



Issue Fourteen

Paying For Retirement - How Do You Finance Succession in the Family Business?

If you're ready to exit your business and pass it on to the kids, let's hope you've done your homework - there's a lot more to succession than handing over the key to the door.

Believe it or not, succession planning needs to begin when you first start up your new business. Most business owners, however, are so busy getting the business running, they cannot possibly imagine planning for when they want to retire - possibly 40-50 years into the future.



But plan you must and the earlier the better. You need to think about whether you want to sell the business or keep it in the family. Either way you still need to plan for it, but if handing over to the next generation, as many owners of family businesses would like, you need to ask: who is the likely candidate to take over the job?; what involvement do you want to continue to have in the business?; how will you provide for other offspring not involved in the business?; and perhaps most importantly, how will you fund your own retirement?

Too often the family business has to be sold just to fund the owner's retirement, and this is a major reason why so many family businesses in New Zealand do not make it through to the second and third generations.

In many cases these forced sales could have been avoided with careful planning. And there's the rub - too many business owners simply haven't done any planning at all. According to the MYOB Australian Small Business Survey, 2004, only 12% of small business owners said they would like to ask their accountant about succession and exit planning. The result implies that many business owners appear to have done little or nothing to plan for their retirement. Other international surveys have turned up similar results.

Succession, like every aspect of being in business, needs to be planned. You need to start planning now, to implement long-term strategies to ensure sufficient funds are available to pay for your retirement.

Your succession plan should include answers to these questions:

- When do you intend to retire?
- How much money do you need on which to retire?
- How much money will you have?
- What will be your ongoing role in the business?
- What earnings or remuneration will you require from the business in your non-executive role?
- If you intend to sell the business to your family members - how will they raise the capital to purchase the business?
- Will you directly retain ownership of assets utilised in the business for which you can receive rental income? Is this understood by the family members?

If you haven't done so already, it would be a good idea to start talking to your accountant about the options available for financing succession. Here are some strategies to discuss:

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Heirs buying the business

Simply handing the business over on a platter to one of your family members can cause a lot of resentment to others in the family. And, if they don't have to pay for it, their attitude to business and the need for continual hard work may become distorted.

Many family businesses now devise a strategy where the heirs purchase the business over a period of time but amassing the funds for this transition must be planned for in accordance with a well thought-out succession plan.

Not only can the owner retire in dignity or pursue other interests, this strategy also allows for a redistribution of wealth within the family, especially if some of the family members are not going to participate in the ongoing business venture.

Importantly, it gives an incentive to those taking over to develop and maintain the business as a viable entity.

Superannuation plans and other investments

Contributing to a superannuation fund or some kind of retirement investment from an early stage should also be considered as a way of financing succession in family businesses.

It is not difficult to establish an external retirement fund early in the business' life, and if seriously undertaken, it's likely that more family businesses would make it through to the second and third generations. It's important to remember that this money is invested away from the business so it is available for the founder at retirement and is not a drain on the ongoing business operations.

Floating on the Stock Exchange

For some, another option to consider is whether the company is suitable for floating on the stock exchange. This can raise money to assist in the succession plans of the founder, but is also likely to help expand the business.

Private family businesses looking to go public may also want to attract outside institutional investors and independent directors into the company. This outside involvement would exert corporate governance discipline on the performance of the business, which will assist in transition to the second or third generations.

Before making any decisions, talk to your accountant. It can take many years to develop the sum of money to fund retirement of the founder which is why the planning must start early. Whether it's funded through superannuation, heirs paying something for the business, floating the company, or development of assets away from the business, unless you start now, succession within a family business will be very difficult.

Next Steps - How Will You Finance Your Succession?

Have you discussed succession with your accountant and written a succession plan?

If "yes":

- Check that it covers in detail all aspects of what will happen to the business when you want to retire, in particular, how the succession will be financed.
- Remember to look through this plan at regular intervals and update where necessary. You don't want to pull out a 10-year old plan and realise that it is no longer relevant, or does not adequately meet your needs.

If "no":

- Start thinking about your options now. If you are approaching retirement age with no plan in place, you are unlikely, at this stage, to accumulate enough funds through a superannuation scheme and may need to implement alternative strategies.
- **Talk to your accountant or advisor as soon as possible about how you will finance succession in your business.**

Be sure to read each article with the mindset "How this could apply to our business". Thinking of it that way will guarantee that you get value. Also make copies for each team member. To really make sure something positive happens, work with your business development specialists to talk your team through ideas.



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Will You Have Sufficient Money to Retire?

- What retirement strategies have you put in place?
- Have you a well-funded superannuation fund?
- What other personal assets do you have which will assist you in retirement?
- Have you calculated what your financial needs are going to be?
- Can an effective superannuation fund still be established, so as to give you adequate funds for retirement?

