Business Succession Planning

Exit strategies for owner-managed businesses

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CHARTERED ACCOUNTANTS

Succession Planning

Secure your business legacy

As an owner-manager, you have poured your heart and soul into building your business, so it is critical that you understand what comes next.

A well-planned exit strategy or succession plan is crucial for ensuring the continued success of your company and securing your financial future.

The importance of succession planning

Succession planning is not just about retirement - it's also preparing your business for any eventuality. Whether you're looking to step back gradually or make a clean break, having a clear strategy in place is essential.

Benefits of early planning:
- Maximises business value
- Ensures smooth transition
- Protects your legacy
- Provides financial security

Understanding your options

There are several paths you can take when it comes to exiting your business and each has its own advantages and considerations.

You will often find those who are good at planning exit strategies are entrepreneurs who are spinning lots of plates,. They start a business and as it is building up, they are already planning their next venture. They have a clear exit strategy in place and they plan to sell the business at its peak.

Whatever an individuals reason for exiting a business, it is essential to have a clear understanding of how you plan to exit the business, so let’s take a look at the different exit strategies in more detail over the coming pages.

Exit Strategies

For any business, one thing that should not be overlooked is an exit strategy. People start a business for a multitude of reasons such as, the desire for independence, pursuit of a passion, financial potential, personal growth and learning, a desire to help others and flexibility and work-life balance.

But what happens when you have had enough? This is where you will need to consider the following exit strategies and implement the right one for you.

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Mergers & Acquisitions

Mergers and acquisitions may be completed to expand a company's reach or gain market share in an attempt to create shareholder value.

Pages 5 & 6

Sell to a Partner or Investor

If you are not the sole business owner, this strategy entails selling your stake in the business to someone known and trusted.

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Family Succession

Keep the business in the family and explore the tax reliefs options available.

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Employee Ownership Trust

A business ownership model, where a controlling shareholding is held by a trust for the benefit of the employees.

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Management Buyout

Selling to existing management can provide a straightforward and seamless transition out of the business.

Mergers and Acquisitions

A merger or acquisition is a strong exit plan for any company with their business for sale, and a particularly attractive option for startups and entrepreneurs. You will be selling your business to another company, who may want to increase their geographic footprint, eliminate competition, or acquire your talent, infrastructure or product.

This is one of the strongest exit strategies for business owners, as they can maintain control over price negotiations and set their own terms. If you are selling to a competitor or entertaining multiple bids, you may be able to drive the price up even further.

Key benefits

- **Synergies: Cost reduction and revenue enhancement**
- **Market Expansion: Quick access to new markets or customer bases**
- **Diversification: Spreading risk across different industries or regions**
- **Acquiring Talent: Gaining skilled employees and management**
- **Tax Advantages: Potential for tax benefits in certain transactions**

Challenges

- Cultural Integration: Merging different corporate cultures
- Regulatory Hurdles: Antitrust concerns and legal complexities
- Overvaluation: Risk of paying too much for the target company
- Integration Costs: Unexpected expenses in combining operations
- Employee Morale: Uncertainty and potential job losses

Sale To Partner or Investor

As long as you are not the sole business owner, you can sell your stake to a partner or venture capital investor while the business runs as usual. The term 'friendly buyer' is often used in this type of exit strategy, as it's likely that you would sell your stake to someone known and trusted.

The Positives

Familiarity

The buyer already knows the business, potentially streamlining the sale process.

Continuity

Existing relationships with staff, customers, and suppliers can be maintained.

Confidentiality

The sale can often be conducted with minimal disruption to the business.

Flexibility

Terms can sometimes be more flexible than with an external sale.

The Negatives

Valuation

Agreeing on a fair price can be challenging, especially with partners who may have differing views on the business's worth.

Funding

The partner or investor must have access to sufficient capital to complete the purchase.

Tax Implications

Different tax consequences may apply compared to selling to an external party.

Legal Structure

The sale process will vary depending on whether it's a partnership buout or a sale share in a limited company.

Other Considerations

When selling to an investor, additional factors come into play:

- Investor's Strategy - Understanding their long-term plans for the business.
- Control - Determining how much control the original owner retains post-sale.
- Growth Expectations - Investors often look for opportunities to scale the business.
- Exit Timeline - Clarifying the investor's expected holding period and exit strategy.

