THE ADVISORY

THE TWO TYPES OF SUCCESSION PLANS
and Why Your Company Needs Both

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RCLCO
REAL ESTATE ADVISORS

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November 14, 2019 | Charles Hewlett, Managing Director

According to the Family Business Alliance, more than 30% of family-owned businesses make the transition into the second generation, but only 12% are viable by the third generation, and only 3% by the fourth generation and beyond. Furthermore, the average lifespan of S&P 500 companies decreased from 67 years in the 1920s to 24 years in 2016, and is now forecast to shrink to just 12 years by 2027.

While there are many factors that contribute to these rather bleak statistics regarding company longevity, including the accelerating pace of technology and creative destruction, in our experience the lack of clear and effective succession planning is one of the major contributors to why real estate companies, and particularly private sector concerns, do not stand the test of time.

At many real estate companies formed over the past 50 years, family-owned or otherwise, baby boomer owners and leaders are facing retirement in droves over the next 10 years. By now, everyone is familiar with the statistic that **10,000 baby boomers will turn 65 every day for the next decade.** This means that many real estate company owners, presidents, CEOs, and senior executives will be moving towards retirement. Most public REITs have good discipline around formal/proactive succession plans dictated by the public markets and the fiduciary responsibility (and liability) of their boards to company shareholders and investors. But many private real estate companies are ill-prepared for the threat that this "silver tsunami" of retirement poses to their continued survival.

A critical part of any company's strategy is succession planning—that is, planning for the grooming and training of the next generation of leadership—and for the planned, or possibly unexpected, departure of a firm's senior manager(s). Every company that seeks to create a sustainable organization needs to put in place and maintain a succession plan for each key senior staff position, whether that involves grooming and promoting people from within the organization or hiring them from outside. Has your owner or CEO thought about how the company will continue to function after they leave? Your CFO may be hit by a bus tomorrow, or he or she may be planning to retire in five years. *Sustainable organizations must be prepared for either event.*

SUCCESSION PLANNING

Succession planning is a strategy for passing each key leadership role within a company to someone else in such a way that the company continues to operate after the incumbent leader is no longer in control. Succession planning ensures that businesses continue to run smoothly after the business's most important people move on to new opportunities, retire, or pass away. *Simply put, succession planning is all about having a purposeful plan to grow, groom, or get the next generation of leaders, and to ensure the continuity of the business* in the event of either an expected or anticipated turnover (such as an executive's retirement) or an unexpected turnover (sudden death or departure from the firm).

Often, the impending departure or unexpected turnover triggers a strategic planning process: change occurs (or is expected), and a company then needs to put a new plan in place. Ideally, company leaders should engage in proactive succession planning before such an event takes place—particularly if it is one that can be anticipated, like the retirement of a key executive. All senior staff members—not just company leaders—must ask themselves, "who will do my job next?" What if one of our key executives is wooed away to another firm? Do we have the next generation of leaders ready to fill those roles? Companies that have continuity in leadership, and a consistent culture, are able to make great progress in executing consistent strategies, while those that are constantly churning through managers have a much tougher time executing their strategies.

There are two different kinds of succession plans, and every company should have both:

