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Transcript

Hello and welcome to the New Knowledge podcast. My name is Mark Singer partnering with Human Advisors, and I'm joined today by my colleague Stephen Target, managing partner of our firm, Steve. How are you today?

Mark, I'm doing great. Thanks for asking.

As always, the New Knowledge Podcast will provide meaningful content to our valued advisor, community and clients who are interested in learning more about sophisticated insurance related topics. Focusing on state planning and executive benefits. During our podcast, we focus our discussions on content that will deliver unique insights into the people, processes, and products that make our industry so critical. New one is a national life insurance. Planning firm delivering customized insurance solutions structured to help clients and their advisors engaged in solving estate planning, wealth transfer, business succession and executive benefits challenges, we are a member of the M Financial Group offering our clients access to the nation's most prestigious insurance carriers and innovative products available only through our. Today we have the privilege in speaking with John McLeod, CEO and founder of PMP Solutions affirm, helping closely held business owners grow their EBITDA and plan for a successful exit. Specifically, John guides owners through the critical operational, professional, personal and family decisions they must make to improve business value today and achieve exit success. Tomorrow, John is also an entrepreneur, investor, advisor, speaker, and adjunct professor at New York University. So no further ado. John, thank you for being with. Us today, how are you?

Great. Thank you so much, Mark. And thank you for the. Opportunity to talk about this very, very important topic. Thanks. Thanks for being with us. It's great to hear your voice and we're just pleased to. Have an expert. Sharing some of your your experiences for our audience and our our colleagues in the industry. So let let me just do. A little kind of positioning here in the beginning. About what our topic is going to be and and help those understand where we're coming from because you know, as business owners, all of us spend the majority of our time really thinking about how to to build our business and it's back to that old adage, we spend very little time work. Being on the business, we spend most of our time working in the business. We put our heads down and work hard and of course at some point there's going to be that that question and the topic of succession planning and and how do we transition to other parties, whether those parties are internal or external, sometimes exits or plans, sometimes they're unplanned. But the bottom line is all of us need to think about what that planning, what that succession planning means. So our take here at Newton one is that we always collaborate with professionals such as yourself. And specifically in the succession planning market, you know we need to have multiple disciplines. We need folks to understand the financial implications. We need to understand the tax implications, the estate planning, our positioning is the the insurance and whether that's through estate planning, liquidity or perhaps. Hancock planning for executives at the company. We just believe it's it's right to have those conversations early. Frequently, and to bring all the right advisors to the table. So that's what you do, John, you. You're one of those advisors and we're happy that you're with us today. So I'm gonna just start off with the very high level fundamental question. It really speaks to what I was just referring to. And the question is why is business succession planning so critical? Steve, great question and of course I have a certain passion for it. Based upon that, the line of work that I've chosen. But I believe first as home as the business owner. Middle Market business owners in particular make the world approval place by creating jobs, serving our customers well, innovating in markets, paying taxes, serving their communities, and of course ultimately expanding the economy, our American economy. So it's important to be business owners, understand that leaving anything that's. Chance can undermine. All the hard work and planning which. Where the the growth and the sustainability of the business and my mission within that is helping these business owners plan for executing successful exit. And what's that look like achieving financial freedom, creating a sustainable legacy and exiting on their own terms which is very important to all of them. Buckets that need to be considered and accomplishing this objective for ISIS. The obvious, which is financial, making sure that we put ourselves and wait put themselves in a position of having the right operating capital taxes and minimizing taxes and transferring the assets, something I don't see them worrying about on the front end and it can be a surprise on the back end and that's never any fun, legal and making sure that operating agreements. In place and written as we so intend, and obviously up-to-date. And then, of course, the operational issues is having the right business plan and that's. Being given by. A competent team. And ultimately, something that's not really giving enough credence, I think is the whole emotional family side of what happens in the owner's life after sale. So getting that some consideration. There's a big element as far as achieve. Being a long term successful exit. And and on the family. Side of the concerns include the style sheet on board the children, what's their expectation now, the proceeds going to be distributed. Now we start to learn more towards the estate side of things, but again all of these elements are critical and they. Potential in terms of adding to the reasons. Why we need to have? A succession plan in place. John, you mentioned there, which I think is an extremely important. Meant with the planning needs to begin. Early so it can, you can. You break down. For us, maybe what some of the the key elements are to start developing a successful plan and really when should the plan begin because that that can certainly impact the the results the. Well, that first, Steve, is the when it should begin. The answer is now. You know I have a number of prospective businesses that I've been talking to for a while. And with this tendency. Just think