By carefully considering these aspects, business owners can navigate the complexities of selling to a partner or investor, potentially achieving a smoother transition and satisfactory outcome for all parties involved.

Family Succession

Passing your business to a family member can be a rewarding way to preserve your legacy and is a popular exit strategy for many owner-managed businesses. However, it's crucial to assess whether your chosen successor has the skills and desire to take on the role.

Advantages

- Maintains business culture and values
- Successor already understands the business
- Can allow for gradual transition
- Potential for tax-efficient wealth transfer

Disadvantages

- Family members may lack necessary expertise
- Can strain family relationships
- Balancing interests of involved and uninvolved family members
- Emotional attachment may cloud objective decision-making

Case Study

UK-based equipment manufacturer with annual revenues of £50 million. Founder, Robert decided to step down. Robert had three children, Sarah (CFO), James (Head of Sales), and Emily (uninvolved in the business). The company had experienced significant growth and had potential for international expansion. A private equity firm had expressed an interest in acquiring the business.

Key Challenges

- **Sarah and James both wanted to be CEO, causing tension**
- **Neither had experience in international business development**
- **Concern over how to fairly include Emily in the succession plan**
- **Differing opinions on the company's worth between family members**
- **The private equity offer added complexity to the decision-making process**

The Solution

After extensive family discussions and consultations with advisors, the family implemented a multi-faceted succession plan:

- **Dual Leadership Model - Sarah became CEO, focusing on finance and operations, while James became President, overseeing sales and business development**
- **External Expertise - Hired an experienced COO to guide international expansion**
- **Family Trust - Created a family trust to hold a portion of shares, benefiting all three siblings equally**
- **Partial Sale - Sold a 30% stake to the private equity firm to fund growth and provide liquidity**
- **Board Restructure - Appointed independent directors to provide objective oversight and mediate family dynamics**

The Outcome

This complex succession plan allowed the company to retain family control while benefiting from external expertise and capital. It leveraged the strengths of both Sarah and James whilst ensuring fair treatment of all family members. It also positioned the company well for international growth.

Employee Ownership Trust

A strong succession plan for your business?

Transferring ownership to an Employee Ownership Trust (EOT) can be a tax-efficient way to exit while preserving your company's culture and independence. It is a business ownership model, where a controlling shareholding is held by a trust for the benefit of the employees.

To create this, a business will set up a new trust company that buys shares from the existing shareholders, and holds them on trust for the beneficiaries, who are the employees of the business.

Individual employees do not normally own shares directly, although some key employees can hold a small number of shares alongside the EOT.

What are the Pro's & Cons?

- An EOT provides a smooth handover of a business and it provides security for the employees.
- Tax advantages to both employees and the exiting shareholder(s). The sale of a controlling interest to an EOT is exempt from Capital Gains Tax (CGT).
- When a qualifying EOT controls a company, tax-free bonuses of up to £3,600 can be paid per eligible employee each tax year.
- Funding an EOT can be challenging, as the immediate cash proceeds will be limited to surplus cash currently in the business and whatever funding the EOT can obtain. In practice a large proportion is usually funded through deferred consideration.
- Decision making will be in the hands of the Trustees and the Board of Directors going forward, so it is important to ensure the correct people are appointed.
- Has to be the right choice for both the employees and the seller. In some situations an MBO is more appropriate, so it is important to weigh up all the options.

Employee Ownership Trusts

The Numbers

1650

Employee Owned

Trusts

To Date

In the last 12 months

330

New EO Businesses

Average Annual Rise

16.2%

In the last decade

Employee Ownership Impacts

Business

- 20% increase in performance, driving revenue increases of up to 43% after becoming EOT
- 25% more likely to have seen profits grow in the past 5 years post transition
- 50% more likely to invest in R&D

Economy & Society

- 8-12% more productive per employee
- 50% more likely to expand their workforces than other businesses

Employees

- 73% more likely to have increased employee satisfaction, motivation, and work-life balance
- 12% higher investment in training, skills, and on the job development
- £2,700 average higher basic wages and share profits

*Source: https://employeeownership.co.uk

Management Buy-Outs

What is a Management Buy-Out?

