Private Business Insights

Creating a smooth transition

Christmas 2011

pwc

Welcome to the Christmas 2011 issue of Private Business Insights.

A note from Robbie, December 2011

This year has been challenging to say the least. February's earthquake, extreme weather events and global economic uncertainty have meant we've all being doing business in what remains a very testing environment.

Yet despite the adversity there have also been things to celebrate. A temporary rebuild is underway in Christchurch and new landmarks, like their containership CBD, are testament to their resilience, positivity and desire to get on with things. Rugby World Cup 2011 was a spectacular event which New Zealanders fully embraced. It was wonderfully capped off with an All Black victory in what was a nail biting finale.

2011 is a year which for many reasons, will not be forgotten. For many business owners, it's been challenging to get ahead - not quite as bad as the recession, but not great either. While the situation in Europe continues to play out, business owners are still proceeding with caution and this trend is likely to continue into 2012.

In this issue of Private Business Insights, we hope to provide you some simple but effective tips that can help you plan for the successful transition of your business.

We'll also share some simple business fundamentals to help you focus on growing the value of your business.

And we'll talk to Mike and Sarah Barr, Owners of Richmond Barr Electrical in Waikato as they share their experiences of buying out a local business in order to get ahead.

We hope you find this to be an insightful and useful tool.

If you would like to talk to me about your business or the findings discussed in this publication, I would love to hear from you.

We wish you all a safe and happy holiday season.

Happy Christmas

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Creating a smooth transition

Transitioning your business is one of the most difficult challenges you'll ever encounter as a business owner. The tough decisions today will affect your customers, employees and – most importantly – you and your family, for years to come.

Yet, ironically, these critical decisions are among those for which owners are often least prepared, since they are often faced just once in a lifetime. Owners may have decades of experience managing their business, but little or no experience with the monumental task surrounding their transition.

While each situation is unique and there's no one-size-fits-all approach, there is one golden rule: getting the best outcome depends on having a carefully thought-out and well-planned exit strategy.

Here are a few of the key things you should be thinking about...

Why think about transition now?

The earlier you start the transition planning process, the better your chances are of getting more value.

Ownership transfers are initiated for many reasons, most commonly:

- retirement of the primary shareholder
- competitive pressures
- death or illness of the owner
- financial difficulties
- readiness of heirs to take control of the business, or
- desire for liquidity and asset diversification on the part of the primary shareholder

In our experience, many owners delay planning because they are caught up in day-to-day operational demands, or because they find it difficult to acknowledge the time has come to think about letting go of their business. As a result, many businesses are reactive when it comes to planning for transition. At best, this can mean failure to maximise value and at worst, can see businesses fail in transition. Effective transition begins long before an actual exit.

Defining your objectives: the mission-critical step

Deciding what you want to do and then getting the best value for your business starts with a clear statement of your goals. Objectives will be both financial (return, sale price, tax and wealth planning) and nonfinancial (succession, legacy and reputation, employee and stakeholder concerns, family dynamic and so on).

Before you start, you need to answer some tough questions:

- What is really important to me?
- Why would I want to keep the business in the family?
- What are my financial needs?
- How important is it to maximise the value I receive, relative to other considerations?
- What kind of ongoing management role, if any, would I like to have in the business? For how long?
- How do I decide whether to retain a financial stake in the business?
- Who do I want to sell or transfer the business to? How do I choose among family members, employees, financial investors, competitors, or others? Why would I care?
- What managerial expertise is required for my business to continue to be successful? Who is willing and able to run the business? What preparation do they need for this role?
- What other motivating factors might affect my decision? How do I feel about the business keeping its name and identity following my transition?
- How important is it that my business retains its independence?
- How should the business be structured and financed to take advantage of future opportunities?
- What can I do to protect, reward, and retain my employees or others with a stake in the business?

Answering these questions needs a clear view of the strategic direction of the business. Whatever your decision, you need a clear understanding of your business priorities so you can choose the transition option that suits you best.

What are your key value drivers?

Value drivers are the real and perceived aspects of your business which enhance its value

Common value drivers include:

- Quality and reputation of your business.
- Cash flow and profitability.
- Customer relationships.
- Supplier relationships.
- Growth trends for key products and services.
- Distribution network.
- Intellectual property, such as patents, trademarks and brand.
- Quality and depth of your management team.
- Technology.
- People and intellectual development.
- Synergies expected from a merger/ acquisition.

