12 February 2020, 11:07AM UTC
Chief Investment Office GWM
Investment Research

Four ways entrepreneurs young and old can benefit from succession planning

Executives & Entrepreneurs

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- Exiting a business can be a moment of truth for an entrepreneur. A solid succession plan can make the difference between success and failure.
- Lack of an exit plan can force entrepreneurs to sell in a hurry at a lower price. It can also cause costly disputes among family members - explaining why 70% of family-owned businesses do not survive even one generation after the founder moves on.
- But despite the high stakes, nearly eight in 10 founders say they are too preoccupied with the day-to- day running of the business to make such plans.
- We believe that a solid succession plan can help entrepreneurs – both young and old – in four main ways.
- Maximizing value: Reducing key person risk, for example, can help a business can maintain its growth trajectory during a transition.
- Harmony among the next generation: Fostering a sense of common purpose for the family and stakeholders can help defuse conflicts and tensions.
- Seize new opportunities: Serial entrepreneurs need to be ready to seize new opportunities at short notice.
- Preserve a legacy: Many entrepreneurs are proud of the positive impact their business has had on employees, the local community and the environment. Finding a like-minded succession can be the best way of ensuring these values persist.

Source: Getty Images

Strengths	Weaknesses
A core priority of most entrepreneurs is to maximize the value of their business, whether they intend to sell it or pass it on to a family successor. Forming a robust succession plan can help achieve this goal, ensuring that a business is well-placed to flourish after the founder has passed on control. A succession plan can also increase the chances that the business owners values – such as commitement to sustainable business practices – continue to be reflected in the operations of the firm.	Poor succession planning can accentuate disputes over the running of a business or the distribution of assets after a sale, potentially causing breakdowns in family relations. Such disputes can also lead to long and costly litigation, ultimately damaging the business. Having a common purpose for the family can help defuse conflicts and tensions that arise from a business transfer or sale.
Opportunities	**Threats**
Many business leaders set up a company and devote much of their energies to it for the entirety of their working lives. But there are examples of high-profile serial entrepreneurs that continually look for the next business opportunity. A good succession plan can help this type of entrepreneur to embark on a new venture or move into philanthropy at short notice.	Businesses that have made indequate succession plans can be vulnerable in the event of a sudden departure of the main owner or a key partner. Rushed sellers are typically forced to compromise on price. Monitoring rivals can also crystalize an entrepreneur's own succession plans, as they learn from the mistakes of others.

Introduction

Exiting a business can be a moment of truth for entrepreneurs. After many years and much effort in forging a company, entrepreneurs typically want their business to flourish after they leave and for it to continue to embody their principal values. A succession plan can be crucial to achieving these goals. Business succession can take many forms such as passing a company to the next generation or selling your interests – whether to a partner, a rival, or the public market. Robust succession planning opens up multiple opportunities. It is vital for entrepreneurs whether they are planning to retire, to move on to a new challenge, or to maintain some role in the stewardship of the company.

It is a myth that such plans are just for older entrepreneurs. In fact, younger business people can benefit greatly from such forward thinking, giving them greater flexibility to pivot into new business opportunities swiftly, to step back temporarily if their lifestyle changes, or adjust if a key business partner becomes unable to work.

Despite the merits of making a plan, close to seven in 10 business owners have none in place, according to Rocket Lawyer, an online legal technology company. Nearly eight in 10 founders say they are too preoccupied with the day-to-day running of the business to make such plans, based on surveys by Wilmington Trust, and four in 10 say their departure is too far off to justify the time and effort in planning. By the time the need for a plan becomes clear, it can be too late to find the best buyer or family successor that shares the owner's principles. This can create an opportunity for rival entrepreneurs or private equity funds to buy poorly prepared businesses at a bargain price.

In this report we explore how succession planning can help entrepreneurs in four main ways: maximizing the value of a business, securing harmony among the next generation well in advance, helping entrepreneurs to seize new opportunities, and preserving their legacy.

