EXECUTIVE INSIGHTS

Business Succession

Experts discuss how to transition privately held companies

IS NOW A GOOD TIME TO SELL MY BUSINESS? IS MY FAMILY READY TO TAKE OVER? WHAT STEPS SHOULD I START TAKING TO GET READY FOR AN OWNERSHIP TRANSITION? THESE ARE THE HARD QUESTIONS THAT BUSINESS OWNERS NEED TO EXPLORE WHEN THINKING ABOUT BUSINESS SUCCESSION. WE LINED UP THREE TOP EXPERTS TO PROVIDE THEIR INSIGHTS ON THE PROCESS.



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WYATT

MODERATOR: Let's start our conversation today with an explanation of exactly what is business succession planning and why it's important.

McKAY: Simply stated it's a road map that outlines a transition for both leadership and ownership of a company and addresses all of the details and issues that go along with that process. As it's often the most important financial decision that a business owner makes in his or her lifetime, it's one of critical importance.

WARD: A lot of times, because we are dealing with privately held family owned businesses, it's a family dynamic issue of transitioning a business that may have been part of a family unit for generations and making sure it's successfully transitioned to the next generation, if that's what is desired in the family – which isn't always the case.

MODERATOR: I'm sure you've come across situations where there wasn't a good transition plan in place, and a business owner was in a tough position when it came time to sell. So why is it that business owners sometime avoid this process of succession planning?

FARMER: It's hard choosing what to do with the business and whether your kids or other family members are ready to take it over, or willing to take it over, or are actually good at it. It's a very hard decision. It takes a lot of time. It takes a lot of effort. And it's a lot easier just to go to work every day and continue to run the business like you always have than to sit down and figure it out.

McKAY: I think Mark stated it very well. Fundamentally, it's one of those big, complicated decisions that isn't necessarily urgent on any given day. So it's very easy for the owner and management to just postpone and kick the can down the road. Unfortunately, that often makes the problem bigger and harder to solve in the future.

MODERATOR: Let's talk a little bit about timing. When is the right time to sell or transfer the business? What are the signals that an owner should be looking for to know when that time is right?

WARD: I think it's as an owner feels like they're reaching a retirement age. It could be a result of a health issue or things like that. Maybe it's earlier than they want to transition, but also, it can just be simply that the economy is doing so well that money's never going to be larger than it is today, which is something we've run into that in the last few years. We may be past that peak now. But all those things play into it, for sure.

FARMER: It's a different answer for everybody. Sometimes the business owner is tired, and doesn't want to do it anymore. And that may happen at 42, or that may happen at 72 or 82. Sometimes it's because the kids aren't ready. Sometimes it's because there's not the right buyer in place. There's a lot of different reasons that people would want to sell or transition to the next generation. And unfortunately, there's not a correct answer for everyone. It's not a one-size-fits-all kind of answer.

McKAY: I agree with what both Chris and Mark said. Sometimes I answer this question somewhat with a joke and say, "the best time is three years ago when the business was performing well". Business owners tend to let the good times roll. If you think about what selling a business is, it's best to do it when the prospects look



most promising because you are selling the future to the buyer. You are going to get the best price when things look brightest.

MODERATOR: Let's talk about the climate right now. Is now a good time to sell, or is it a bad time?

McKAY: I would say somewhere in between. We have been in an excellent market the last two years, with record mergers & acquisitions activity. The market right now, I think, is trying to find out where it is. There's still a lot of activity. There are approximately 10,000 private equity/financial firms that are sitting on $6 trillion that needs to be put to work. For good companies that are performing well, this certainly can be a very good market because there is a flight to quality and a premium on really good companies.

WARD: I agree with Andy's comments. I think we may be in between, kind of figuring out where we are right now. I believe maybe two years ago, three years ago, was the peak of where you were seeing large money being thrown around, some of it from equity firms. But I think right now it's just a matter of getting a feel for where the market is – because even the market, day-to-day, reacts differently to different things. So just finding the right time and realizing when it is a good time is difficult, but right now, it is kind of in between. I don't know how else to put it just because of the way the economy has performed in 2022.

FARMER: The impact of interest rates on the debt market is significant because that's what gets the final turn or two on your valuation. The capital is out there.

MODERATOR: Mark, talk a bit more about the deals you're working on in terms of timing, good versus bad.

FARMER: Well, like Andy was talking about, it's a flight to quality. If you've got a good business now, there are a lot of buyers out there. There's a very competitive market. Everybody's looking for deals – looking for good deals – providing discipline for the strategics who are trying to come in and get a good deal on something. As far as "is today a great time?" it's still very good. When I started at the law firm – I started in September of '08 – that was not a good time to be in the market. Now is still good in the relative sense compared to where it was ten or 15 years ago. It is not what it was a year ago. And the deals now are faster, and they're bigger. If someone is still looking for a deal, there's money out there to buy it if you have a good quality business.

MODERATOR: What are some practical things a business owner needs to start thinking about now to prepare for that eventual exit?

