

Relationship-Driven Business Succession



Extension
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Outline for today

- Why a session on business succession assistance?
- Nuts and bolts of business succession
- Approaches to business succession assistance
- Toward comprehensive frameworks for business succession assistance
- Storefront succession



**Why a session on
business succession
assistance?**



A crisis of transition

- 6 of 10 business owners in Wisconsin plan to sell in the next decade
- 51,000 Wisconsin firms are owned by baby boomers, HALF of all privately held firms
- 80% of private business owners have no written transition plan, and 50% had not done any planning.
 - 99% of owners agreed that having an exit strategy was important to their future and the future of their business.



2024 Main Street America National Trends Survey

- Which of the following services or programs does your organization currently manage or administer? *401 respondents*
 - Support for entrepreneurs and small business owners **87%**
 - Business/social networking events or support **70%**
 - Business succession assistance **14%** *bottom response*



Why a session on Business Succession Assistance?

2024 Main Street America National Trends Survey

- Which of the following services or programs that you are not currently managing or administering would you like your organization to manage or administer in the future? *359 Responses*
 - Business succession assistance **32%** (14%) *top response*
 - Business/social networking events or support **13%** (70%)
 - Support for entrepreneurs and small business owners **9%** (87%)



Why a session on Business Succession Assistance?

Nuts and bolts of business succession



First question: Is the business a transferable entity?

- The business is not dependent on a specific individual with skills or relationships that cannot be transferred.
- The business generates sufficient cash flow for BOTH market compensation and return on investment.

from "Succession Planning: It All Begins With Understanding & Increasing Business Value", Cathy Durham, Capital Valuation Group www.capvalgroupp.com, February 12, 2021.

- Not a transferable entity? Storefront succession.



Example: Joe's Barbershop

- Single chair barber, no employees
- Cash business
- Clients go there for Joe, not for a future owner.
- Due to health issues, shop is now operating 3 days/week.



Options for succession

- Retain family ownership and management control
 - Retain ownership but hire outside management
- Sell to someone other than family
 - Sell to upper or middle manager
 - Sell to group of employees – Worker Cooperative, Employee Stock Ownership Plan (ESOP), Employee Ownership Trust (EOT)
 - Sell to customers – Customer Cooperative
 - Sell to an outsider
- Hybrid (e.g., family/employee purchase)
- Donate/sell to local charity
- Close the doors, liquidate (the default in the absence of preparation)
 - Storefront succession



Example: Schroeder Brothers Department Store

- 133-year-old fifth-generation business
- Building and business owned by board of family members
- Sisters Theresa & AJ employed as day-to-day managers
- Ownership format allows for gradual transition/low overhead but also accommodates market adaptation



Customer or Employee Ownership

Board provides oversight, managers provide management

- Employee Stock Ownership Plan (ESOP)
 - A retirement plan. Each year, shares of company stock are given to the employees via a deposit into their retirement account.
- Employee Ownership Trust (EOT)
 - A type of perpetual trust. The employees are the intended beneficiaries of the trust. Wealth is created through the sharing of profits each year.
- Customer or Worker Cooperative
 - A “one share/one vote” system allows customers or employees to elect the board of directors and make other corporate decisions. Wealth is created through the sharing of profits each year.

Ryan Kauth, Executive Director, Wisconsin Center for Employee Ownership (WICEO), www.wiceo.org

Kristin Forde, Cooperative Development Specialist, UW Center for Cooperatives, www.uwcc.wisc.edu

See also: Community Supported Enterprises and Crowdfunding



Example: Artisans, Inc. Glen Flora, WI



- Apparel manufacturer & retailer
- Retiring owners, 72 employees
- Sale of business would have resulted in out-of-town buyer/likely downsize or closure
- Transition to ESOP using WEDC business loan



Types of Outside Investors

- **Third Party** – first time buyers
 - Finance with mix of down payment, bank financing and seller financing.
- **Personal** – friends/customers with means
 - Seller typically must finance transition over multi-year period (down payment and installments)
- Strategic/Synergistic – looking for businesses that compete, complement or partner with existing businesses
 - Price depends on duplication of equipment, employees, etc.
 - **May result in closure of the business by successor**
- Turn Around/Flip – looking for struggling businesses with low values
 - Goal of investing minimal dollars and selling quickly (**not as common for micro businesses**)
- Venture Capitalist – buy businesses with proven history, large-scale deals (**not as common for micro businesses**)



