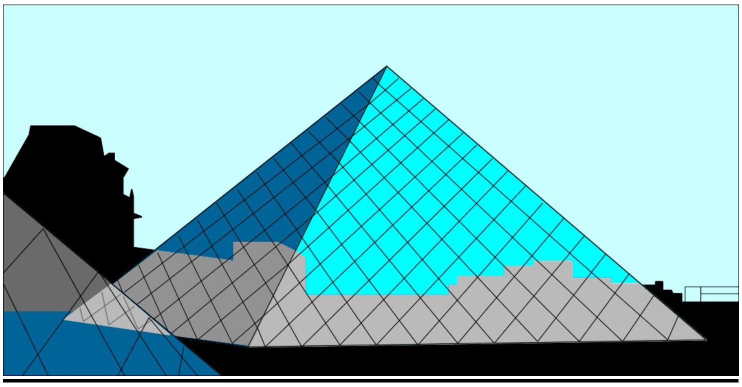
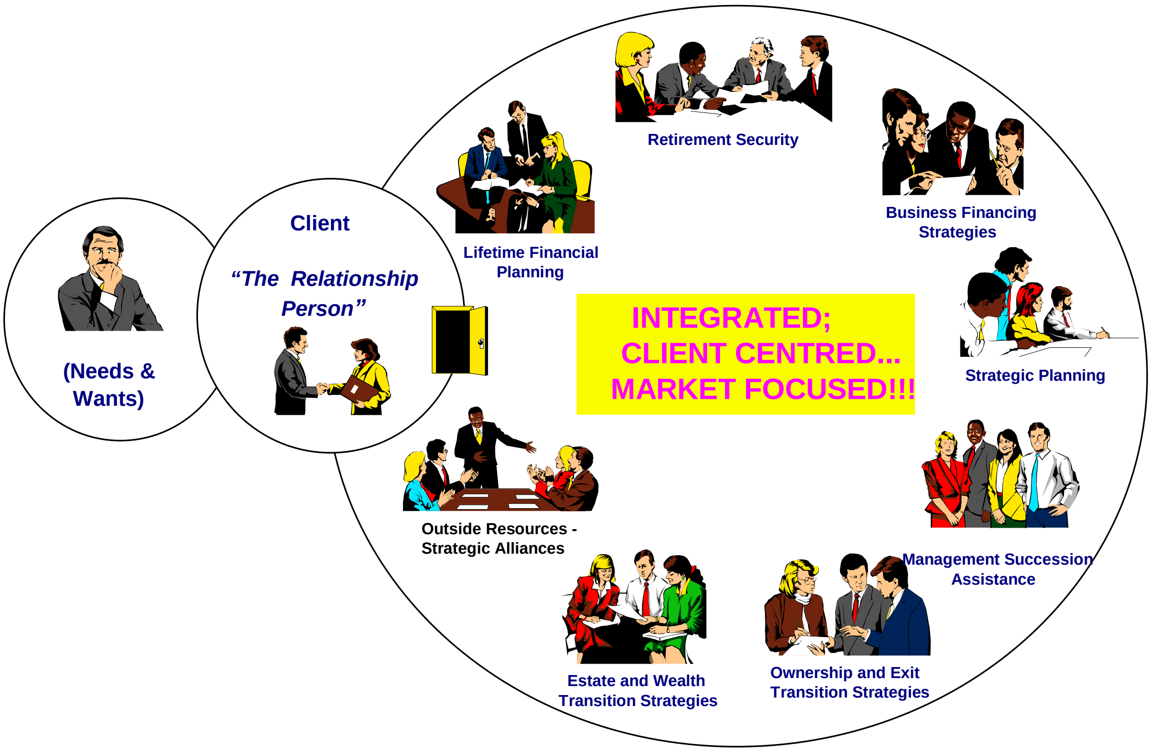
OWNERSHIP TRANSITION



“Looking after you….. our client”



