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Navigating a Clear Path to Successful Ownership and Management Transition

By Hugh Rice

While there are no cookie-cutter solutions for ownership transfer, there are some viable strategies to consider when it's time to successfully hand over your company's ownership and management to the next generation.

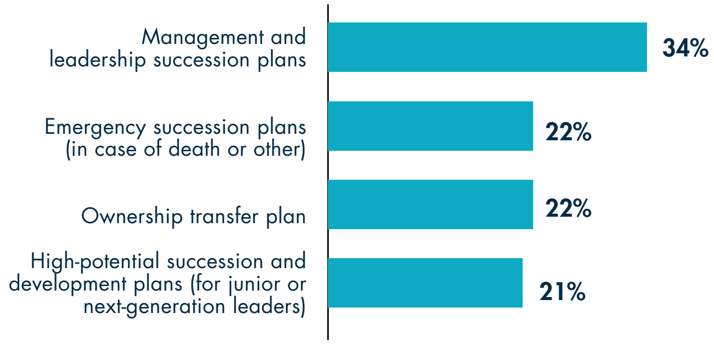
Ownership transfer is no easy task for engineering and construction (E&C) firms that know they should be thinking about the next generation of ownership, but that don't always have the time or motivation to start getting a plan of action down on paper. And while there is no "one-size-fits-all" answer to this industrywide issue, there are some viable strategies to consider when it's time to successfully hand over your company's ownership to the next generation.

If your company hasn't thought about ownership transfer in a while or considered it without doing anything about it, you are certainly not alone. According to FMI's most recent industry research,[1] only 22% of the owners surveyed have a formal plan to transition ownership of the business (Exhibit 1).

Family-run firms are particularly vulnerable to ownership transfer and succession management challenges. According to the Family Business Institute, 88% of current family business owners believe the same family or families will control their business in five years; yet actual succession statistics undermine this belief. According to the Family Firm Institute, for example, just 30% of family businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family businesses operate into the fourth generation or beyond.

EXHIBIT 1

For continuity planning purposes, the following components are formally in place in my business.



Source: 2017 FMI NRCI and CIRT industry surveys, Q1.

[1] Preliminary results of FMI's 2017 OTMS study. These are based on responses from FMI's NRCI and CIRT surveys for Q1. Final statistics will be published in the second quarter of 2017.

"There is a disconnect between the optimistic belief of today's family business owners and the reality of the massive failure of family companies to survive through the generations," the Family Business Institute points out. "Research indicates that failures can essentially be traced to one factor: an unfortunate lack of family business succession planning."

The need for good ownership transfer and succession management goes beyond just ensuring that there's someone prepared to take over the reins when the current owner retires. According to Software Advice, which develops software that companies use for recruiting, succession planning also plays a critical role in successful talent management and organizational growth. In a recent survey, for example, the firm found that:

- 62% percent of employees would be "significantly more engaged" at work if their company had a succession plan.
- 94% percent of employers say having a succession plan positively impacts their employees' engagement levels.
- Over 90% of younger workers (age 18 to 34) say that working at a company with a clear succession plan would "improve" their level of engagement.
- 79% of employers surveyed note they have succession plans in place for midlevel manager positions.

With these dynamics in play, it is increasingly important for owners to start planning early and focus on the long-term development of the next generation of leaders. In this article, we explore the issue of ownership transfer and succession management as it relates to E&C firms and introduce a number of strategies that your company can start using today to prepare for the future.

Handing Over the Reins

At its core, succession planning involves the handover of ownership and control of a firm to new management. In most cases, this entails:

- Transferring ownership to family members
- Selling the business to a third party
- Selling the business to key employees/ESOP
- Liquidating the business voluntarily—if the other options do not work

If you don't think your own firm is in the position to start thinking about one or more of these options, think again. FMI estimates that about 50% of construction firms will have a significant change in ownership in the next 10 years. Based on this estimate, the question becomes: When and how will these transfers take place? And with less than half of today's firms believing that they have capable, strong managers who could run the company in their absence—and even fewer having a formal transition plan in place—when will firms start thinking about this very important topic?

