Succession Planning

Twists and Turns

By Jim Wilson

The subject of succession planning has bubbled up to the top of many people's list because of the emergence of a large group of baby boomers, and those five to ten years behind them whose thought and planning have turned toward retirement. A relatively robust economy may help the multiples of EBITDA for which some business owners sell their dealerships. And, a stronger economy will drive a perceived sense of urgency to sell. However, economic cycles are just that. And, no matter when you get ready to transition your business on the spectrum, if you haven't considered some of the things mentioned in this article, your business will be undervalued. Detailed here are the mistakes to avoid and positive steps you should take to preserve and optimize the value of your business.

Over my 42-year career with an OEM primarily interfacing with several hundred equipment dealer principals, their families, and key employees in North and South America, Europe, and the Middle East, the topic of Succession Planning remained implicit in our relationships. The subject remains yet today, difficult and emotional for both OEMs and dealers to think clearly about and discuss openly five years out and beyond regarding the steps that need to be taken to prepare for the inevitable event.

OEMs, dealers, investors/bankers, employees and customers are all concerned with Succession Planning. This article will focus on dealer succession planning, particularly family owned over which the principal has the most direct control and influence. However, some aspects of what's discussed here still apply to companies that are accountable to non-family investors and/or holding companies.

If you are looking for a numerical range of multiples that machinery or material handling dealers are selling for these days, this article won't meet your needs. If you want information on what drives the multiples, other than the business cycle, then please read on.

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At a high level, what are some of the most important goals of "successful" Succession Planning? From my observations and personal involvement, I think they include assuring survival of the business, avoiding surprises, making wise choices, continuing to retain and satisfy customers, rewarding ownership, honoring employees, preserving relationships with key suppliers, and maintaining integrity in the process. This sounds like a lot of work and it is!

I am often asked if it's harder for a large dealer or a smaller dealer to work through Succession Planning. There's no correct answer, but I think the smaller ones encounter more surprises. Added to that is the emotional factor due to more involvement and dependency of family members on the business along with the available resources to undertake succession planning while still remaining heavily involved in day-to-day operations and oversight. The bigger ones are more complex because of scale…the size of the capital investment, tax ramifications, and perhaps the financial eligibility and restraints of potential suitors and successors.

Let’s begin with a checklist of mistakes that I’ve seen some independent dealers make over the years, and not just in my industry, and then progress to the more positive things that others do well. Many of these you have seen yourself but what have you done to avoid them?

As you scroll through the list, consider grading yourself. Simply use three categories: Doing Ok, Could Use Improvement, and Needs Urgent Attention.

Checklist of Mistakes to Avoid

Here are some failures to avoid and many of them are equally important considerations for key employees as well as the Principal:

- Principal’s death without any will, trust, or succession plan put in place.
- Sudden illness or accident that incapacitates the principal from establishing or completing a succession plan.
- Successors forced to sort out among themselves who should lead the company.
- Co-leaders appointed, with equal “voting” shares.
- Under or over stating the “market value” of the company.
- Ignoring the wealth of information…books, seminars, testimonial, and professional services available to learn about and execute a plan. One of the best is Ernesto Poza’s book and treatise simply called Family Business.
- Alienating neighboring dealers (including competitors), association members, and even OEMS who might become potential suitors.
- Unrealistic expectations as to what the business may be worth or who may be attracted to it.
- Inadequately rewarding key employees whose success, the business depends on and who may be potential successors themselves. Instead, they leave the company.
- Designating a new Principal who is unqualified or uninspired to run the business.
- Not addressing the developmental needs of key employees, including their potential replacements.
- Inadequate insurance for the loss of a key employee or Principal.
- Lack of timely communication to key employees, suppliers, and even customers not just about the future of the business, but in real time how it is performing. If the latter is good news, all the better. If not, then communication on measures being taken and expected can be reassuring to maintaining desired relationships.
- Little attention to planned asset replacement and investment in the business that could strength it…just milking the cow.

- Selling the business to employees (think ESOP) at such a high premium that it strangles the business' ability to accumulate retained earnings to support growth and operational excellence.

This list could go on and on. I am certain if you have been around long enough in the construction equipment or material handling industry, you could expand upon it.

Checklist of Positive Steps to Take

Moving onto more positive steps that lead toward successful Succession Plans, here's a slightly different cut at the topic. Again, for your quick digestion, just another list:

- Begin the process at least five years out. This is the timeframe it typically takes to decide whether to pass the business on to a family member or employee or to engage, qualify, and sell to a third party. You need this lead-time to get the business performing at its best… especially if selling to a third party. I know one dealer who got an unheard value for his business because he stepped on the gas achieving record sales and earnings. Those last three years of such performance established a record high multiple.

- If you think a family member might make sense, test that person in a variety of positions, but don't rubber stamp success. Leave him or her in the position long enough to have some successes and failures. This phase is about understanding the key revenue and profit drivers of various departments. Assign trusted mentors to work with your family candidate, empowering them to administer tactful but beneficial tough love.

