MAGENTA PERFORMANCE PARTNERS

SUCCESS-ION SUCCESS

MAGENTA INSIGHTS

INTRODUCTION

In the scientific worlds of physics and chemistry, an ‘ion’ is an atom in which there are an unequal number of electrons and protons.

This inequality creates either a net-positive or a net-negative electrical charge.

Succession, involving a change in ownership (and leadership) in a business, generates the same outcome options. If it’s your business, it will produce either a positive or a negative impact on your life.

Three phases of activity create your succession outcome. All have to ‘work’ well together to ensure your experience is positive.

1. **Readiness**
2. **The deal**
3. **The transition**

The terms of the deal often receive the most attention, and of course are very important. But if the ‘readiness’ and ‘transition’ phases are not well planned and executed you’ll take on an unacceptably high risk that your experience turns out to be negative

A CASE IN POINT

This case (with identities changed to preserve confidentiality) illustrates the danger of not lining things up properly as you move towards and through a succession event.

Malcolm and Kate were partners in a very successful interior design practice.

They had been in business together for over 25 years, and could demonstrate most of the ingredients that anyone valuing their business would say were important.

They had:

‘Strength’ and ‘Value’

- A diverse client portfolio
- Long-standing clients
- Well-established client and project management processes
- A proven ability to bring in new business
- A strong team – with depth in key roles and strong design and project management credentials
- Profitable growth over the preceding five years
- A number of valuable long-term contracts and retainers
- Long term lease on favourable terms

Over a two year period, leading up to the date on which they planned to wind back their day-to-day involvement in the business, they had agreed and documented succession terms (including a reasonable share valuation) with the three most senior designers in their practice. Each of the three were very well credentialed, having won business, led major client engagements, and being well regarded by the wider team.

The transfer of ownership arrangements involved the three designers acquiring 100% of the equity in the firm at the agreed succession date. The arrangement required them to pay 20% of the agreed value at that date, with the remaining 80% to be paid to Malcom and Kate in equal quarterly instalments over the following two years. Malcom and Kate stepped down as directors on the succession date, with each of the three new partners stepping into those roles.

Malcolm and Kate took security for the unpaid instalments in the form of a charge over the number of issued shares in the firm that represented the percentage of the total agreed value still owing to them.

SO FAR SO GOOD. THEN, OOOPS!

What Malcolm and Kate experienced over the six months immediately following their succession 'event' provides some salient lessons for anyone thinking about their own succession plans.

Although Malcolm and Kate had offered to continue to provide management and other advisory support through an agreed 18-month transition period, and to be generally available for client interaction, the new owners decided they would now hold the reins tightly themselves. The monthly management meetings that Malcom or Kate had always chaired continued, but Malcolm and Kate were effectively disinvited. And they were practically frozen out of ongoing client conversations and planning.

Three months later Malcolm and Kate received the first instalment of the remaining sums owed to them. Around the same time they started to receive calls from clients. The clients expressed concern about how their projects were being managed, and how they were being asked to sign up to new terms and higher fees.

It wasn't too much longer before Malcolm and Kate were also fielding 'off the record' calls from concerned staff members who were anxious about some of the decision-making in the firm, especially in relation to changes in peoples' roles, the amount of money being spent on what they felt were pointless marketing pursuits, and a micro-managing style of leadership.

Malcom and Kate did not receive the second quarterly instalment when it was due six months after the sale. Calls to the new owners were met with assurances that a new bank facility was being established and the funds would come through within 14 days. But they did not, and nor did they at any time over the following three months.

Nine months after the original transaction, Malcolm and Kate found themselves holding 70% of the shares in their old firm again - and soon after negotiated to buy back the other 30% for a nominal sum. However the business had racked up trading losses of over $200,000 in that period, had lost five key clients and, most vitally, almost half of its best talent had left to join competitors.

They had 're-acquired' their own firm, and it needed to be completely rebuilt. Their retirement plans were shattered.

AVOIDING THE PAIN

Apart from changing the commercial terms of the sale, so Malcolm and Kate received 100% of the value at the date of the share transfer, here are seven things that might have helped them avoid all the pain their succession activity caused:

1. Document what a 'great outcome' of succession looks like for you – in a way that includes all the tangible and intangible outcomes sought, and which, as much as possible, gets to grips with the potential unexpected consequences that could arise.

2. Build a real partnership with your potential successors, well before your succession journey starts. This makes the path much clearer for them, and it enables you to understand their motivational drivers, and ensure these are likely to be consistent with success in new ownership and leadership roles.

3. Never assume that great technicians will make great leaders or commercially-astute managers.

   Provide ample opportunities for your successors to be exposed to, and involved in, the more strategic aspects of running the business well before succession time.

4. Create opportunities for your successors' firm-building ideas to be aired and tested before the succession event – so the harder lessons are learnt in relative safety.

   And provide leadership development support (involving your own coaching as well as external coaching and programs).

AVOIDING THE PAIN... (cont'd)

5. Plan together (offsite) – agree a transition plan covering the first 100 days and the first one or two years. A change management approach needs to be part of this plan – to address the impact of your progressive exit on both clients and team members and to give any other planned operating changes the best chance of success. Anchor the plan around building extra value and mitigating risk – not just running a slightly stronger 'business as usual' state.

6. Build decision-making and sign-off mechanisms into the transition agreement – so you stay connected until you've been fully paid - and can vet and approve decisions that might impact the business value until that time.

7. Invest in the development and engagement of your third tier. This is the group that will need to step up as the critical second tier after you exit, and is also the group that will sustain the business if the succession fails to deliver what it promises.

And finally, check your employment agreement to make sure they contain appropriate non-compete provisions so that you can protect your clients and team in the event your succession aspirations don't go to plan

SOME OF THE THINGS WE'VE LEARNED FROM OUR SUCCESSION WORK

- ✓ Seek a fair value, not the value you emotionally attribute to your business. The value relates solely to the future, not the past.

- ✓ Speak to professional peers who have already been through the journey. They will have extremely valuable 'war stories' to share about what enabled and what blocked the outcomes they were hoping for.

- ✓ Make sure there is sufficient cash up-front where-ever possible. It creates greater commitment and less scope for you to get tangled in ongoing troubles.

- ✓ If you're a leader now, make sure you look like you're enjoying the role. It's aspirational to want to follow someone who enjoys their work. The opposite is also true.

- ✓ Make sure your successors feel part of the leadership team early.

- ✓ Identify and implement at least three ways to 'freshen' your business, internally and externally every year in at least the two years immediately before your planned succession event date.

ADDRESS
Level 32, 101 Miller Street, North
Sydney NSW 2060

TELEPHONE
+61 2 9959 2354

EMAIL
info@magentaperformance.com

WEB
www.magentaperformance.com