

Why Succession Planning and your Business Equity Value has just gone from Important to Critical

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If you think Succession Planning isn't a particularly high priority, Rachel Reeves' budget on 30th October 2024 has changed everything – Succession and Business Valuation have now been cranked up from important to absolutely vital!

The implications of this means the shares and assets in your private business may be subject to IHT (Inheritance Tax, at the prevailing rate) over a £1m threshold, with your beneficiaries being responsible for paying a potentially hefty bill.

Which begs the question: just where would your family get the cash from to pay this new and potentially onerous tax burden?

From April 2026 (subject to consultation), if you happen to pass away during your business tenure the value of your business would be included in your IHT calculations. Therefore, to ensure this is not left to chance, having an accurate and professionally prepared valuation of your business, carried out by trusted advisors, is now more vital than ever to fully appreciate your potential IHT liability. As, without a plan, your legacy could create a catastrophic tax burden and prolonged heartache for your family and workforce.

Don't Put Off What You Should Be Doing Right Now

You've probably heard the proverbial Chinese saying: when is the best time to plant a tree? Answer? 10 years ago. So, when's the second-best time? Right now!

Well, the same can be said of planning the succession or exit of your business, irrespective of whether you are currently planning to sell it or not. Therefore, THE best time to start working on your Succession Planning is right now, before you find yourself or your family being forced along a pathway that's both undesirable and chaotic.

In reality, every business owner will eventually exit their business one way or the other, whether they like it or not. Therefore, you need to ask yourself - are you currently heading towards a planned or an unplanned business succession and how much control do you want over that inevitability?

Whilst it often gets overshadowed by day-to-day operations, neglecting to develop a clear Succession Plan can jeopardize a business's longevity, stability, and success.

Why Does Succession Planning Matter?

This article delves into the reasons why small to mid-sized businesses should prioritize Succession Planning, the factors they need to consider, and actionable steps to create an effective plan.

A Business Optics Survey conducted from 2010-19 found that, out of the estimated 1.3million small-to-mid-sized businesses (that employ between 1 and 50 people):

- More than 90% are not sellable in their current format,
- Of those that are for sale, less than 20% will sell,
- And of those that do sell, less than 5% will sell for what the owner expected.

On top of that, it is estimated that around 50% of business owners will be forced to exit their business unexpectedly due to ill health or a change in their personal circumstances. That's one in two business owners! This is coupled with the growing trend of next generation 'reluctant business owners' who are family members that unexpectedly end up owning a business they're neither interested in or ill-prepared for. Therefore, robust Succession Planning comes down to the fact of making sure that you're able to exit yourself from your business 'successfully' and on your own terms.

From a survey carried out by the Exit Planning Institute; between 80% to 90% of a business owner's wealth is tied up in their business and yet;

- 67% of business owners do not know all their succession or exit options
- 78% have no transition plan
- 83% have no written plan
- 49% have no plan at all
- 40% have not planned for any unexpected events
- 86% have not carried out a strategic review or value assessment growth plan.

It's also very true that Succession Planning doesn't happen quickly. It can take two or three years to get your business succession ready and into a position to maximise the return for all the hard work and time you've ploughed into it. The question is: do you simply want to throw it all away or invest the time to maximise its value?

Going from a Manager Mindset to that of a Shareholder

Just as a caveat, exiting your business doesn't necessarily mean

selling it. It can also be you exiting the operational/executive aspects of your business, so that it's run by your secondary management team. It's all about you moving from an executive role to a shareholder role, in the true sense of the word. It's about raising your standards so that you're working ON your business rather than constantly IN your business. It's when you move from doing the doing to doing the thinking.

I remember it being a revelation to one of our clients, a £10m business. She didn't recognise that just because she was the 90% shareholder it didn't necessarily mean she had to be the Managing Director. It could be someone else. From her assumption bias and past conditioning, she naturally thought you automatically had to be the MD, but she was confusing share ownership with operational executive duties, which are not the same thing.

