

## **Succession Planning Speech – April 11, 2006**

*National Tooling & Machining Association*

*Host – Jimmy Langston – Columbia Machineworks*

**Succession Planning – the goal of this talk is to expose you to key concepts needed as you approach the next decade of your company's history**

Our company is named 2<sup>nd</sup> Generation because our founders recognized a basic fact in American business – 2 surges came with the end of WWII – an entrepreneurial explosion as returning GIs were educated and started new businesses and the famous baby boom

These have combined to position many US businesses for a transition during the 1990s and the first two decades of the 21<sup>st</sup> century. The businesses started by the boomers and their parents are turning over – we always say it is not a matter of if a privately owned business will be monetized, but when and by whom

One of our goals as a firm is to participate in the whom as a principal (investor or agent) by being part of the planning process of the when (as an advisor)

I'll discuss 2<sup>nd</sup> G more as I move through major areas for consideration in Succession Planning

**Three Approaches –**

**Successor Planning** - the type of succession planning you read about in Forbes, Fortune or Business Week – a need for any chief executive or any type of organization

- who will take my job when I choose to retire or am disabled for whatever reason
- am I grooming a successor
- have I communicated who the successor is to all the folks who need to know – if not, I may create a situation where the chosen successor loses other key people due to disappointment
- How do I set the stage for promotions or career ladders in my company – am I developing talent?
- probably the simplest, but still difficult to find time for – it is hard to motivate yourself to make long-term investments in your firm’s human capital when you are busy selling or handling customers or running the shop

**Estate Planning - probably what most of you expect me to discuss**

- how to pass along ownership of your business to another generation
- & how to fund the transfer for your estate (given tax planning requirements, etc. )
- the focus is one how to perpetuate the company & take care of your family
- this is, of course, the ultimate end-game
- tax accountants, legal advisers & life insurance experts can best speak to these issues for the typical mid-sized business
- wise investment plans are the key here - if the company has sufficient cash flow to fund the insurance or other investment vehicles
- it is also very important to realize that this is not a one-time effort – as laws change (especially in

the tax arena) this part of your succession plan must be reviewed frequently and updated – it will change & evolve

### **Future Planning for your Organization – the third approach**

- often implies you aren't yet ready to completely leave or face your mortality
- you are not planning for transfer to heirs, but for positioning your own retirement lifestyle
- what do I need out of this business in terms of future income?
- do I care if it survives if I have the cash?

- if I want the company to survive me, what must I do to plan for its next generation of leaders?
- ties to successor planning, but goes further – not just who should get my job, but what should my company look like in the next decade

- from this perspective, you must really step back and focus on the long-term strategy and goals for your business
- you have to evaluate the people and the assets of the business from the standpoint of upgrading it and preparing it to thrive and grow without you

Succession Planning ultimately needs to be what the business owner wants it to be – can you foresee a future that wisely uses your capital and resources? Can you foresee your company thriving in likely future market conditions? Are you motivated to change your role in the near term?

Why does it matter? In 2001, a survey of US corporate directors found that over 45% of businesses worth \$50mm & up did not have a succession plan...these are businesses that are not prepared for the worst. For smaller companies the percentage is undoubtedly higher. One survey I read recently discussed the fact that more than 2/3rds of business owners do not have a designated succession plan – even when they have already reached age 65. Do you want your staff and family to face the need to plan for the future without you??? Are they really ready for this process? If you were to choose, would they be the ones you would put in charge? Do they want this responsibility?

### **If you choose to plan a future for your organization -**

1. How much of the business is tied up in my persona?
  - If you view your business as a monument to your personality and skills, it will probably end up as a tombstone only...eventually it will fade away...the only question is time
  - If you manage your business as a manifestation of your persona – there is often no real enterprise value – thus limiting your ultimate options
  - This ties to ability to sell it and walk away versus effectively do a sale-leaseback and stay in the key role – too often you must then stay as a consultant or manager, but with new constraints on your decision-making
  - End game sales of the persona business are often just planned liquidations – since the buyer can't really

expect to replace you, he must value the assets not the income (or future cash flows)

- Even a non-monument business may have no real long-term value in the mind of its owner...if you could sell to a competitor for a good price, knowing that he will close it as soon as he gets your customers, would you?

2. Do I really want to maximize value – do I have shareholders? What plan will maximize long-term value for shareholders? Look at it from the perspective of an investor? Where is the enterprise value? Is it geographic, equipment, processes, sales relationships, your personal skills, your staff, etc?

3. Is the business solid enough for me to be an absentee investor – do I have the people in place that can run it for me?

- o If so, you may choose simply to hire or train young people already in the business (or in your family) to run it for you, with a little long-distance guidance or relationship maintenance with key customers... as long as they don't steal from you (or at least don't steal more than they are worth) – you'll probably keep reaping a good gain from your asset

- This can even work with family members – but you must clearly delineate the role you will play and stick to it

- Sometimes, it helps to bring in trusted outside advisers to act as a mentor to the next generation – if you don't already have a Board of Directors, you may want to implement one several years before you intend to step aside

#### 4. What are the biggest mistakes you can make?

Hire a trustee or name one from your family – the trustee is not expected to be an entrepreneur with a growth objective – a trustee is there to protect value (and often to provide dividends for many family members)

Trustees have to protect principal – they get too careful and tend to carry deadwood in the organization

Trustees also become a clear target for shareholders – even if they are good stewards, they can't please everyone...

Think about how many times you have seen this in business – lots of Nashville's biggest brand name companies have gone through this stage & few are still based here...

#### 5. What if you just want to sell?

- This is a strange market – the economy seems relatively sound, and the Fed seems to be protecting it, but there is still much long-term uncertainty.
- It is so hard to predict big multiples – and often a big multiple is required for you to sell and replace the income you may already be taking out of your business as its owner/manager...your decision to sell may need to reflect your desire to limit risk by removing your cash from the table, not an expectation that you will get a big premium in a lump sum

- You can find a take-out player – firms in the leveraged buy-out business are there for you – but they need to see sound management in place for the next decade, and they need to price it to have an upside for the growth they will contribute over their investment horizon – they can't pay top dollar and generate the expected returns for their investors  
( Gencap is an example of this type of company based in Nashville)
- You might find a strategic buyer – if your industry offers real advantages from scale economies or regional coverage...
- You might sell out to insiders – but you will probably need to be the bank for them, especially if you want to get a non-discounted price.

#### 6. Are there alternatives to selling as an end strategy?

- One of the best is to diversify – use the current earnings of the business to expend it into different markets or business segments...  
Ingram is an example

The barge business was not sound long-term, but it generated cash to get into book distribution and video distribution and computers

This is also a helpful approach for the family patriarch or matriarch who wishes to set up several children in their own businesses –  
Tallent example

- Long-term transfer planning – always an option, but be careful not to create a trustee relationship or to trigger unnecessary taxes.

You may choose to set a date to retire, then put in place a plan to gradually transfer both operating responsibility and stock ownership to key staff or family (or both). The key to is to work with legal and other advisors to build a plan that you can and will execute...

Tell “worst case scenario” story of the Southeastern specialized construction company – unsophisticated family with the stock, key managers with a promise they could buy it, but no actual agreed method or price, resulting in several years of stalemate and bad feelings – worth too much to the managers for them to quit, but family always feeling they were at risk and not getting enough return...despite 50% growth in revenues and profits over the 5 years after owner’s death. Ended with failed efforts to sell to third parties and a lawsuit that it is still underway...in excess of \$45mm in revenues, large market share, but now coming apart at the seams...