Once you've identified your value drivers, you need to assess their strengths and take actions to enhance them. For example, systems may need to be upgraded to support growth; the balance sheet and cash flow may need to be improved, perhaps through cost-cutting or debt restructuring. The management team may need to be upskilled, and so on.

You need to be honest with yourself and your business. Look at the business and its operations through the eyes of a prospective buyer or ask a third party to do an assessment for you.

Position your business now

The amount of leverage you have is determined long before any negotiations with a buyer. Proper timing helps you invest in building your strategy, building your team and managing the process. Early planning gives time to understand the strengths of your business and identify and shore up any weaknesses. Ultimately it lets you embed value in the organisation and move it away from individuals, including yourself.

Early and effective planning provides knowledge to help you drive your exit process rather than letting potential buyers or others gain control.

Effective planning enhances value in yet another way, even as negotiations for an actual transaction occur. It gives you the best available information to make an informed decision whether to accept an offer – or walk away.

Through DealConnect we help connect buyers with sellers of privately owned businesses. If you are looking to buy or sell a business, or would like more information about our Business Transition services, please visit our website www.pwc.com/nz/en/business-transition

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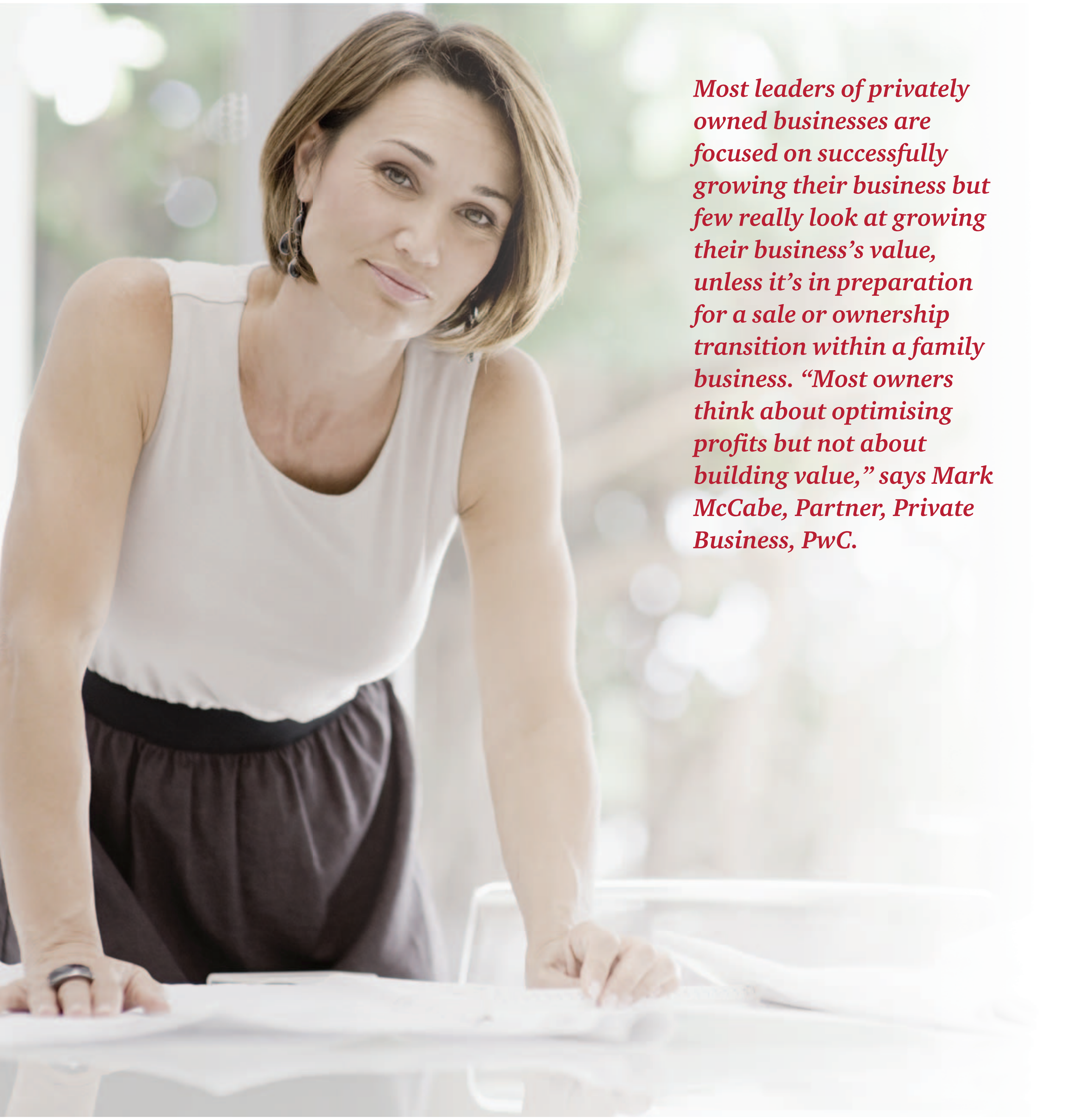
You're growing your but are you growing