Example: The Wooden Chair



- Established 20-year destination restaurant
- Retiring prior owner listed the business with a broker
- New owners looking to return to restaurant industry and relocate to central Wisconsin
- Established a transition period, able to retain existing staff, menu and buildout
- Opportunities to refine over time, rather than start from scratch



Why family businesses fail to transfer from generation to generation

- Lack of viability of the business
- Lack of preparation
- Little desire on the owner's (predecessor's) part to transfer the business
- Little desire on the on the offspring's (successor's) part to join the business



Little desire on the owner's (predecessor's) part to transfer the business

- Fear of aging and death
- Reluctance to talk about financial affairs
- Reluctance to let go of power and control
- Fear of personal loss of identity
- Fear of losing work activity
- Feelings of jealousy and rivalry toward successor
- Procrastination and lack of preparation in general
“Let them figure it out when I’m gone”



The entrepreneur who successfully lets go

- Sound financial plan for retirement
- Activities outside the business that can provide social contact and power
- Goodwill toward and confidence in the successor
- Willingness to listen to outside advisors



Advisors

Social capital

- Predecessor needs to first determine their intentions, and then use professionals to find the best way to fulfill those intentions
 - Social networks can help them clarify their intentions
- Paid advisors should not dictate intentions for the predecessor
- Business Appraiser/Broker/Intermediary
- Asset Appraisers
- Accountant/CPA/CFP/Wealth Manager
- Banker
- Attorneys/Transactional Attorney
- Insurance Agent
- Business-for-Sale Websites
 - www.bizbuysell.com



Management succession

Social and human capital transfer

- Select a successor
- Help the successor attain legitimacy within social networks and critical relationships
 - Help the successor earn the trust and confidence of customers
 - Preparation for transferring the reputation and goodwill that's been built up over the years
 - Help the successor earn the trust and respect of employees
 - Preparation for transferring employee attachment and loyalty

Affects transfer of other intangibles like processes, customer loyalty, market share/brand identity



Example: Mugs Coffeehouse & roastery

- 6-year track record
- Gradual transition of coffeehouse to new management, retain relationship with roastery and management staff
- Closed for three months to train and renovate, reopen as Mugs & More



Training for the successor

Social and human capital development



- Formal education
 - Specialty of the business
 - Management
 - Business/accounting
- Experience at a job outside the business
- On the job/inside the business training



On the job/inside the business training

Social and human capital development and transfer

- Should have a job description
- Should be delegated responsibility and authority for certain tasks and relationships
- Should be supervised and evaluated the same as all employees
- Should be introduced into the predecessor's outside network
- Should be selected and integrated with help from valued, long-time key employees





Transferring ownership

Financial capital transfer

- “Value today is the present value of future economic benefits”
- *from Capital Valuation Group www.capvalgrou.com*
- Valuations:
 - Market-based (some businesses are more in demand than others)
 - Asset-based
 - Earnings-based (multiplier method)
 - A multiple of cash flow or multiple of EBITDA (earnings before interest, taxes, depreciation, and amortization)

More art than science (business appraiser)



Value greater than the sum of the parts

Location/facility +

Equipment/Inventory +

Manager/employee relationships, loyalty (*human capital*) +

Supplier relationships (*social capital*) +

Business processes/retail floor strategy (*human capital*) +

Customer list/relationships, brand recognition/loyalty (*social capital*) +

Contractual relationships (*social capital*)



The average buyer wants to purchase a turnkey operation

Among the 10 Commandments for selling a business

- Carry on business as usual (or better than usual)
- Let your business broker/intermediary create a competitive situation
- **Be willing to stay involved**



If same EBITDA, which has more value?

