

## SPECIAL REPORT: SUCCESSION PLANNING

# Inertia Remains a Powerful Force

Despite Awareness of Importance, Exit Planning Elusive to Local Business Owners

BY SARAH DE CRESCENZO

**A**shish Jariwala, managing director at San Diego-based investment banking firm **PierCap Partners**, wasn't planning to join his family's business, which made texturized dyed yarn.

But his father's sudden death prompted his involvement, and he helped to run the company for five years ahead of its eventual sale.

The process of selling the firm, Jariwala recalls, was complicated by the lack of a well-documented transition plan for the business, and the complexities that come with transitioning ownership of a family-owned firm.

"Things happen in life," he said. Succession planning, even if an owner is not planning to sell soon or ever, "is like insurance you have to have in place."

In his work advising companies seeking to sell, Jariwala estimated a meager 5 percent or so have a well-documented plan in place.

Overall, companies in San Diego are woefully underprepared to transition what they have built in a way that preserves the value of what they have created.

That's according to a 2016 survey of about 200 San Diego business owners conducted by the **Exit Planning Institute** in partnership with **California State University San Marcos** and **BNY Mellon**.

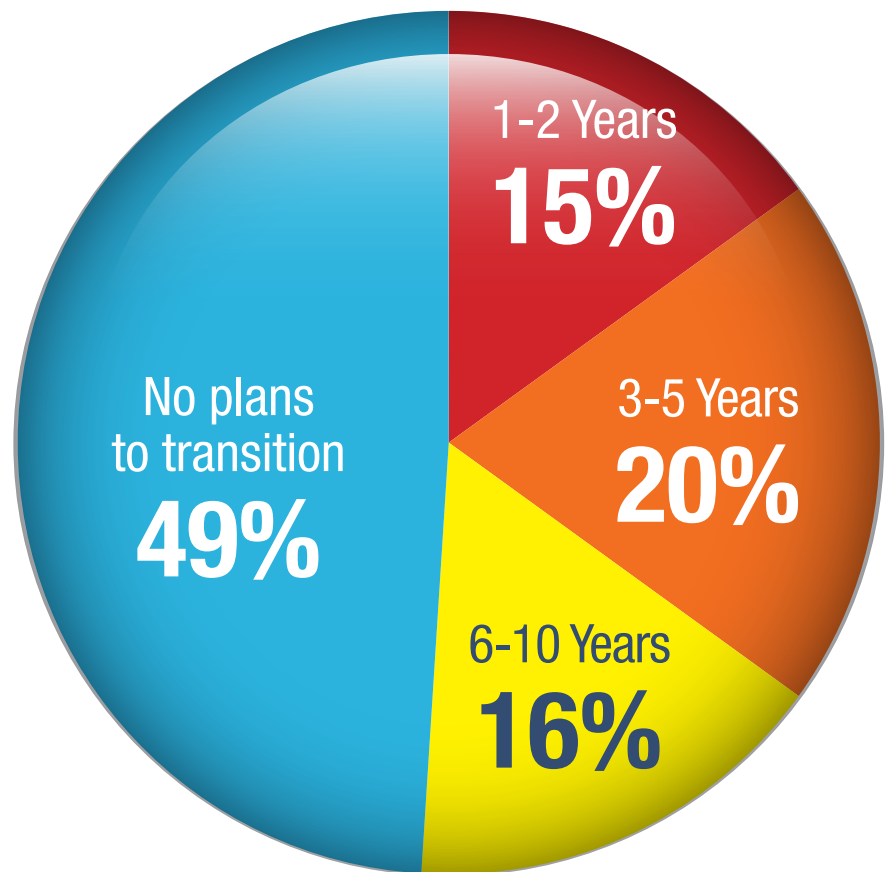
A total of 83 percent of respondents said they agreed that having a transition strategy was important for their future and the future of their business, but 66 percent indicated they do not have a transition plan.

Of respondents to the San Diego survey, 75 percent were age 51 or older, meaning that a successful transition should be a high priority since the importance of such a transition rises as the owner ages, the EPI said in its report.

"If the No. 1 part of exit planning is increasing of the business, it should be a business practice from day one," said **David Noosinow**, a senior director at **BNY Mellon Wealth Management** and a Certified Exit Planning Advisor (CEPA).

Business owners should model their practices after those of private equity firms, which buy businesses and aim to make them more profitable so the firm can sell them for more than the purchase price.

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### When are you planning on transitioning ownership of your company?



#### THE LIST

**18** Largest Employers

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## Business:

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“What are the professional buyers doing?” he said. “They have exit strategies. They have a velocity of money issue; they have to be able to get in and out of a company.”

Even if a business owner does not plan to transition ownership – and 49 percent of respondents to the San Diego survey said just that – that can change quickly, especially in the face of The 5 Ds: death, disability, divorce, distress and/or disagreement.

“Part of an exit plan is de-risking, having your contingency plan in place,” he said.

But, like other disagreeable notions, those eventualities are not topics on which many business owners seem willing to dwell.