Preserving Your Business Value and Personal Wealth: If your business represents a significant portion of your personal wealth, then it stands to reason that you establish your future financial goals, establish the current value of your business, and identify the wealth gap in between. Then plan out how you're going to structure your business in such a way as to maximise its value to achieve your desired future financial outcome. Succession Planning can enhance your business value and make it more attractive to potential buyers or successors.

Begin With The End In Mind: Stephen R. Covey, in his seminal book: 'The 7 Habits of Highly Effective People', provided a transformative guide for personal and professional success, by stating that; Habit 1 is 'Be Proactive' and

even more importantly here, Habit 2 'Begin With The End In Mind'. So, when it comes to Succession Planning, you need to proactively begin now with the end in mind, whether you're planning 2 years, 5 years, or 20 years ahead.

The Key Elements of Succession Planning

So, what are some of the key considerations when setting out on your journey of thoughtfully evaluating all your Succession Planning options? Especially when a robust Succession Plan will help minimize disruptions and ensure that your business can thrive beyond its current leadership.

Owner Dependence: One of the key starting points, or key constraints, within any business is the owner dependence question. In other words, within an owner dependant business the majority of responsibilities and decision making will be allocated to the owner. Whereas if it's been intentionally transitioned into a value dependant business, the day-to-day operational management and running of the business will be with the management team/employees.

Goals, Vision, and Dreams: An important starting point is answering the questions: What am I trying to do and how am I trying to do it? It's important to ascertain your business goals, your objectives, your priorities, and your aspirations to see how well your business aligns with your important personal and family lifestyle goals and dreams. Ultimately, developing a Succession Plan requires you to clarify your long-term vision and goals. This process can lead to a stronger business strategy and a more focused organizational direction.

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Secondary Management: This inevitably leads on to taking the pre-requisite time to establish your potential secondary management or leadership team. Do you already have family/staff members internally that could take on higher managerial responsibilities and decision making in the business, or that could be nurtured into those positions? If so, you'll need to develop a personalized training plan for each successor. This may include mentorship, formal education, job shadowing, or cross-training in different areas of the business. Or will you need to look externally for these skillsets and experience? These key person recruitment decisions will require strategic planning, rather than simply hiring for the immediate operational duties you require today.

A clear Succession Plan signals to employees that their careers can progress within your organization. This can enhance employee morale and retention, as staff members feel more secure about their futures.

Risk Profile: It's important to assess your risk management profile & contingency planning. Some of those contingencies include: Distress, Disagreement, Disease, Disability, Divorce, or Death. As I said earlier, when around 50% of business owners will be forced to exit their business unexpectedly due to one or several of these issues, I don't need to tell you how difficult and painful this can be without a carefully considered and robust Succession Plan in place.

Critical Legal Documents: You'll need to consider shareholder agreements, articles of association, business handbooks, operating manuals, wills, power of attorney

and the like. Do you even have these? Too many businesses we see don't have any of these provisions in place, or if they do, they are woefully out of date, which again can cause a great deal of anguish, frustration, and major delays in getting anything done.

Due Diligence: This is an industry norm when it comes to understanding the quality and position of the intricacies of a business and its value. If you can have all this due diligence prepared in advance, it would give any potential buyer, whether family, management, or investor, confidence in the thoroughness of your preparation, and improve the value and attractiveness of your business.

This also helps if you're contacted, out of the blue, by a serious credible buyer. It could enable you to really seize the opportunity and demonstrate your professional standing. Or, on the other hand, should the unexpected happen, you and/or your business team will be more ready and prepared to handle the effects of that unexpected event.

Mitigating Business Risk: These considerations all form part of the Succession Planning process with such items as; locating all major documents & contracts, bank accounts, online passwords, safe combinations, health and safety, HR, physical and information security, business continuity, environmental & sustainability, GDPR, quality control, buildings, EPC's, anti-money laundering, procurement & supply, storage & warehousing, insurance, IT, and the like.

Formal Business Valuations: So that you know where you are, equity value wise, your business needs a thorough business

valuation to establish where you are today, so you can gauge where you think you are compared to where you really are. Then to consider a maximum potential valuation, coupled with a future goal of what you'd like it to be worth, with a Value Gap Analysis.

