SUCCESSION PLANNING REPORT

Understanding the current perceptions of business owners towards succession planning.

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ARE AUSTRALIAN BUSINESSES GETTING IT RIGHT?

We firmly believe that succession planning is just as important as business planning, since exiting the business is inevitable, and the repercussions from a poorly executed exit could be grave. But research undertaken by RSM in 2015 revealed that the majority of Australian business owners surveyed (66%) do not yet have a formal succession plan in place.

We wanted to understand more about the current perceptions of business owners towards succession planning.

To this end, we surveyed 2,000 NSW business owners, consultants and directors to ask them about the effort involved, the challenges faced, and what a successful plan should include.

AT SOME POINT, EVERY BUSINESS OWNER NEEDS AN ENDGAME STRATEGY

HERE ARE THE KEY FINDINGS OF OUR STUDY:

How long will a plan take?
Over two thirds of business owners believe a plan takes more than two years to successfully implement, whilst a quarter believe it takes more than five.

However, almost one third consider two years or less adequate time to implement a plan.

Challenges
Almost a quarter of respondents suggest that the biggest challenge facing businesses without a succession plan is maximising the value of their business.

Other major challenges faced by businesses that respondents identified are the stability of the business and the continuity of strategy – and the impact that problems with these could have on the internal culture of an organisation.

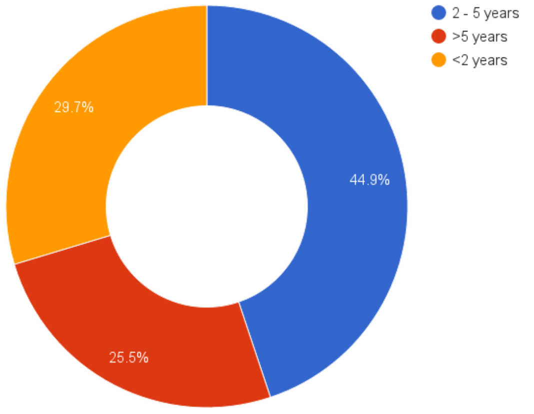
Most important component of a successful plan
Building value for all stakeholders (employees/shareholders/clients) was seen by 28% of respondents as the most important component of a successful plan.

While a significant number (16%) suggested that finding the right successor is the most important component, it is interesting to see that continuity and relationship building were deemed more important by most people.

Read on to discover the full survey report and our experts' reactions to the findings.

KEY SURVEY INSIGHTS

QUESTION ONE: HOW LONG DOES AN EFFECTIVE SUCCESSION PLAN TAKE TO IMPLEMENT?



Over two thirds of business owners believe a succession plan takes more than two years to successfully implement. A quarter believe it takes more than five years.

44.9% said that it takes between two and five years to properly implement a succession plan.

> "Experience from working with our business partners suggests a transition involving a sell-down over, say, five years tends to work the best."
> Managing Director, Financial Services

25.4% of respondents stated that it should take at least five years, often longer, to allow time for the right people to transition into the company or to be trained sufficiently. These respondents suggest that, generally speaking, the longer a succession plan is in place the better, to allow for an effective transfer of intellectual property and client trust. Some did qualify this by stating that in cases where a successor is already in the company, less time may be required for the transition.

At the other end of the spectrum, almost a third of respondents believe that it may take two years or less to implement a plan. In fact, the responses in this bracket ranged from two weeks to two years, with many highlighting the importance of the successor entering the business as soon as possible.

> "Ideally a two year transition would occur where the buyer comes into the business and starts to meet the clients. At a minimum, a 12 months transition should be in place to ensure a trouble free transition."
> Managing Director, Insurance

The period it takes for a plan to be successful will vary, depending on a number of factors.

Of course, every business is different and each will have unique challenges and issues that their plan will need to deal with. This will inevitably mean that the amount of time it takes to implement an effective plan will vary, as recognised by our survey participants.