Noosinow said there are a number of reasons why owners, even those who know the importance of exit planning, avoid doing so.

“It’s a very personal subject, so confidentiality (is an issue),” he said.

Further, entrepreneurs, by the nature of the role, are busy people, and delving into setting up a process through which, were it initiated, they would give up control of the business and the identity inherent in owning a business is not necessarily a pleasant or comfortable thought.

As if that weren’t enough, business succession planning is a complex process that requires a number of professionals to handle, each of which tend to use their own industry-specific jargon to discuss the topic.

“You add all this up and you get inertia,” he said.

To top it all off, the reward for wading into such a morass can seem nebulous.

“(Business owners) don’t understand the return on investment,” Noosinow said.

That return typically surpasses the most obvious benefit of an increase in the value of the business. It encompasses benefits from appropriate tax and estate planning and accounting fixes that can ensure a potential buyer wouldn’t find reasons to offer less than the business’s true value.

That inertia can be costly, to business owners and to the broader economy, the EPI said in its report.

Success rates for business transitions in the U.S. are “in the range of 20-30 percent,” said the institute, which bodes poorly for owners, most of whom have 80-90 percent of their financial assets tied up in their businesses, according to the EPI.

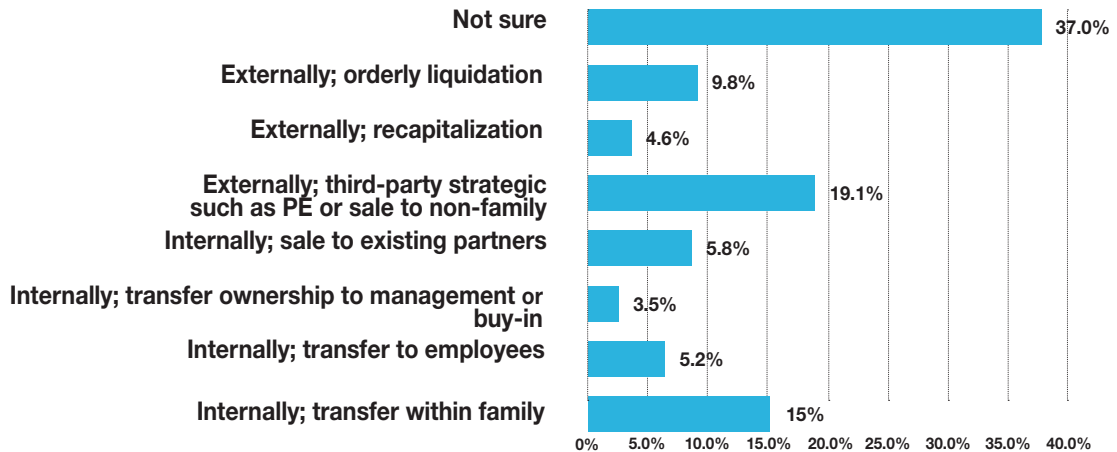
The first step for business owners should be to think through who the stakeholders are in the business. For some that might include family members, key employees, vendors, or even the broader community.

“Let’s say you sold the company for the highest price possible, but the company gets moved to Texas,” he said. “Everyone here loses their job, the people in the community lose the business with those people, and charities lose out.”

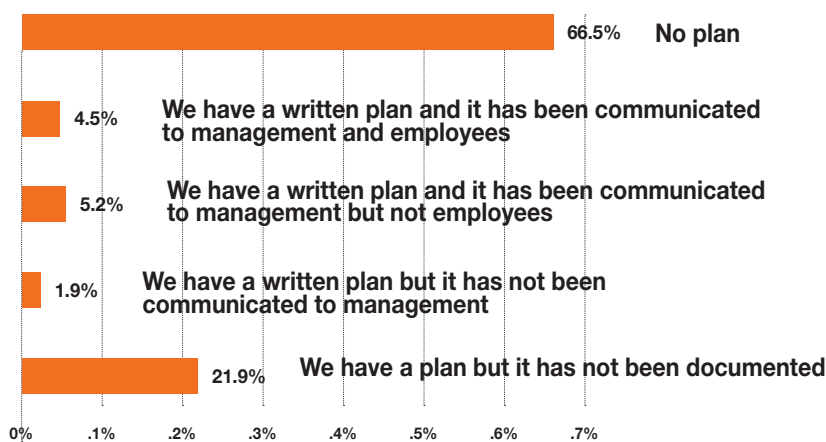
But even if the pool of stakeholders is as small as the business owner and his or her spouse, it is important to identify that before launching into planning for a potential transition.

