



The Business Value Manager

Advice for business owners, investors and service providers on how to build value and wealth through investment in closely held companies.

Why Do You Own Your Private Company?

(Part Two of Two)

While the title asks a fundamental question, it is frequently not a simple one for many owners to answer. Our experience tells us it is very beneficial for owners to explore this issue, because doing so helps to clarify your motivations, which makes your long term planning more effective. It also encourages planning to avoid the disastrous results for owners, employees and other stakeholders that frequently occur when no plan exists. This and the previous edition of *The Business Value Manager* assist owners to explore why you currently own some or all of a private company, so that you may use your increased understanding to make sound long term decisions about your business.

MOTIVATIONS

While owners give various reasons for private company ownership, we have found that most commonly fall into two primary categories, financial and non-financial. A third category actually could be “don’t know”, where ownership is pretty much on auto-pilot because owners are uncertain as to why they own, or they “haven’t thought about it.”

A first step toward clear thinking to establish sound objectives is for owners to carefully consider common financial and non-financial goals that may apply to your circumstances and evaluate each for their relevance and applicability. That is, identify the reasons behind your ownership and then evaluate whether or not they make

sense, based on your company’s performance and the goals you want to achieve.

OWN FOR NON-FINANCIAL REASONS

Most individuals we work with own their business for more than just the money. For some, it is a major part of their life and their identity, while most have a more balanced viewpoint. The following is a list of ownership motivations we commonly hear with our reactions and recommendations. We encourage you to candidly examine your own motivations. Identify which of these best describes why you own your company. Then determine if owning for that reason continues to make sense for you, considering your life circumstances and your company’s performance.

Business Challenge – You do it because it is what you do best and like most. If this is you, your challenge is to make sure

there is a well thought out plan for when you are no longer there, because you want to remain on the job as long as you are healthy. Sometimes, these owners deny their own age and mortality and their company declines as they do. *If you do it for the daily challenge, candidly consider how long you can continue in good health, and begin your succession planning five years prior to that date.* Pick a date, design a plan and commit to it for everyone’s benefit. Succeeding at this final business chal-

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lence has actually been a very rewarding experience for several owners with whom we have worked.

Control of Company Strategy and Policy – People who have built a business frequently want to continue to set the agenda and direction. If this is you, it is probably your desire or need to *control* that lies at the heart of why you own. As long as you are effective and healthy, success frequently follows.

For some owners, however, the hard work, discipline and control that created the company's success, later threaten its future because they are unable to relinquish control. Have you planned for your succession, or will your business begin to decline as your ability or energy wanes or upon your disability or death? With an effective plan, you can *gradually relinquish control* as you help and mentor your successors to carry out *your vision for the company's future*.

Exhibit 1—Clear Signs of an Owner's Inability or Unwillingness to Plan for the Future:

"I am not ready to think about succession."

"I cannot decide who my successor will be because I want to treat all my children fairly."

"Those decisions will be up to my heirs."

"We have got to get this next project completed before we address anything else."

"I'm too busy running the company to think about those long term issues."

"Market conditions now make long term planning impossible."

"I am going to work three more years and then decide."

"I'll sell when someone comes along and offers me the right price."

Transition to Children or Others – If you want to pass ownership to the next generation of the family or to others, you must recognize the distinction between *ownership transition* and *management succession*. While the former involves a sale or gift of securities with the possibility of little or no need for management skill or involvement by the recipient, the latter requires management competence, experience and a commitment to the business for long term success.

Many parents want to keep the business "in the family," and just assume their children possess both the desire and ability to successfully run the company. This assumption is faulty in most cases because few people have the talent required of a successful executive and few possess the drive, ambition and commitment that leadership of a business requires.

When management succession is a serious consideration, a formal program for education, training and experience (frequently outside the family business) is a necessary step. You must carefully explore and test your children's commitment to the business and to the company's culture and values before you pass management authority to them. To be most effective in management succession, install an appropriate system of *accountability* to accompany the transfer of *authority*. Remember, those with *authority* have the *responsibility* for the company's success. They are more likely to stay focused to achieve the company's goals when their performance is accurately measured through a proper system of *accountability*.