Ownership Transition

Introduction

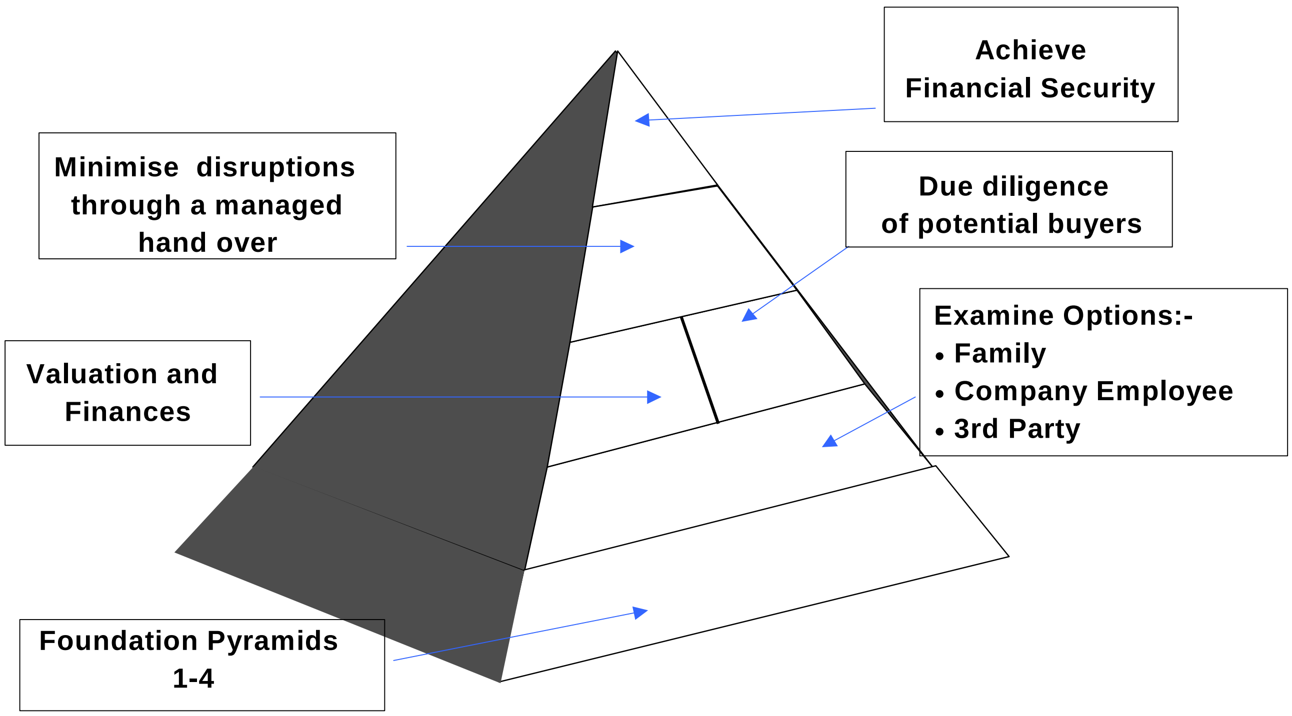
When owners desire to transfer ownership to family members or employees, these questions must be answered:

(a) How will the valuation of the business be determined?

(b) Do family members and/or employees have access to enough of their own capital to purchase their ownership interest?

(c) If they need to borrow the capital, how will the financing be arranged and what will the impact be on future internal operating cash flow for the business?

(d) If it is determined that a third-party buyer is warranted, who will profile and pre-qualify buyers, and how will the transaction be negotiated and executed? We work with our clients to evaluate ownership transition alternatives and determine viable financing strategies that accomplish their ownership transition goals without impairing the future operating environment.



Ownership Transition

What is Involved in Succession Planning

Succession planning is a process involving:-

- Transferring management control;
- Transferring assets;
- Determining and communicating with potential successors;
- Preparing any children as potential successors;
- Estate Planning;
- Financial Planning.