External view: insights from private business owners

In the course of our recent interviews with members of the UBS Industry Leader Network*, several of the surveyed entrepreneurs said they had not yet set up a succession plan. The reasons they gave included that they were too young for one right now, a lack of relevancy given the development stage of their business, or the lack of natural successor (for example having no children, or having very young children, or that family members weren't interested in running the business).

Yet members of the network that have begun planning their succession (many of whom work in multigenerational family businesses) stressed consistently that they had worked on it for a long time. In several instances the process began with educating wider family members in the business's heritage and values, or sharing training on responsible ownership. Members also said it takes time for family members or external expertise to learn about the business, whether from a top-down management or a bottom-up work experience perspective, and to integrate into it.

The stages for attracting and retaining top external talent—recruitment, assessment, management, motivation, and development into a next generation of leaders—require time, patience, and open-mindedness to test succession plans and see how they work in reality. Finding a new company CEO can take 10-12 years according to one network member, while another had to trial three different CEOs before finding one with the international exposure needed to lead the business.

*The UBS Industry Leader Network is a global group of UBS clients and prospects who are business owners and executives. Their views may differ to those of UBS.

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1. Maximize the value

Why?
A core priority of most entrepreneurs is to maximize the value of their business whether they intend to sell it or pass it on to a family successor. In the event of a sale, the amount raised will have a major impact on a number of entrepreneurs' goals. Retirement plans, taxation, compensation levels, insurance, shareholder agreements, and corporate finance strategies can all depend on it. Valuation also matters to other stakeholders, notably partners, staff and family members. But an entrepreneur leaving a business to family members also wants to ensure it has the maximum value and long-term potential. A farsighted succession plan can help in a number of ways:

1. **Business continuity and operations:** The departure of a founder or owner can interrupt the operations of a business, reduce product and service quality or jeopardize business growth. Clients won't often be patient during a disruption or decline in standards of service. While founders or owners may be able to control much of their own lives, they have less control over the priorities of partners or key stakeholders. This is a potential issue, even for younger entrepreneurs. Older entrepreneurs who intend to pass on their business to family members should also be aware of the destructive potential of disputes to derail business growth. This partly explains why 70% of family-owned businesses do not survive the transition from an entrepreneur to the next generation of the family, 88% fail to pass on to the third generation, and 97% don't reach the fourth generation or beyond, according to statistics from Deloitte.[1]
2. **Boosting the value at sale:** Unlike listed companies, private businesses are by nature illiquid assets and can take plenty of time to sell at a price that reflects their true value. A strong succession plan—with robust financial information and strong management and structures in place—makes a company look more appealing and may boost its value. Entrepreneurs also need to explore the different routes of sale—whether to a rival, partner, or the public market—as different buyers appreciate different business qualities. Before looking at ways to boost value, however, business owners need a robust valuation estimate. Liquidation value may not reflect the intangible assets or the goodwill embedded in the business. And a fair market valuation (as opposed to an investment value) may not capture the value of running a turnkey operation that a buyer can take over with less effort or slot neatly into an existing business framework. Buyers may pay a premium valuation if an acquisition quickly contributes to their bottom line. On the flipside, a failure to plan for succession can provide an opportunity for competitors or private equity firms to buy firms at closer to liquidation valuations.
3. **Maximizing tax efficiency:** Depending on the country in which a company operates, there can be a variety of ways to boost value legitimately by reducing tax costs. This can begin as early as inception, as in some jurisdictions the initial business entity chosen can have major tax, administrative, and transparency implications (even shutting down some exit routes due to complexity or excessive cost). Company or holding company adjustments often need to made years in advance to gain approval from the tax authorities. These factors speak to considering a succession plan even at the early stages of a business. And failure to plan can potentially lead to outsize tax liabilities that compromise the viability of a business or shut down potential routes of sale.

[1] Deloitte (2015) *Business succession planning: Cultivating* enduring value (All six volumes in one collection), p.7.

Case study

Entrepreneurs Kristina and Sanjeev both established successful technology businesses. But their approaches led to very different outcomes when it came to selling their interests.

As her business expanded, Kristina built a strong management team to whom she could delegate responsibility while incentivizing them with ownership stakes through a buy-sell agreement. Kristina regularly worked with a bank and corporate finance house to get up-to-date business valuations. As her business expanded she used flexible debt facilities to fund growth, while also engaging a specialist tax planner to optimize her stake.