1. **Emergency/Contingency Plans**

2. **Long-Term/Proactive**

TWO TYPES OF SUCCESSION PLANS

EMERGENCY/CONTINGENCY PLANS

Legal transfer of ownership
Orderly liquidation
Temporary leadership plan/search

LONG-TERM/PROACTIVE

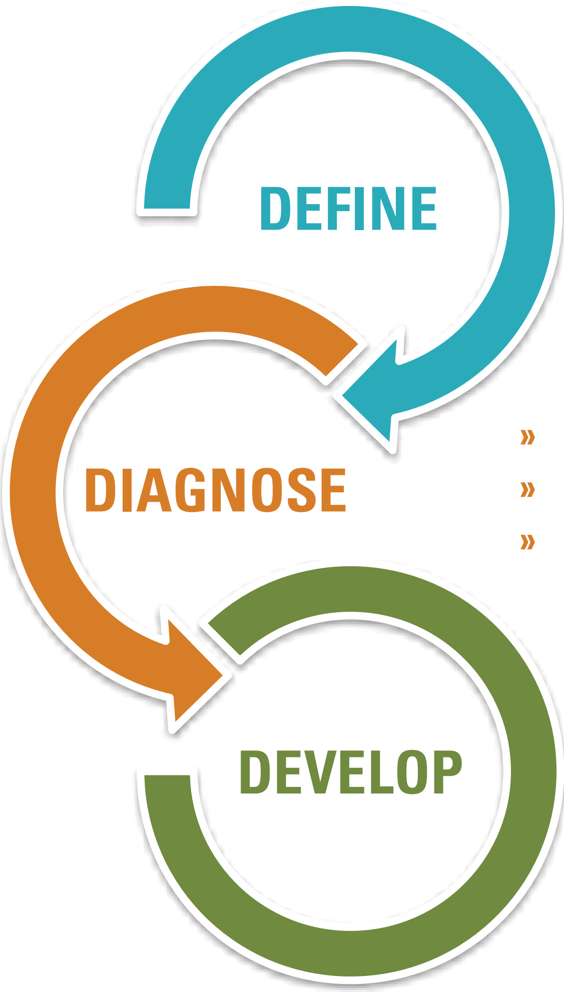
Purposeful/deliberate
Talent ID/development
Gap analysis

At a minimum, Emergency/Contingency plans should deal with legal transfer of ownership. In some cases these plans prescribe an orderly liquidation of the company's assets, or a divestment of high-risk activities and/or business lines in the absence of a knowledgeable steward of these industry roles. **Effective emergency plans should specify how the company is going to be operated in a period of transition.** Who is empowered to make what decisions and under what circumstances as a fiduciary to the non-active company stakeholders? Should the Board step in and appoint a temporary CEO while initiating a search for a replacement, whether that's an internal candidate or an external hire?

Many companies talk about Long-Term/Proactive succession planning, but the key is to make it operational. It is not a one-and-done activity, but rather on ongoing process that needs to be kept current. The most effective way to minimize the impacts of lost leadership is to develop a program to identify and foster the next generation of leaders through mentoring and training so that they are ready to take the helm at the appropriate times.

Research supports sound succession planning—yet many struggle to take succession planning beyond a static list of names slotted for a few top spots. We at RCLCO advise our clients to gain "3-D" vision around their succession plans, including:

1. **Define**
   - » Determine roles/positions necessary to successfully implement the company strategy
   - » Define what successful leaders look like for your organization—"success profile"
   - » Identify future skills the company will need
2. **Diagnose**
   - » Conduct a skills assessment of current leaders and potential successors
   - » Determine how "many" future leaders you will need, and how "ready" each one is to assume the responsibilities
   - » Through this process a company will clearly define where they have succession gaps
3. **Develop**
   - » Then finally, the company needs to create a talent leadership training and development program, typically customized to the individual
   - » To be effective, make leadership development and succession part of each senior leader's bonus calculation
   - » Then, rinse and repeat—the plan needs to be tracked and progress measured to keep it current



- » Identify critical roles/needs
- » Develop leadership profiles
- » Determine future skills necessary for success

- » Assess current skills inventory
- » Understand talent readiness & pipeline potential
- » Identify gaps in people & roles

- » Create talent mobility, development & skills enhancement goals
- » Incorporate succession into compensation plan
- » Track and measure progress against goals

Source: RCLCO

Succession planning is not a one-time event—plans should be updated at least annually, or as changes dictate. In our experience, most companies may have 25% to 50% of their workforce ready for the next step.