WARD: I think more than anything you want to have a good financial report. You want to have clean financials. You want to have profitability going when you're looking to sell your business. So many times I'll come across clients that come in and they'll give me their financial statements, and you'll see maybe three, four years ago, they were very profitable. And they're not as profitable today and may have missed their best transition opportunity. I think just internal cleaning of your own house, initially, is the first thing you need to do and a practical thing you need to do before selling your business.

McKAY: I think one thing to do is start early and make sure you've done all the estate and tax planning you need to do. For example, if you're in a C-Corp, it may not be the best structure for you, and there's a time element involved in achieving a more favorable structure. So thinking about it long-term first, and then secondly, developing successor management and leadership. If the owner is looking to retire, it can be problematic if there's a void left, and there's no one really around to step in and fill that void.

FARMER: I think Andy's point about estate planning starting now or starting three years ago is the best way to do that. You'll maximize your estate planning exemption, and you'll minimize your tax if you start early. But I think the biggest thing is being honest with yourself, and being honest with yourself about who in the family wants to and is capable of taking over, is the management team willing to take over, capable of taking over? A lot of folks think they're going to sell to their executive leadership, but the executive leadership has not been an owner, and have been working in the business for 20 years. There's probably a reason that those folks are not owners of a business. They're maybe not wired for it. It takes a different personality. It takes a willingness to personally guarantee debt. It takes a willingness to take risks. And a lot of the management team, that's just not how they're wired, and that's fine. They may be great managers. But business owners need to be honest with themselves about what the succession plan actually is, and then make it happen.

MODERATOR: It's certainly not a journey a business owner can undertake on his or her own. What kind of advisors does a business owner need, and what are the roles that they play in this process?

McKAY: You definitely need a really good business attorney and I can certainly recommend Mark, as I've worked with him a number of times. I think the key with advisors is just making sure they have the requisite experience in M&A transactions. The tax part of it is very complicated, so you certainly need a tax advisor that understands corporate tax and corporate transaction tax, which in and of itself is a very specialized area. And then we, of course, are big proponents of having an experienced M&A advisor to run the transaction and achieve the most optimal outcome. And last but not least, you might need a therapist to really talk you through the process. It's very emotional. Sometimes I feel like I am a therapist.

WARD: I agree 100 percent with what Andy said. I would just add that sometimes you want to also have your financial advisor involved because if you do sell your business, all of a sudden you're sitting on all this cash, and what are you going to do with that to maximize its value going forward?

FARMER: A lot of business owners are focused on income, and the financial advisor, post-closing, is really who puts the money to work for you to maintain that income level. But it's really a team effort. Everybody's got to be on the calls; everybody's got to be in the meetings; and everybody's got to be rowing in the same direction. Because if your lawyer's telling you one thing, and your M&A advisor's telling you another, and your tax advisor's telling you the



third thing, and then the financial planner's telling you I'm going to guarantee you a 15 percent return every year on this money you're putting in with me, you're going to mess it up. Everybody's got to be together. Everybody's got to be experienced at what they're doing and honest with themselves about how this is all going to work.

MODERATOR: Let's talk a little bit about valuation. How is valuation of a business determined, and do you find that owners often really know the true value of their business?

WARD: To answer the second part of that question first, no. I find that owners do not know the true value of their business. And it kind of goes both ways. They either significantly overvalue the businesses, and some of them, believe it or not, significantly undervalue their businesses. But as far as determining the valuation of the business itself, you use an advisor to come up with that valuation. And there are different approaches. There's an income approach, an asset approach, and a market approach. A lot of it's based upon either historical financial statements or projections going forward of how we expect the business to perform in the future, just at a simplistic level, and using different variables to determine a valuation. Sometimes the result of that exercise can be quite eye-opening to the person looking to sell a business.

McKAY: I certainly agree with Chris in that regard. I would just add that at the end of the day, it's what someone will write you a check for, and everything else is theory, and guidance, and supposition to some extent. There's really only one way to find that answer out. So you try to get the best information you can and the



best guidance or view that you can. But fundamentally, it's about getting someone to get their checkbook out.

WARD: It's a willing buyer and a willing seller relationship. So someone may come up with the value of your business as $20 million, but if the buyer wants to pay $30 million, let's make that happen.

MODERATOR: How do you advise companies that aren't sure if selling the family business is the right thing to do?

FARMER: I tell them to call Andy and have Andy tell them how much it's worth, have Andy run a process. The market will tell you what your business is worth. And what a lot of folks don't grasp until they really get into the nitty gritty is that businesses are valued differently depending on the industry. If somebody's at a cocktail party, and they say, "Oh, yeah, my buddy got 12 times X, 12 times EBITDA, or four times revenue or something," it's, like, well, was that a tech startup business, or was that a CapEx heavy equipment business? Was it a construction business? All of those businesses are valued differently in the market because they're just fundamentally different. If you really want to know what your business is worth, it's not necessarily what you think. It's people going to the market and asking the market what it's worth. Somebody who's got experience in selling in a particular market is going to be able to tell you pretty close to what's out there in today's world.

