WHAT'S NEXT ?

Transition strategies for your manufacturing business

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Cover image: Heath Ceramics

INTRODUCTION

Manufacturing business owners have a lot on their plate: from finding a qualified workforce and the right equipment, to entering new markets and managing their supply chain. Oftentimes the day-to-day leaves little room for thinking about the business' long-term future. **However, succession planning is critical to the future of every company, whether an owner is nearing retirement, employees are looking to become more engaged, or an unanticipated disruption is around the corner.** As they decide to transition out of their business, the puzzle every entrepreneur faces is finding a balance between their priorities, such as preserving their investment, the jobs they provide, their legacy, and their health and well-being. This takes time and resources to plan for — both of which business owners often lack.

That's why we created this toolkit: to help manufacturing business owners better understand the transition strategies available to them.

Transitioning a business (also called succession planning or creating an exit strategy) is the process of bringing a company into its next chapter. Manufacturing business owners have a lot to consider: perhaps they're hoping to reduce their responsibilities while increasing the wealth of their employees — something achieved by turning the business into a worker-owned cooperative or ESOP. Maybe they're hoping to preserve the legacy of the business by passing it down to family or through a sale that keeps the business going. Or, maybe they think it's best to close the business, turning the value of their company into cash for retirement or new investments.

The following case studies feature the voices of manufacturing business owners who have gone through the process of transforming their businesses. They talk about what went right and what went wrong.

This document is a starting point. As businesses put together their succession plans, the first thing to do is to consult an accountant, lawyer, or non-profit that specializes in helping businesses plan their next steps. To help you get started we've included resources at the end of this toolkit that point in the right direction.

No matter what decision a business makes, we hope it brings the owner closer to their business and personal goals.

DEFINITIONS

- **Acquisition or Sale:** A sale to an employee or to another third party. It typically removes the owner from the operations of the company (though not always).

- **Family Sale:** A family sale is when the owner sells to a family member (or a set of family members), and it is generally anticipated in advance. The owner may retain a stake or an active role after the transition.

- **Merger:** A merger occurs when two businesses combine into one business. In a merger, the owner(s) often remains a part of the business. Mergers can be structured in many ways, no two look alike.

- **Worker Owned Cooperative:** A worker cooperative is an employee-owned business where each member (worker) has one equal share of the business and one equal vote in the co-op — no matter their pay or how long they've been a part of the business. The owner can continue to work in the business if desired.

- **Employee Stock Ownership Plan:** In an ESOP, ownership transfers through the creation of an ESOP Trust (ESOT). While a separate financial advisor administers the trust, the prior owners or a third party manage the company. Employees can receive shares of the trust that can be cashed out at a predetermined time, spreading the profits of the company among its employees.

- **Liquidation and Bankruptcy:** When a business owner liquidates, it means they convert assets into cash or cash equivalents by selling them on the open market. Bankruptcy is a legal process through which owners or other entities who cannot repay debts to creditors may seek relief from some or all of their debts. Depending on the type of bankruptcy pursued the owner/board may or may not retain control of the business.

ACQUISITION OR SALE

Case Study

McRoskey Mattress Company; San Francisco, CA
Robin McRoskey Azevedo, Owner and CEO

Why did the company decide to pursue an acquisition?

For the past 20 years McRoskey Mattress owner and CEO Robin McRoskey Azevedo has thought about who would take over the company when she retired. At the same time, she wanted the brand to grow, perhaps by reaching an audience outside the West Coast. She didn't want the company or brand name to come to an end, and she wanted to ensure that it landed in the hands of a company with the infrastructure to expand its footprint.

How did they start the transition process?

Azevedo received a lot of information about other mattress manufacturers through the International Sleep Products Association, a trade group. In 2017, she began reaching out to Pleasant Mattress, a family-owned manufacturer with decades in the business whose owners had known Azevedo since the 1990s. That year Azevedo toured their facilities and became more familiar with Pleasant Mattress' operations. In 2018, the two companies came to a deal: Azevedo sold the production, marketing, and distribution rights for McRoskey Mattress to the Fresno company, which plans on selling McRoskey mattresses across the country.