Kristina chose eventually to exit day-to-day running of the business in order pursue her philanthropic goals. Her diversified management team bought her controlling stake out at a mutually agreed sale price, while she retained a non-controlling stake and committed to one day a week's work for 18 months to smooth the management transition. Six months later a larger competitor identified the business as a good strategic fit whose managers fitted their culture and bought out Kristina and her partners. Meanwhile, Kristina could pursue her new philanthropic venture without distractions.

Sanjeev built his business rapidly by himself. He was reluctant to hire new managers in case they challenged his authority, and those managers he did bring in were rewarded via fixed salary rather than equity. Sanjeev focused on day-to-day operations and had no time to consider succession planning, although he did meet with a tax adviser once a year to explore ways to optimize his financial assets.

When Sanjeev's health suddenly deteriorated, his doctors said he needed to step away from the business immediately. He decided he needed to sell the company. But his imminent departure put off prospective buyers who were only willing to offer the liquidation value of the firm. With no recent valuation or strong management team in place, Sanjeev had to accept a relatively low price from a local competitor.

How?

1. **Establish and maintain an up-to-date plan of sale.** This can include buy-sell agreements, company buybacks, a plan for initial public offering, or direct pass down to the next generation. Such agreements can stipulate how a partner's share of a business may be reassigned if they leave it. Establishing such frameworks in advance can be especially important if business partners or family members unexpectedly withdraw from the business and want to sell their stakes. For family businesses, it can be especially important that such agreements reflect the entrepreneur's goals and those of the wider family.

2. **Identify, educate, and train potential successors early, whether a family member, partner, or outside executive.** Finding the right individual—and team—to take the helm can be a lengthy process, often taking years. Similarly, finding the right professional to guide a sale (whether to public markets or to close associates) can be time-consuming. It can be helpful to have a range of options, given that a preferred successor or preferred sale route can fall through. Companies that have devoted attention to this process, including cultivating several possible future chief executives, can be more attractive to outside buyers. More broadly, an HR strategy that reduces key person risk can boost the value of a business as a going concern

3. **Consider governance models.** These can determine how decisions over family interests are made and open up multiple sales options (including initial public offerings). Decisions made without consultation can lead to conflict, which can undermine value creation. Without such structure, decision-makers may overlook the broader interests of the family. A family governance council may be better able to take into account the long-term value for both the business and the wider family, while any single individual family member may have narrower interests. **For more details on how to think long-term amid uncertainty, please see here.**

External view: insights from private business owners

A number of UBS Industry Leader Network* members recently discussed the importance of a succession plan to continue their day-to-day business work in areas like identifying new business opportunities, promoting an innovative operating model, or building a corporate culture.

Bringing in family members or external talent to offer fresh perspectives on operational challenges and future needs can often be the first step to finding a successor. For example, next-generation managers may be more in tune than the 'old-guard' with new technological developments like artificial intelligence or new customer demands around social and environmental issues.

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2. Secure harmony among the next generation well in advance

Why?

Succession is a time of heightened risk for business owners whether or not they propose to hand control to family members or sell. An overall wealth plan—including a succession plan for the business and an idea on how to distribute any sales proceeds—can help to avoid or mitigate these risks, while also cementing family relationships across generations.

Disagreements over the running of a business or the distribution of assets after a sale can cause breakdowns in family relations. For example, entrepreneurs working in partnership may be happy to hand over to their next generation, but the other partners may not be happy with this arrangement. Succession planning can help to overcome this problem by, for example, defining how businesses pass between generations by drawing up agreements between partners and their respective families.

Entrepreneurs need also to consider what types of business interests they pass on to the next generation. This could involve passing a controlling stake to a family member that shares the entrepreneur's care for the business, while giving non-controlling stakes to other family members that decide to pursue other interests. In the event of conflict, a shared family mission statement or family council can help find consensus.

