ORANGE KIWI

The M3 Framework for Successful Business Owner Transitions

CASE STUDY INTRODUCTION

A family owned specialty packaging company with an enterprise value of ~$28M was facing it's first significant ownership transition. The founders (G1) are a 70 something husband and wife team, who founded the business 23 years ago and bootstrapped their way to success. G2 consists of two adult children (Daughter, 53 and a Son, 49) that have worked in the business for more than a decade during which time the business has realized its most significant growth.

The family is closely knit and the children have gained ownership via both sweat equity and by purchasing their ownership shares. Their initial approach to preparing for succession was to respond to private equity inquiries and view the transaction processes as an exploratory experience. They went as far as signing letters of intent (LOI) with four successive firms without defining their unique formula for transition success. As a result, the family pulled out of the deals at various points in the due diligence process. When asked why they said, "even though they were costly lessons, we needed to experience them to learn what we didn't know."

Scale. Sale. Succession.

This document is designed for low- to- mid market business owners who are within 1-7 years of a significant business transition.

These critical transition points for both the business and the owner(s) are often once in a life-time events. Every owner is unique and every business is distinct. In order to remain truly in control and ultimately successful, an owner needs an approach that is custom fit. Where should an owner begin? Right where they are - not where an "expert" says they should be. Who decides what success is? The owner - the one who must live with the choices.

There are lots of tools out there to help business owners. However, many approaches run contrary to the natural instincts of owners. Most owners are consumed with running the business today and have little interest or capacity for a time consuming linear planning process.

Our approach has been forged in the trenches of business, refined via ground-breaking PhD research, and based on the understanding that:

- Business owners are hard-wired to build and run a business.
- A business owner's life, business, and wealth are interwoven and not easily separated.
- Significant transitions expose owners and their businesses to internal and external threats and challenges
- Exploiting opportunities resident at points of significant transitions requires substantial transformation for owners, families, and their businesses.

Thus, the M3 framework is designed to be highly flexible and responsive to the business owner's needs. This proven approach is designed to help owners achieve maximum results during periods of significant transition be that scale, sale, or succession.

Authors

Allie Taylor, PhD (candidate), and Andrew Taylor are the principals of Orange Kiwi. They are recognized as national experts in helping low-mid sized business owners successfully navigate key business transition points. Allie's highly regarded PhD research has broken new ground in understanding owners during such key transition points.

A formula is defined as, "a method, statement, or procedure for achieving something, especially reconciling different goals or positions." Therefore, by definition, the creation of a formula necessitates intentional choices to select the variables (constituent parts of the formula) that lead to an intentionally derived goal or position.

For successful low to mid market business owners those variables reside in three critical dimensions that create unique complexities, opportunities, and challenges. These three dimensions are "My Business", "My Money" and "My Self".

After years of working with successful owners, reading everything we could get our hands on, and doing our own PhD research, we developed a process and framework that hits all the essential variables in these three dimensions – we call it the M3 Framework. The M3 is designed specifically for sale, scale or succession events.

