SME succession planning: WELL-CONCEIVED AND EXECUTED SUCCESSION PLANNING PROVIDES OWNERS WITH A MEANS OF CONTROLLING THEIR OWN FUTURE – AS WELL AS THAT OF THE BUSINESS, WRITE JAMES BECK AND ANDREW RODGERS

A blueprint for the future

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DOES YOUR ORGANISATION HAVE more than 10 staff or annual revenue of more than $5 million?

Do you have an owner who is MD/CEO/manager/worker? Do you get all the jobs the owner does not understand or want to do? Are you and/or the owner stressed and never seem to get away for a decent holiday? Do your decision-making processes/reporting structures look like those in Figure 1?

If you can answer some or all of these questions in the affirmative, then read on.

SMEs often rely heavily on an entrepreneurial owner-manager. Problems arise when it all gets too much for them, or it is time to step away from the business and the owner-manager cannot let go. This situation will be further complicated by the degree to which they are regarded or believe they are essential to the day-to-day operations of the business.

Chances are that they will have spent most of their time working in the business rather than on the business at the detriment of the business's medium to long-term succession planning. Providing owners with an exit strategy that benefits them as well as staff and investors is essential to ensuring greater certainty in terms of the direction of the business after the owner has gone. This is the objective of business or strategic planning, and includes a succession process – a key part of which can be the contribution of a formal board of directors or team of expert advisers, commonly called an advisory board.

Planning for the future

In SMEs there is sometimes a lack of understanding of what business plans are and how to prepare them. Our observation is that even where business planning documents do exist, they are often filed away and forgotten or ignored. Succession planning is even less understood, and is often relegated to the "too hard basket" due to a number of factors, including the complexity involved, the emotional ties an owner will have to the business and the perception that there is minimal practical help or advice available.

The inability of owner-managers to keep working is one of the key risk factors faced by SMEs. Therefore, business planning and the way in which an owner handles the succession process can have a dramatic effect on a company's viability. A lack of forward planning can also have serious implications for the owner's family and key stakeholders – that is, employees, advisers, suppliers and customers. Numerous surveys, including one conducted by CPA Australia in 2004, have shown that SMEs struggle when it comes to business and succession planning.

A clear business strategy in the form of a business plan provides a roadmap for the future of the business. Clarifying the owner's intentions and view of the business's future direction is vital to the process. Is the owner seeking retirement in the next five years? Are they seeking capital realisation? Is business continuity important to them? Is the management team capable of running the business? Have they established a board to provide the necessary leadership/advice to the business now and in the future?

Many such questions can and should be asked. To clearly communicate the future direction of the business, we recommend beginning with a five-step process:

Step 1: Conducting a strategic audit (situation analysis, SWOT and the like) to answer the question, "Where are we now?".

Step 2: Developing mission, vision and values statements to provide a long-term view of where the company is headed and answer the question, "Where do we want to be?".

Step 3: Setting objectives involves developing specific performance targets (KPIs) for the results the owner wishes to achieve.

Step 4: Implementing the strategy – this includes developing competencies, budgeting and policy making.

Step 5: Reviewing activities against objectives and performance outcomes, and updating if necessary.

Succession planning

With a strategic direction in place, it is then time to develop an ownership and management succession plan. This will involve viewing the situation both from the perspective of the continuity of the business and exit routes for the owner.

The succession process will entail the owner to clarify their needs and that of the business and stakeholders – both internal and external. It also allows them to evaluate the present and future ownership, management and governance structure. Many questions will arise: How can I keep the business going while I reduce my involvement to focus on other commitments (other businesses; hobbies; retirement etc.)? How do I choose among several potential successors? Who would constitute the best management team? How can key employees be motivated to stay committed? Should I have a board to manage our interests? Who should sit on the board?

Answering these and providing a solid foundation for the future will require professional guidance in a number of areas including business valuation, tax, superannuation, legal implications and corporate governance.

