VAN Radar 2019

Roundtable session summary

Session: Future-proof your business with a successful succession structure

Presenter: John Day, Smart Equity

When there are multiple equity partners in the business, all at different stages in their career, building a succession structure can be a real challenge. A lot depends on the Board of Directors' individual plans for their own future in the next 1 year, 5 years, 10 years or 15 years. Different people might envision:

- Continued ownership – actively, or as a non-Executive Director
- Outright sale – to a third party or another partner, shareholder or unitholder
- Acquisition or merger with another firm

Maximise value, regardless of plans

Even if you think succession will come from within, it's worth maximising the value of your practice. An investor-ready succession plan, especially in a multi-equity practice, has the potential to:

- Attract and retain high calibre professionals who can ensure the ongoing success of your practice
- Maximise the value of your practice should you decide to sell
- Maximise the successful merger or takeover of a target practice

Valuation methodologies

When it comes to valuation methodologies, the only right way is the one that everyone agrees to. Keep it simple and keep it consistent. You can:

- Base the valuation on profit multiples – rather than a percentage. E.g., selling at a high multiple, like 10x profit, means you also need to buy back the shares at 10x if the shareholder wants to sell.
- Discounted cash flow can be difficult to work out and is more suited for institutional sale.
- Use 3-year averages, rather than just using a single year's result, for a more stable valuation.

Build structures for resilience and longevity

Set up the rules now to prevent problems in the future. Getting into bed is easy; getting out is hard!

Corporate structure – Having one corporate structure for your practice can simplify operations. It means having a consolidated balance sheet showing profit and loss, and unifies shareholding. It's worth considering a Holding Company/Trust as it's an effective mechanism for retaining control.

Maximise business value through employee incentive plans – Offering employees a share in the business can broaden the base and help you retain your most valuable assets, but it only works if every owner believes 100% in the business:

- Use a trust structure so the Board of Directors can still retain control. Running a share plan through a trust arrangement can guard against any minority shareholding issues down the line. Also, if you're not operating from a trust structure, then managing a share registry can be laborious.
- When an employee's future incomes are linked to the future success of the client, the business will be much more attractive to an independent for outright or partial sale.

- Incentive plans work well, but nothing retains like equity. Make the shareholder offer to all employees, not just advisers. Create a share certificate to stick on the fridge so it's a visible, tangible reminder of their role in the company.
- Offer lots of different options for ways to fund their shares. E.g. rather than pay a $50K salary, you could negotiate to pay an employee $40K in salary and $10K in equity. The more ways people can buy in, and the more they can bring in, the more you can reduce minority shareholding risk.
- Advocate tenure levels before people can come on as shareholders.
- Shareholders should not remain shareholders if they've left the business. Use age-based ceilings: e.g. if you're X age, you need to sell Y%
- For more information about employee participation plans see the Australia and New Zealand Employee Owner Association.

John Day is a founding director of Remuneration Strategies Group and the employee share plan administration company, Smartequity Pty Ltd.