EMPOWERING THE NEXT GENERATION

As Singapore's first-generation entrepreneurs reach retirement, we look at their broad options and the common pitfalls to avoid on the way there BY *HOON CHI TERN & JASSELYN SEET*

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CLOSELY-HELD family businesses have traditionally been built on the reputation and credibility of its founders and the goodwill accumulated with business partners over the years and even across generations. For businesses where goodwill can be lost because of a change in ownership or corporate identity, it is important for the founders to consider succession within the family.

On occasion, the ambitions of the next generation may lie elsewhere or there may simply be no suitable successor waiting in the wings. In this case, rather than risk leaving the legacy in unwilling or unprepared hands, the founders may have to consider external professional management who are appropriately incentivised to grow the business as a co-stakeholder. This could include partial compensation with a stake in the business through management incentive plans.

EXIT VIA A TRADE SALE

If monetisation of the business is a key consideration to the founders, a trade sale – whether in full or in part – will achieve that objective.

Some private equity (PE) players look to structure a transaction where the founders and/or management retain a minority interest in the business and share in the upside of any growth. The PE would work hand-in-hand with the founders or management to achieve those goals.

Strategic investors on the other hand, who already possess industry expertise, may look for a full takeover of the business. The right PE or strategic investor can create value through different ways, including access to additional funding for growth, professionalisation of the business and placing the business in a larger synergistic network of portfolio companies.

LISTING ON A STOCK EXCHANGE

For many first-generation entrepreneurs, the natural progression for growth would be to pursue an initial public offering (IPO) and listing of the business as a public company. There is a certain glamour about an IPO which a trade sale cannot match.

Broadly, an IPO could involve the sale of both new shares (proceeds to the business to fund expansion, growth and working capital) and existing shares (proceeds to the selling shareholders). While family ownership and control may be diluted as a result of the IPO, it also provides:
(i) a platform for further fundraising after the IPO for future growth,
(ii) access to institutional investors who may have limited mandates of trading in public equities, and
(iii) a liquid market for the shareholding interests in the company.

The choice of the IPO jurisdiction is also important, and key considerations will include:
(i) the main geographic markets the business is present in and its future areas of growth,
(ii) the visibility of the business to local and foreign investors,
(iii) sector valuations, and
(iv) liquidity and ease of fundraising.

An IPO may be glamorous, but the road there and beyond requires significant commitment of time and resources by the owners and management of any business, and can take anywhere from six to 12 months, depending on the complexity of the operations.

LAYING THE GROUNDWORK

Founders should, as they gear up for succession, take note of these key matters which could lay the groundwork for a smoother transition and would be applicable regardless of which route the founders choose to take.

- **Management continuity:** Whether or not the founders are keeping it "in the family" or planning for an exit (whether by way of trade sale or IPO), management continuity is key. In case of a trade sale, the new buyer may look to continuity in management, especially with a view to retaining existing business partners. In the case of an IPO, the founders will continue to be significant shareholders in the listed company, and it is paramount that the business continues to be well managed so that there is no destruction in value as the business transitions to the new generation. Many stock exchanges also require substantial continuity in management as a pre-requisite for at least three years prior to an IPO.
- **Corporate structuring:** Some family-run businesses may not have an efficient corporate structure with rational segmentation of business and financial reporting lines. For some, it could be the founders directly holding shares in various entities, rather than consolidating the business in a group structure. In extreme cases, multiple entities, including some which may be held by nominees, are used to carry out similar business activities. Other examples include transactions with related parties such as advances which may need to be repaid or written off. A well-thought-out pre-transaction restructuring process can rationalise the business and make it easier for a buyer or investor to understand and appreciate. The last thing that a founder wants is for buyers or investors to shy away because the corporate structure is too complicated. Clear segmental business planning and financial reporting may also allow the founders themselves to understand where the growth areas and value of the business truly lies.
- **Housekeeping:** Common issues include missing statutory records and regulatory compliance issues involving licensing and employment practices, especially if the business has expanded to developing jurisdictions. In the context of a trade sale, the buyer and/or investor may decide that they require specific indemnities for such issues to be provided by the founders, and this has a resulting impact on the post-closing risk for the founders and potential erosion of value. For an IPO, regulatory compliance issues, if not resolved or mitigated beforehand, may result in questions over the company's suitability for listing and may potentially delay the IPO process.

Time is the common factor across these key matters. When the market is primed and vibrant and conducive for transactions, founders would not want to spend time waiting for restructuring to be completed or for due diligence issues to be resolved. Getting your next generation members involved in the detailed due diligence process would also bolster their understanding of the business and allow them to take ownership by managing and spearheading this process.

In planning for succession, it is important to keep open all options, whether preserving family ownership, opening up to external investors or even exiting the business completely. The next steps to take are important for any business, and is an essential conversation that the business stakeholders need have sooner rather than later.

Alternative exit options have to be considered where succession planning is a challenge; and a sound strategy has to be put in place, with the help of professional advice. This is to ensure that the legacy of entrepreneurial success does not simply fade away, even if it is not left for future generations of the family. ■

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