GOOD AND BAD EXAMPLES

Two of the most challenging succession planning issues are the replacement of a CEO, and the introduction of family successors into a real estate organization; and over the years, RCLCO has witnessed good and bad examples of each. First the good:

> Since going public in 1993, AvalonBay has made the successful transition from not just one, but two CEOs. Tim Naughton, AVB's current CEO, took over from Bryce Blair in January 2012, who succeeded Dick Michaux, the public company's first CEO, in 2001. In both cases, the succession from one leader to the next was very public and telegraphed far in advance of each transition in a very overt and purposeful manner. This gave both the external markets, and those inside the company, complete transparency and plenty of time to get comfortable with the planned transitions, and the company's performance never skipped a beat. Contrast this with, say, the announcement in October 2019 that Kevin Plank is stepping down as CEO of Under Armour, the company he founded. OK, the company stock price was actually up following the announcement, but most likely the company did not want CNBC to begin its story with "In a surprise announcement…."

Transition of family ownership/leadership from one generation to the next can also be a challenging transition for many real estate organizations. Perhaps the best example of how to do this right is the Bozzuto Group, a super-regional diversified, independently operated, family business focused on multifamily development, construction, property management, and homebuilding.

> Toby Bozzuto succeeded his father Tom, one of the company's co-founders, in September 2015, but the plan had been in the works for years. The involvement of family members often can be a touchy subject in the context of strategic planning. What Tom did right was to encourage Toby to have a successful career elsewhere first, and to get the requisite education, including a Masters in Real Estate from NYU. Then once Toby did join the family company, Tom made it clear that he intended for his son Toby to take over his ownership stake in the business and occupy the leadership of the firm one day. Addressing these intentions openly in the context of a strategic planning process has been beneficial to the organization, because no one has to guess what the plan is for succession. Gain a deeper insight into the Bozzuto transition by listening to our podcast interview with both Tom and Toby.

There are plenty of bad examples, of course, and no point in calling out names. But one mistake that many parents make is to bring their children into the family business and bestow upon them titles, responsibilities, and/or compensation that they do not deserve. Worse, the intentions of a parent with regard to the ascent and ultimate ownership of the company are often unspoken. Valued members of the team who don't happen to share the right last name resent the unearned station of these children, and in the absence of clarity assume the worst. Many leave assuming there is no future for them.

> In another case, a private family-owned company had no emergency succession plan, and when the second generation president met with an untimely death, there were no instructions or rules of engagement left behind to guide key decisions and the stewardship of the company and its portfolio. In the wake of its tragic loss, the company had a string of "interim" non-family presidents who were not aligned with the wishes of the family stakeholders, and this company probably lost 10 years of what should have been productive growth coming out of the Great Recession.

So the advice is, first and foremost, have succession plans, both for emergencies and for the long-term continuity of the real estate enterprise; keep them current, make sure they are transparent; and telegraph the plans as far ahead of time as possible.

Interested in learning more about how RCLCO can help with your own succession planning? Contact us today.

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"I have engaged RCLCO many times over the past 20 years. Each assignment resulted in community lot sales pace and lot prices above my pro forma values. RCLCO is the GOLD standard for real estate consulting."
-- Jimmie Jenkins, Vice President, Toll Brothers, Inc.

Since 1967, RCLCO has been the "first call" for real estate developers, investors, the public sector, and non-real estate companies and organizations seeking strategic and tactical advice regarding property investment, planning, and development.

RCLCO leverages quantitative analytics and a strategic planning framework to provide end-to-end business planning and implementation solutions at an entity, portfolio, or project level. With the insights and experience gained over 50 years and thousands of projects–touching over $5B of real estate activity each year–RCLCO brings success to all product types across the United States and around the world.

RCLCO has expertise in five major areas: real estate economics, investment strategy, asset management, management consulting, and legal support. Our multidisciplinary team combines real-world experience with the analytical underpinnings of thousands of consulting engagements.

We develop and implement strategic plans that strengthen our clients' positions in a market or sector, add value to a property or portfolio, and mitigate price erosion.

Since we first opened our doors, RCLCO has been governed by our core values. We believe that excellence, integrity, honesty, respect, exceeding expectations, and quality are great goals that all firms must possess. These goals and values shape the culture and define the character of our firm. They guide how we behave and make decisions. Our extensive network provides us with a unique and comprehensive outlook on the industry, not to mention unmatched access to the best minds in real estate.

CONTACT US TODAY!

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