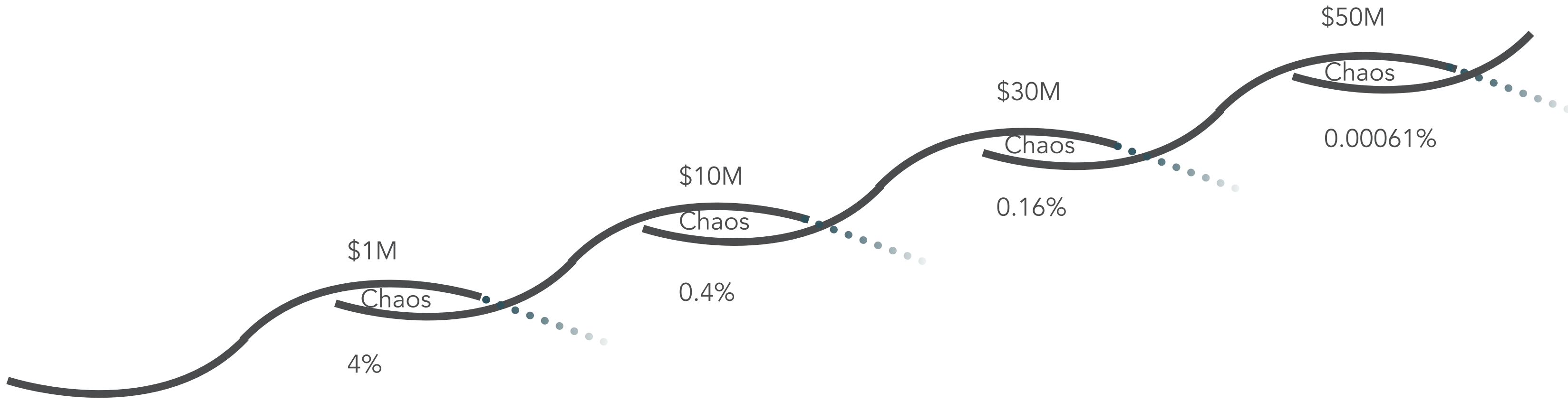
WHAT MAKES AN OWNER DIFFERENT?

This framework recognizes that low to mid market owners exist in a more complex environment than employees, hired CEOs, or shareholders of public companies. Research demonstrates significant differences exist in certain personality dimensions of successful owners as compared to "hired gun" CEOs that contribute to success in their respective career paths. These differences in personality and professional development contribute to how each experiences the threats associated with significant transitions. Specifically, while both grew into the top job, entrepreneurial CEOs built the company they lead. The "hired gun" CEO likely entered into an established organization.

This seemingly innocuous difference actually has substantial implications. Consider the hired gun. He or she had some career trajectory that involved acquiring the so called KSA triangle (knowledge, skills, and abilities) along with experience as they rose through the various organizational levels. Over the course of their careers hired guns are shaped by the external forces in the corporate environment that cause them to conform to culture, strategy (often designed by others), and play their role in execution. They are held accountable for performance measures that may include bottom line financial aspects, but it is very rarely their own money on the line.

CEO owners (we'll call them entrepreneurs) on the other hand are responsible for top and bottom line performance from day one. A client said it best when he said, *"As an owner I eat only what I hunt, kill, fillet, and cook… and then I have to clean up the mess."* Entrepreneurs are the force that shapes their organizational culture and they are responsible for every aspect of its performance. Where hired guns are often well trained formally, entrepreneurs are self-made via the "school of hard knocks" even when they have a formal education and it is always their money, reputation, and future on the line.

