, the value in your business will retire when you do.

Succession Plus spells out a practical 21-step succession planning process suitable for any business owner, no matter what their circumstances.

Investing the time to develop a succession plan is one of the most important financial decisions a business owner may ever make.



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