Too many business owners over value what they think their business is worth, especially after all those years of blood, sweat, and tears. But many times, you have to be careful not to fall into the trap of the ugly baby syndrome or the sunk cost fallacy. Because your business is your baby, you'll always see it as beautiful; and because you cared for it and know every aspect of its development you've sunken a great deal of effort and energy into it. This means it's difficult for you to see it from a prospective investor's viewpoint.

This is where you need impartial advice on what it's really worth and how a prospective buyer will see it. Through undertaking a formal valuation process and developing a robust realistic Succession Plan you'll be able to see it from a new perspective and not be blinded by those biases and rose-tinted glasses.

Legal and Financial Considerations: Consulting with your legal and financial advisors to address the implications of Succession Planning is also a critical part of your 'A Team' development. This includes estate planning, tax implications, accountants, wealth advisors, and the like. Proper planning can prevent legal and financial disputes and ensure a fair and planned distribution of assets.

Business Transferable Value: Unfortunately, as 90% of small to mid-sized businesses are not sellable in their current form, they

need a professional team to help them in changing that position. In essence, transferable value is what a business is worth to a new buyer/family member without the current owner(s). It's determined by gauging how well the business would run without the original owner. How well do you think your business would run without you?

I was working with a business owner who said his business was running without him as he'd reduced his time in the business down to only four days a week. But when I quizzed him about how many hours he worked each of those four days, he said about 12 hours. So, he was still doing a 48 hour week, but over four days instead of five!

Business Attractiveness: You need to look at your business's external potential in its current condition from a business, financial, market, and investment point of view. This is to identify key areas that need development to make your business more attractive to a buyer, for when it's time to sell.

Business Saleability: Your business's saleability is anything other than the financials and profit figures. It's all about the internal drivers and workings

of the business, including such things as customers and suppliers (spread, satisfaction, dependency & loyalty), systems and processes, housekeeping, financial reporting, reputation, internal culture, your team dynamics, etc.

Intangible Assets: Last, but not least, is to identify your intangible assets; goodwill, reputation, brand, intellectual property (IP), patents, distribution channels, etc. and aligning/defining those to the potential uplift in the value of your business.

Review and Revise: Succession Planning is not a one-time event; it requires ongoing evaluation. You'll need to regularly review your plan to ensure it remains relevant and effective as circumstances change within the business or the broader marketplace.

Conclusion

Succession Planning is an essential aspect of long-term business strategy for small to mid-sized businesses, and even more so with the significant budget changes. By proactively preparing your leadership transition, you can ensure business continuity, preserve value, and maintain employee morale. While the

process requires time, effort, and careful consideration, the benefits will far outweigh the challenges. Ultimately, a thoughtfully executed Succession Plan not only secures the future of your business but also will safeguard the livelihoods of your employees, customers, and stakeholders. By taking the time to plan, you can create a legacy that will endure way beyond your tenure, fostering resilience and adaptability in an ever-changing market landscape.

A Word of Caution: Succession Planning is essential, all-important and high priority, but does take time and patience to formulate and implement. However, there are too many business brokers giving poor advice, giving owners false hope by agreeing to represent their business, making money primarily off their large sign-up fees, and exaggerating valuation figures and quick sale timeframes to secure business owners' engagement; where in many cases those business owners never actually get their business sold. As you've probably never done this before, and don't have a frame of reference, it goes without saying that it's important to get the correct and trustworthy advice from experienced seasoned professionals.

Next Steps

As we've said, Succession Planning is not always generally at the top of your priority list, or even on your radar, but if you feel this article makes sense and resonates with you, we're here to help. Working with Strategic Business Exits (SBE) you can gain access to a professional and high-calibre team of trusted advisors who can help you with both your initial Succession Planning Assessment, along with a retained service, guiding you through the on-going implementation of your Succession Action Plan.

Should you wish to explore this further, you're welcome to book a free and confidential online Succession Planning review meeting by contacting the author of this article, Carl Jarvis, on carl@strategic-business-exits.com