Manana is all going to be OK down the road and when I say, oh, well, when do you think you would like to? It's your business. The answer is sometime in the next five years probably place within the five year horizon and five year three years from now. And I asked the same question you answered the second sometime in the next five years. So the answer is you've got to get on it and get on it. Now it's critical to do so because it has no value. What's? So there are really four things for the business owner or get their head around in order to begin to do successful exit plan, first determine what their exit magic number looks like. Now with the definition on that, what that means is how much do they think they're going to need to exit and continue to live without. Check and keep it and maintain the simple lifestyle. You know that begins to inform how we exit in terms of what will make that most possible. Is that going to be transferring that or transitioning to family members? We're keeping the family which most and want to have a conversation about or identifying the right side of outside buyers. Outside bar. Excuse me, but ensuring business continuity that's establishing and maintaining. Committed talented management team and taking a hard look at them and having the right conversations with them and doing the right things in place. So to make sure that they can be very useful in terms of of how a business owner intends to exit silicons and renewal and then undertaking regular valuation exercises. And the metrics of the business that impact the events and the growth and ultimately the transferable value. And then ultimately uh creating a comprehensive business and exit plan that includes a state plan. Each of these steps are are interdependent and we can't do one without the other. If we expect the successful. Thanks John and I'm going to circle back to the first of those four elements that you mentioned and let's spend a. Little time talking. About identifying who that next generation of owners is, because as we know. You know each business is structured differently, but they could be family owned businesses and family owned businesses, perhaps as family members that work in the business and their family members, members that don't work in the business, could there be an opportunity for a transition to existing employees or executives? And then of course, there's always that opportunity or or potential. To to make the sale or the transition to an outside third party. So let's kind of walk through those and and from your experience. And what should we know about the the different potential? And perhaps I missed some, but the potential next generation of owners, the regression Steve before a business owner can really act on this informed way. They really have to formulate a clear vision of what they think or want that business to look like going forward and who's going to be in the best position to steer and how does that tail tail back to them achieving their exit, their successful exit. And it could very well be that you know, changing conditions in the market will require going forward different types of investment, whether it be in technology or different types of talent. So if we start thinking about family or passing it within the family and the question becomes, is there a family member that's not only deserving? But more importantly, capable of taking the health, or would this business be better served on the asset better serve? If they were sold from outside buyer and that would require identifying the type of buyer and then obviously we prove that fire which these days is often too much problem. There are really. Four kinds of transitions that take place. And I have little little. Catchy terms for each of the first I call a passer, and that's the transfer. That would be great for business company. That it also can raise some very complex issues, some of which we described before. That's the fair treatment of family members, especially those we're not going to be involved in the business or taking any value out of that asset going forward. And there's this whole back end, I call it Thanksgiving dinner conversations and making sure the people in the family understand what and why. And and can sincerely hate themselves to the businesses. The Golden goose asset that makes it all possible for everybody and feel good about what they're taking out of it. However, that looks whether it be through the estate or perhaps some passive stock in the company. The 2nd is what I call an Annie, and that's the selling. Employees and stops are available for that. And then what is more often seen these days is some kind of a transition to some senior leaders or loyal employees or. And very integral part of growing the business and have proven themselves or demonstrated their ability to run it and sustain it going forward. Biggest problem there is access to capital they they tend to be wonderful people, but they have no money still getting business loans and finding the cash. If you will to acquire the company could be challenged. 1/3 I call an Audi and that's selling to an outside party and.

That could be.

A competitor, it could be, you know, a financial entity such as a private equity firm. And both of those can be quite appealing and quite lucrative. But I I find that business owners are very concerned about that because they're interested in, but I guess they and they're interested in the. Even the more employees going forward, they're not very happy at all if they think that a new choir or from the outside is going to change everything, change the culture and maybe. Fire everyone to single woman simple way and the last the last way out is by calling the squeezer and that's basically just to bleed out the asset and run it from my sound until there's nothing left in something. Retire. Those tend to be professional services firms and other firms that you know don't have either. And the obvious place in market going forward can't be bolted on to some other kind of an acquisition entity. And you don't have any successors that are obvious and natural. So those are really the options for for well, they invest transition.

John and I'd like to hear your take on maintaining the strengths of the current and future leadership teams and also discuss some of the opportunities that can be structured such as golden handcuffs plays in in order to do so.