- Ideally, a family candidate worked in another business before coming into yours. Some of the most successful transitions I know were the result of the principal insisting that the child work for someone else to mature and establish a sense of value, accomplishment, and pride without feeling like the job was handed to him or her. Even working outside the industry could prove useful because what's important is that a child learns to listen, embraces learning, takes constructive criticism, exercises good business judgment, and follows as well as leads.

- If you can arrange for a child to work for another dealer or OEM as an intern or in a paid position, seriously consider this option. I am surprised that more OEMs, associations, dealer councils, and advisory or top twenty groups don't offer this option. If necessary, there's nothing wrong with offering to split the child's salary with the other employer.

- If you are leaning toward an employee to succeed you, again work to give that person a wide variety of experiences and special assignments. Ask your trusted senior managers whom they view as candidates. Even if you decide to pass the business onto a family member or sell to a third party, you need the business to retain this talent pool to help perpetuate the business' success.

- Many organizations are unduly fearful of 360-degree leadership. But having people above you, below you, and laterally give constructive performance feedback results in one of the most powerful ways for an individual to learn his strengths and master or minimize his weaknesses…to become the person who can lead the business or head a department. I also suggest that input come from inter-dependent departments.

Many employees fear reprisals from giving the boss feedback. Input can be anonymously structured. Leaders are not born. They are made. 360-degree leadership or a variation, provides a great way to develop people for future roles as well as improve performance in present ones. Principals and boss's insulated from what they need to hear are deprived of information that could have ultimately affected the multiple the business sold for.

- Whether you decide to do an ESOP or sell to a third party, first put in place a program committed to continued excellence and performance benchmarks such as The McDonald Group's workshop, *Master's Program in Machinery Dealer Management,* that drives value, customer satisfaction/retention, employee retention, and OEM retention. If done correctly and in balanced measures, these efforts will positively influence return on equity and capital and therefore the worth of your business when it comes time to pass it on.

- Speaking of the value of your business to a successor, I wouldn't be doing my job if I didn't also mention Profit Planning Group's Albert Bates' classic presentation on the value of 1%. You must take steps to assure that your key departmental managers know what a 1% increase in revenue, a 1% increase in sales price, a 1% reduction in cost of goods sold, and a 1% reduction in expenses in each of their departments means to your bottom line. Then they need to know how to apply the available tools to effect constructive improvement to the bottom line. These are disciplines that add worth to the enterprise value. (See Suggested Resources below.)

- Strategic Pricing Associates Inc.'s David Bauders has been conducting seminars and webinars for years to demonstrate how powerful analytics and related training help dealers and distributors capitalize on their invoicing history. Their clients learn to selectively segment their customers and raise prices on non-core non-sensitive parts SKUs with little push back from customers or retaliation from competitors. It's no secret that private equity and investment firms often come to these meetings. Those companies embracing strategic parts pricing disciplines appeal to them.

  When it comes to strategic pricing, many dealers under value the powerful information inherent but hidden within their invoicing history. Without the assistance of computer aided analytics and algorithms, the human mind cannot see the opportunities for selectively and moderately increasing prices on a per customer basis without fear of repercussions. Instead, simplistic and arbitrary approaches are taken. These include distinguishing between fast and slow movers, proprietary vs. non-proprietary product groupings and, out of production models. Or, applying the simplistic approach that just involves administering "peanut butter" across the board markups. All of these put a ceiling on the business' financial performance.

  Of course, OEMs don't possess the kind of information you do, so they are not inclined or capable of helping you do the analytics that could make a huge difference whether your business financially performs in the lower third, middle, or top tier among your peers. (See Suggested Resources below.)

- It's important to find the right balance between these two extremes…being over leveraged and over capitalized. Either extreme can scare away an investor/buyer. The Material Handling Equipment Distributors Association (MHEDA) has published and presented plenty of advice on these matters.

- Naturally, it's the owner's prerogative, within the covenants of lenders, to determine his salary and how much retained earnings to take out of the business. I think it's important to be aware of industry standards on these matters… especially when it comes time to transition the business. Record keeping better be accurate enough to document and recast the true performance capabilities of the business when it is time to sell. The better the record keeping the more confident a buyer will be and perhaps the higher the multiple.

- Certified Financial Planners submit that wealth is more often created by what you do **after** you receive a salary/bonus. I think this advice applies to business owners as well as employees. If you haven't saved, diversified and invested wisely to build a nest egg outside your business, then you may be very vulnerable and too dependent on artificial expectations as to the real worth of your dealership.