Growth Curves of U.S. Businesses By Annual Revenue



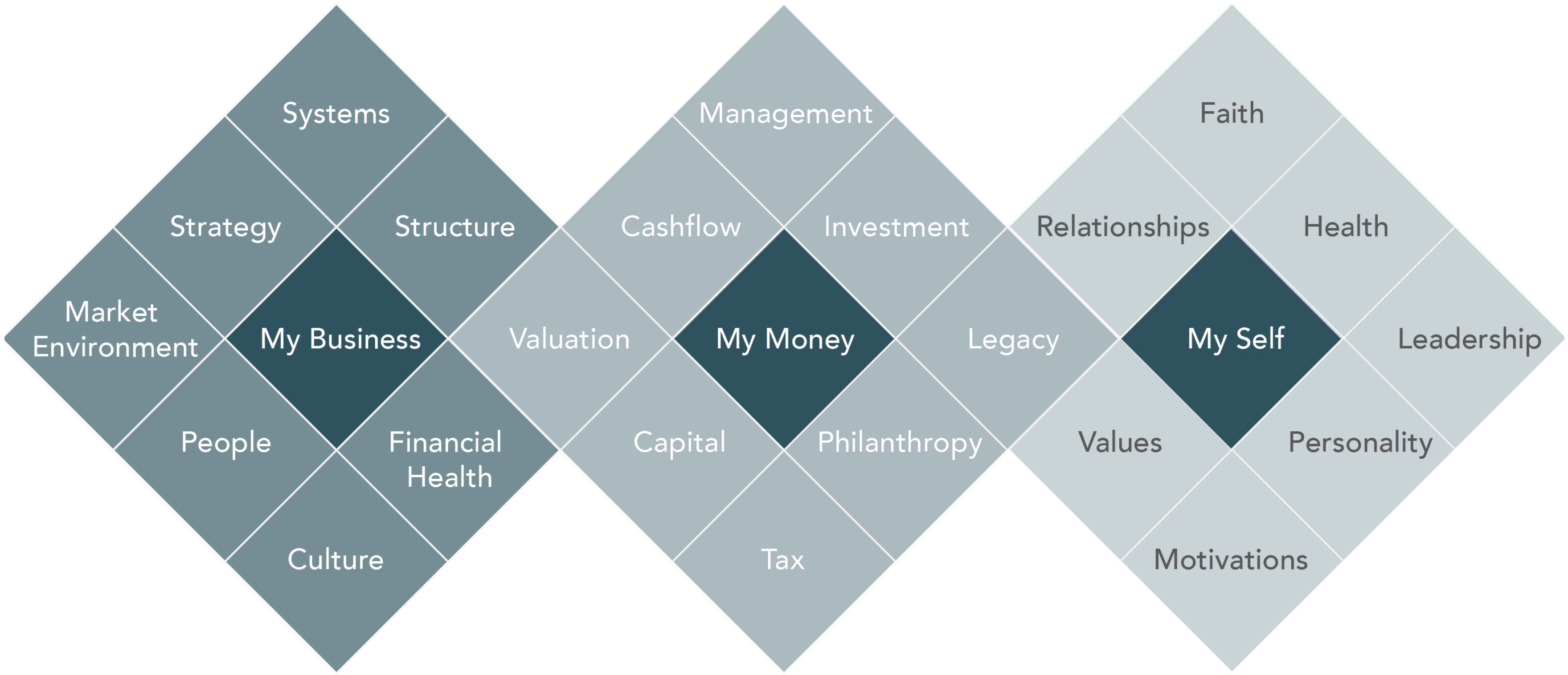
The magnitude of the scaling challenges is daunting when you consider that only 4% of all businesses ever get above $1M in annual revenue and most fail before they reach the 7-year mark. In order to survive where many fail successful entrepreneurs leverage certain characteristics:

- Risk taking propensity
- Tolerance for ambiguity
- Innovativeness
- Need for goal achievement
- Need for control

and they build the business so that it works with their strengths. They are literally able to shape their culture so that it gives them the best shot at success. The downstream impact of this effect is that most owners will face a seemingly insurmountable ceiling through which they cannot break. Consider the barriers to annual revenue described by the S growth curves above.

What's happening? Why is the attrition so significant? Can this really be due to market forces? Do owners intentionally choose to limit their business's growth? One of the most common reasons is that the demands of personal change required to transform a business for scale keep owners stuck. The best business consulting or financial advice available in the market cannot conquer an owner's lack of personal readiness for transition.

A silver lining is that the organizational development and personal challenges owners must conquer are predictable as are the potential pitfalls. Interestingly, the areas owners must explore for growing the business are the same areas they have to explore when contemplating a sale or succession event. By doing the exploratory work early to build their custom M3 formula for success, owners buy themselves the competitive advantages of time and foresight – two essential elements for achieving their long-term goals.



THE M3 FRAMEWORK

How do owners build their custom formula for transition success? Our answer to that question is the purpose built M3 Framework.

The reality is that for most low to mid-market owners, their business, their money, and their self are deeply interdependent. As such any transition - be it scale, sale or succession - must consider all three components in totality.

We have worked with many owners that successfully build businesses, yet they have not even considered the implications a significant transition demands *of* - or the impact it will have *on* - them. As a result opportunities are missed and the business eventually fails to transition largely because the owner is blind to critical variables.

