KTS, INC.
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Featured Article

The Succession Planning Process

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Effective succession planning is emotionally complicated and deeply personal. The decision for an entrepreneur to consciously evaluate retirement and transition from the business is perhaps the most difficult one they will encounter.

According to the ***"Small Business GDP: Update 2002-2010"*** from the SBA's Office of Advocacy "Small businesses continue to be incubators for innovation and employment growth during the current recovery. Small businesses continue to play a vital role in the economy of the United States. Small firms accounted for 63% of the net new jobs created between 1993 and mid-2013 (or 14.3 million of the 22.9 million net new jobs). Since the end of the recession (from mid-2009 to mid-2013), small firms accounted for 60% of the net new jobs." Privately held businesses are the foundation of our great country's economy, but each year billions of dollars of enterprise value and personal wealth are eroded as a result of inadequate succession and contingency planning.

Legacies integrate sharing what we have learned with what we have earned. Business owners often neglect to address, or even understand, how their decisions impact their clients and heirs, especially in the event of an untimely death. The reality is that we must proactively plan for the unexpected and inevitable. As financial planning leaders and fiduciaries, we collaborate with allied professionals by providing information to facilitate protecting small business enterprise value and promoting the entrepreneurial spirit.

Every organization or business represents a living, breathing entity. Enterprise value is a capital structure-neutral valuation tool used to better assess synergies and future returns. While data for market capitalization is readily available for publicly traded companies, calculating enterprise value for privately held firms necessitates some degree of subjective estimation, even when engaging the most experienced industry professionals. A multitude of quantitative and qualitative factors help define value (or perceived value).

Independent valuation consultants evaluate tangible value in terms of assets and liabilities. Valuations also account subjectively for intangibles such as goodwill, relationship capital, and brand equity.

Most business owner clients have not committed the time to develop an optimal contingency or succession plan. According to the Family Business Institute, 88% of current family business owners believe their same lineage will control their entity in five years. Yet only about 30% of family businesses survive the second generation, 12% into the third, and 3% into the fourth. The statistics show a clear divergence between perception and reality.

At the heart of our country's succession planning challenges is the fact that decades of precious intellectual capital and experience will not automatically transfer. A succession plan is not sustainable without purpose and passion. Business owners may check a box for succession planning and unknowingly position their successors or heirs for failure. For example, ownership responsibilities are multidisciplinary, and may cross-pollinate amongst management, sales, marketing, finance, operations, and client service departments. *Success planning isn't just exit planning, it's planning for success!*

Further exacerbating the succession planning challenge is the fact that entrepreneurs often have distorted perception or unrealistic expectation concerning the value of their business. They have invested 15, 20, 30 or 40 years of their time building their enterprise, which represents a fountain of economic rewards for their families and clients. Business owners and their management teams often have an idea of the price they want for the business without accounting for economic reality and other important considerations. Intelligent, but uninformed people make bad decisions on opportunity costs. An entrepreneur's attachment to a

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perceived value prevents them from exploring their options and proactively addressing succession planning.

There is a mistaken notion that just because someone has invested time and energy over decades, the business has aged like a fine wine into extraordinary value. One element of goodwill is intangible capital, represented by the business owners' relationship and strategic capital. It is important to note that the value of a business may correlate to the reputation of the owner, and that reputation does not easily transfer with a sale.

While the likelihood of being struck by the proverbial bus is naturally something most people prefer to ignore, life or disability insurance are necessary components of an adequate contingency plan. Liquidity and succession planning are predicated on a series of proactive decisions. A comprehensive transition plan encompasses issues beyond the obvious monetary ones, including control —ensuring that an entity or financial asset remains with a family—providing care for valued employees, and establishing a legacy.

Contingency planning is an absolute necessity. We recommend addressing business continuity risk as part of a succession plan. Unfortunately, the sale or liquidation of a business at the most inopportune time occurs frequently. You may recall the story of an unexpected event that forced the sales or transition of a friend or client's business. Partnering with a qualified valuation firm, is a critical step of the contingency and succesion planning process. ❒

In Memory

Published by: Anita Thomson

It is with great sadness that Klaris, Thomson & Schroeder, Inc. announces the passing of Mr. Raynor J. Klaris. Ray was a co-founder and President of KTS since the Company's formation in 1993, and he will be deeply missed.

Mr. Klaris was well known in the appraisal industry, having been active in this profession since 1961. He had a B.S. degree in Agricultural Economics from the University of California, Davis and an MBA from UCLA. He served as president of the LA Chapter of the Appraisal Institute and testified numerous times as an expert witness. Some notable assignments that Ray was in charge of included the valuation of the Irvine Ranch Company in Hawaii and the Estate of Howard Hughes, both for the IRS. He was a mentor to many and friend to all those he met. His contributions, work ethics and professionalism has been a role model and a tribute to the appraisal industry standards.

Please keep Ray and his family in your thoughts as they go through this difficult time.

RIP Ray ❒