Lack of forward planning with regards to superannuation and other assets to fund retirement is one of the major problems affecting successful succession in small businesses.

This is usually caused through business people ignoring retirement planning until they are very close to retirement age. By then it's often too late to accumulate enough retirement assets. Unfortunately this can often mean that either the founder will hang on and jeopardise the succession of the business, or the business will have to be sold to finance the retirement of the business owner.

"...planning ahead for business transition and being prepared for a wide range of challenges will pay enormous dividends to owners."

What Every Business Owner Should Know About Valuing Their Business, Dr. Stanley Feldman, Dr. Timothy Sullivan, Roger Winsby.

Pass On Your Product Knowledge

When you hire someone to join the team, make sure you train them comprehensively in the products or services you are selling.

As customers, we expect staff to be able to answer our questions on a particular product or service - after all they are the ones trying to sell it to us.

But too often, we hear the words: "I'm sorry I don't know." Sometimes, that spells the end of the conversation, because if they can't answer the question a potential customer will simply find someone else down the road who can. Sometimes, the staff member will offer to find out, which is commendable, but with appropriate training, the sales people should know the answer themselves.

To be successful in business you must have a team who has excellent product knowledge. There's no point in you, the owner, holding all the knowledge because you cannot be everywhere at once. The business needs to be able to stand alone when you are not available - you may just be on the phone but you're still not available - and that means all your staff, whether temporary, casual, part-time or full-time, need to be as knowledgeable as you are.

You need to think about: holidays (your own and those of your staff), sick days, long service leave, training days and succession, so that on any particular day the business can still present excellent product knowledge.

Think too about what is happening in your industry, what the key players are doing and be alert to industry trends and fashions. It is important to keep abreast with developments in the business environment and make sure you update staff regularly. The more informed they are, the more knowledge they have to help sell your products.

An important characteristic of a well-run business is that product knowledge is a shared resource amongst the staff, not jealously guarded by the owner or one key employee.

Excellent Product Knowledge - What Your Staff Should Know

- Range of products and services currently available
- Key features, benefits and limitations
- Price
- Points of differentiation, uniqueness
- Substitutes and comparison with competitor products
- Relevant standards and do the products meet them
- Products which are more acceptable to customers because of packaging and presentation
- Trends in the industry
- Use of unique selling or promotional techniques
- Relevance of patents, copyrights, registered designs or



- trademarks
- Exclusive distribution rights or agencies
- Target customer group for each product range.

Are You Adequately Covered?

On page 1 we raised the issue of how a business owner would fund his or her retirement. But consider the situation where that business owner became permanently sick or injured before retirement age?

This is an entirely different situation and relies on adequate insurance cover to carry the business through a potentially difficult period.

A properly constructed insurance portfolio is vital for the stability of any small business. Of course there are numerous insurance policies available and, as various businesses are more prone to particular risks than others, not all policies will be relevant to all businesses. You need to talk through the options with your accountant.

Most businesses, however, should consider key-person and/or income protection insurance.

Key-person insurance provides funds to the business in the event of a key person dying or becoming totally or permanently disabled. It is taken out to cover income that will be lost until a replacement person is found and can also be used to cover any loans or commitments owing by the business.

Income protection insurance is insurance for the individual. Many different policies are available but in most cases a policy will pay up to 75% of a person's substantiated income through to retirement age or even until death in the event of sickness or accident.

Business owners should consider this:

- What would happen if you were unable to perform your normal duties?
- What would happen if you were run over by the "proverbial bus"?
- Who would take over the business?
- How would the bills be paid?
- Would the bank call up the loan?
- How would the principal's family survive?

These are important questions to consider and others will be relevant to your particular situation. For example, if you are in partnership with other people, you need to consider the implications of one partner dying and surviving family members wanting to sell out. Appropriate policies are available for this type of business structure.

As with any insurance portfolio, you need to consider the risk involved to yourself, your family or your business and cover yourself accordingly. Permanent illness or injury or even sudden death may not be part of your business plan, but they can and do happen, and you or your family could be left seriously financially burdened unless you take prudent precautions. Key-person and income protection cover should definitely be considered as part of any small business insurance portfolio.

If you have already implemented a sound insurance portfolio, make sure you review it annually with your accountant to ensure your cover continues to be relevant and adequate. You need to be mindful of any changes made to business operations and also take into account the current business climate.

An important Message

While every effort has been made to provide valuable, useful information in this publication, this firm and any related suppliers or associated companies accept no responsibility or any form of liability from reliance upon or use of its contents. Any suggestions should be considered carefully within your own particular circumstances, as they are intended as general information only.

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