- Relationships are important to the worth of your business. Many years ago, as a greenhorn Regional Manager, I called on a dealer who made it clear in our first visit that they didn't want OEMs "snooping" around their business or their help and, that the principal was best friends with the OEM's chairman. This implied threat and negative attitude strained relationships with every representative calling on that dealer. Lacking relationship management skills, when their friend upstairs retired, the principal lost that OEM's sales and service agreement. The value of his business was greatly diminished because of poor judgment.

- Some dealers contend it's the value of their customers and their business name that establishes the most worth to a buyer. Some OEMs lean in the other direction and contend that it's their brand reputation. Don't fall prey to either extreme view. It's the demonstrated synergies between the two that helps register value. Before making an offer, most bona-fide candidates to buy your business will talk to your important OEMs about the wellbeing of these synergies.

- Make sure to give your key OEMs plenty of advance notice of your intention to transition the business and a rough timetable. Often, they may bring you candidates. The last thing you want to hear late in the game from your key OEMs is they think your preferred choice lacks qualifications. I know of a top tier distributor in another industry whose critical OEM rejected several potential buyers. Finally, out of frustration, the distributor used the substantial increase in cash flow from strategic pricing to help fund acquisition by some mutually respected employees. Of critical importance, you must know contractual obligations regarding transferability with your OEMs. You need to make sure your lawyer reviews related documents fairly early in your succession planning process. Lawsuits rob all parties of the energy to do a constructive transition and can diminish enterprise value.

- Talk to professionals, association groups, trusted OEMs and those who have gone before you to get a feel and understanding of what motivates potential buyers to put a high value on your business. Please know that if your financial statements, and key performance indicators are mediocre, the worth of your business to an informed prospect will reflect it. You might get a bit more of a premium if the prospect sees a strategic fit. What's strategic depends on a lot of variables unique to every suitor like access to new markets, talented personnel, product lines and/or need to give key employees or other family members an opportunity to run a business or an OEM who wants to own some dealers to diversify into retail or pre-empt a competitor, and so forth.

- Compatible business cultures can also make a difference to a suitor. Years ago, I hosted a nationwide webinar with two independent dealers discussing the importance of business culture and how to create and sustain it for positive value to the enterprise. Interestingly, one of them actually measured annually, if not more often, where each employee fit on the enterprise's cultural grid. An otherwise high performer could be let go if they didn't fit the culture the company wished to sustain. Both of these companies continue to flourish and expand over the years. I can't help but think this is partially due to wise leadership and the time, effort, and resources they invested in creating and perpetuating a definable culture. If and when these dealers ever decide to sell, they will get an above average multiple due their investment in a culture that drives performance.

- There are multiple reasons for passing a business onto a family member or talented employee, doing an ESOP, selling to another dealer, private investor, or OEM. Ernesto Poza's *Family Business* book and workshops touch on them as well as anyone. If you anoint a family member to succeed you, please be sure to designate majority control (there can only be one ship captain), do the dirty work yourself if necessary to make sure the business is in order, including addressing lingering employee issues that might burden the business going forward… don't leave this mess to a successor. Conversely, it's the new principal's responsibility to bring a dynamic vision and fresh ideas for the business going forward. Then, get out of the way because some of these ideas you might not agree with but they might just be what's needed to take the business to the next level.

If you are within ten years or less of contemplating succession, you are aware of most of what's been shared here. But, the key to your successful transition is do you really understand the issues and opportunities laid out here? Have you been translating it into a series of methodical steps and measures to preserve the value of your business for you personally, your customers, employees, and a future entrepreneur?

If you have, then such a plan will serve you very well. Even if your dealership hits a downturn in the business cycle that extends the time horizon for succession, the value of your business will rebound faster and prove more attractive if you have done your succession homework.

Suggested Readings and Resources

- ***Family Business*** by Ernesto J. Poza, 4th Edition
- ***The 360 Degree Leader: Developing Your Influence from Anywhere in the Organization*** by John C. Maxwell
- **Triple Your Profit: Stop Being a Profit Soldier and Start Being a Profit Winner** by Albert D. Bates
- ***The Master's Program in Dealer Management Workshop*** with Walter J. McDonald, www.mcdonaldgroupinc.com.
- ***Strategic Pricing Associates,*** David Bauer, http://www.strategicpricing.com

About the author: Jim Wilson is a Principal Consultant with The McDonald Group, Inc. He has also worked closely with Strategic Pricing Associates Inc. Prior to that he worked 42 years domestically and overseas in marketing jobs with Caterpillar related companies, including MCFA. Various capacities included N.E. Regional Manager, Manager of Corporate Advertising, Industrial Sales Manager for Canada and Latin America, Manager of Corporate National Accounts, and European and North American Dealer Development Manager. Jim has written several books and these can be viewed

on his author website www.jamesmikelwilson.com. *Churchill and Roosevelt: The Big Sleepover in the White House* has been converted to a stage play and will premiere in England 2022. You may reach Jim at 281/660-9783 or jmwilson0426@gmail.com. His business web site is <u>www.mcdonaldgroupinc.com.</u>