One key factor that our respondents highlighted as affecting the length of time needed was where the successor is coming from; whether it is a family member, a current stakeholder in the business, or a complete outsider.

If the successor is a family member or has come from inside the business, then it seems logical that a successful succession could be swifter. However, this does still depend on how many stakeholders need to be brought on board and how much learning and development is required of the successor. For a complete outsider, the 'bedding in' process will usually take longer, because amongst other things the learning and development required will be far greater.

Respondents came up with several other factors that could cause variations to the time required, including how much the business is reliant upon the current owner, and finding the right successor in the first place.

> "Length of time for implementation depends on several key components: maturity of organisation, size of organisation, industry etc. I would suggest that for a SME, you would need to allow approximately two to three years, and probably three to five years for a large organisation."
> Finance Manager, Building Materials

Regardless of the individual circumstances of a business, it is universally acknowledged that a smooth transition requires time – but how much time is the right amount of time?

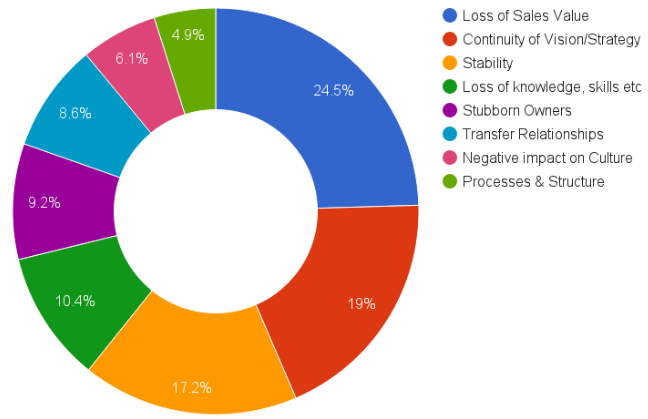
THE BIG PICTURE

In our experience, CEOs and business owners are often unaware of the key components involved in a strong succession plan. The result can be that the time required to formulate and implement one is often underestimated, and consequently the succession is inefficient or hampered.

Time needs to be taken in finding the right buyer or equity partner; but beyond this much of the time required for the process to work is in making the business sales-ready – something which may take many years.

Because selling or transitioning a business is complex and time consuming, our experts estimate 5-10 years is required for effective succession planning. This means that almost three quarters (74.6%) of respondents could be underestimating the time required for an optimal outcome.

QUESTION TWO: WHAT ARE THE MAIN CHALLENGES FACED BY THOSE WITHOUT A PLAN?



Almost a quarter of respondents said the main challenge is not being able to maximise the value of their business.

> "People without plans will be put on the back foot with negotiations and may not achieve the value they believe the business is worth."
> Owner/Consultant, Financial Services

Respondents recognised that it's extremely difficult to achieve full value without a plan that identifies dependencies on the founders, as well as identifying strategies to replace the founders or reduce these dependencies without damaging the business.

With no succession plan, a business owner can fail to fully grasp what is required of them and they may also be blinkered to potential opportunities that arise, which can affect the value of the business and leave them forced to sell at a less optimal price. This in turn can directly affect retirement planning. One respondent painted a particularly grim scenario:

> "No future income, no reward for a lifetime of effort."
> Networking Strategist, Coaching & Training

Businesses also risk a lack of continuity in the company vision creating a culture of confusion, instability, and mistrust.

One in five respondents said that without a succession plan, the main challenge a business faces is that its core vision and continuity of strategy will be in jeopardy. Over 17% consider the absence of a plan harmful to the fundamental stability of a business.

Without being able to properly demonstrate the endurance of direction and vision, those without a plan may risk damaging their business outcomes.

The key problem here is that without a plan that demonstrates continuity and stability, shareholders, management and staff can become concerned about the future. This internal disruption can cause numerous problems, including the chance that high quality potential successors become unsettled and leave the business, as well as loss of investor confidence.

