



Ownership Transfer Techniques That Work

Ownership Transfer Techniques That Work

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There Are Only Three Alternatives

- Internal transfer
- External transfer
- Liquidation



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Three Components of Ownership Transfer Planning for All Three Alternatives

- Ownership transfer plan
- Management succession plan
- “Red Truck” or contingency plan



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Factors Creating Salability & Value *(1 of 2)*

- Profits
 - Size and growth
 - Volatility
 - Recurring
- Type of customers, services and markets
 - Strategic appeal to potential buyers
 - Service component
 - Negotiated/less price sensitive
 - Recurring client opportunity



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Factors Creating Salability/Value *(2 of 2)*

- Critical mass
- Management and organization
- Growth potential
- Synergy with buyer
 - Client base
 - Cost structure
- Location
- Scarce resource
 - Real estate
 - Material reserves
 - Permits
 - Technical or operational capability
 - Labor



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Objectives and Motivation *(1 of 3)*

- Financial and risk issues
 - Fulfill financial needs
 - Resolve estate planning issues
 - Reduce personal risk
 - Maximize value



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Objectives and Motivation *(2 of 3)*

- Lifestyle and personal issues
 - Desire to retire or do something different
 - Willingness to be an employee and give up control
 - Desire to manage a larger business
 - Ensure continuity



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Objectives and Motivation *(3 of 3)*

- Business issues
 - Resolve management succession issues
 - Provide growth/diversification opportunities for business
 - Resolve dissension in management or family
 - Provide opportunities for management
 - Alleviate declining market/increasing competition



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U.S. Surety Industry Survey

Method Used by Clients Successfully “Cashing Out” of Their Contracting Business

33.0%	Sold to key employees
30.7%	Sold or gifted to family
20.0%	Liquidated
5.9%	Sold to outsider
5.8%	Sold to ESOP
<u>4.6%</u>	Merged with another firm
100.0%	



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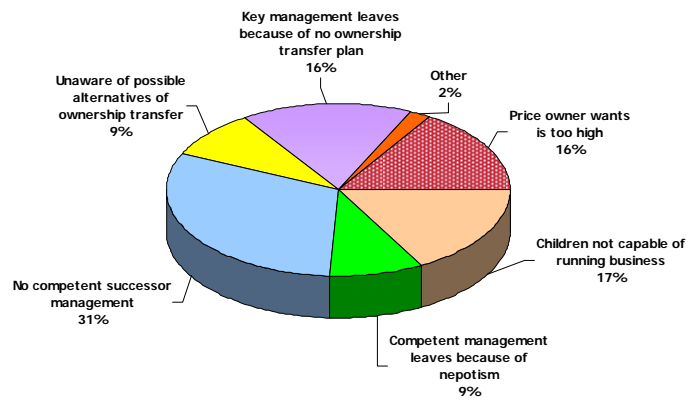
The Internal Option



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Surety Industry Survey

Most Common Reasons for Ownership Transfer Plans Not Working



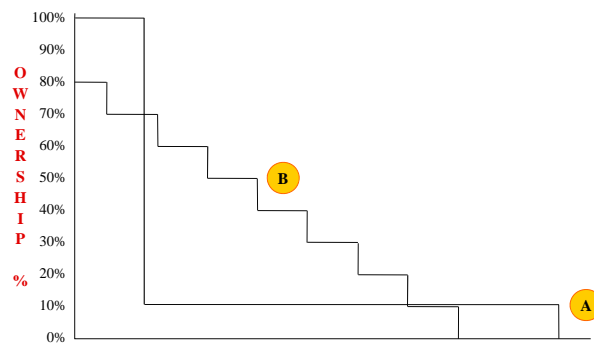
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Reasons Why Plans Don't Work

- People issues
- Poor communication
- Inadequate profits
- A lot of good/bad and bad/good advice
 - Tax, legal and estate planning
 - Consulting



Ownership Transfer Profile

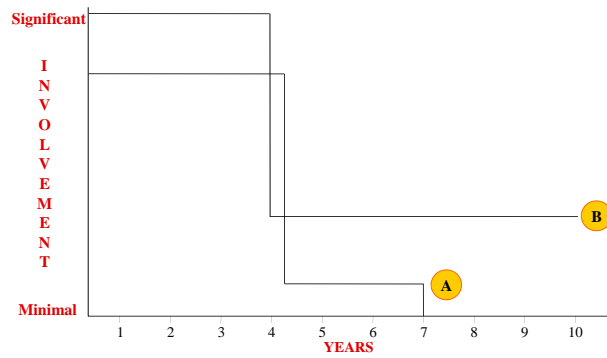


A Own 100% today, sell 90% in year two, and retain 10% for 9 years

B Own 80% today; sell 10% per year for 8 years



Management Succession Profile



A Full time for years 0 through 5; minimal role, perhaps consulting in years 5 through 7

B Overly involved for 4 years; reduced role for 6 years



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Key Facts and Assumptions

- People side is the hardest
- B Y O W Y O \$
 - Time frame without external financing of 5-10 years
- Internal sale can maximize value



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Why do Owners Hesitate to Sell Stock to Employees?