The harsh reality is that only a small percentage of construction firms are salable to a third party at a so-called "reasonable" price. Because the sale option is not on the table for the majority of firms in our industry, we have to look more carefully at internal transfers and succession—a prospect that's not always easy to tackle when owners often assume that their firm is worth more than the employees can afford to pay. A good example of this would be a sole company owner who is currently in his or her late 60s. One morning that person wakes up and says, "Well, I think it's time for me to get out and take my money off the table and turn this business over to someone else." Unfortunately, selling your company to your employees doesn't happen overnight. In our experience, such transactions typically take five to 10 years, since employees do not usually have the necessary financial resources to buy out the owner at short notice.

The challenges don't end there. Here are other key considerations to take into account when developing an ownership transfer initiative:

Succession is both a money issue and a people issue. As construction firms consider their business transition options, there are two sides of the equation to evaluate: money and people. Both sides have to be taken into consideration if the business is to survive from one generation to the next. I've spent much of my career focused on the financial issues related to ownership transfer, which in most cases is the easier part. The people side is more complex. Consider this: The construction business is very much an entrepreneurially driven, risk-oriented business that requires a certain personality type to succeed. It's often challenging to find those people, and we frequently hear company leaders say, "We've got one really strong leader, but that person's retiring, so we're going to replace that person with five or six other people." This kind of transition can be challenging because it always takes a strong leader to make things work. Committees cannot manage businesses.

Your second lieutenant probably isn't the best choice. Even though he or she may have helped shepherd your company through good and bad times over the last few decades, that right-hand person doesn't necessarily have the instincts needed to lead the company into the future and take it to new levels. Besides, that individual may not even want to be in that top job. Knowing this, we often encourage people to move down a generation into the 30-something age group to find their successors. This goes against the common sentiment that people in their 30s lack the experience to lead. The reality is that someone with 10 years of the right kind of experience in construction—a very difficult business—is often well-equipped to take over.

Bonding and banking issues can present major stumbling blocks. In our industry, bonding and banking both present significant hurdles for any firm looking to transition to a new generation of ownership. Put simply, the bonding companies and the banks are not going to provide you with credit unless the company has a meaningful equity. If you start taking equity out, your bonding and banking credit levels decrease. So it becomes an issue of how to get your money out and maintain adequate financial capacity. In short, you have to be able to make enough money to replenish the funds that you're taking out. That's a tough pill for some people to swallow.

Selling the business to your employees takes longer than you think. Transferring ownership is a long process and entails myriad legal, accounting, tax, insurance and business planning issues. A firm that plans to sell stock to its employees over a 10-year period, for example, will probably start by selling just 10% of that stock (meaning, the owner still benefits from 90% of the firm's growth). By the end of the 10-year period, the employees own the company entirely. This type of slow buyout is necessary to allow the business to fund the buyout through profits. The business effectively funds its own transition.

The cycle of ownership transitions happens every 25-30 years for every business. Every construction firm in America that's not publicly traded goes through ownership transitions. This transition process is currently being fueled by the high level of baby-boomer retirements. As a result, more people are trying to figure out how to exit their companies and leave those entities intact and on a growth path as they move into retirement. This isn't any easy task for firms—particularly those 95% or so that aren't candidates for sale to a third party. This can be difficult to accept, particularly for someone who has spent 30 to 40 years of his or her life creating and building the business. Successfully transitioning the business from one generation to the next is a never-ending process.

No Silver Bullet

When it comes to ownership transfer, there is no clear-cut guide to the question, "How can I successfully transfer my company to a new owner or owners?" In fact, ownership transfer is a lot like a chess game in that it involves a lot of moving parts and some very focused concentration to navigate successfully. It's not simply a financial or tax problem nor is it an organizational or family problem. It's also not just a bonding and banking problem. It's a combination of all of these elements, and that's why there is no cookie-cutter solution that applies to all construction firms. Each entity is different, and making all pieces fit together is an extremely important step that's contingent upon the company's individual nuances, traits and the goals of the current and future owners.

To construction firms seeking the best possible ownership transfer solution for their individual situations, the best approach is to consider the pros and cons of all options that lie before them. The final answer will depend on the individual circumstances, the preferences of current and future owners, and what approach "feels right." By taking the time to understand your company's current situation and your objectives, and assessing the options and planning well in advance, you'll be well-positioned to handle the transition when the time comes to do so.

Hugh Rice is a senior chairman with FMI. Because of his expertise and experience in dealing with strategy and ownership issues in the construction industry, Hugh is frequently asked to speak before groups of international scope. He may be reached via email at *hrice@fminet.com.*

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