Most leaders of privately owned businesses are focused on successfully growing their business but few really look at growing their business's value, unless it's in preparation for a sale or ownership transition within a family business. "Most owners think about optimising profits but not about building value," says Mark McCabe, Partner, Private Business, PwC.

business
its value?

That's a mistake because beyond preparing a business for sale, there are several key reasons to grow value: the first and foremost, the business' value will typically represent a huge percentage of an owner's personal net worth. From the business's perspective, growing value can play an influential role in attracting new financial stakeholders, strategic joint ventures with suppliers and/or customers, as well as in attracting and retaining key employees.

Unfortunately, many private business leaders, particularly those who have never gone through the experience of a business purchase and sale transaction, do not have a good understanding of what the actual value of their business is. "Without that knowledge," says McCabe, "you won't know how to grow it." That's because growing value begins with an accurate assessment and understanding of your business's current value and then setting a goal for what you want it to be within a certain time frame.

Solid business fundamentals are critical to growing value. "There are two key questions business owners should be able to answer. On a scale of 1 to 10 with 10 being great, give me a ranking to the question "are you reaching your profit potential?" It's an inverse way of talking about value. When there is room for improvement, most owners immediately think top-line sales; new products; new geographic markets. The next question is 'How would you grade the quality of your business processes?' In order to create and crystallize business value, you have to have a solid business strategy supported by an effective operation. I believe the fundamentals of business strategy linked with performance management capabilities facilitate growing value.

Bottom line: it's always important to create value and have a clear assessment and understanding of what that value really is. Here are a few key strategies to help you do just that.

- ***In many businesses, there has to be a clear distinction between business value which includes goodwill versus the personal value and goodwill associated with the owner.*** "You have to separate the two out because often the business is the individual," says McCabe. "Building value is about building an excellent management team where the owner is not integral to the ongoing and future success of the business. If the success of the business is highly dependent upon the owner's involvement, the enterprise value of the business will be reduced, this is in contrast to a situation where an owner has built an executive team who can carry on the continuity of key relationships (customer, suppliers and people) if he/she wasn't there. This is a big part of building value."
- ***Create a strategy plan or map.*** "it's rare you see small and medium businesses prepare a strategic business plan but an owner should be able to speak to the primary components of a strategic plan," says McCabe. "The strategy should address numerous key questions which include: How do you create barriers to entry for competitors?"
- ***How do you create proprietary processes?*** What is the quality and effectiveness of your business processes in order to achieve your goals? How do you enhance business strength by way of building a management team? "It is only when you have a clear, comprehensive business strategy can you come up with goals and objectives for both the short term and long term," says McCabe. "The link between the ability to execute on those goals in an area where some entrepreneurs don't spend enough time. This area is called performance management."
- ***Almost every single business irrespective of size will have the same five functional parts or performance management drivers:*** marketing/sales; people/HR; finance; operations; governance, which includes communication, leadership and effectiveness of decision making. "The deeper a business owner can take me through the quality of those five functional business parts and the more interdependent they are is an indicator of stronger business profitability and value," says McCabe. "It's those performance management drivers that facilitate the achievement of goals and objectives.
- ***Maximising annual profits is important, but for building business value you should set longer term strategic goals and objectives to create a plan for long term success.*** "When you do, by definition you are creating long term value," says McCabe. Building value takes time. In fact, it will likely take between two and five years to effect the strategic and operational changes necessary to enhance value, so don't leave until tomorrow what you need to start today.