What were the pros and cons of this approach?

While she is still CEO of the McRoskey Mattress retailer, Azevedo was able to reduce her workload and get paid for the value of part of the company while retaining some control over the future of the brand. McRoskey's San Francisco showroom is still open and now sells McRoskey mattresses and other mattress brands. On the other hand, being acquired by Pleasant Mattress meant shutting down their Bay Area factory and letting go of nearly 80 percent of their workforce. While the acquisition had a significant impact on her employees, it ultimately allowed Azevedo to step back from the company after 40 years and hand the reins over to another manufacturer that shared her family's vision.

What's one piece of advice they would give to someone investigating an acquisition?

Azevedo said not to be afraid to speak with a wide variety of companies that might see a business opportunity in taking over your brand name or products. While in hindsight, she could have spoken to more companies, she has no regrets about selling to Pleasant Mattress—but there's always a benefit to having as many options as possible. Azevedo noted that sometimes when a company is acquired, the acquirer holds on to the brand name but stops producing or selling the brand's product; she is pleased to see that Pleasant Mattress is continuing her family's legacy.

What types of partners should the business bring in to help make the acquisition a success?

Azevedo said the International Sleep Products Association trade group connected her with other mattress manufacturers who helped her understand the state of the industry. She also recommends working with a legal group that specializes in acquisitions to make sure all parties make the right legal and tax moves during the transition.

KEY RECOMMENDATION: Contact your industry's trade association for introductions and insight into the state of the industry.

SMALL BUSINESS SALE

Case Study

Kika's Treats; San Francisco, CA
Cristina Arantes, Founder and Previous Owner

Why did the company decide to sell the business to an outside owner?

After ten years of running Kika's Treats, owner and founder Cristina "Kika" Arantes was burnt out. The chocolate entrepreneur ran everything from finances to sales to production, and it was interfering with the business' success. Sales were stagnant, as was new product development. She sold the business to keep Kika's Treats alive while removing herself from its day-to-day operations.

How did she start the outside sale process?

Arantes started by hiring a financial consultant, who helped put together the big picture on the company's value and projected sales. Together, they came up with an asking price, and she started to spread the word about the sale among her connections, through small business support groups like SFMade and La Cocina, and on the online platform BizBuySell.com. About 20 people contacted her to learn more about the business but most of them were turned off by the fact that it wasn't a "turnkey" business; without Arantes at the helm, the new owner would have to hire additional managers to run Kika's Treats. Eventually a Sacramento chocolate operation contacted her and she agreed to sell the company to them.

What were the pros and cons of this approach?

If she could do the sale again, Arantes would have maintained a stake in the company. She sold the company at about 30 percent less than asking price because her building lease was about to expire and she was starting a new job at another chocolate company. However, she is satisfied knowing that her products are still being sold and distributed.

What advice would she give to someone investigating a sale to an outside owner?

Key to Arantes' process was hiring a financial consultant to help with the valuation of the company. She suggested owners take the time to evaluate the sale proposal to make sure that it sits right with them and their vision for the business' future. She also suggested reaching out to other business owners in their industry who successfully sold their companies to hear about their experiences.

What types of partners should the business bring in to help make the sale a success?

Arantes found that the help she needed to prepare her company for a sale were an outside financial consultant and local business support groups, like SFMade and La Cocina.

KEY RECOMMENDATION: Bring in outside experts to evaluate your company and to help spread the word about the sale of your business. Also, remember that you are an integral part of the business and without you it may be worth less than you expect, especially if you wear multiple hats.

FAMILY SALE

Case Study

Lemur International; Richmond, CA
Carol Rakotomalala, President and Owner

Why did the company decide to sell within the family?

Lemur International is a family-run company that wanted to remain that way. Lemur was founded by current owner Carol Rakotomalala's father in 1996. When her father fell ill, Rakotomalala became VP of Operations and officially became the President of the company when he passed away in 2010.