Any internal uncertainty and tension of this sort can severely impact the business's relationship with its current customers.

> "Those without a plan can risk uncertainty for clients and employees if anything was to happen unexpectedly before the successor was in place."
> Managing Director, Travel Services

Not having a succession plan in place can lead to a loss of skills, knowledge, and trust in the business.

The risk of losing knowledge when a business is succeeded by a new party was seen as the critical challenge for businesses without a plan by 10.4% of respondents.

With the departure of key personnel in pivotal roles from a business, highly valued corporate knowledge, intellectual property and/or technical know-how also exits the business. Without an effective succession plan it can take a longer period of time for the new successor or employees to gain this relevant business knowledge, and to navigate the culture, before becoming fully effective in their role.

One respondent outlined what they saw as the solution to this potential loss of skills and knowledge:

> "To train the successor in the operations and intricacies of the organisation, including the customers, internal politics, technology, systems, processes, and evolution of the industry."
> VP Sales & Marketing, Management Consulting

Owners themselves may be part of the problem.

Interestingly, 9.2% of respondents believe that the main challenge facing businesses without a succession plan will be the owners themselves.

Without a carefully-considered plan in place, when it comes to succession (which is inevitable at some point) owners could be vulnerable to making subjective decisions, directed by sentiment and emotion rather than commercial good-sense.

Some owners are reluctant to let go and accept that someone else must take over their business. If a plan is not in place, the future of the business may well be uncertain, which will only serve to compound the owner's reluctance to let go of the reigns. This will inevitably lead to further uncertainty and delays which could weaken the business.

THE BIG PICTURE

CEOs and business owners who do not put time into a plan are devaluing their business and presenting unnecessary and serious challenges to the continuation of the business after they have moved on.

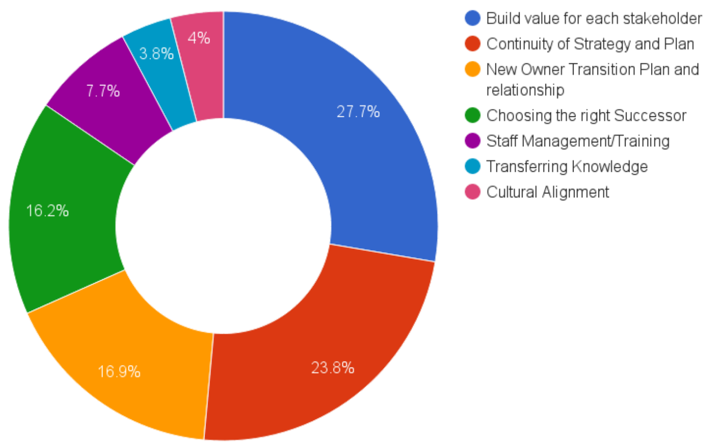
The loss of enterprise value is the most obvious effect of not having a plan; but there are other consequences to consider. When a successor moves in without an effective transition period, problems in the transfer of intellectual property and knowledge will undoubtedly occur. The disruption of company culture, which can result in trust issues with employees, investors, and customers, is another potentially very damaging outcome.

Exiting the business is inevitable, so the incumbent should align business strategies around the exit plan to keep the business on track and minimise risk.

This will involve communicating the plans early, to make sure the right people are involved at the right time to ensure a smooth transition.

Ultimately, the ability to rise to the numerous challenges associated with an exit is determined by the owner's willingness to consider the whole picture and to start planning early enough.

QUESTION THREE: WHAT IS THE MOST IMPORTANT COMPONENT TO BE ADDRESSED IN A SUCCESSFUL EXIT?



Building value for all stakeholders is the most important component of success.

The importance of building value in terms of employee involvement, shareholder engagement, and client retention was cited by 27.7% of respondents as the most important component of a successful exit plan.

What's in it for me?
All of the stakeholders should be given confidence that they won't be negatively impacted but rather the process will be advantageous for them.