Potential problems are magnified when only some children in a family decide to work in the business, or if family members are treated unequally when a business owner shares the proceeds of a sale. Ways to resolve such conflicts include maintaining up-to-date valuations that are frequently reappraised, and even setting up a holding company that distances family members not working in the business from day-to-day operations.

Passing on or selling a successful business can ensure prosperity for a founder or owner and their families for generations to come. It can also cause siblings to stop talking and engage in long and costly litigation that ultimately damages the business.

Case study

Aleksandr and Bianca have both built successful businesses in the consumer goods sector. Both are now in their 50s, and each has three children. But they have taken very different approaches when it comes to involving the next generation in their businesses. Bianca was very keen to include her children from an early stage, inviting them to work in the business over the school holidays, attend staff meetings, and learn about operations from the inside. Bianca worked closely with her bank to establish a family council and succession plan, so that business colleagues and family members know how she intends to pass her controlling share to her eldest child, but leave equal non-controlling (but dividend-paying) shares to other family members.

"Aleksandr has invited his eldest son for work experience in the family firm as he had shown interest in working for the business. However, Aleksandr's two other children want to pursue careers outside the firm. Aleksandr plans to pass on ownership to his eldest son, but has not discussed this with his family.

When Aleksandr and Bianca are no longer able to run their businesses, their paths diverge. In Bianca's case, open communication between the management team and family permits a smooth transition. Bianca accelerates her plans to pass on her shares in the business to her children, with her eldest daughter now the owner and her other children receiving business income through a trust.

By contrast, Aleksandr's departure is marred by disagreements between business managers and his family. In particular his children have stopped talking with one another, as the two not working for the business feel aggrieved that their brother has received all the company's equity. Tensions are also high between Aleksandr's son and the management team due to disagreements over strategy. A lack of succession planning and preparation has put both Aleksandr's business and his family's long-term harmony at risk.

How?

1. **Make a wealth plan and a succession plan.** Entrepreneurs need to make a plan on what to do with their business (sell it or pass it to family members) and how to use their money (whether distributing sales proceeds or treating family members equally). Succession and wealth planning may also involve exploring borrowing strategies to release liquidity, or private sale routes (such as selling to a rival, partner, or public markets). If set out long in advance and transparently communicated, this planning can reduce the threat of conflict. On the other hand, there is potential for dispute or disappointment if entrepreneurs are unclear about what to do with their business and their subsequent financial plans. Entrepreneurs may allocate more money to their spending or retirement than heirs had expected, leaving fewer financial resources for family members. **For more details on borrowing in a lower-for-longer interest rate environment, please see here.**

2. **Develop a shared family mission.** Having a common purpose for the family can help defuse conflicts and tensions that arise from a business transfer or sale. This common purpose beyond profit can take many forms, but sustainability has additional benefits, notably reducing long-term business risks and potentially improving future growth prospects.

3. **Separate family and executive roles where appropriate.** Tensions can arise when certain relatives want to take an active role in managing a business, while others have less interest. But it can reduce the threat of tensions if more family members are drawn into the process of managing not just the family firm, but also the family wealth or any charitable foundation. Equally, if certain family members or heirs have entirely separate interests, it can be helpful to identify this early to ensure that agreement can be reached on determining an equitable distribution of business and financial assets among heirs, while installing an impartial external executive to make commercial decisions that maximize business and collective family value.

External view: insights from private business owners

Members of the UBS Industry Leader Network* say that, in family-run or closely held businesses, succession planning or intergenerational planning may be critical to ensuring the smooth running of a business without compromising family members' financial and non-financial needs. Several Industry Leaders noted that succession planning can help to iron out differences of opinion between family and non-family members of a company. An example of how succession planning can help is the provision to pay non-family executives through performance bonuses and family members via dividends. Setting up a holding company to distribute family dividends rather than paying them directly from the operating business can also help avoid potential conflicts between family owners that work for the company and those that don't.

