
Value Management Inc.

The Investment Banking Resource

# THE M&A RESOURCE

VMI's Quarterly Investment Banking Newsletter


## In This Issue




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## *All in the Family Business*

Family business is alive and well in the United States. There are millions of families who have invested their time, talent and money to create their own version of The American Dream and become their own bosses! Based on IRS tax return data, there are over 33 million privately owned businesses in the United States, many of which are family owned. According to Forbes ("The Facts of Family Business"), family businesses generate over 50% of the U.S. Gross National Product ("GNP").

While family business owners are adding to the GNP and focused on the NOW - operating and maintaining their successful business – it is also important that they consider the WHEN – the time to plan for a successful ownership transition. If they think that now is not the time, family business owners should ask themselves this one question: WHAT IF? What if something happens to the owners?

Is the family ready to take over the business? Just as important, is the business ready for the family to take over?!

You've heard the statistics and they tend to support the opinion that many families and businesses are not ready and have not planned for an orderly transition let alone a forced change that arises from some type of emergency. That same Forbes article stated that less than one third of family businesses survive the transition from first to second generation ownership, and an additional 50 percent don't survive the transition from second to third generation. Fourth generation and beyond survivors are in the single digits.

This issue of *The M&A Resource* is devoted to family business and the planning necessary to successfully transition business ownership when the time is right.

## *Family Options and Resources for Planning*

There are various options available to a business owner when the time comes to transition his/her ownership. Oftentimes, the first choice is to pass the business on to the next generation. However, for a variety of reasons, this may not be a viable option. Hence, the business owner should consider alternative exit strategies such as: a management buyout; selling to an employee stock ownership plan ("ESOP"), putting the company on the market, or maybe even bringing in outside investors. Regardless of what exit strategy best suits the needs of the owner, the family, and the company, it is good practice to engage a team of professionals that can help in all aspects of the process and assist families achieve their goals. It's good to have options; it's better to know what they are and to understand enough about them to make the right choice, keeping in mind that the right choice for one family or business may not be the right choice for another. Families benefit by utilizing experienced professionals who have the resources readily available to help them understand how the various options would best fit a unique family situation.

Since 1991, **VMI** has worked with thousands of family businesses, spanning numerous industries and markets, and ranging in size from mom and pop


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businesses to those generating multi-billion dollars in annual revenue. **VMI**'s purpose is to help family business owners achieve their exit strategy goals, from valuing family businesses for estate planning and other corporate purposes, to representing owners in the sale of family businesses of all sizes. Not only is **VMI** in business to help family businesses, we are a family business!

As an investment banking resource, **VMI** utilizes a comprehensive network of trusted professionals serving the merger & acquisition, succession planning, and estate planning communities. One of our partners, Teleos Partners ("Teleos"), is a succession planning company that focuses on family business.

**VMI** had the opportunity to sit down with Brian Middleton, one of Teleos' principals, and get his thoughts on Teleos' family business succession planning process. Since 1979, Brian has worked with over 400 family businesses in the area of succession planning. With much experience working with families who own businesses, Teleos and Brian are well schooled in the unique challenges faced by family-owned businesses. Initially, the Teleos process focuses on and addresses the emotional, psychological, and spiritual aspects in successfully transitioning a family business' ownership. Presented below is the interview:

**VMI:** How does the Teleos process differ from typical, technical estate planning (which deals with wills, trusts, buy-sell agreements, insurance and the like)?

**Teleos:** The typical planning process presupposes that the issues surrounding estate and succession planning are technical in nature and can be solved entirely through the proper use of mechanical planning tools such as wills, trusts, buy-sell agreements and life insurance.

The Teleos Process begins with a recognition that succession planning and implementation is one of the most difficult challenges of an entrepreneur's career. The decisions made will ultimately determine whether a lifetime of work will retain its economic, as well as its emotional, relational and psychological value. All of these categories must be dealt with to have a successful succession plan. Ignoring these realities will often lead to unfulfilled expectations, compromised relationships, and decreased business value. Through our Readiness Assessment and clearly defined process, we are able to manage a process that effectively deals with all of the issues involved with succession.

**VMI:** When should business owners start planning for transition to family members or others?

**Teleos:** Ideally, the business owner should start thinking about succession as soon as they decide to start a business! Practically, however, serious discussions about intra-family succession should begin before the next generation completes its formal education. These early conversations should be intentional discussions that create appropriate expectations about criteria for entry into the business and future opportunities. The single largest source of conflict that we see in family businesses is when expectations do not match reality. Many of the expectations have been unintentionally set by casual conversations that were never clarified.

**VMI:** What are common obstacles to beginning succession planning?

**Teleos:** Common barriers for succession fit into four primary "readiness" areas. The first is family readiness. Are there unresolved conflicts from the past that get in the way? Are the communication patterns of the family effective enough to deal with the challenges of succession? How will you treat the children not active in the business?

The second is successor readiness. Does the next generation view succession as an opportunity or as an entitlement? Do they have the appropriate professional skills? Do they have a shared vision, value and purpose? Do they understand the commitment?

The third is business readiness. What are the voids created when the entrepreneur exits? Who will develop long-term strategy? How will the business be governed? Are the important processes that drive the business documented or do they reside in the intuition of the retiring owner?

The fourth readiness area is the entrepreneur himself. His/her role is not a job, it is his/her identity. Is he/she ready to live without the purpose and meaning that his/her role has given him/her in the family and community?

These are the barriers that need to be confronted and resolved to successfully navigate the waters of succession. The clearly-defined Teleos Process is a structured methodology that identifies and addresses the primary "readiness" issues specific to each business. It then provides critical tools necessary to address these issues, generates realistic options, and supports clients through the implementation phase with the goal of maintaining the economic and relational value of an entrepreneur's life work.

