

10 Myths

OF SUCCESSION PLANNING FOR MIDDLE MARKET BUSINESSES

By Mark C. Bronfman, MBA, CPA

Owners of middle market companies are always slaying the dragons of scarce resources: scarcities of talent, cash and confidence that the business will survive the owners/founders. Succession planning offers the strategic weapons of executive compensation, capital structure and exit planning strategies to overcome these scarcities.

In his excellent book, *Stumbling on Happiness*, Daniel Gilbert explains that most people fundamentally lack an imagination to understand the actions today that will bring true happiness tomorrow. Business owners also suffer from this myopia – living in a world of myths about how they can successfully grow and exit their business in style. It's time to debunk these myths.

Succession is like happiness – it is easy to talk about and much harder to attain – precisely because it takes imagination to act differently. In succession planning, if you want to eventually EXIT your business, PULL and attract people and capital to it today.

Doing succession right can be so empowering. This is possible because an effective leadership and capital succession strategy increases your company's value; enhances your employees' commitment to the company; expands your exit strategy options (keep, sell, go passive, etc.); strengthens your balance sheet; and provides personal "psychic" benefits. In short, having the right succession plan is one of the shortest paths to achieving the deep fundamental desires of business ownership.

After counseling over 100 business owners on succession pathways ranging from lifestyle businesses to going public, I am convinced that many business owners do NOT know how to powerfully achieve leadership succession and capital succession. I offer below executive compensation, capital structure and exit planning strategies as a portal into the ten myths and realities of succession planning.

Myths 1 to 5 on Leadership Succession

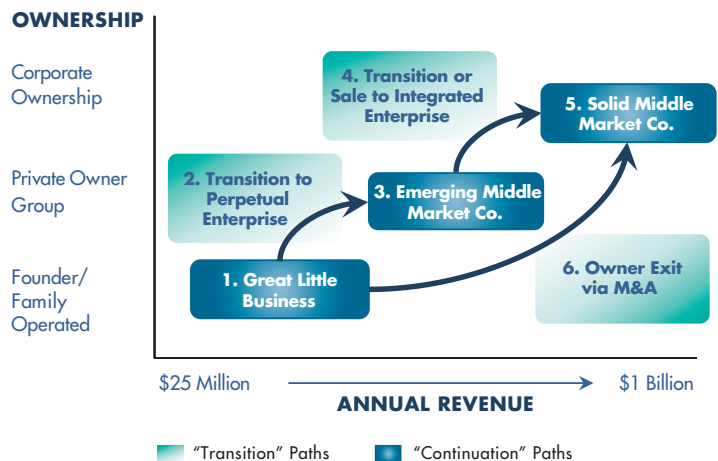
MYTH 1: Leadership Succession is all about the money

REALITY: Great talent is attracted to great corporate culture, career opportunity, customer engagement, owners' vision and financial security - not just a pot of money at the "end of the rainbow." Surprisingly, owners who can make their company perpetual may have the clearest pathway for their personal succession plan.

MYTH 2: Succession must mean a dramatic change for the company

REALITY: In our BOLD Value practice, we have identified 6 Succession Pathways® – three of which are continuation paths with a modest shift in ownership structure and company direction and three of which are transition paths where succession enables a fundamental and often dramatic shift. All owners benefit from exploring and crafting their own custom succession pathways.

SIX SUCCESSION PATHWAYS



These are hypothetical numbers. Individual company's revenue growth may vary.

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MYTH 3: An owner needs to keep paying more in salary and bonus to attract and retain superior next generation leadership

REALITY: Over the past ten years, the tide has dramatically changed from straight high salaries to a performance based pay. In fact, the Grant Thornton 16th Annual Government Contractor Survey highlights that salaries and bonuses DROPPED in 2010 compared to 2009 for the number 2, 3 and 4 executives in Government Contractors with sales over \$50M. Conversely, company proxy statements show a dramatic increase in long-term incentive plans such as stock appreciation rights and performance-based long-term profit sharing.

MYTH 4: Stable and strong middle-market companies don't need to bother with succession planning

REALITY: As companies grow, they face fierce scarcities of cash (needed to fuel growth and balance risk), talent (needed to provide true leadership and skills for growth) and confidence (that ALL key leaders can enter AND exit the business in style.) Leaders address these three scarcities head-on before they jeopardize the company's future. Result: owners can then address succession from a position of power – not weakness.