This is a detailed process which involves more that putting together wills and valuations of a business. Succession planning, ideally, should start when the business is putting together its business plan.

Statistics Succession Matters - The Australian Family, Business Survey 2000

- 30% of enterprise owners plan for their succession;
- 83% of all private sector firms are a family business;
- Employ more than 50% of the workforce; and
- Represents three times the capitalisation of the entire Stock Exchange listed domestic companies.

Despite the economic significance, most family owned businesses struggle to survive beyond the first generation due to lack of planning.

The typical average business owner is 57 years of age.

Need to understand the difference between ownership transition and management succession.

Management Succession

The management issues remain focussed on

WHAT	changes will occur;
WHO	will run the operations;
WHEN	will they be accountable for results; and
HOW	the results will be measured.

"*If you can measure it, you can manage it*"

Ownership Transition

WHO is to take control:

- family;
- company employees;
- third party

WHEN when will this occur; and

HOW will it occur.

Before the ownership transition plan we must have the management succession plan in place.

The ownership transition plan requires the future owners to be nominated.

The characteristics considered important for successors are:

- Integrity;
- Commitment to business;
- Intelligence;
- Decision making qualities; and
- Self-confidence.

In reality, many fathers continue to leave their business to their sons and daughters.

With Ownership Transition, there are a number of key issues that need to be demonstrated:

The size of the sector and upcoming generational change:

- Upcoming generational changes with SME means that business transfer will not occur monthly and will require proper planning;
- 60% of all family business owners plan to retire in the next 10 years;
- $607 billion in business assets will be transferred to other parties.

Interests of families and business partners are not always the same:

- Need to protect both sets of interest in advance;
- Family of the departed person and the surviving business partners often have mismatched interests;
- Many private businesses are the key part of the owners financial security;
- Protection of the business and family interests is an important part of the owners financial plan;
- Need to have appropriate mechanism to calculate the value of the business equity;
- Require a necessary funding mechanism in place to buy out each owner's share;
- Need to avoid conflict between families and business partners:
    - loss or disability of a loved one brings high emotion;
    - these feelings may be combined with a sense of financial insecurity.
- The transition needs to be done in a calm and rational way.

Funding the Transfer of Ownership

- Many businesses have not properly funded the transfer of business;
- Require documentation for the form the basis of valuing the business;
- Define a funding mechanism to buy out the departing partner or their family;
- Define the businesses current value and ownership status and a provision for any tax (including CGT) liability.
- Common source of funding would include life insurance with appropriate provisions for death and permanent disability;

Ownership Transition

Why The Owner Sells

- To grow the business needs additional equity from third party;
- Owner achieved business objectives;
- Business too big, “tiger by the tail” and requires new management team;
- Share ownership – management layout;
- Estate planning – sell part or all of business;
- Timing is right - industry is strong and business performing well;
- No identified successor and owner wants to develop a new owner partner.

Objectives to Consider

Personal:

- Does owner want to be involved in the future?
- Does the owner need a specific cost amount?
- Are there employees who rely on the company for future security?
- Are there key employees whose owner wants to reward;

Business:

- Is the business profitable and growing?
- What are the opportunities for future growth?
- Is additional capital required for growth?
- Is the business a leader in its niche or industry?
- Does management want to strive for niche or industry leadership?

Developing the Plan

One way to sort through these issues is to develop three plans: a Family Plan, a Business Plan and a Succession Plan.

The Family Plan

- Are those who are not currently active in the business allowed to enter? If so, when and with what experience?
- Is it "okay" to talk about leaving the business if one of us isn't happy?
- How does our family view the wealth that has been created? What income is needed for withdrawing owners?
- Does the business financially support inactive family members? If so, for how long?

The Business Plan

- What industry issues impact us today?
- What competitive issues do we face?
- What changes (if any) do we need to make? How can we monitor our results?
- What basic values do we hold collectively as owners and managers? What values do we not unanimously agree upon?
- What do we need to understand from our company's financial statements?
- What investments does our company need to make for its future?
- What is the value of the business and what can we do to enhance that value?
- What risks should we not take?
- What can we learn from business cycles we've gone through? What is our "free" cash flow?