- Requires disclosing financial information
- May create unrealistic expectations and inappropriate actions
- Owner has to discriminate among employees
- Potential for financing a competitor
- Usually requires continuing indemnification
- Owner is still at risk during the buyout
- Fear retirement and loss of income



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Why Might Employees be Hesitant to Buy Stock?

- You may be asked to provide personal indemnification for bonding or banking
- You will probably have to borrow money or dedicate savings and income to a purchase
- Control of the company and policies will remain with the majority stockholder(s)
- More authority and perks may not be given—these items should still be based on performance and position
- Could be a risky investment



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Why Owners Hesitate to Plan for Management Succession

- Management style not conducive to the development of successors
- Believes one person is better than a team
- Reluctant to make decisions about successors
- Fears development of successor management
- Complete identification with business
- Fears a lessening of importance—both in the company and in the community



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Advantages of Selling Stock to Employees— To the Owner

- Can retain and motivate key employees
- Allows owner to retain control
- Provides for owner's continued involvement
- Significant flexibility as to structure of the transition
- Value can exceed 3rd party sale




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Disadvantages of Selling Stock to Employees—To the Owner

- B Y O W O \$
- Requires disclosing financial information
- Usually requires continuing indemnification
- Owner has to discriminate among employees
- May create inappropriate actions
- Sale typically takes 5 to 10 years




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FMI's Laws of Management Succession *(1 of 2)*

Law 1:	The people who own the business should run the business
Corollary:	Minority interests may motivate some people some of the time
Law 2:	Control is only important when you need it
Corollary:	Don't give up control as long as you are at great financial risk



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FMI's Laws of Management Succession *(2 of 2)*

Law 3: Blurring the distinction between compensation and return on investment causes confusion

Corollary: Pay management and employees what they are worth and provide owners return on their investment

Law 4: After age 25, age becomes a factor in effectiveness; maturity is the issue

Corollary: You never know if a dog can hunt until you put him in the woods



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FMI's Laws of Management Succession – Family Issues *(1 of 4)*

Law 5: Business relationships caused by accidents of birth have a low probability of success

Corollary: Children should be treated fairly and equitably – not equally



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FMI's Laws of Management Succession – Family Issues *(2 of 4)*

Law 6:

There is no such thing as a contractor gene.
Women give birth to babies—not contractors

Corollary:

Family members given responsibility beyond
their capability are going to be angry—at you

Corollary:

Family members “pressured” into the business
will never forgive you

Corollary:

Being a son or daughter does not automatically
imply incompetence



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FMI's Laws of Management Succession – Family Issues *(3 of 4)*

Law 7:

The number of family members employed
in a business is inversely proportional to
long-term profitability

Corollary:

The number of family shareholders has a
similar relationship

Law 8:

The quality of non-family management
employees is inversely proportionate to the
number of family members in the business

Corollary:

Never promote relationship over competence



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FMI's Laws of Management Succession – Family Issues *(4 of 4)*

Law 9:

Parents are not capable of objectively evaluating the competence of their children

Corollary:

The offspring with a proven, unaided track record has an excellent chance of winning the respect of the employees



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Buyout Issues

- Projected profitability – now & projected
- Employee capital & compensation available
- Asset base & working capital requirements
- Management succession
- Banking & bonding requirements
- Business structure (e.g., S, C corporation, LLC, etc.) and tax issues
- Nonoperating, real estate or excess assets in business
- Voting control & power
- Control requirements
- Owners liquidity requirement & risk tolerance
- Who, when and how much



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Primary Methods of Internal Transfer

- Direct sale/redemption
- Stock options
- Restricted stock
- Stock bonus
- Sub-S buyout
- ESOP
- Brother/Sister
- Permanent joint venture
- Recapitalization
- Parent-subsiary
- Spin off/split off/split up
- Family limited partnership



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The External Option



Is a Straight Sale Feasible?

- Management succession is in place?
- Value meets expectations of owners?
- Backlog and asset base to sustain business?

Preparation

- Evaluation of alternatives
- Trends in the marketplace
- Feasibility of sale
- Presale changes
- Business valuation

Search Process

- Package preparation
- Candidate identification
- Candidate contact



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Negotiation

- Buyer evaluations
- Deal structure



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Transaction Complete

- Closing the transaction
- Integration plan implemented



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- Mergers, Acquisitions and Financial Consulting[†]
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Questions

Up Next: Lunch in Biscayne and Chopin

Breakouts resume at 1:30

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