While many challenges are predictable, all owners and businesses are unique, meaning a prescriptive linear process is ill-suited to these demands. The M3 is designed as a dynamic, flexible approach to address different developmental foci over time. For some businesses the emphasis to prepare for transition might be Financial Health - without it there is little value in discussing philanthropy. In other cases the owner's personal Leadership, Personality and Motivations are key for transition success.

Try this exercise: (a) You have 5 dimes to spend. Allocate the dimes to My Business, My Money, and My Self based on the amount of focused effort you think is required to achieve transition success (more focus, more dimes); (b) based on the amount you put in each dimension indicate how much you would allocate the specific variables in that dimension; (c) without revealing your allocation, ask your management team, your spouse, and informed advisors how they would allocate the dimes for you. To what extent do they agree? Differ? Would you change anything as a result?

MY BUSINESS

Businesses are dynamic and there are two ways to lead them – proactively or reactively. Reactive owners respond to circumstances as presented and build capacity in an ad hoc fashion. The key to successfully transitioning a business (be that scale, sale, or succession) is by leading proactively. Proactive owners learn to examine the current organizational capacity and health of their business and how to design transition strategies that align all eight essential variables and the two other domains (My Money & My Self).

Proactive owners leverage their innate strengths to manage weaknesses and continue to push the envelope of what can be achieved. The eight variables that proactive owners consistently monitor and address are:

Market Environment: what forces are working in your favor, what forces are working against you, and how do you compete in the future? More importantly… how do you know? Proactive owners not only examine the market environment for their own business, but they are also looking at the market forces impacting their top customers and identifying potential down stream opportunities and threats. Is our saleas team attuned to the market?

Strategy: what are your current and future competitive advantages? How do you compete? Where do you compete? Are there adjacent lucrative and exploitable strategies that should be tested? Does a coherent and documented strategy exist? How often is strategy evaluated and are adjustments made? Do you know what is required of your business in the other 7 variables and 2 domains to achieve the strategic objectives? Do you know what could kill your strategy and have you planned for it?

Structure: Legal structure: is your businesses optimized? If you are planning to exit (through sale or succession) your ownership structure holds the key to a number of possible strategies if you have enough time.

Organizational structure: Is your leadership structure aligned with the other 7 organizational capacity variables? Is your structure optimized for innovation and responsiveness? Does the structure maximize efficiencies and internal coordination? Is your structure designed for growth?

Systems/Processes: What formal and informal systems and processes are aligned with strategy and structure and what aspects equire adjustment? Are human systems, policies, protocols, and processes commonly understood and documented? Do the metrics and feedback loops in the systems provide management visibility and proactive responsiveness? What technological solutions are serving the organization well and where is the room for improvement?

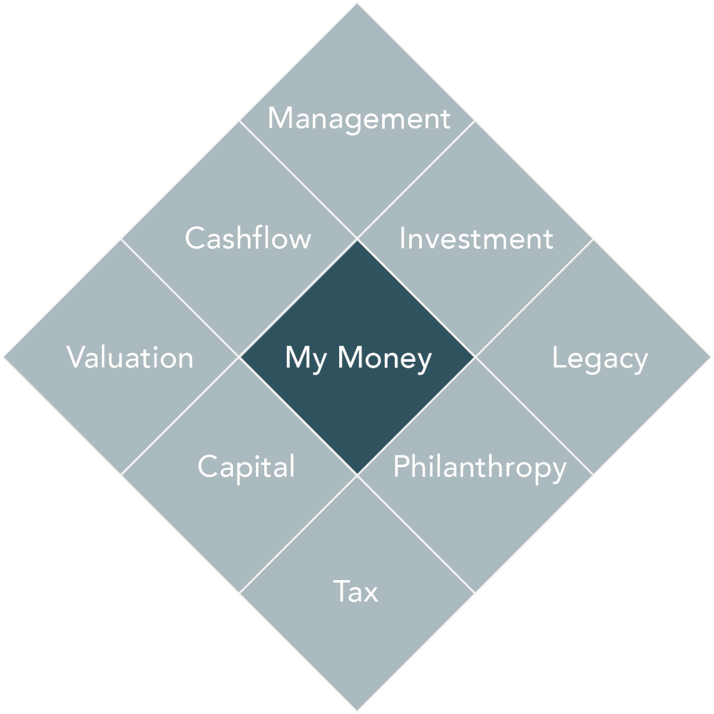
Culture: "culture eats strategy for breakfast" (Peter Drucker)… unless culture is accounted for in the strategy. What type of organizational culture predominates (market, hierarchical, adhocracy, clan) today? How well does culture align with current and future strategy? What aspects could be enhanced and what aspects need to diminish? To what degree do our hiring and management practices align with our culture objectives?