Circumstances could change depending on the outcome the owner is seeking. For example, if the owner is intent on business continuity and would prefer the incumbent management team to buy or acquire a large part of the business, they will need advice as to how to structure and finance the deal. This may include providing vendor finance to ensure it goes ahead. Even with generational succession where a family member steps into the owner's position, there are a variety of issues to deal with, including aligning the interests of the current owner and their successor and the release of capital from the business. The timeframes

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FIGURE 1: SME

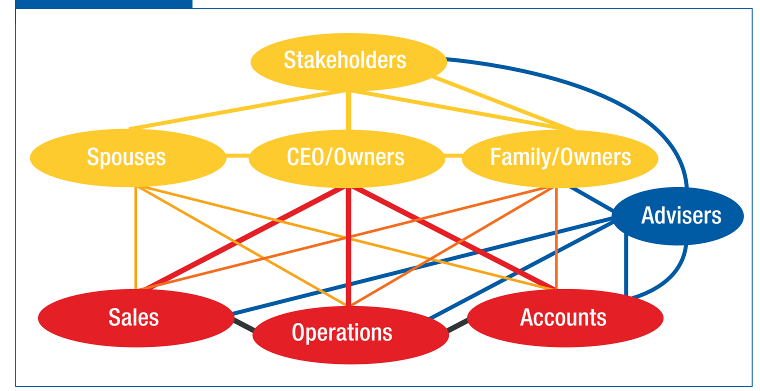


FIGURE 2: Private (Family Held)

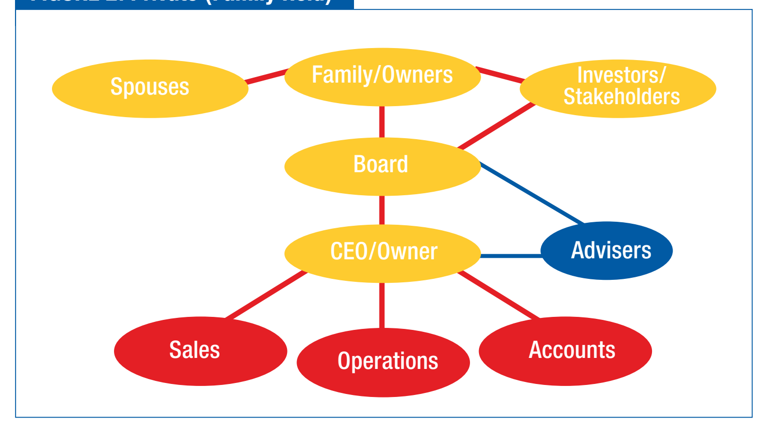
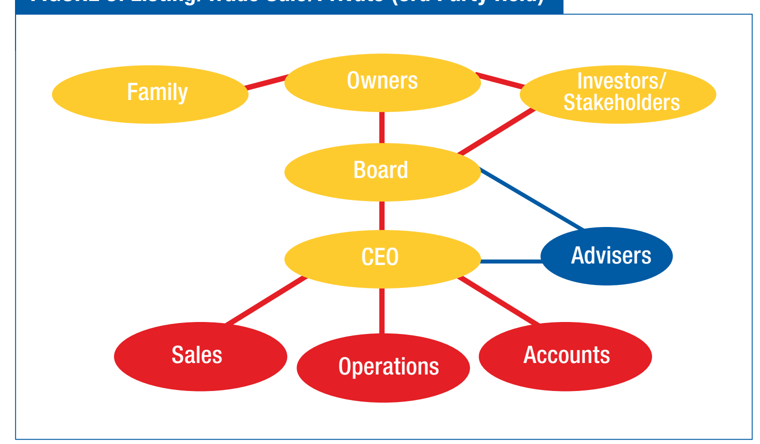


FIGURE 3: Listing/Trade Sale/Private (3rd Party Held)



for implementing a successful exit will also differ. While a sale of the business or liquidation of its assets could be accomplished in under six months, other options such as public listing, a management buyout (MBO) or generational succession could require from one to three years to complete.

Developing a plan for when and how the owner intends to step back from the business will include setting a timeframe and process that recognises the owner's personal circumstances, such as age, health and personal plans. The plan should also recognise that not all owners will want to retire. Indeed, for those who have an entrepreneurial bent, stepping down from managing the company day to day may allow them to grow the business in other ways, or even to start a new venture. And the business they leave may be able to leverage their expertise and contacts through board membership, for example.

Well-conceived succession plans enable an owner to exit, leaving the business as a going concern whatever the ownership structure: single owner, multiple owners or family business.

Among the options available are: Family members continuing to own and manage the company; continuing ownership with outside management; selling the company to business partners, key executives or employees; or selling the company to outsiders.

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It should be noted, however, that an over-dependency on the owner will limit the ability to attract investors to the business.

Figures 2 and 3 on the previous page show examples of possible organisational structures following a succession process.

The role of governance

The Corporations Act stipulates that a proprietary company must have at least one director, who must ordinarily reside in Australia, and a public company must have at least three directors, two of whom must reside in Australia.