For a Succession Readiness Quiz or Real World Stories, you can visit the Teleos web-site: *http://teleospartners.com.*

## *The "When" is "Now"– We're Older Than We Think!*

Just in case the statistics on family business survivorship rates aren't enough to convince families that it's always good to have a succession plan in place for the family business, according to the U.S. Census Bureau's Administration on Aging ("AOA"), we're getting older! Based on AOA estimates, at least 20 percent or 1 out of every 5 people in the country is at least 60 years old. That means that there are currently over 64.4 million U.S. residents aged 60 or over! This compares to 1 out of every 10 in 1940 when there were 13.7 million. That number is projected to increase to 75.8 million and 101.8 million by 2020 and 2040, respectively, or more than 1 out of every 4 citizens.

## *Selling the Family Business and Staying Sane*

According to a Private Wealth Magazine article (which is the inspiration for this article and its title), approximately $10 trillion of private business value will transfer over the next ten years. While most families will agonize over the decision to sell, for many families it is the right answer as less than one-third of family businesses make it to the second generation. Given that just the decision to sell is often gut wrenching, it's good to have a plan in place to help families maintain even a semblance of mental and emotional normalcy during the process. The process begins by finding competent advisors with whom the family feels comfortable and can trust to help them understand what to reasonably expect.

A big concern for any business considering sale is confidentiality. Without an advisor, the family and the business are more exposed to information leaks. Discretion is the better part of valor, and key for family companies to continue business as normal while generating as much interest as possible in the business.

An experienced advisor will lay out the process, and help the family to know what to expect and when to expect it when putting the business on the market. Generally speaking, businesses need time to prepare to go to market. Even if the plan isn't a full-blown market sale or auction (where numbers of buyers are contacted simultaneously and given a limited period to express their interest), the family and business still need time to get ready for a sale. If the family and business are in good shape, six to eight weeks lead time is not uncommon, including the time it takes to find an advisor, figure out value, structure the sale, and factor in the family's tax planning. This time may also include the preparation of the company's information for presentation to potential buyers.

Identifying, contacting, and qualifying potential buyers is typically the next step. The advisor will secure a non-disclosure agreement ("NDA") from any suitor that expresses interest, after first making sure that they are earnest in their desire to buy, and that they have the financial capacity to complete the contemplated transaction. Even when dealing with companies worth tens of millions, there are tire kickers and competitors who may be fishing for secrets of success or exploring new areas to enter. Imagine a family trying to manage all of that while doing what they normally do – running the business.

Once buyers are found and qualified, soliciting indications of interest could take several weeks. Here, it's not just seeing who offers the highest price, it's determining the right fit in terms of post-transaction growth and success, defining the roles and desires for key management and personnel, examining and refining the transaction structure that suits the family's goals, as well as laying forth the ground rules and timing for the buyer's due diligence, completion of documentation, and ultimately, the closing.

While indications of interest lead to negotiations which lead to a letter of intent with the selected buyer, more negotiations are to come during the buyer's due diligence, which can last three to ten weeks. It is at this point that it truly takes a team of professionals to ensure that the family's goals are targeted and its interests are protected. It's not uncommon for buyers to work over the seller, and the typically non-binding terms of the letter of intent. Many subtle legal battles unfold, and tax implications and strategies, both big and small are analyzed, assessed and implemented to ensure that what seems like a good deal for the seller actually turns out to be a good deal after all the documents are signed, checks are cashed, and keys are turned over.

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Even with a team of advisors, ample preparation, and a defined process, selling the family business is still stressful. However, by managing the process in a professional manner, the stress and anxiety can be kept in check, and the true mental demons can be avoided by getting help dealing with the devil in the details.

## *Do Unicorns Exist For Some Family Businesses?*

Most of us know unicorns as legendary animals that have been described since antiquity as a beast with a large, pointed, spiraling horn projecting from its forehead, so why would anyone want their business to be described as one? Well, because in tech parlance, as reported in a recent issue of The Week, unicorns are startups valued at $1 billion or more. The article continues on to say that while once considered rare, there are now some 142 unicorns that roam the land, with a collective value of $506 billion. Some, like Uber, Airbnb and Dropbox, have become household names and may have been touted as possibly changing the world.

The vast majority of unicorns lose money hand over fist acquiring customers, hoping they will eventually acquire a "nice cozy monopoly." Once that happens, goes the thinking, then they will get serious about making a profit. During the dot-com era, most burned through piles of cash, then abruptly went out of business when the money ran out.

Some of the investors in unicorns are now sounding the alarm that magical thinking about young, unprofitable companies has dangerously inflated a new tech bubble. The enchantment of the unicorns is wearing thin for many of the venture capitalists who gave these firms their multibillion-dollar valuation in the first place. It is expected that there will soon be some dead unicorns.

Unlike the dot-com bubble of the late 1990s, this bust won't hit individual investors hard. These tech start-up have largely shunned going public in favor of the private markets. If they begin to implode, just the startup founders who are paper billionaires, and some venture capitalists will feel the hard fall back into reality!

**ABOUT VMI INVESTMENT BANKING.** **VMI**'s investment banking division is a boutique financial consulting firm focusing on selling businesses and identifying acquisition targets in the lower middle market while also providing strategic merger & acquisition consulting services. **VMI**'s investment banking professionals are experts in financial analysis who have been involved in over 100 transactions, and have worked with thousands of family-owned and other privately-held businesses, partnerships, trustees, boards of directors, and other corporate owners and advisors. Our newsletter is published quarterly and does not constitute legal or financial consulting advice. It is offered as an information service to **VMI**'s clients and friends. Those interested in specific guidance for legal and accounting matters should seek competent professional advice. Inquiries on specific transaction matters are welcomed.



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