Factors EBITDA misses

from Capital Valuation Group www.capvalgrou.com

ABC Company

- High employee turnover
- 46% of revenues from one customer
- No contracts for future work
- Facilities at capacity
- Contracts with suppliers for raw materials
- New competitor just came to town

XYZ Company

- Low-no employee turnover
- 4% of revenues from one customer
- Contracts in place for future work
- Facilities at 60% of capacity
- No contracts with suppliers
- Competitive landscape unchanged



Six key business practices

Key to succession preparation as well as business success

- Detail the business processes (*human capital*)
- Set financial goals/cleanup financial statements (*financial capital*)
- Invest strategically in marketing (*social capital*)
- Capture customer information (*social capital*)
- Engage employees (*human capital*)
- Do a literal housekeeping, cleanup



Approaches to business succession assistance



Supporting business succession and transition

From University of Minnesota Extension

- Take the first step
 - Identify a **local champion team**
 - Conduct a **business inventory**
- Get organized
 - Create awareness of the importance of succession planning
 - Make a list of all resources available to sellers and buyers in your community
 - Identify strategies to reduce the four main reasons sellers do not plan for succession — **cost, time, confidentiality concerns, and lack of awareness of the benefits of succession planning**



Supporting business succession and transition

From University of Minnesota Extension

- Promote business health prior to sale
 - Promote business planning resources
 - Encourage businesses to **keep accurate financial records**
- Promote a successful ownership transition
 - Encourage owners to get a **professional business valuation**
 - **Connect** buyers to financing
 - Consider employee ownership options
 - Look for resources on seller financing (*financial capital*)
 - Community Supported Enterprises (*social, financial and human capital*)
 - Crowdfunding (*social and financial capital*)



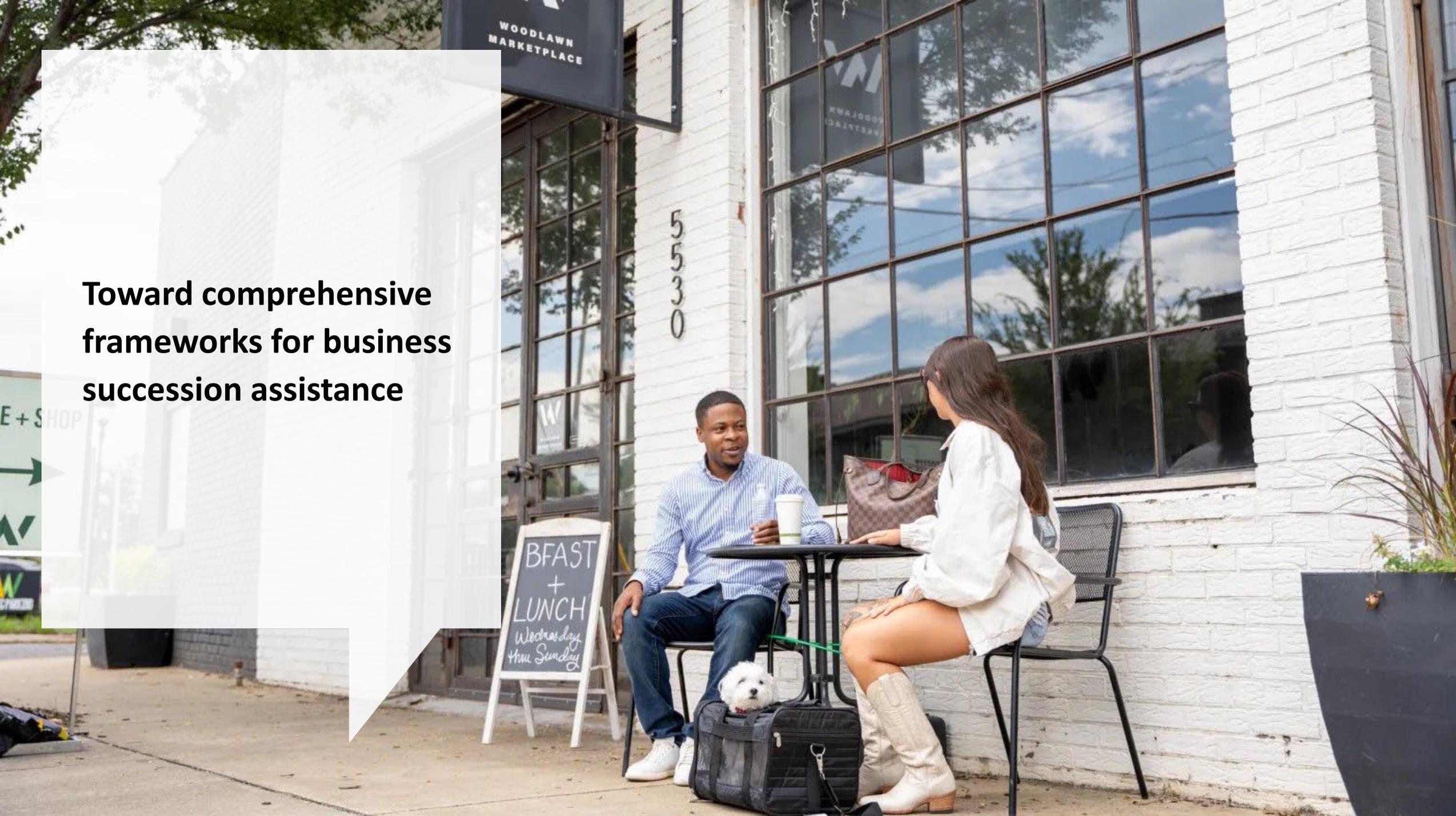
Supporting business succession and transition

