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Planning for business transition:

The importance of working on "why not" and setting personal goals

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Introduction

As the owner of a small or midsized company, you have been taking risks since the day you started or acquired your business. But if you are more than 50 years old, your most critical risk is (or is quickly becoming) the transition of your ownership in the business. As you may have experienced in all other aspects of your life as a Baby Boomer, you have lots of company. Sixty percent of small business owners were born before 1964, and a Baby Boomer business owner will be turning 65 every 57 seconds over the next 17 years.

If you do not have a written plan for transition of the ownership, you are also not alone. A CMI Research study of closely held businesses ("America's Entrepreneurialist Generation: Exit Planning and the Baby Boomer Age Wave") found that 96 percent of business owners agreed that having an exit and succession strategy is important, yet 87 percent did not have a documented exit or transition plan.

Over the past few years, numerous articles have warned of the coming tsunami of Boomer businesses for sale, so this should not be the first article you have read on this subject. If you still do not have a transition plan, the question remains, **why not?**

Understanding your own "why not"

The skills you acquired in the earlier years of building your business haven't changed. Winning customers, buying equipment, securing financing, and convincing bankers are all challenges with which you're accustomed. Developing key employees and losing some you never thought would go as well as fighting cash flow battles and absorbing the inevitable mistakes that go with business are all likely familiar experiences. All this has occurred while surviving personally and working to expand your leadership capabilities. Now thinking about transitioning ownership may seem unnatural to you and, if you have labeled the thought as an "exit," it may seem like giving up. Boomers, of course, don't give up; we believe in building, transforming, and staying young.

A practical reason that may block your thinking about business transition is that it takes all of your time to run the business, and you don't want to risk allocating time to something that is in the future.

Many business owners are fearful of the "slippery-slope" story. If they start talking about and working on a transition plan with a long lead time, it may be understood by those around them as an announcement about the future of the business. In other words, you will be putting into motion something over which you have little or no control. Like many entrepreneurs, you may identify so closely with your business that the risk of it being understood as an announcement about the future causes you to put on the planning brakes. So continuing to focus on the business is the default behavior.

An ownership transition implies a "who." Who will be the next owner? That is followed by: how will that impact me, my legacy, my business, or my loyal employees? The "who" options, even if one of them is a family member or key employee(s), represent new territory to you, and it is not easy to envision the answers to your questions. Since answering "who" at this point is a premature step, it can quickly prevent you from moving forward.

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The truth is that you have learned at one time or another just about everything you need to make your business run and thrive. But unless you are a serial entrepreneur, you have probably never executed an ownership transition plan. You have a plethora of "how" questions that you will know the answers to only after you have lived through it, which can lead to frustrating circular thinking.

If you are one of the 87 percent without a documented transition plan, your answer to "why not" may be a combination of these factors or something completely different. In any case, the starting point to overcoming the block is to understand your "why not." Over the next few weeks, start unpacking your "why not" by writing out your questions, and don't try to answer them yet. If you are like most entrepreneurs who successfully transition a business, there is a good chance you will need outside help.

How to think about transition

To develop a successful transition plan, you may need to acquire different behaviors, which starts with different thinking. You will need different answers to your ownership transition questions than the answers you have been giving yourself or borrowing from others.

Developing a transition plan is a process, not an event, and an effective process requires a facilitator.

Some business owners are able to act as their own facilitator or quarterback—most are not. Most need an outside party, someone who has or can gain an understanding of you and who is capable of seeing the bigger picture of all the stakeholders. So you will need to identify someone who can serve in that role for you. If it is one of your current advisors or professionals who serve you or your business, be sure to make a new agreement with them on their role for this assignment. They may already have an existing technical service role with you, such as a tax or legal advisor. They will need to be capable of acting in both a facilitator role and a technical role and keeping them separate in terms of focus.

Once you have enlisted the help of a facilitator, start the first phase of the process by either sharing what you have self-discovered about your "why not" or asking your facilitator to help you. Exploring your answers to that question can, with the help of a good facilitator, naturally lead to exploring your personal goals. The combination of answering "why not" and exploring personal goals will provide guidance and direction to developing a transition plan. Your facilitator should help you resist the default tendency to translate goals as business goals rather than personal goals for yourself. While your personal goals will need to be balanced by the specific realities of your business, they also are critical to helping you develop a pathway to the next chapter of your life.

That is why it is called a transition plan. It may eventually involve a transition of ownership, but that will only be a part of your more important personal transition. Creating a nonprofessional purpose for transitioning the ownership of the business will provide a healthy framework for a successful transition.

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You need to understand that what you create in this starting phase will be a draft. As you move to exploring, considering, and understanding your options for your business, always allow yourself the opportunity to circle back to confirm or revise your personal goals. Start this process early to give yourself enough runway so you are not eventually forced to select an option.