A proportion of owners are serial entrepreneurs, but for many, they will only transition ownership of one business in their lifetime. “They’re doing it for the first time, and they only have one chance,”

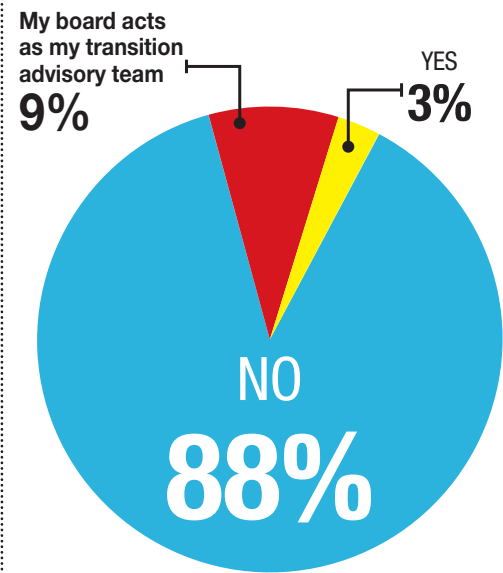
### How are you planning on transitioning your ownership?



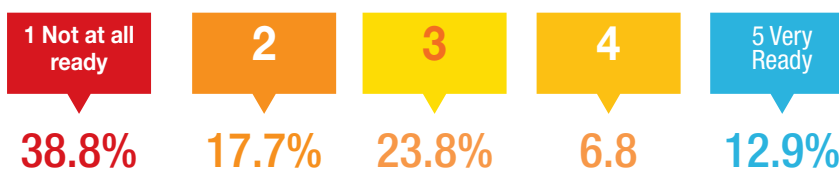
### What is the state of your transition plan?



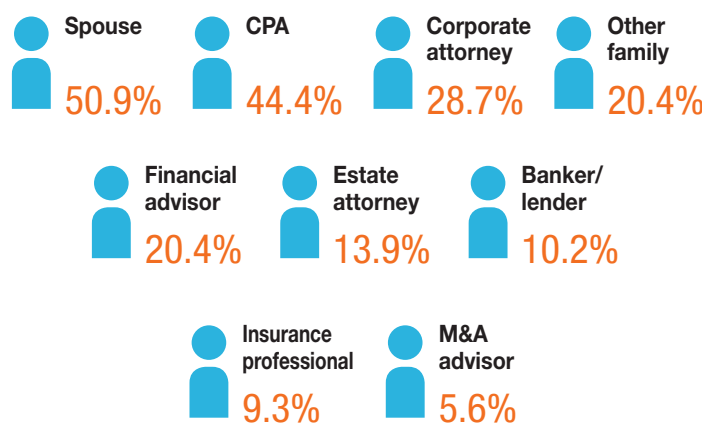
### Have you established a formal transition advisory team?



### On a scale of 1-5, what is your state of readiness to transfer your business?

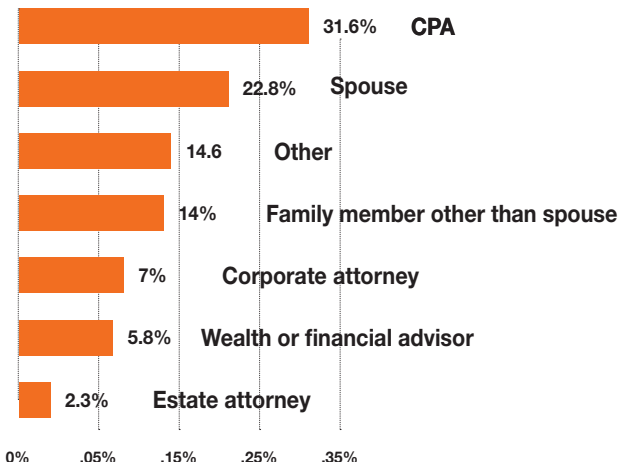


### Which advisors should be on your transition team?



Note: securities attorney and exit planning advisor were listed as options but received less than 5% of responses

### Who do you see as your most trusted advisor?



Note: securities attorney, exit planning advisor, M&A advisor, insurance professional and banker/lender were listed as options but received less than 1% of responses

Source: EPI State of Ownership Report, 2017 Greater San Diego; survey conducted by Cal State University San Marcos, College of Business Administration

Noosinow said.

But only 3 percent of respondents to the EPI survey said they have set up a formal transition advisory team, only 20 percent said they had an outside board of advisors and while 29 percent said they had a contingency plan should they be forced into an exit, only 56 percent of those had it documented.

“Many have thoughts of what they want to do and achieve but either don’t have the time or are reluctant to put money behind what they want to do because

they’re so consumed with managing the business,” Jariwala said.

Zaheer Dhruv, who started PierCap with Jariwala in 2016, said the growing economy is likely playing a role in the lack of attention being paid to preparing a business for an ownership transition.

“Business are doing well, so you’re not necessarily in a corner,” said Dhruv, also a managing director at the M&A-focused firm. “You don’t have enough time to spend on what you think is probably the right thing to do – think about what’s

going to come next.”

Of the San Diego business owners who replied to the EPI survey, 19 percent said they plan to sell to a third party while 15 percent said they plan to transition ownership to a family member. Even so, 42 percent said they have never had a family meeting about the business.

“There is a responsibility for everybody involved to really think about successful planning and an exit strategy, how best to go about it and when best to take action based on the plan,” Dhruv said.

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