The Succession Plan

- Who will be the future owners of the business? What method or combination of methods will be used to transfer legal ownership to successors? What involvement will withdrawing shareholders have in future decisions?
- When will a transition occur and what will it be contingent upon?
- Is active participation in the business required for ownership? Can non-family (key employees) become owners? Can inactive family members hold ownership?
- Will there be a distinction in voting rights for different owners; i.e., some holding nonvoting stock and other owing voting shares?
- Are there existing shareholder agreements – also known as stock redemption or buy/sell agreements – that influence or restrict the ownership decision? Will those need to be amended?

Should You Keep the Family Business in the Family?

If participants are not willing to make commitments or to compromise on issues, selling to a third party may be in the best interests of the family and the business. If there are no family members to succeed the current owner and no cash-rich buyers on the horizon, key employees may be interested in buying the business. However, there is generally an overall sense that perpetuating the business keeps the family together.

Ownership Transition

After the data from the questions has been collected we should prepare a written report to be presented to the business owners. The information should discuss the findings and the family's ability to adopt to change. The implementation is only findings and recommendations for change should be optional.

FAMILY PLAN CHECKLIST

- What are the current assets, investments and liabilities?

- What are the cash requirements for the future?

- Does the family have adequate insurance?

- Have we distinguished between the family assets and the business assets?

- Are we selling the business to:-
  - A third party?
  - Family member?
  - Employees?

(Is there is an option for management and ownership succession?)

- Does the business need to be restructured prior to transition?

- Is the owner ready to retire?

- Do they want to stay on?

- Are the other family members who may be staying on adequately skilled?

SUCCESSION PLAN CHECKLIST

- Is there a written succession plan?
- Has the succession plan been communicated to all relevant family members?
- Is there a strategic plan for leadership in the business?
- Has estate planning been considered?
- What commitment do we have from all family members?
- What will their role be in the future of the business?
- Are there any contingency plans for forced sales, insolvency etc?
- How strong is the management team?
- Do we need additional external advisers for a management team?
- Is the family culture likely to be a problem for successors?
- Can the owner let go of the business?

CHECKLIST FOR SUCCESSOR

- What do you want from this business?

- How will you contribute to the business?

- Do you have the qualifications and skills?

- How will you interrelate with existing family members? – (Note: The successor is joining the family – owned business.)

THE ACCOUNTANT - AS THE ADVISOR

What Strategies Should Accountants Provide?

- Provide owners with reliable information to develop a succession plan with a time frame;

- Help owners cope with retirement – “to let go”

- Assist with a network of business peers who have retired to share ideas, thoughts and experiences;

- Assist to build a strong management team with independence;

- Establish appropriate relationships to ensure strong foundations for a successful consultation.

Succession Planning – Requirements for Advisors

- Have strong interpersonal skills;
- Able to establish trust with family numbers;
- Prepare for long term relationships;
- Understand the family;
- Able to prepare and install a successor;
- Avoid conflict;
- Be proactive;

Questions to be Asked of the Business Owner(s)

- What is the history of the business?
- When and where did it start?
- Who started the business?
- How has the business grown?

- What are the current strengths and weaknesses?

- Who contributes to the business?

- What do we expect for the future?

- Who are the senior managers?

- What expectations do we have for current children and their respective spouse?

- Are the current employees worth retaining?

Questions for the Owner - of the Business

- What is special about this business?

- What features make it successful?

- How dynamic is the market place for the business?

- What market share does this business hold?

- Does the business have a strategic plan?

- Does the business have a business plan?

- What are the major clients and suppliers?