Exploring your options for the business

Keep it in the family. A transition of ownership to the next generation of family members requires a long-term perspective and qualified family members. If you have family members qualified or willing to come into the business, it is probably because you and they have done the hard work of preparation, which for many includes working outside the family business. Determining if your family members are capable of owning and leading the business is the most challenging aspect of this option. The needs of the business should be the primary factor in this determination, not just your personal goals or their desires. Creating a permanent job for a family member, especially as the CEO or president, is never a good reason to transfer ownership to them. A sound decision on this matter requires outside assistance. This may be an additional role of your facilitator, or you may need specialized help.

Developing your buyer internally. Succeeding ownership to key employee(s) also requires a long-term plan. The first hurdle, similar to that of a family generational succession, is determining the qualifications of the individual(s). Your propensity to take personal risks with nonfamily owners may change the dynamics of the decision. Inherent risks in starting an ownership transition process with your key employee(s) include issues of value, terms, financing, etc. Your key employees will undoubtedly be one of the value factors for an outside buyer, and you want to minimize the risk of losing them due to a failed deal. Internal buyers need financing, which is often direct or indirect financing from you. For those reasons, you will need an advisor who can act as a facilitator to determine if the economics work for both sides before entering into the legal aspects of an actual transaction. If successful, this can be a satisfying option for owners who have prepared their personal financial situations to allow them to take the inherent risk.

I want some liquidity and a capital partner. Regardless of the stories you have heard about private equity firms, an equity firm can be the appropriate partner to help take the business to the next level if you select the right one. Depending on the economics of your business, it may allow you to gain some liquidity and still provide you an opportunity to share in the growth of the value of the business. Since a private equity firm typically wants to own a business for a five-to-seven year period, you are setting in motion a plan that will lead to the full sale of the business after that hold period. Securing mezzanine financing from a private equity fund is a subset of this option. This type of financing could fit the economics of a business with near-term high-growth prospects that open the door to a sale of the business to a competitor or strategic buyer. A sale to private equity owners may require you to continue to lead or be involved in the business for some transition period, depending on the strength of the business model and the development of the management team.

I want to maximize the proceeds from the sale of my business. After years of owning and operating a business—and the hard work, commitment, and struggle that goes with it—it's natural to want to realize the highest financial return possible from the transition. A strategic buyer normally provides the fastest exit.

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Exploring these options could include meetings with owners who have already executed one of these options, private equity firms, investment bankers, and potential strategic buyers. Again, your facilitator can be a bridge to identifying and approaching potential firms and individuals who could be helpful. These meetings are about exploring and understanding options; they are not discussions about a deal. To be sure, the individuals and types of firms in this list are always eager to talk, even if your succession may be some years in the future. The quid pro quo is that you learn something and they have the opportunity to understand a little about your business. More importantly, it opens a relationship for future business.

Understandably, you may see these steps as unacceptably high risk, unless you have worked on your "why not" and personal goals. In other words, you need a personal motivation that creates separation between you and your business.

Understanding the value story of your business

As you move into the exploratory phase and hold meetings over time, you will find it helpful and necessary to develop the value story of your business—that is, the picture of how your business model works and creates value. This does not mean sharing financial statements, even though high-level metrics that indicate the level of success could be a part of your story. Although the sales pitch you use to sell to customers could be helpful, this story will have a different focus. You have read these kinds of write-ups on competitors or other businesses that have been offered for sale, but you will find it challenging to prepare your own. So again, involve advisors, and your facilitator may be able to help you find the right resource.

Identifying and determining the key value drivers of your business form the backbone of any succession plan and any eventual transaction.

When and if you call an investment banker to actually sell your business, they will undertake this task as one of the first steps. Creating your own value story for your business before that time is a part of understanding and managing the perception of its value. You will find, as you begin to hone and deliver this story, that it will impact how you lead and manage the business. And when you personally experience the blunt reality that the value of everything you build or create will be determined by someone other than you, it may change how you make decisions. These are additional reasons to start planning early so there is time for these benefits to impact your leadership of the business.

Transition plan elements and execution

A transition plan does not have to be long, and it is not a legal document. It is at least a summary of personal statements, a rough timeline, and bullet points of critical elements. The value story is a separate and supporting document or presentation that can be in continual revision. This information can be used to guide your advisors as

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you begin to execute your transition plan with financial plans, projections, legal documents, etc. This part of the work is tangible, and your advisors will understand how to best implement it. The hard work is the intangible work, and no one can do it for you.

Conclusion

This approach to planning assumes an investment of your personal time and the cost of enlisting a facilitator. The old adage that what you pay attention to and invest in grows, also applies to transition planning. Since you may never be able to fully determine the biggest cost of not starting to plan your transition—a personal opportunity lost or the business value left on the table when you eventually exit—isn't it worth the peace of mind knowing you took the time to find the right people to continue the legacy you began?

Note: If you're an owner contemplating the future transition of your business, review The Eight Principles of Business Succession.