People: Would we rehire 100% of our staff? Are they the right staff in the right roles to achieve our strategy? Are roles and deliverables well aligned with strategy and culture? Is our compensation structure aligned with strategy, culture, and attracting the level of talent required? What changes are possible to develop and manage our talent pipeline so that it is a competitive advantage for long-term success? In what areas could external skills increase our internal capacity while avoiding unnecessary fixed overhead?

Financial Health: Are all lines of revenue and expense driving value to the bottom line? Do we know the profitability of each customer? Are the key financial ratios defined, monitored, and managed against? How well are cash cycles managed? Are AR and AP optimized? Are the balance sheet and income statement strategically managed? Can holding costs be reduced with an adjustment to business processes? Are we harvesting every dollar possible in all budget lines?

Valuation: understanding your business's value in the market is important even if you don't plan to sell for years to come. Valuation is an essential part of your financial reality and most owners have never discovered how to proactively improve their valuation or how it impacts both their business and their personal financial picture.

Business valuation is enhanced when the business can thrive without the owner(s). If you can't be absent from the business for 30 - 60 days without a negative impact on operations or profitability, there is room for valuation improvement.



MY MONEY

Money is the most common method of exchange between the business and the self. An owner's personal finances are almost inevitably directly impacted by the well-being of the business. The stories of entrepreneurs putting their family's security at risk in order to see the business survive are endless. On the positive side, a truly successful business creates wealth that can dramatically impact how that owner and their family think about philanthropy or money management.

Many financial planning tools are useful only when there is liquid wealth. But, a business owner's greatest asset is often their business - and yet, it is so much more than an "asset". Often it is the life's work of the owner and the generations that came before them. Any consideration of My Money must be explored in the context of the Business and the Self as they are inextricably connected.

The components on the following page contain key variables that must be explored to achieve any significant business transition.

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Cash flow: Growing companies eat cash. How are your cash needs impacted by growth? Do you know your cash flow thresholds? Are you managing cash for maximum profitability? How do you know? How often do you stress test your cash flow model? What customers or vendor/suppliers are draining cash? Are your customer and vendor/supplier terms optimized? How are your personal and business cash flow dependencies related?

Capital: Do we have the right capital structure to maximize profitability of the business? What options exist for capitalizing growth? Is our capital strategy SMART? How do my personal financial picture and my business's capital needs relate?

Tax: Are my business and personal tax efficiencies maximized? How does time impact the tax strategies available when I want to exit via sale? via succession?

Management: Have I maximized the financial opportunities that exist in both my business and personal finances? What options can be created so that I have financial freedom and increased control of my financial future? Do I have the right legal structures in place to protect my business, my family, and myself and to ensure continuity for the business and my family?

Investment: Most investment advice focuses on liquid wealth, but most owner's wealth is illiquid. Investment strategies for business owners are complex and require expertise that understands the pain points. What is the best way for a business owner to get a home mortgage? What investment strategies best fit my risk profile and cash needs as an owner?

Philanthropy: When giving is important how do I get the most out of my donor dollar? Are there opportunities for giving that have nothing to do with cash today? What is the difference between giving out of cash flow and giving out of assets? How can owners design philanthropy into their exit (sale or succession) strategy and maximize both the assets they keep and those they give away? How does time impact philanthropic choices?