How did they start the transition process?

When her father passed away, Rakotomalala and the rest of the shareholders had to figure out how to divide his shares. It was a tough transition process because the company didn't have detailed bylaws that described what to do if the primary shareholder was suddenly unable to run the business. Their corporate lawyer made sure that shareholder information going forward was legally sound and that all parties were satisfied with how the shares were divided.

What were the pros and cons of this approach?

Allowing Rakotomalala and her brother, another major shareholder, to take over meant the company would still honor the family vision of promoting fair commerce between Madagascar and the United States. The challenge wasn't necessarily with the succession strategy itself, but the lack of legal documentation. Rakotomalala also said the business wasn't well organized when she took over. Her father worked based on memory and didn't record any of his processes or procedures. When he passed away, she had to completely reconstruct them.

What's one piece of advice they would give to someone investigating a family sale?

Simply: have a strong documentation process in place, covering everything from quarterly results to how each department is performing, so that there are facts on hand when deciding how to transition ownership. On top of the lack of detailed bylaws, Rakotomalala said some non-family shareholders wanted to sell their shares because they didn't believe the company was viable without her father's leadership. The company was indeed viable, and is still thriving today, but having strong documentation available would have made it easier to convince these shareholders to continue their support. She also recommended purchasing life insurance for the company executive, to help cover purchases or expenses without dipping into the company's bank account in the event that they pass away.

What types of partners should the business bring in to help make the family sale a success?

The main outside partner they relied on was a corporate lawyer who helped oversee the division of her father's shares.

KEY RECOMMENDATION: Prepare for the transition well ahead of time by documenting business functions and by regularly informing all shareholders of your future plans.

WORKER OWNED COOPERATIVE

Case Study

Adams and Chittenden Scientific Glass; Berkeley, CA
George Chittenden, Co-founder

Why did the company decide to turn into a worker cooperative?

George Chittenden, Co-founder of scientific glass company Adams and Chittenden, said he and his business partner, Tom Adams, had always adopted the cooperative mentality at work. They paid an entry level wage of $15 an hour long before this became the minimum wage in the City of Berkeley, and spent significant time training their employees. As retirement loomed near, they began to talk about options for the future. The continuation of their successful enterprise felt like a worthy goal. Chittenden cited the "ridiculous" level of social inequality in the San Francisco Bay Area as one of their concerns, and the cooperative model appeared to be one way they could address that inequality while also continuing their business. And, shared responsibility among co-owners (who were previously employees) in the company also promised less work for Chittenden and his business partner.

How did they start the transition process?

Chittenden said their company reached out to Project Equity, a non-profit that helps businesses transition to employee ownership. The organization shepherded Adams and Chittenden through the entire transition, helping with everything from finances to legal reviews, and even preparing employees for the cooperative model.

What were the pros and cons of this approach?

The cooperative model was appealing because it would allow the owners to cut down on their responsibilities while continuing to do meaningful work with the company. It has also created more wealth for employees who are now owners. Selling owners can also avoid capital gains taxes and broker's fees. The downside, however, is that there have been new and unforeseen issues regarding roles and responsibilities. Chittenden said those issues have not been fully resolved, but he and Adams are optimistic that things will work out as they move towards retirement.

What's one piece of advice they would give to someone investigating the cooperative model?

Chittenden's primary piece of advice is to closely examine who is going to become a cooperative member with you. He said to treat the process and the people involved with the same deliberation as you would if you were all about to buy a house together.

What types of partners should the business bring in to help make the transition to a worker cooperative a success?

Chittenden and his business partner worked closely with the non-profit Project Equity along every step of the transition. Project Equity also connected them with a Silicon Valley legal firm who was able to provide pro bono services. The City of Berkeley, which has been trying to encourage more co-ops to take root in the city, supported the transition although they didn't play a significant role in the process itself.