I should say we didn't close the whole business right outside purchaser, a state management team is in power. It's imperative to business continuity if we are looking at children. We're about to take over the business. As an example, the business owner has a daughter that's interested in the business. And she hasn't had enough time in Kenneth to really understand operation. What need to be done. We need to find ways to make sure that the key people who have their own exit plan will stay with the company long enough to not only continue to do what they do, but to support that daughter or family member. In transitioning to a place of the kind of maturity required to operate the business well, so there are number of ways to do that. Also an outside buyer is going to be very interested in who the key drivers in the business are and how that impacts. You have it. So if you have a key guy sales guy as an example, who may be the number one producer, you could be responsible for 50 percent, 60% of the production, and you want to take the business in other directions. You wanna make sure you're securities if you're 64, if you're 60%, so you need to lock them in for some period of time and give them an incentive. To stay with the business and usually that is for a minimum of two years in some sort of a. OK.

Deferring back to the four elements of a successful exit plan, starting with the first one is that number that the business owner has in mind that would suffice without having a paycheck following the the exit of the business. And really the importance of the business valuation as we know in, in most cases the the sale, there's usually 3 numbers used for that. Evaluation when doing what the seller thinks is fair, 2 being what the buyer thinks is fair, and then three, what the actual final agreed number is. So how do you help your clients work through the valuation exercises?

Big question and critical point, Mark, thank you for that. There really a couple evaluation approaches that can be utilized and the most important element of all of them is establishing the right formula. So example a business owner may decide upon a certain multiple revenue. Profitability and that then establishes the value of the business. Or they could create a a dynamic valuation metric that could even be an agreed upon price that is visited or revisited on a regular basis. That would be more appropriate if we were selling to some people inside the company. Or even family member. Then the last courses and agreed to appraisal form. With the right appraisal purpose and that would be an agreement generally between two partners if they're not in alignment in terms of what their exit timing might look like. So all of this is, is well codified and then an operating is going. But and and there's no right or wrong way to do it, so you know I I tend to advise people to look around their industry and see how other assets are being sold and what formulas are being used and industry trade associations obviously would be a good source of how to model that or put that together. In any case, whatever the formula, it the evaluation of the business should be regularly reviewed. Preferably on an annual basis and no matter the option we all need to ensure that there's proper funding available. If that's in place to achieve that purchase price and it's critical here to make sure that that's required, that that's reviewed on a regular basis. So I'm gonna. I'm gonna circle back again to kind of the pre planning aspect here because we get very engaged with the state planning with our clients and sometimes clients come to us after the sale of a business and.