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Source: gettyimages

3. Be ready to seize new opportunities

Why?
Many business leaders set up a company and devote much of their energies to it for the entirety of their working lives. But there are examples of high-profile serial entrepreneurs that continually look for the next business opportunity. A good succession plan can help this type of entrepreneur to embark on a new venture or move into philanthropy at short notice. This consideration mostly applies to younger entrepreneurs who plan to sell or give up business control rather than pass the business to family members. However, some serial entrepreneurs could seek to pass control or ownership to family members too. It's also worth noting that many entrepreneurs mingle their business and personal wealth. Disentangling these sources of wealth may involve reworking a company's corporate or legal structure or releasing money through borrowing, not only to free up funds for other ventures, but also to make a business appealing to an external buyer or investor.

Succession planning is especially important if one entrepreneur wants to leave other partners to pursue other opportunities. Without a succession plan there may be no buy-sell agreement in place to allow other partners to take over the business seamlessly. A lack of succession plan may make it harder to pursue alternative sale routes (such as selling to a rival or public listing). And without prior preparation it may be more challenging for the leaving partner to pass their stake onto family members without compromising the business's future growth prospects.

Entrepreneurs lacking financial and succession plans may also struggle to find the necessary capital for their next opportunity.

With an "always on" succession plan, entrepreneurs can act quickly if the need arises. For example, they may want to release capital (by selling to a partner, back to the company, pursuing an external sale, or passing down to future generations) or to borrow funds to buy out partners or another private business. Alternatively they may decide to cede financial and management control to family members.

The bottom line is that a succession plan allows dynamic entrepreneurs to pivot more swiftly into new opportunities.

Case study

Patricia and Paul are both entrepreneurs in the healthcare sector. Each set up their own company manufacturing and selling equipment to dentists.

But increasing trade tensions and rising research and development needs persuade both to leave the industry. Paul intends to become an angel investor, whereas Patricia wants to take up an advisory board position for a healthcare foundation.

Paul has already made succession plans with his two business partners. These included drawing up a buy-sell agreement where the company buys out his stake, covered by a dedicated insurance policy. Paul and his co-owners have also set up a holding company so that he can receive a small income for his old business. With the quick release of liquidity, Paul is able to make his first angel investment and start a new career.

Patricia, however, had made no succession plans. Without a formal buy-sell agreement, Patricia's partner argued the business won't be able to cope with her day-to-day involvement. Patricia cannot persuade her partner to buy her out as the two don't agree on the business's value, and they cannot find an external buyer as Patricia's exit is off-putting to company outsiders. The delay causes Patricia to lose the healthcare foundation role, and has damaged her relationship with her business partner.

How?

1. **Regularly value the business, consider opening lines of funding backed by it, and gather market intelligence on sales to stay ahead of the private business marketplace.** An up-to-date valuation estimate for a business is crucial in succession planning, especially for entrepreneurs who intend to use gains from their business to finance new ventures. Maintaining valuation data can help identify aspects of the business that can be adjusted over time to maximize a valuation. For example, a corporate finance team or investment bank may determine that a business

may fetch a lower sale price than peers if it has a large exposure to a particular high risk country or industry. Valuations may be dragged down by a wide range of considerations. Identifying these in advance can help with strategic planning and increase an entrepreneur's exit options, whether a transfer or a sale. It can also ensure that the company is collecting all the data that potential buyers might demand ahead of a sale. The valuation process can also help provide access to a network of potential strategic investors, helping the entrepreneur or successor to finance new projects or access new markets.

2. **Learn from peers that don't plan.** Entrepreneurs can snap up companies with no succession plans at good prices, while having a plan of their own. Identifying rivals that failed to devise a succession plan can be a source of competitive advantage for entrepreneurs seeking acquisitions. Rushed sellers are typically forced to compromise on price. Monitoring rivals can also crystalize an entrepreneur's own succession plans, as they learn from the mistakes of others.

External view: insights from private business owners

Several UBS Industry Leader Network* members said that they had acquired competitor companies that had not found successors or lacked sufficient planning. Identifying and buying businesses without a successor had even become a business strategy for some entrepreneurs, especially if organic growth opportunities were more limited.

Some business owners favored exiting their business rather than learning new skills or hiring in external talent to address structural business changes like increasing digitization or shifting consumer preferences, for example increased focus on sustainability or digital marketing. These fast-moving structural trends have led some entrepreneurs to sell without a formal or comprehensive succession plan, but have also provided some Industry Leaders with attractive opportunities to acquire companies at more competitive prices than perhaps would have been the case otherwise.