KEY RECOMMENDATION: Future co-owners should carefully assess themselves and each other, including the former owner (if they are staying involved). Address any potential issues prior to partnering around the transition. Make sure roles and responsibilities are clearly communicated throughout the transition itself.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

Case Study

Heath Ceramics; San Francisco, CA
Robin Petravic, Co-owner

Why did the company decide to turn into an ESOP?

Robin Petravic and his wife, Catherine Bailey, purchased the company in 2003 from the Heath family. In 2016, they started thinking about their own next chapter — a future in which they would work less, eventually leading to retirement. They pursued an ESOP because they believed giving their employees company shares on top of a paycheck was the best way to engage them in the company's success. They were also worried that selling to or merging with another company, although likely a more lucrative exchange, would lead to a shift in work culture and brand exploitation.

How did they start the transition process?

Petravic and Bailey approached a Bay Area law firm that specializes in structuring ESOP transactions. They led Heath Ceramics through the entire process, which included creating an ESOT and establishing the rules to decide how many shares each employee would get, among many other steps. They also worked closely with employees in Heath Ceramics' finance and human resources departments to guide the creation of the trust.

What were the pros and cons of this approach?

Petrovic and Bailey turned employees into shareholders, thus increasing their wealth, and avoided radically altering the business through a sale or merger.
A challenge has been building a sense of shared responsibility within the company. Even though the employees are now owners, they won't see any financial benefit of the "co-owner" title until they leave the company or retire when they can legally cash out their shares. So Petravic and Bailey are working to create a culture in which employees feel like their voices have equal impact. Another challenge is that Heath Ceramic's ESOP trust is audited every year by a CPA to make sure the company's value (and therefore its shares' values) is up to date. That process costs about $30,000 every time.

What's one piece of advice they would give to someone investigating the ESOP model?

Petravic said it's vital to speak with as many ESOP companies as possible before embarking on the process. Then create a timeline that allows you to visualize all the costs from the start to your own exit from the company. Petravic also suggested creating a plan beforehand that lays out how to build a culture of shared responsibility in the workplace.

What types of partners should the business bring in to help make the transition to an ESOP a success?

Petravic relied heavily on a law firm that specialized in ESOP trusts. He also suggested working closely with a CPA, and employees who deal with finances and human resources, throughout the process.

KEY RECOMMENDATION: Any business succession strategy is complex — but approaches that have multiple stakeholders need buy-in from all parties and dedicated time and resources to be successful in the long term.

LIQUIDATION AND BANKRUPTCY

Practitioner

Brett Hazlett, Director, Advisory at BPM LLP

Why would a company decide to pursue bankruptcy?

Bankruptcy is the last resort for a business that faces significant debt and has neither the existing assets to cover that debt nor a future in which revenue increases enough to sustain the business. Businesses that want to close up shop but do not have significant debts can also sell off (or "liquidate") their assets to get cash. These businesses have most likely looked at other options, like the ESOP or cooperative models, but prefer to end their responsibility as soon as possible. Bankruptcy and liquidation of assets are both part of the same continuum of options.

How would they start each process?

A business owner's main focus during the end-of-life process is to make sure they don't face any personal liability by ending the business. To start, speak with legal counsel that can help differentiate the ways to turn assets into cash and settle debts with creditors. There are a few potential ways this could occur. First, if the business has value, owners can save costs (but increase workload) by overseeing the sale of assets and working directly with creditors to agree on a settlement that relieves them of liability. Hiring a business broker could be helpful here. A second option is to pursue an "assignment for the benefit of creditors," in which the owner transfers all assets to a trustee who liquidates them, takes an agreed upon fee, and negotiates with creditors to work out a deal on any remaining liability. The final option, if your debts greatly exceed your assets, is to pursue bankruptcy.

What are the pros and cons of each approach?