Say, hey, you know, I've got this estate tax issue or it looks like I'm going to have an. Estate tax issue. What? What can I do? And clearly there are are planning opportunities prior to the sale of the business or the transition or the this the succession planning of the business that could benefit the family. Are there a couple of things that? That you might. Highlight for folks to think about as or as they're transitioning and and potentially getting in front of an estate tax issue. Yes, this this is where you see this is where I like to say that exit planning is a A-Team sport. So from that perspective, I tend to work closely with not only the business owner or owners, but their professional advisors, specifically their accountant, their corporate attorney, their state attorneys and commercial banking relationships. They have their wealth managers in terms of where is the money going to go and their insurance profession. All of those folks are important and ought now in order to do what they do well. What? The long term. Plan is and how any recommendation that any of them makes affects recommendations that the others are making. In the best interest of the outcome, the owner is trying to achieve and the goal here is planning a manner that we are surely maximizing the transfer of the value of the company. Every asset in general and minimizing their taxes and it should be top of mind for business owners. They need to think about tax effectiveness and the steps that they have taken in the past and understand how their assets fit into their other tax. Location for example, it's possible to overlook things like inventories through legal expenses and the impact rose on final numbers. And surprisingly, a lot of business owners just don't think of themselves as facing these issues. They think someday they're going to sit at the table and somebody's going to pass them a. Big check their life is going to be. Wonderful. But then they find out that these other things are all impacting what they're walking away with and achieving their exit on magic number. So it it tends to be particularly true because they've been so laser focused on building their business that they haven't paid attention. To the rest of this self. So as a result, no, there's been on estate planning and let's pass on with the take away of what's passed on to the next generation can be finished legs, insurance and would send elegant solution to reducing this kind of liability and whatever the solution needs to be part of our conversation. It's different from the dialogue focused on, it's just purely. Let's say with that I like the way you said that that the team effort or team sports. So let's let's stay kind of in that zone a little bit and understanding that there was a number of professionals that should be working together as we mentioned at the beginning and you just mentioned as well. Are there any other planning opportunities and I'll use I'll bring back in the word. Unless like any other planning opportunities, that should be considered in this kind of holistic high level restructuring that you think would be important to address. Sure, actually. But once the business owner understands the crew transition plan, anybody integrating a a holistic approach that that includes as we've discussed, executive retention, session funding, state planning tools sales etcetera, etcetera and executive benefits? The discontinuity piece because they ensure that experience management team remains in place, maintains that continuity and will continue to drive revenue, both leading up to and after exit as we discuss. Right. And of course this requires good consideration around how we're going to make it interesting to those in place to stay with us through the transition. This is sort of the golden handcuffed concept, right? And election Chance is a flexible tool and and and enables and dollars to pay existing owners and creates the cash needed to fund the ultimate state tax obligation with the owners and their family will face top employees should ideally have formal financial incentives to stay in the business. For at least two years beyond that. And hopefully design non solicitation non compete agreement and ideally owners need to put themselves in a. Position where they. Can go to their top person, business core leaders and share with them the future exit plans and create. Building and gas. So the idea here is as business owner achieves his exit magic number and retires successfully, he need make sure that those who run and there and those who saw it through for him. Are properly compensated. It would change as well, or incentives should go so that that's new. Transition is very important no matter what or which four types of buyers we have those three types, these squeezer doesn't matter. But the other three types of matters is going to be very important to an outside the choir. It's going to be very important. To family members who are transitioning to keep the business into the future and take their ownership of it and put their handprint on it. And so in the end, when that on our exit. And their skills walk out the door. They can't have everybody walking out the door. With them not. All at the same time, in the same point. So golden anchors programs keep keep people there is essential. Steve is number ways to do this. I'm sure you have thoughts on this. Everyone has thoughts on this, but it's executive benefits, deferred compensation. And section 163 bonus points, split dollar life insurance policies. I'm not. Going to get. Into the intricacies of those things, but I would I would strongly encourage business leaders to look at all of them. And talk to professionals such as yourselves about how they might apply. And of course life insurance, which is highly feasible and we can use them as. Ranging from funding the purchase in the business and to helping existing owners fund their retirement pay, state taxes provide death benefits to family members in the event that it's being with their death and or. Thursday will be sending job. And provide shareable locations upon their bet. That's John. That's that. That was a that. Was a good way. To kind of summarize some of the opportunities out there now, as we're winding up here, there's there's a lot we talked about today, but clearly there's a lot more that we really should be talking about. This is not a a quick process you mentioned five years, maybe it's. Or maybe for some businesses it takes longer than five years and and part of that is the emotion of it. Part of that's the practicality of of putting that deal together and and figuring out what the next step is and having the right team, having the right professionals. You know, as you're speaking here, it it, it seems to me that. Clearly you, you. Be either the choose the back to.

The team where you.

Could be the quarterback you could. Be the core of the planning and putting together that right team. So I'm gonna. I'm gonna punt back to you and ask is there anything that we missed? Is there anything that that you want to kind of close with here that would be important for folks that are considering succession planning or are in the profession and it will be important for you to share? With them? Yes, absolutely. First and foremost. Take that next step right now. With these business owners spend a tremendous amount of time building their businesses.

Because they are.

Cash and they may not imagine themselves ever not running it, but that they will come and after hard years of work and risk taking, they need to make sure that that business it's so important to them, will continue to flourish. And they have sufficient funds to retire. So start. Planning down that later to determine your exit magic number. And to get our plan to achieve it, the training with the next owner should be to help you achieve. Build a strong management team and incentivize them with compelling comparative benefit programs to keep contains and will allow you or help you achieve the extent that your vision of build an ongoing growth and development plan that should be written and it's going to allow them to achieve not only the evaluation that's necessary to achieve the exit magic number. But also with the long term eye towards successful exit. And incorporating state planning into the processes early as possible, since they do those things, they're on the right track.

John, thank you for your time. Thank you for sharing such great information. This is a really good segment. I think it's very applicable, especially if the economy when right now a lot of people are selling. So it's it's of the essence in regards to planning for successful exit strategy. So I really appreciate your time as do our as do our listeners and. Thanks, John. Talk soon.

You're very welcome. Thank you, gentlemen. Talk soon.

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