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As I see it: a successful transition

*As part of our **As I see it** series, we interview owners and leaders of New Zealand private businesses. We hope you'll find their views insightful and they'll be helpful as you develop your own strategies and practices.*

Mike and Sarah Barr's electrical business was booming until the recession changed the game. The Barr's had some big decisions to make - they could do nothing, or they could take a risk and throw all their energy into growing their Waikato business. We catch up with them at their Hamilton office to see just how far they've come.

You started Barr Electrical from scratch 13 years ago. Why did you decide to go into business on your own?

"I was working as an electrician but really wanted to run and build my own business. We bought a van and went from there. It worked well with me being the electrician and Sarah being able to manage the finances and administrative side of the business."

What was your business like before the recession?

"Before the recession our business peaked. Construction was booming and high end houses were going up everywhere, the kinds of people building these houses wanted high spec finishes so there was increased demand for some of our more specialist services like designer lighting, landscape lighting and automation services. Demand for general electrical maintenance work, which is our core service offering, was also the best it's ever been."

"Things were going smoothly" says Sarah.

So the recession hits. What did it mean for you and what changes did you make?

"Three years ago we were fortunate enough to be in America and saw firsthand what was coming our way," says Sarah. "It was frightening. We came straight back home and talked to Roger Wilson (Managing Partner at PwC Waikato) about what this would mean for us and our business."

"When the recession finally hit New Zealand, we had to make a lot of changes. The construction industry staggered to a halt so most of the high end work dried up which affected our cash flow. We had to have a shared focus on maintenance and that helped us through the recession."

"We put all our costs under the microscope and made cut backs wherever we could. We made a couple of redundancies and took some of our vehicles off the road. It was a very difficult time and we were worried about keeping our team intact and maintaining our client service."

You decided to take a risk and grow your business. How did you arrive at this decision?

"About a year after the recession hit we felt like we were just treading water, so we had a ***Come Think With Us*** session with Roger Wilson and some of the PwC team and threw around some ideas about how we could grow our business," says Sarah.

"A key challenge facing our industry is we have a lot of electricians in the 50 to 60 age group who own their own businesses and are looking to retire in next two to five years," adds Mike. "While this is a challenge for our industry, as both Sarah and I in our thirties, this issue presented us with an opportunity.

We decided the best way to grow our business was to buy an existing business from an owner who's looking for a way out. Although we were still in a recession, it was crunch time for us. We had to take a risk and make our move."

Buying a business isn't an easy process. How did you go about it?

"Roger and PwC's Business Transition team, led by John Dobson helped us to identify and approach a few local businesses which were similar in size, structure, and values to us," says Mike. "They also had to have a good brand reputation," adds Sarah. "That's how we found Noel Richmond from Richmond Electrical, it was a good fit."

"Over the next year we worked closely with Roger and John on the transition process," says Mike. "It was more difficult than we thought, especially when it came to determining the value of the business. We spent a lot of time around the table and finally came to an agreement to buy part of Noel's business. The process took a lot longer than we thought so we were glad we started when we did."

"It was great having PwC there," says Sarah. "They helped us prepare everything we needed to present to our bank. At the time banks weren't lending, so we weren't sure we'd get the green light from them. While the process was exciting, it was also nerve racking. There were a lot of sleepless nights!"

"We still remember getting the phone call from the bank with the good news. Throughout the entire process we were honest and upfront with the bank about where we were and where we were going. We had a good plan and we stuck to it and I think that made the difference."

You merged the two businesses and started trading as Richmond Barr Electrical over 18 months ago. How are things going for you now?

"We've got a great team, great relationships with our customers and we're now starting to see the results of all our hard work. Our turnover's up and well ahead of budget, so we feel like we made the right decision," says Mike.

"Taking over another business was challenging," says Sarah. "We introduced new procedures and at first we were concerned about the challenges around merging another business with our own, while staying true to our vision of success. We've got a great team now."

What's your secret to success?

"We keep learning every day," says Sarah. "The recession taught us many things and we've learnt not to take anything for granted. The key to our business is to maintain good relationships with our customers and to keep an attractive environment for our team. It's important for us to invest our time into looking after them."

"We're much more focused now," says Mike. "Our goal is to become the best service electrical busines in Waikato. We have regular meetings with Roger and PwC which we value. Roger always tells us what we need to hear – not what we want to."

Your PwC local teams

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