From University of Minnesota Extension

- Promote a successful leadership transition
 - **Connect** new owners to resources that help with business operations
 - Create a community climate that **welcomes** new people and businesses
 - Develop or obtain a **leadership succession** guide template that could be completed by retiring owners for buyers
 - Encourage sellers to **mentor** the buyer

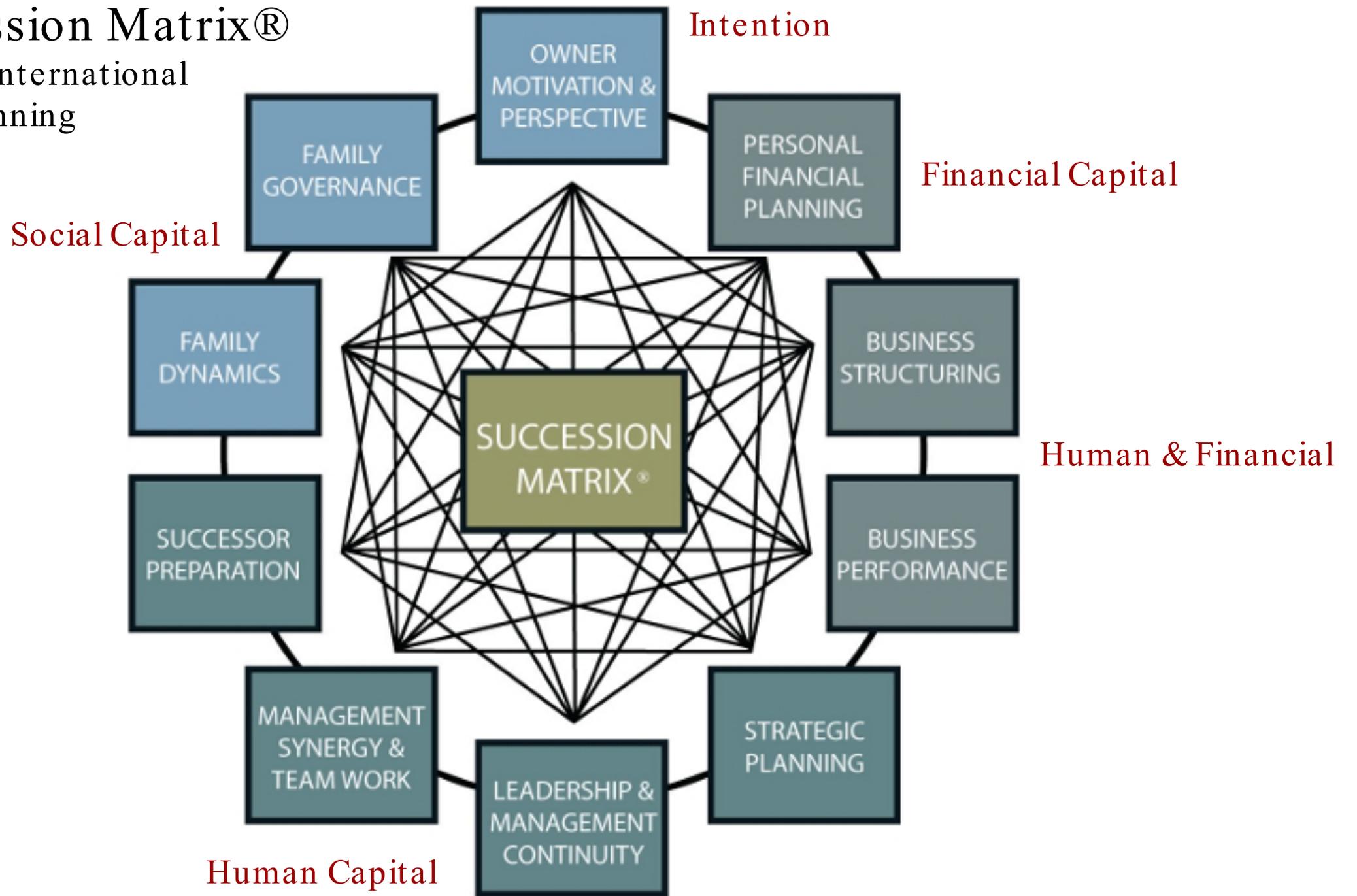


**Toward comprehensive
frameworks for business
succession assistance**



The Succession Matrix®

ISPA® Board (International Succession Planning Association)



Stepwise Business Succession Framework

Stepwise Succession	Social Capital (SC)	Financial Capital (FC)	Human Capital (HC)
Predecessor preparation	Inventory/map, evaluate, improve social networks – seek/select successor	Cleanup biz financials, appraise business – create competition to be successor	Dev. employees, delegate, document operations – seek/select successor
Successor preparation	Strategically build and doc. social networks	Cleanup pers. finances, assemble biz FC	Learn, train, experience
Transfer	Plan SC transfer, integrate social networks	Plan FC transfer, complete sale, tap financial incentives	Plan HC transfer, transfer operations, retain emp.
Successor success	Tap, transition and expand social networks	Increase/diversify revenue, decrease expenses	Engage and further develop employees/self
Predecessor success	Assume advisory role, est. new social networks	Receive financial return from sale	Start new venture (professional or personal)

Note regarding Built Capital (BC): Predecessor preparation and successor success to include improvement and maintenance of physical assets

Social Capital Driven Succession Support

Stepwise Succession	Social Capital (SC)
Predecessor preparation	Build & promote community social network/entrepreneurial ecosystem, help predecessor map & evaluate their pers./prof. social networks, offer successor search assistance