An management buy-out (MBO) occurs when a management team sees an opportunity to take control of a business that the owner is looking to sell. It is sometimes more beneficial for a management team to take control instead of outside investors as they have a better understanding of the company's operations and potential.

Key Benefits of MBOs

Continuity: Preserves existing relationships and business operations
Insider Knowledge: Management already understands the business intimately
Motivation: Aligns management interests with company success
Smoother Transition: Often less disruptive than a sale to external parties

Challenges to Consider

Financing: Securing sufficient funds can be complex
Valuation Disputes: Agreeing on a fair price with current owners
Role Changes: Managers must transition to owners, requiring new skills
Potential Conflicts: Balancing management and ownership responsibilities

The key to a successful Management Buy-Out

The key to a successful Management Buy-Out is the strength and quality of the management team, which is a major factor in raising the required funds to complete the transaction. The management team are usually required to contribute some personal funds, but often the bulk of the buy-out is funded by external funds, which could be either debt or equity or a combination thereof, and the seller through deferred consideration.

Preparing for a successful exit

Regardless of your chosen strategy, thorough preparation is key to maximising value and ensuring a smooth transition.

Analysing the Financial Health of the Company

Ensure your financial records are in order. Potential buyers or successors will want to see clear, accurate financial information.

Understanding the financial health of your business is crucial when it comes to succession planning. An accountant can analyse your company's financial statements, tax returns, and other financial records to help you assess your company's financial performance and anything that could impact your succession plan.

Enhance Business Value

Succession planning and business valuation also go hand-in-hand. You need to be aware of the value of your company to ensure the succession plan you put in place is correct for you and your business. This is where an accountant can help evaluate a business based on its historical and future trading performance and market and industry conditions.

Start by identifying areas for improvement in your business. This might include:

- **Streamlining operations**
- **Diversifying your customer base**
- **Strengthening your management team**
- **Investing in technology and systems**

Tax Planning

Significant tax implications, with regards to succession planning, can also occur when transferring ownership of a business or control of the company to a new generation. An accountant can help a business to minimise tax liabilities and maximise tax benefits to support business owners in creating a succession plan that is tax-efficient. They can also provide guidance on tax planning strategies that align with the ambitions of a business.

Estate Planning

Estate planning, which can often be a complex process, is also involved in the process of succession planning. Having an accountant to support you in developing an estate plan is essential in achieving your objectives and ensuring the transfer of any assets is smooth and successful. They can also assist with creating trusts, gifting strategies, and other estate planning tools that can help minimise tax liabilities and protect your assets.

Developing Financial Strategies

An accountant can also help you develop financial strategies such as creating a budget and cash flow forecasting to ensure a company's financial stability if and when a company transitions to a new generation of leadership.

An accountant can be an invaluable asset in helping business owners to create a successful succession plan that ensures a smooth transition of leadership and the long-term success of your company.

Seek Professional Advice

Navigating the complexities of business exit strategies requires expert guidance. Consider engaging with:

- **Accountants for tax planning and valuation**
- **Lawyers for legal structuring**
- **Business advisors for strategic planning**

Planning for Your Personal Future

Your exit strategy isn't just about the business - it's about your personal goals too. Consider what you want your life to look like after the transition. Will you retire completely, start a new venture, or take on an advisory role?

The Time to Act is Now

Whether your exit is imminent or years away, the time to start planning is now. By taking a proactive approach, you can ensure that the business you've worked so hard to build continues to thrive, while securing your own financial future and legacy.

Remember, every business is unique, and there's no one-size-fits-all approach to exit planning. We're here to help you navigate this complex process, providing tailored advice to meet your specific needs and goals. Let's work together to secure the future of your business and your personal legacy.

> "Succession planning is about securing the future of your business by fostering growth, continuity, and stability."

A cuppa and a conversation

If you are considering getting your house in order, please do get in touch with us.

Our corporate finance specialist along with our tax experts are on hand to ensure you get the best advice.

We can also recommend great legal teams and introduce you to sources of funding. We really are your one-stop-shop for succession planning.

Get in touch today!

Publication Date: October 2024

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