> "Key components of the plan are to ensure you can maintain confidence of staff, customers, and stakeholders. You must project the image that any changes that are coming are part of an overall strategy and are for the long term best."
> Senior Director, IT Services

Another key component of a succession plan is demonstrating continuity of business strategy.

23.8% of respondents highlighted that a succession plan's core component is really all about being able to keep momentum and drive strategy. Respondents said that if continuing business strategy is the main focus, financial performance, value growth, and growth of the culture, will all follow accordingly:

> "It's really about being able to keep momentum and drive strategy, which in turn drives financial performance and value growth."
> Chief Financial Officer, Financial Services
>
> "It's extremely important for it to be seamless for both the organisation and the customers. All stakeholders need to feel that they haven't lost a part of the company."
> Owner, Consumer Services

A new owner transition plan is essential to a successful exit.

16.9% of respondents felt that a seamless transfer process from owner to successor is the most critical element of an effective plan. A successful exit requires complete trust in the successor – respondents believe that building in a transitionary period where the owner can transfer trust and knowledge to the successor would allow succession to be successful.

A successful exit needs the right successor to take over.

16.2% of respondents identified that getting the right people to fill the functional gaps of what the owner previously filled is the most important component of a succession plan.

> "The most successful component is the selection of an individual with in-depth industry-related experience and a clear vision, mission and execution plan of how the business can be grown."
> General Manager, IT Services

As the outgoing owner will understand what is needed to be successful, their insight into finding a replacement is crucial.

Staff management and training is another vital part of a plan.

7.7% of respondents felt that the key focus should be on training staff and maintaining organisational culture, as those that remain in the business could struggle to adapt to change. Respondents highlighted that change and cultural management needs to be incorporated into a succession plan, especially in smaller businesses where the owner has developed the culture.

THE BIG PICTURE

Clearly, there is no 'one size fits all' approach to succession planning and every business will have its own unique set of demands and challenges. In our experience, though, all of these components are critically important and must be taken into account when planning an exit:

1. Develop a carefully considered plan
2. Make your business attractive to buyers
3. Consider the market environment
4. Be aware of the tax implications of selling your business
5. Ensure you have a current valuation
6. Communicate your plans early and involve the right people at the right time

SUMMARY

An effective succession is complicated and involves years of planning: there is no time to waste

Many business owners underestimate the number of considerations and, by extension, the time required in creating an effective succession plan.

It can take many years for a business to arrive at a point where it can command its true value in the market and where a transition is relatively smooth and painless for the stakeholders, even if it is being passed down through the family. As one respondent on our survey stated:

> "If you plan to pass it onto your children, then it may take years to train them up to be ready to take over. Any succession plan will take years to achieve, which is why it needs to at least be a thought in your head in the early days of the business."

This means there is no time to waste for those 'baby boomer'-owned Australian businesses that lack a succession plan.

For most, with the necessary planning, it is possible to ensure that all stakeholders are prepared for the future changes, and that they will embrace them. This requires a willingness to confront the issue head on, but once the right mindset has been achieved, there are ways to expedite the plan:

> "Ideally all mature businesses need to be thinking about how they make their founder/owner 'redundant' in terms of the day to day running of the business. Once the business achieves that, only a short time may be required to actually plan succession. But all the hard yards are in the former phase."

The salient fact is that business owners who don't consider a succession plan may find themselves in a position where they can't retire when they would like to.

So where do you start?

> "When change is shown to be part of an overall strategy, it is well embraced. When it comes unexpectedly, it is not welcome."
> Senior Director, Information Technology and Services

One of the main challenges for many businesses without a succession plan is knowing where or how to start, and failing to understand both the scope of the tasks ahead, and the commitment required to ensure success.

Planning for change and succession requires a commitment to face the challenges ahead, as one respondent put it:

> "A succession plan is a mind shift rather than an action."