Successor preparation	Host conviviality events; connect successor with peers, mentors, cohorts; encourage successor to join trade association
Transfer	Celebrate succession, welcome successor into community social network/entrepreneurial ecosystem
Successor success	Help successor map & evaluate their pers./prof. social networks, offer network operation & management training including strategic marketing/public relations
Predecessor success	Welcome predecessor into new roles within community social network/entrepreneurial ecosystem

Financial Capital Driven Succession Support

Stepwise Succession	Financial Capital (FC)
Predecessor preparation	Connect predecessor with accountants/CPAs, appraisers/brokers, bankers, and CFPs
Successor preparation	Offer training on personal finance skills, create new and promote all business succession financial incentives
Transfer	Offer training on and facilitate gap and nontraditional financing including seller and crowd financing
Successor success	Teach best business practices including financial practices
Predecessor success	Connect predecessor with CFPs/wealth managers

Note regarding Built Capital (BC): Assist predecessor and successor with improvement and maintenance of physical assets, offer technical assistance and financial incentives

Human Capital Driven Succession Support

Stepwise Succession	Human Capital (HC)
Predecessor preparation	Offer training on detailing businesses processes and documenting operations including retail floor strategy
Successor preparation	Offer business training including for co-op and ESOP business models
Transfer	Share employee engagement and attachment techniques, invest in community placemaking
Successor success	Offer more business training, encourage successor to access training through their trade associations
Predecessor success	Support serial entrepreneurs, create roles for predecessors within community social network/entrepreneurial ecosystem