Legacy has multiple meanings it is both the tangible things we leave behind (usually governed by estate plans, trusts, wills, insurance, and other contractual agreements.) - the "hard" side of legacy. Many successful people have to address these issues, but successful owners have an added dimension of legacy - the soft side - in and through their business that must be addressed. Will they leave a positive, enduring business legacy - one that they and their family can be proud of?

Our strategic partners are experts in understanding the financial realities that business owners face. While not all financial advisors, CFOs, or analysts understand the world of the small business owner, our third party partners do – they are skilled at helping you define the My Money variables that contribute to your M3 formula for success.

MY SELF

When transitioning a business - through scale, sale, or succession - owners are confronted with demands of personal transformation at the very same time they must transform their organization. Over the course of the business lifecycle successful owners undergo personal transformation in preparation for each new level of success. At some point the vast majority of owners hit a limit and seem to experience a glass ceiling through which they cannot break. As with most areas of life, strengths have a tendency to become weaknesses. The very traits that fostered the owner's success are the traits that may get in their way of achieving greater success.

Proactive owners recognize this potential and choose to avoid the down side by doing the difficult introspective work to continuously evolve their leadership of self and others. But, for many, taking time out to work on personal development is a luxury busy owners easily overlook. In the My Self dimension of the M3 Framework we help owners systematically examine 8 variables of the Self (in the context of My Business & My Money) to help them with the intentional continuous personal transformation necessary for ongoing success:

Legacy: A legacy is something that is handed down from one generation to another. That "something" may be tangible items like money, the business, stories, a letter, or it may be less tangible like a reputation and memories. Business owners who care about their legacy have the opportunity to craft the type of legacy they want to leave.

Values: drive decision-making. Values are an owner's essential beliefs that shape how they work and live – they are directly related to an owner's success (or lack thereof). Overt values are explicit and intentional. Covert values are the values that live below the surface. When the two are in conflict owners experience tensions and exhibit behaviors like self-sabotage or an inability to efficiently and effectively make decisions. These are pitfalls that derail an owner's attempts at business or personal transformation. Bottom line: Values must be intentionally examined, defined and reconciled because they will ultimately define your success and satisfaction.

Motivations: All people have certain motivational drivers (relatedness, competency, and autonomy) that must be satiated in order to have psychological health. When these motivational drivers are largely met through the role as "owner", transitions can be more complex and lead to pitfalls that sabotage the effort all together. By taking an intentional look below the surface at how these drivers are satiated owners are able to increase their awareness and ability to overcome barriers to transition success.

Relationships: Owners shape and are shaped by the relationships in their life. A challenge that many owners face is navigating shifting relational dynamics at significant points of transition. Taking an intentional and thoughtful look at the meaningful relationships in your life helps to align priorities. In this way owners are able to lead themselves and others through impending interpersonal shifts (both business and personal) to minimize avoidable conflict while maximizing the opportunity for increasing relationship quality.

Personality: Successful owners are complex and unique individuals. Yet, the literature asserts that there are common personality traits that allow successful owners to persist where others fall short. Simply put, owners are "wired" to build businesses. As with all strengths this wiring has a downside. For owners that downside is often experienced most directly at points of significant transition. Understanding your natural inclinations provides critical insight that allows you to leverage your strengths and manage your weaknesses to increase your control at these key moments.

Leadership: There are at least three domains of leadership that owners operate in – business, family, and self. These domains create distinct leadership tensions, but the most challenging of all is self-leadership. Proactive owners use the M3 framework to design a formula and action plan that serves as the their guide for leading through significant transitions.

Health: An owner's health is a critical factor for their long-term success and satisfaction. Change inherently introduces complexity and stress into what are already demanding lives. The M3 Framework provides an opportunity for owners to proactively examine their current practices and develop or refine strategies to support their efforts at maintaining physical and mental health over the long haul.