MODERATOR: And if an owner is contemplating a transition of ownership within the family, how can they go about determining if that next generation is really willing and capable to take over?

McKAY: That's one of the hardest questions that you see business and family businesses face. I think working with a good family business advisor, sort of a business psychologist can help. I'm a big proponent of people getting experience outside of the family business. It's hard if you work at one place your entire life to really have an understanding of the complete picture. But business owners agonize when their son or daughter is in the business. Do they have the right stuff to run the business successfully and lead it? I think you're doing your children a big disservice to put them in a position where they're not going to succeed. It is a very difficult subject, and I've seen great outcomes and really bad outcomes. Family business is hard in a lot of ways, and sometimes you have get the family out of the business.

WARD: I think the word "agonize" is a good word that Andy used there because I think it is a tough decision many times for the owner of the business to transition to their sons or daughters. There's a lot of family dynamics that go into it. Also, sometimes there's one child that works in the business, and others do not, and they want to treat everyone fairly. All that plays into it. You definitely need a therapist at times, a business therapist. I would agree with that. I come across a lot of situations where there's reluctance of the parents to share how much wealth the family has with the kids. And these are adult children. I think that also is a tough conversation sometimes, believe it or not, to let the kids know what exactly it is that the family has from a monetary standpoint. And that also plays into some of these decisions and situations. It's a very tough decision for a family to make to keep the business within the family and to make sure that the business survives on to the next generation. It's by no means easy.

> "Start early and make sure that you get the right advisors involved. Don't try to sell your business on the cheap."
>
> CHRIS WARD

MODERATOR: A lot of times in privately held businesses, the owner is really the main asset for that business, with so much intellectual property held by that owner, him or herself. In those instances, how do you advise companies to start working on their succession plan?

FARMER: You've got to start early and stay on it. That's a very real issue to have the customer relationship, the supplier relationships, the knowledge of the business. A lot of times the owner is functionally the CFO, too. They know everything about the finances of the business, and maybe the kid works in the business but is on the sales side, not on the operations side, and they don't have a view into the entire picture of what's going on with the company. It takes a long time for a business owner to transition all of that knowledge to the children. It's not something that happens overnight. It happens over several years.

McKAY: And the problem compounds when you get in multigenerational businesses. You get to the third generation, then you get to the fourth generation, and you've got cousins, and it becomes a complicated matrix. There are some organizations like Vistage and YPO that I think have good resources. Family business centers can be a good resource for addressing some of those issues and I'd certainly encourage business owners to avail themselves of those things.

FARMER: I think a lot of times those business owners know the answers. Deep down, they understand what needs to be done, but whether they're willing to do it is a whole other question because it's very difficult. It's very difficult to tell your kid who doesn't work in the business that they don't get a third of the business because they're not working. They're living in Seattle doing something else. That's a very hard conversation to have, so they just avoid it.

MODERATOR: What's one thing that you find that business owners are surprised to learn about this process – something that isn't always on their radar and once they get into it, it's a revelation or a surprise to them?

McKAY: How much work it is, how hard it is, and complicated it is. I've yet to have a business owner tell me that "Oh, this was a lot easier than I thought." It requires a lot of preparation, a lot of planning, and a lot of work because at the same time it's imperative that the business owner run the business successfully.

FARMER: To echo Andy's point, it's the timeline. Everyone says, "Well, I want to do this quick." Well, what does quick mean? It takes a long time to do this correctly and get it right. It's not going to happen in 30 days. It's impossible to get done in that amount of time and do it right. The timeline is one of the most challenging things the business owners don't really understand.

WARD: As the tax person on the call, I'll say that the taxes associated with the windfall they receive. Obviously, we're going to try to advise them to structure it to minimize the tax impact, but oftentimes I find the owners are very surprised by the taxes they have to pay on a transaction.

FARMER: Good problems to have, though. If you've got a lot of capital gains tax, that means you've got a lot of money.

MODERATOR: Are there any parts of the process we didn't talk about today that you think are important for our audience to understand?

FARMER: I think we hit the highlights of the process, but just to reiterate an earlier point, it's about starting early and getting it right more than anything else. Because if you get it right, you're going to maximize the value both for yourself and your family in the long term.

McKAY: I'm going to quote Groucho Marx, "Blood's not thicker than money."

WARD: Start early and make sure that you get the right advisors involved. That would be my main takeaway. Don't try to sell your business on the cheap.

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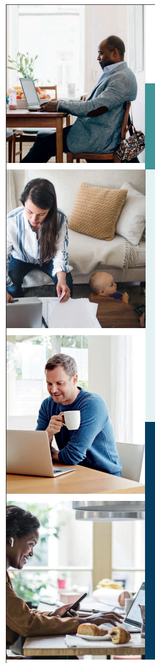
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