Should you treat each child the same in terms of the role and authority you give them in the new company? Setting your child up to fail by giving him or her a job they do not want or cannot perform frequently results in family stress as well as business failure. Similarly, don't handcuff your talented, committed child by forcing him or her to share authority and control of the company with siblings who are much less capable or dedicated to the business. *With proper legal structure and agreements, certain children could receive an annual cash return from the company, or a percentage of the proceeds from its sale, without those children having any authority or control over the company's operations.*

In making the distinction between ownership transition and management succession, you must think with your brain rather than your heart, and outside independent counsel is frequently well worth the investment – for the sake of your family and your wealth, as well as your company.

Concern for Employees and Community - Owners of companies which have become a significant employer and economic force in their community frequently worry about employees, customers and others who have contributed to the company's success and rely on it for their economic well-being. When perpetuating the company

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for others becomes your goal because your financial circumstances are secure, your need is to create a corporate governance structure and plan that addresses the long-term stability and competitiveness of the company. Evaluate future ownership options, such as an ESOP or trust, including the tax consequences of each option, and their effect on governance and management. Recognize that in your absence, key people, including your children, may behave much different, so you must establish a future structure of governance for the business that best enables it to succeed in the long term without you.

For example, where the founding father's business reputation and personal stature –both in the company and the family– enabled a less formal governance, much more formal structure, reporting and accountability may be needed for the new leader, who lacks this persona and track record. A board structure, perhaps including outside, independent directors, with quarterly meetings, reports, performance reviews and formal notes is generally recognized as necessary for long term governance success.

Default Planning – This strategy, or absence of strategy, is identified in one or more of the quotes from owners shown in Exhibit 1 on page 2.

If you have resorted to these excuses to avoid making a sound decision about your future, consider some of the *likely consequences of default planning*, including the following:

- * The company's cash and debt position are weakened by the high estate taxes that are triggered by an unexpected death.
- * Without proper leadership after an unexpected disability or death, the company's value immediately declines and its strategic options may be limited, which threaten all stakeholders and the family wealth.
- * After the company leader's disability or death, those who are left in control may make poor decisions due to lack of experience, competence, adequate motivation or time to devote to the business, which threatens all stakeholders and the family wealth.
- * In the absence of clear direction, family members who must assume control suffer stress and dissension, which threatens relationships and family harmony, as well as wealth.
- * As the company drifts without leadership or a strategy, employees, customers, community, and family wealth are all at risk.

These sad, unnecessary outcomes frequently occur in family businesses. They don't have to, but company leaders must be proactive to prevent them. Does your com-

pany have an up-to-date realistic plan, or is a bad outcome likely in your future?

Exhibit 2—Clarifying Owner's Goals and Objectives

Owners need direction and clarity for sound decisions if they lack answers to questions like the following:

- > Do you know whether your company's value is increasing or decreasing?
- > What family issues have been a source of concern in the recent past and probably will continue in the foreseeable future?
- > Who are the people in your organization, whether by knowledge, skill or contacts, who are most important to the overall culture and success of your company? Are their goals and company goals aligned?
- > Are all legal documents (shareholder agreements, board authorizations, etc.) for succession planning in your Company accurate and up-to-date, and if not, why not? When were these documents last updated, and have your circumstances or goals changed since then?
- > If you were unable to run your Company tomorrow, who would have the skills and ability to run the organization successfully, and is that person available to do it?

CONCLUSION

Business ownership can bring substantial rewards beyond "the money." Reaping these rewards over the long term while preserving the company's competitive position and value, and family harmony, is the challenge.

Owners should explore their motivations and goals, and reassess them over time as business conditions and their life circumstances change.

This process creates perspective for owners, helps them to identify their weaknesses or flaws, directs them toward what they want most, and enhances their judgment when they face major company decisions. In the process, it reduces their risk and works to preserve their private company wealth. Call our office for guidance on how to identify and assess your goals, and to resolve the conflicts or planning gaps that frequently challenge private company owners.

To read Part One of "Why Do You Own Your Private Company?" go to www.evansandassociates.net



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