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Source: gettyimages

4. Preserve a legacy

Why?

Many entrepreneurs have a very clear sense of purpose when it comes to running their businesses. They often run their operations with a clear vision and operating model, which may or may not be formally documented or shared across the business. However, entrepreneurs can also consider whether this same purpose and vision would carry on as their legacy after they step away from or exit their business. The best way to preserve a legacy is to choose the right successor in the first place, whether an outside buyer or family member. Having done so, entrepreneurs can build up an enduring corporate culture that reflects their values. Finally, some entrepreneurs can continue to play a stewardship role as a minority shareholder or non-executive director.

Entrepreneurs often feel a sense of pride in the contribution their companies have made to local communities or the wider society. The company may embody their ethical values, and these can be a source of ongoing value as intangible assets are an increasingly large share of total business wealth. A well-considered and rigorous succession plan can be the best way to ensure that your staff are treated well after your exit and that your ethical values—including environmental, social, and governance (ESG) frameworks—remain core to the running of the business and its financial performance.

After a business sale or transfer to the family, an entrepreneur or owner may want to spend the profits on their retirement, a family foundation, a philanthropic trust, or a trust for heirs. A succession plan with firm intentions for the company's directions can ensure that the entrepreneur's charitable, philanthropic, or investment impact matches what their former business is doing, rather than be erased through a deterioration in the company's environmental stewardship or a loosening in labor standards.

Case study

Li Wei and Wang Yue both established manufacturing operations in their home towns. Both have resisted opportunities to relocate to lower-cost countries, instead creating high-quality local jobs and investing in productivity-enhancing measures. Both take pride in the positive impact they have had on their local communities. Years before environmental, social, and governance (ESG) standards became a focus, Li and Wang worked to minimize the environmental damage caused by their operations, using low-emission forms of electricity.

After years of success, both entrepreneurs decide to sell their businesses - Li to focus on running a charitable foundation, Wang to pursue a new business venture. Li has spent several years in talks with a rival firm that shares his commitment to both the local community and strong ESG practices. Under new owners, the bulk of local jobs are preserved, along with the company's strong ESG record. Li is satisfied that the company that bears his family name retains a good reputation in his home town and beyond.

By contrast, Wang has not made a succession plan. With little time to find a like-minded buyer, she sells to a rival who is just focused on maximizing short-term return. Operations move to a lower-cost nation, creating significant local job losses. Wang and her family are also distressed to learn that the acquirer firm is engaging in abusive employment practices and environmentally damaging manufacturing techniques. Wang feels that much of her positive social impact has been undone.

How?

1. **Define and document the key tangible and intangible assets of the company and consistently update this document.** ESG considerations are increasingly a necessity to doing business. Setting up systems to measure and monitor their impact on the environment and society can be a multi-year challenge. A robust succession plan centered on sustainability which is widely shared across the company can help ensure that ESG criteria are not neglected when a founder or owner exits, potentially to the detriment of the firm's profitability and growth.

2. **Increase the likelihood that the entrepreneur's ethical influence will continue to be felt.** Systems that enshrine strong corporate ESG practices are increasingly viewed as a must-have for businesses. As above, founders or owners can increase the chances that their influence will continue to be felt by choosing the right future owner, putting in place the right business systems, and even retaining some type of role within the company.

3. **Work closely with partners to realize the entrepreneur's wider philanthropic, sustainable and impact investing goals.** Seeking outside advice in these areas can enable entrepreneurs to draw on best practice in insuring their philanthropic and sustainable goals are achieved. **To discover more about how to embed sustainability in an entrepreneur's business and personal wealth, please click here.**

External view: insights from private business owners

Members of the UBS Industry Leader Network* noted in recent interviews that working alongside potential successors on aspects of corporate culture such as transparency, a shared company vision, or support of a local community can increase the chances of that culture enduring once an entrepreneur steps back from full-time management or ownership.

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Number 06/2019. CIO82652744