Note regarding Built Capital (BC): Assist predecessor and successor with improvement and maintenance of physical assets, offer technical assistance and financial incentives

Individual versus Community Social Capital

and Entrepreneurial Intention *(support intention clarification through community social network)*

Capital-driven Succession	Financial Capital-driven	Human Capital-driven
Individual Social Capital	Harvest/liquidation	Stewardship/biz retention
Community Social Capital	Entrepreneurial ecosystem (entrepreneur exit/entrance, storefront succession)	Social entrepreneurial ecosystem (triple bottom line - profit, people, and the planet)

“The findings show that the four facets of community social capital [participation in the local community, feelings of trust and safety, neighborhood connections, family and friends’ connections] have strong positive effects on an individual’s perceived self-efficacy, perceived desirability of entrepreneurship, and perceived social norms toward entrepreneurship which, in turn, have positive effects on **entrepreneurial intentions**.

Roxas, H. ‘Banjo;’ Azmat, F. (2014)

Storefront succession:

When the business is
not a transferable entity.

When the predecessor
did not prepare or
intends to liquidate.



Drawn from business succession

- Remember “Value greater than the sum of the parts”?
 - **Location/facility – still valuable in storefront succession**
 - **Equipment/inventory – may still be valuable in storefront succession (e.g., when one restaurant succeeds another)**
- Remember “Six key business practices”?
 - **Do a literal housekeeping, cleanup – still valuable in storefront succession**
- Remember “Conduct a business inventory”?
 - **Also conduct a building (storefront) inventory**



Storefront Succession = Entrepreneur Development

- Plant the seed for entrepreneurship and grow entrepreneurial spirit/culture (social and human capital)
- Grow entrepreneurial ventures: Phase 1 (social, human and financial capital)
- Attract entrepreneurs and field entrepreneur inquiries (social capital)
- Continue to grow entrepreneurial ventures: Phase 2 (social and financial capital)
- Proactively recruit entrepreneurs (social capital)



Stepwise Storefront Succession Framework

Stepwise Succession	Social Capital (SC)	Financial Capital (FC)	Human Capital (HC)
Predecessor preparation	Consult social networks to clarify intentions	Appraise assets, tally inventory	Prepare employees, write letters of recommendation
Successor preparation	Strategically build and doc. social networks	Cleanup pers. finances, assemble biz FC	Learn, train, experience
(P)cessor exit- (S)cessor enter	P. Exit old social networks S. Consult social networks	P. Sell assets/inventory S. Invest financial capital	P. Thank and release HC S. Hire human capital
Successor success	Tap and expand social networks	Increase/diversify revenue, decrease expenses	Engage and further develop employees/self
Predecessor success	Establish new social networks	Receive financial return from sale	Start new venture (professional or personal)

Note regarding Built Capital (BC): Predecessor preparation and successor success to include improvement and maintenance of physical assets

Stepwise Storefront Succession Support

Stepwise Succession	Social Capital (SC)	Financial Capital (FC)	Human Capital (HC)
Predecessor preparation	Build & promote community social network/entrepreneurial ecosystem	Connect predecessor with appraisers/brokers and CFPs	Help employees prepare for finding new employment or start a venture
Successor preparation	Host conviviality events; connect S. with peers, mentors, cohorts; encourage S. to join trade assoc.	Offer training on personal finance skills, create new & promote all business startup financial incentives	Offer biz training/coaching from middle school on, communicate/celebrate best business practices
(P)cessor exit-(S)cessor enter	Celebrate predecessor, welcome S. into community social network/entrepreneur ecosystem	Facilitate access to financial capital, reduce disincentives	Workforce development, invest in community placemaking
Successor success	Help S. map & evaluate their social networks, offer network operation & management training including strategic marketing	Teach best business practices including financial practices	Offer more business training, encourage successor to access training through their trade associations
Predecessor success	Welcome P. into new roles within community social network/entrepreneurial ecosystem	Connect predecessor with CFPs/wealth managers	Support serial entrepreneurs, create roles for predecessors within community social network/entrepreneurial ecosystem

Note regarding Built Capital (BC): Assist predecessor and successor with improvement and maintenance of physical assets, offer technical assistance and financial incentives