Faith: A set of personal religious or spiritual beliefs and practices. For many owners this dimension is fundamental to their view of self, others, and the world around them. We create space for owners to incorporate their expression of faith as an essential feature of their exploration process.

CASE STUDY (continued):
THE M3 FRAMEWORK IN ACTION

Our clients pushed pause on responding to private equity firms and instead took time for robust exploration. They defined their formula for transition success and gained the clarity and confidence they needed to engage in a transaction. Here is a look at their formula:

My Business: over the next 12-months, protect G2's position, ensure long-term financial health, and improve valuation by:

- Focus on organizational development and sales to restore the company's historic growth rate
- Bring on a sales team to exploit adjacent markets
- Move the tacit knowledge from G1 into the organization
- Build out a formal HR process and upskill HR so that we can more effectively manage talent and minimize risk
- Realign the org structure to include a family board
- Improve performance management by updating success metrics and re-aligning management practices with strategy

My Money: G2 has not secured their financial future and are financially dependent on the business. G2 intends to continue to own and operate the business. G1 has the ability to choose - they do not need the sale proceeds to retire. Therefore, G1 can confidently exit the business while allowing G2 to structure a deal that works best for all parties. This gives them the competitive advantage of time to achieve:

- A target valuation of ≥ $30M within 18-months or less
- The right capital partner that brings both money and skills to the table
- A tax efficient strategy for both generations
- A long-term money management plan that includes the development of a "family bank"
- A second bite at the apple in 5 - 7 years for G2 at a valuation of ≥ $40M

My Self: All four family members individually explored the My Self dimension of the framework. Unlike the My Business and My Money dimensions that have interdependent decision-making requirements for G1 and G2, the My Self dimension is unique to each party.

G1: was most concerned with leaving a legacy for their grandchildren, employees and the community. They explored their personality styles, motivational needs, and what is required to have significance and satisfaction beyond their roles as owner. One aspect that emerged under both the legacy and leadership variables is the husband's desire to have a formal advisory role and maintain a 10% ownership share. This resulted in the development of two structures: (a) a family board for the foundation that included the grandchildren; and (b) an advisory board for the business.

G2: Both siblings embraced the concepts of the foundation and setting up a skilled advisory board. As CEO, the son viewed the advisory board as a powerful addition and resource for his leadership. In addition, the son recognized that self-leadership is the hardest form and that he could benefit from executive coaching through the transition.

He had two goals: (a)to grow as a leader that can intentionally shape a vibrant culture and achieve the strategic goals; and (b) to learn to manage stress more effectively.

The daughter valued the inclusion of her older children in the family's philanthropic and legacy activities. She was most concerned about her long-term health and relational changes that would happen as her parents' roles changed. She developed a work rhythm that increased her opportunity to exercise before work with friends. She also spearheaded development of the family council so that she could continue to work closely with her parents.

Both siblings developed long-term transition goals including projected timelines, business and personal financial goals, and the ideal buyout scenarios they will aim for achieving.

CONCLUSION

All business owners seek to maximize their return on investment (ROI) and sometimes the smallest changes can yield significant results. But, change is really tough and fraught with pitfalls that are hard to measure. Using the M3 Framework owners are able to pro-actively design a formula that serves as a guide for navigating changes associated with their transition goals (scale, sale, succession). Having a documented formula significantly enhances the competitive advantage necessary to achieve transition success. They know where they are, where they want to go, how to get there, and what (or who) they need when to realize their transition goals. This small investment of resources can make all the difference for ROI where it really matters - at points of significant transition.

The power of the M3 Framework is 3-fold:

1. Owners have the opportunity to escape the tyranny of the urgent working <u>in</u> their business to holistically work on their business.
2. Owners explicitly know what they do and do not want from a transition and what is required to get there.
3. Owners have the necessary insights for proactive management to overcome potential transition pitfalls.

For more information on how we can help you define and reach your transition goals, please contact us using the details on the following page.

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