financial **snapshot**

Nothing succeeds like succession planning

Small business is generally regarded as the backbone of the Australian economy, but that strong back is showing signs of age. With 30 per cent of all small business owners aged on the wrong side of 55,[i] it is important to have a succession plan in place.

Ideally, succession planning should begin when the business is formed to ensure a smooth transition if and when the need arises. But all too often founders put succession planning in the too-hard basket, leaving themselves open to financial and emotional stress when the decision is thrust upon them.

There are a number of reasons why this is the case. Fear of death, reluctance to hand over control, difficulty choosing among children or a refusal to acknowledge the need for planning.

Handing over power to a new generation is a tricky process in any corporate environment. Rupert Murdoch, at age 83, has only just anointed elder son Lachlan as his heir apparent after years of playing his children off against one another.

A cautionary tale

Large organisations devote significant resources to finding and grooming chief executives and board members, and small businesses can learn from their example.

But sometimes even the most successful companies get it wrong.

Computer software giant Microsoft recently drew criticism for its handling of the appointment of a chief executive officer to replace Steve Ballmer.[ii] After 14 years at the helm Ballmer announced last August that he was stepping down. The company did not announce a successor immediately, instead signalling it would happen within a year. To make matters worse, at around the same time Microsoft founder Bill Gates announced he would step aside as chairman to make way for an independent non-executive chairman.

Nothing succeeds like succession planning continued

This created a leadership vacuum and wild speculation in the press about likely external candidates. The company also gave conflicting signals about its future direction. It took five months to appoint Satya Nadella as CEO. Given that he had been with the company for 21 years observers wondered why the succession had not been organised earlier.

Canvass your options

Many small business owners hope to keep it in the family by handing the baton to the next generation. That is an option but it is not necessarily the best one.

Appoint a family member

Handing control to an adult child or another family member does have many advantages provided the chosen individual is qualified and willing to accept the role. But that is not always the case.

On the positive side, it ensures the founder's vision for the business has a good chance of outliving them, they can maintain some influence over the company after they retire and have the satisfaction of knowing that their life's work has been of benefit for future generations.

Appoint a manager

If there are no suitable candidates within the family, an outsider can be appointed. This might be an individual already employed in the business or an external manager. Sometimes a temporary professional manager is appointed to bridge the gap and perhaps mentor a family member until the are ready for the role.

The most important issue for family businesses turning to an outsider is trust. The family must be confident that the company, and their interests, will be in safe hands?

Sell as a going concern

Sometimes the best option for an owner is to sell the business and move on to new challenges or retirement. Options include a trade sale, stock market flotation or a management buy-out.

With a stock market float the founder can retain equity and cash in some of the value they have built in the company while raising capital to fund future growth.

A management buy-out is a compromise solution to ensure continuity of the business without having to sell on the open market.

Liquidate

The least palatable option is to sell off the company's assets, settle all outstanding debts and close the business. This is generally seen as the last resort because it can be costly and is unlikely to raise as much money as the sale of the business as a going concern. There may also be an emotional cost in having to let loyal employees go.

Do nothing

Burying your head in the sand is the default option and unfortunately it is all too common. By the time the founder is no longer able to run the business, or the business has struggled for many years, a fire sale may be the only option left. And unfortunately, that is the least profitable outcome.

Succession planning begins with owners and managers incorporating succession planning into their business plan from the outset. Your adviser can help you initiate discussions about succession planning for your business and ensure you are prepared for the future.

i ABS, Small Business: An economic overview, May 2012. http://www.abs.gov.au/websitedbs/d3310114.nsf/4a256353001af3ed4b2562bb00121564/d291d673c4c5aab4ca257a330014dda2/$FILE/RBA%20Small%20Business%20An%20economic%20Overview%202012.

ii 'Microsoft appoints Satya Nadella and demonstrates how not to appoint a CEO' by Andrew Cave, Forbes, Feb 4, 2014.

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