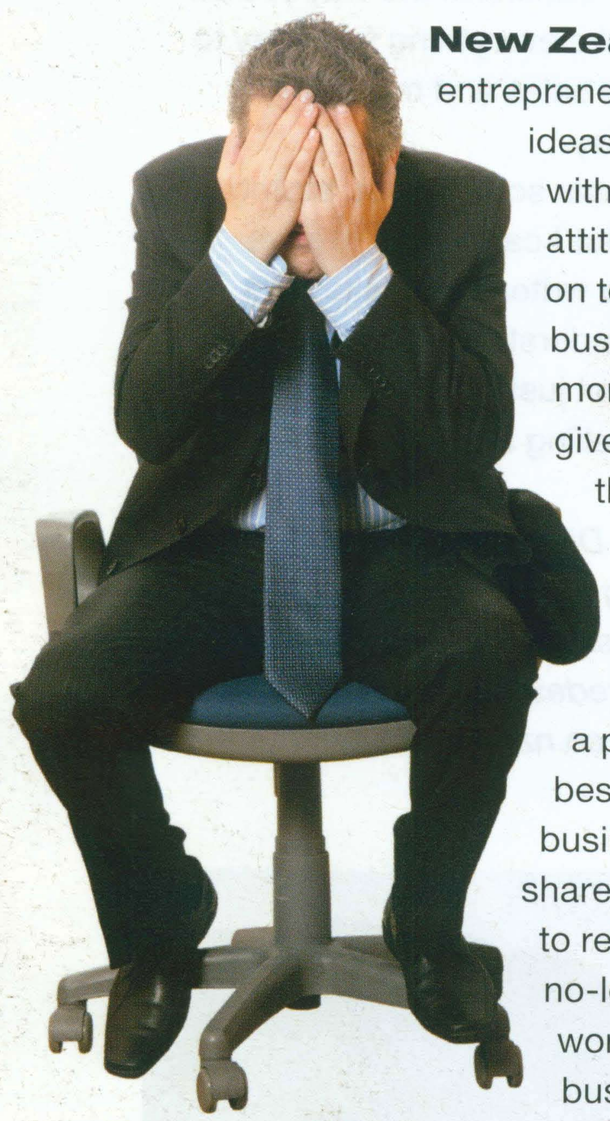
HELP DESK

Do you have an exit strategy?

Dean Kaye examines the options for succession planning and highlights the dangers of failing to plan for future crises.



New Zealand is full of entrepreneurs with great ideas: capable people with 'can do' attitudes. Many go on to form businesses, but more often than not give little thought to the 'end game' in terms of an exit strategy. In other words: putting in place a plan to gain the best value for their business if a key shareholder chooses to retire or is no-longer able to work in the business because of illness or death.

I firmly believe a business's value often comes from the individuals within it and the intellectual property held in their heads. Currently 97 percent of New Zealand businesses can be categorized as small to medium sizes enterprises (SMEs), meaning they have ten or less employees including the owners. If a key person is no-longer able to work in the business due to illness, death or retirement, without a succession plan, the effect on the business can be devastating.

No-one knows what the future holds. Those in Christchurch who've had their lives literally turned upside down during the recent quake will attest to this.

I know of a Supreme Court lawyer; a man with a fabulous career and a well respected figure among his peers. Unfortunately he became incapacitated upon receiving a seemingly innocuous blow to the head during a skiing trip. He'd just started a new law firm and was celebrating in Queenstown with his fellow business partners. This bang on the head turned into a severe head trauma causing brain injury. He lost his short-term memory and this once capable man regressed to the mentality of a child. Obviously he was no-longer able to function as a lawyer.

Of course, this was a tragedy for his family and all involved; however, it could also have been the death knell for his law practice. Thankfully, he and his colleagues had the foresight to put in place a succession plan to protect against such a scenario. He was insured against death or incapacitation which allowed his colleagues to buy his share of the business and provided his family with much needed financial security.

Incapacitation isn't just physical. Today mental illness is a major issue. Experts say that over the next 40 years, one in four of us will suffer from a mental illness of some sort. I dread to contemplate the delayed effects the Christchurch quake will have in terms of depression, stress and breakdowns – it's not just your four walls you need to protect.

Calculated risks

Business is about taking risks: calculated risks. Insurance is a key factor in negating the risk and maintaining profits.

My job is to say: "these are the areas you believe are important for your future profitability. What can you manage yourself in terms of risk and what do we need to cover?"

If you have deep pockets you probably don't need insurance, but most SMEs don't have deep pockets. What they do have is cashflow, but this usually isn't enough to cover the cost of buying someone out. As the survivor of the business you probably don't want just anybody coming in, potentially having an equal share and telling you what to do.

The best outcome is to have a level of insurance to cover you against such an event that allows you to buy out that share of the business or provide time to sell. This provides security to the spouse/partner left behind and to the remaining shareholders, stakeholders, clients and suppliers.

Mark Twain said "A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain."

In the current economic climate, convincing a bank to extend a loan to buy out a key shareholder can be a difficult task; particularly if they are integral to your business's success. Insuring that person allows you to continue business as usual, and is cheaper than paying back a loan.

Best options

Business succession is the process of identifying the best options available for transferring assets, wealth and authority to a potential successor from the business's current owners/shareholders. Having this allows your business to out-last the individuals within it.

So when planning for succession – what are your options? Train a successor? Sell to someone new? Merge? Close the doors?

There are pros and cons for the above and of course each will be different depending on your industry. Your business will need to be valued to identify what you're actually selling.

Prepare for any due diligence process of your buyer, where they will complete an assessment of your financials, management, clients, markets and competitors.

Considering the above and all connotations, it's no wonder few businesses reach the final stage before one of the shareholders falls ill, dies or retires.

Do you have a shareholders and buy/sell agreement for the business? Do you want to be in business with your partner's wife's second husband's lawyer?

Without a plan, transition can become a crisis for any business. Will you get the best return on your investment during a crisis?

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