MYTH 5: Long-term incentive plans to attract and retain great people should be based primarily on company sales and profits

REALITY: Paradoxically, rewarding only profits can result in value destruction. It is far superior to reward a balanced HEALTHY company. We use the acronym QQERO to refer to a balance of lagging and leading key metrics to drive incentive compensation. This includes Quantity of earnings; Quality of earnings (products, services, customers); Efficiency of earnings (return on invested capital, days sales outstanding); Repeatability of earnings (backlog, customer satisfaction) and Other strategies objectives (commitment to corporate culture, innovation, scalability.)

Succession planning does not have to and should not be a tool used when you are desperate to get out of your business. Rather it's a strategic process to give you the freedom and fulfillment you deserve now and when you eventually choose to exit your business. Choosing the right succession pathway for you and your firm is critical for you to move from just making a good living to creating real equity and in time a legacy you can be proud of.

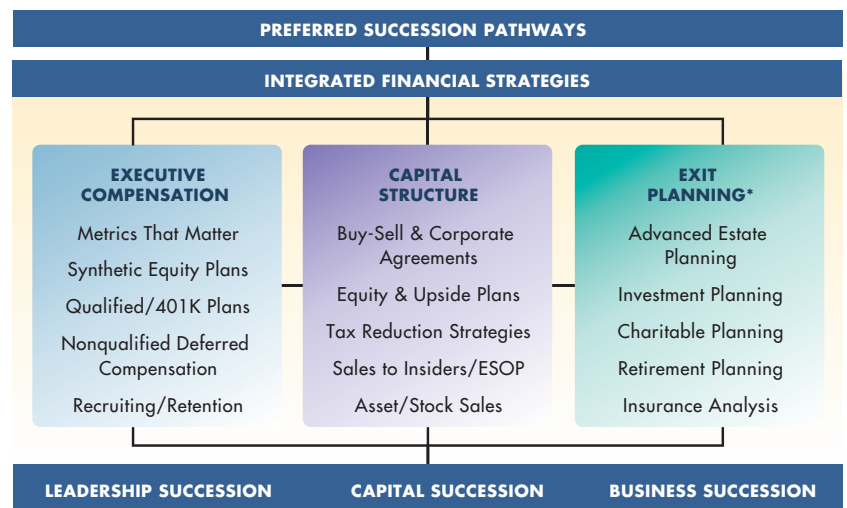
Myths 6 to 10 on Business Owner's Capital & Exit Strategies


Here is the conventional wisdom: the company's "business model" determines the eventual success or failure of the business. The nuanced reality is that it is the people and the capital that have a dramatic influence on the company's success at implementing the business model. Time and time again, leadership and capital succession is the critical human capital enabler that permits a company to succeed wildly beyond their founders' expectations. For example, Accenture (my former employer), succeeded in the consulting world because our culture enabled us to out-execute the competition.

Too often business owners address succession planning in isolation. Most owners have neither the venue nor the skills to discuss executive compensation, capital structure and exit planning with their key people and circle of advisors. Hence, the need to shine the light on the succession planning myths.

MYTH 6: Succession Planning is a euphemism for Selling the Company

REALITY: Succession planning has three fundamental and interconnected pillars: Leadership Succession, Capital Succession and Business Succession. Successful companies proactively address the entry and exit paths for ALL top executives on a systematic basis. Succession planning is less about selling the business and more about re-energizing and re-committing to the future of the business either in or out of its





Regardless of where you are in your business owner lifecycle, now is a great time to evaluate your Succession Pathway Options.

current capital structure.

MYTH 7: A full and outright sale is the most effective way for an owner to “exit” a company

REALITY: M&A transactions to third parties can be very lucrative and often provide the highest immediate value to selling shareholders. However, depending on the owners’ objectives, many other exit strategies deserve consideration. Consider the following: minority sale to a 3rd party, partial sale to an ESOP, sale to management via a MBO, stock redemption over time, performance-based equity compensation and other solutions. The first question really is: what kind of exit does the owner seek: a capital exit and/or a leadership exit? Avoid the myths by putting first things first.

MYTH 8: I know the “value” of my company

REALITY: Believe it or not, business owners most often misestimate (high and low) the value of their business by 50% or more. Furthermore, owners fail to understand that there are at least five simultaneous and very different “values” for their company ranging from strategic value, financial value, book value, contractual buy-sell value, and liquidation value. Knowing when and how to use different valuations can often mean the difference between a joyfully-successful and a painfully-difficult exit strategy.

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Regardless of where you are in your business owner lifecycle, now is a great time to evaluate your Succession Pathway Options. It takes courage to face the business succession myths head-on. Do the planning, debunk the myths and reap the business, business owner and personal benefits from the planning.

Contact us for additional information or visit us online at www.BOLDValue.com.

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