In the case of SMEs, boards are often seen as an encumbrance. The directors, often the owners or relatives and friends, will be there for form rather than function. However, as is made clear in the decision in Deputy Commissioner of Taxation v Clark (NSWCA 91, 2003), any director who takes no active role in the management of a company does so at his or her own risk.

In ignoring the role a board and its directors can play, SMEs are also ignoring the contribution this governance structure can make to long-term viability. First, the separation of management from control means that the managers are accountable to the owners, who are represented by the board. Good governance fosters accountability.

Secondly, good governance practices will improve a company's access to capital, because they provides confidence to investors, financial institutions and venture capitalists that a company has instituted adequate systems of internal control. This is particularly the case for companies seeking growth and expansion. Therefore, implementing good governance practices and procedures at the earliest opportunity is advisable.

Thirdly, a well-structured board can contribute to the performance of the business through roles such as strategy, advising and mentoring the owner or CEO and providing the business with vital contacts or resources.

When creating a board of directors, the owner must decide on whether it will constitute "inside" or "outside" directors. An "insider" board will generally be comprised of family and friends as well as trusted advisers, and is what most SME owners first establish. An "outsider" board will be recruited based on the skills needed for the business as it expands. For example, for an IPO a company may need talent and reputations that it can only get from outside directors.

In SMEs it is particularly important that the board complement and supplement the skills of management to improve organisational performance. The selection and appointment of directors should focus on the necessary and desirable competencies of board members. Similarly, there should be a process for regularly reviewing the board's capability requirements against the mix of composition. This will ensure that the board can develop and evolve in line with business requirements.

Guidance not governance

If the owner does not wish to constitute a formal board, an advisory board is an option. An advisory board is more informal than a board of directors in that it generally does not have regular meetings, has little or no delegated authority and is created primarily to provide business advice and bring specialist skills or knowledge to the owner and business. An advisory board is a good choice when an owner or company needs ongoing professional advice and contacts, but may feel threatened by a formal board that has the power to direct the business.

However, an advisory board's effectiveness will depend on whether the owner or management respects its advice and/or takes advantage of the knowledge and skills it brings.

Proactive business planning demonstrates leadership, and benefits not only the business owner(s) but their successor, family and … key stakeholders

When appointing people to an advisory board, owners should look for those who bring necessary areas of expertise to a company. This is particularly the case if the owner is looking to exit a business, since the advisory board members can not only assist with the succession process, but can also fill the gap left by the departure of the owner. An advisory board can later become a formal board should the circumstances warrant this move.

Why champion the formation of a board?

Business and succession planning through the establishment of a board may seem complicated. But it should not be difficult for either an internal finance manager or trusted adviser such as an external CPA to mount a case for doing so by presenting the owner with the consequences of failing to plan ahead for the business and for their own exit. For example, what if the owner is hit by the proverbial bus just before the day they want to sell the business? What if they are required to transition the business to the new owner – this might extend the time taken to sell. They may not get the price they want, tax issues might arise. There are
a lot of ways things can go wrong.

And what if something does go wrong? What if the designated successor is unable or unwilling to assume control? What about an unplanned exit – what if the worst happens, and they suffer serious illness or sudden death? Is the business sufficiently prepared for such an event? Will a family member be ready to take the reins? Will the management team be able to carry on? And is there a contingency plan in place that deals with such a tragedy? We have seen many circumstances where having an established board mitigates these risks to ensure the ongoing viability of the business.

Controlling the future

We see successful business and succession planning in SMEs as providing owners with a means of controlling their own future as well as that of the business, rather than making important decisions at the eleventh hour or responding to a critical event after it happens. Proactive business planning demonstrates leadership, and benefits not only the business owner but their successor, family and other key stakeholders. In particular, it can benefit employees, who will require certainty about the future of the business to remain motivated.

A board, whether formalised or advisory, can assist both the owner and the business to achieve their overall objectives by providing advice and filling any skills gaps that may exist. The formula we see is therefore:

strategy + KPIs + structures (ownership, management, governance) = less stress proactivity

To help reduce the stress levels of both your boss, your clients and yourself, in a future article we will explore how to build an advisory and formal board, the processes involved and how it cancontribute benefits to the business both short and long term. ■

James Beck is managing director of Effective Governance, a consulting firm that delivers corporate governance and strategic planning advice. James.Beck@effectivegovernance.com.au

Andrew Rodgers has extensive experience in the SME and listed company environment. He has been actively involved in strategic, succession and governance planning for a number of companies. He currently sits on a number of advisory and company boards in the SME sector. arodgers@callsara.com.au