- What would they say about the business?
- Who are the key employees?
- What would they say about the business?
- How will employees react during the transition?
- What strengths and weaknesses does the business have?
- How financially stable is the business;
- Should the business be sold?
- If the business is sold, what effect will there be on other family members?
- Is there a strong management team for the future?
- Can the sale of the business to family members be funded by the owner without limiting future growth requirements?
- How healthy is the business?
- Do we know what the business is worth?

Questions for the Owner - of the Family

- What does the family think about the business?
- How vital is the business to the family?
- What is the family plan in what they want from the business?
- What are the family members' goals and objectives?
- Is there a commitment for succession?
- Does the owner know how to let go?
- Have you considered how much you need in retirement?
- Does the family understand the business structure?
- How important are the family to the business?
- What members of the family would not like change?
- How healthy is the business? Can it support the lifestyle of all family members?

TRANSITION EXAMPLE 1 : BROWN BROTHERS

The Brown Brothers Winery Story, which follows, is an example of the way in which family businesses have worked towards professionalising their firms and dealing with conflict.

Case Study: Brown Brothers Winery

The Brown Brothers, a well known winery in the state of Victoria, have laid down a set of guiding principles for sons and daughters wanting to make a career in the family wine business. The rules state that each applicant must have worked somewhere else for at least four years, and must apply, like everybody else, to the board. A suitable opening must exist before they will even be considered for employment.

Cynthia Brown and her brother John junior are the first of a new generation at the wine conglomerate to meet the recruiting criteria. Both have a university education and had careers at BHP (a large Australian energy and mining multi-national company). Cynthia, 27, in human resources and John, 30, in engineering and information technology. ‘I always wanted to come back and work with the company since I was a little kid’, says Cynthia, who is now overseeing marketing operations. ‘I like the culture here. There’s love and passion around the place not just from the family, from the staff as well’, she adds.

The ambition to return was shared by John, who is restructuring the company’s information technology. ‘It was always my intention to come back. I gave myself 10 years when I left university but it turned into five.’ Working for the family company rather than BHP means decisions are made more cautiously. ‘We don’t move as quickly as we might. But if the truth be known, you’re spending your own money and that makes a difference’, he said.

Succession planning has been exercising the collective minds at Brown Brothers for some time. The current blueprint will see Ross Brown, 53, currently in charge of strategic planning; take over as managing director from his older brother John senior in the next few years. But that is just a stop-gap measure as Ross says he is not interested in holding that job beyond 60. ‘My father set a good example by stepping aside and letting the next generation have a go. We want to mirror that’, says Ross.

So the question is who will succeed him? ‘Our preference is that the CEO be a family member but they would have to have the skills to fill the job’, says Ross. For the Brown family the wine business is more than an important part of family culture, it’s the wellspring of its existence. Where most business families talk about the younger generation ‘going into the business’, the Brown’s speak in terms of ‘coming back home.’

The family has been making wine since 1889 but the current generation of Browns, brothers John senior, Ross, Peter, and the late Roger, built up the operation from a traditional mixed farm and vineyard to Victoria’s largest private winery in 30 years.

The Brown formula for success is a mixture of passion and vision for what the family believes possible, along with a good dose of traditional Australian farming values.

'For us, capital was always a struggle. We've been very frugal, ploughing profits back into the business and trying to maintain a modest level of borrowings', says Ross. Now the business turns over somewhere near $50 million annually, crushes 12,000 tones of grapes, and employs 250 people. The family is said to be worth $95 million.

Strategic use of the talents of different family members has been vital in allowing the business to grow the way it has. 'When we came back from school we could see enormous growth opportunities but taking advantage of them was going to be very complex', says Ross. The best way to handle that complexity was to allow each brother to slot into the area that fitted their skills and passions. John took on wine making, Peter went into viticulture, Ross was the marketing chief, and Roger developed wine varieties.

The Browns are well aware that such family coalitions are fragile. Cynthia says a family forum 'developed a family agreement on how we will behave and work together. If you don't treat each other appropriately all sorts of problems occur', she said.

(Source: The Saturday Age, 15 May 1999.)