Liquidating a business' assets or pursuing an assignment for the benefit of creditors won't impact a business owner's credit score and gives them a chance to get out of the business without any major financial loss. Bankruptcy, however, has a number of cons—though is often an owner's only option. A bankruptcy court will assign you a trustee whose goal will most likely be to sell the assets, settle the debts, and get on to the next case as soon as possible; in other words, they likely won't be fighting for the owner. Depending on the business' incorporation and the type of bankruptcy pursued, if the gap between debts and business assets is high enough, an owner may be required to sell personal belongings (like a car or a house) or give up personal wealth (like cash or certain investments) to help cover debts. Additionally, bankruptcy leaves a negative mark on the business owner's credit score that will make getting future loans more difficult.

What's one piece of advice you would give to someone investigating each model & what types of partners should the business bring in to help make the transition a success?

There are a variety of bankruptcy options available so it's important to find a competent advisor and legal representation that will help minimize personal liability while selecting the best way to move forward. One way a business owner can find competent help is by speaking with others who have liquidated their assets or gone through bankruptcy, and ask if they can recommend quality counsel. Business owners can also reach out to other consultants and professionals that they've worked with for recommendations of advisors or counsel.

KEY RECOMMENDATION: The first step when thinking about pursuing any transition is to find a competent advisor or legal counsel who will support the owner in evaluating available options and determining the optimal strategy for the business.

WHAT TO CONSIDER WHEN CHOOSING A TRANSITION STRATEGY

Yes | No | Depends

As a business owner, will I . . .	Merger	Sale	Co-op	ESOP	Bankruptcy	Liquidation
Increase wealth in my community	Depends	Depends	Yes	Yes	No	No
Increase family wealth	Depends	Depends	Depends	Depends	No	Depends
Increase my wealth	Yes	Depends	Depends	Depends	No	Yes
Maintain my legacy	Yes	Depends	Yes	Yes	Depends	No
Maintain the business' legacy	Depends	Yes	Yes	Yes	Depends	No
Keep jobs in the local community	Depends	Depends	Yes	Yes	Depends	No
Preserve business' mission	Depends	Depends	Yes	Yes	Depends	No
Increase business' stability	Yes	Yes	Yes	Yes	Depends	No
Exit quickly (within a year)	Depends	Depends	Depends	Depends	Depends	Yes
Be able to stay active in the business	Depends	Depends	Depends	Depends	Depends	No
Be able to change lifestyle	Yes	Yes	Yes	Yes	Depends	Yes
Grow market share	Depends	Depends	No	No	No	No
Increase supply-chain access	Yes	Depends	No	No	No	No
Relieve business' financial burdens	Yes	Yes	No	No	Yes	Yes
Be protected from creditors	No	No	No	No	Depends	No
Receive tax benefits	No	No	Yes	No	No	No

ADDITIONAL RESOURCES

Mergers, Acquisitions, and Sales

- "Explaining The Advantages Of Selling A Business To Employees Vs. To Outsiders," *Forbes*; June 2016.
- "Don't Even Think 'Merger' Without Taking These 5 Steps First," *Entrepreneur*; December 2017.
- "The 3 Ts of a Successful Family Business Transfer," *Entrepreneur*; December, 2017.
- "Transitioning Locally Owned Businesses to Employee Ownership: A Place-Based Strategy," Concerned Capital; April, 2018.
- "What You Need To Know About Mergers & Acquisitions: 12 Key Considerations When Selling Your Company," *Forbes*; August, 2018.
- "Why Do Companies Merge With or Acquire Other Companies?" *Investopedia*; July 2019.

Cooperative & ESOP Conversions

- "5 Steps to Turn Your Business Into a Worker-owned Co-op," *YES Magazine*; September 2015.
- "Sale To An ESOP: The Most Undervalued Exit Path," *Forbes*; August, 2016.
- "More U.S. Businesses are Becoming Worker Coops: Here's Why," *Fast Company*; May, 2018.
- "Guidelines for Equitable Employee Ownership Transitions," Rutgers University; June 2020.

Bankruptcy

- "Thousands To File For Bankruptcy: What All CFOs Should Know," *Forbes*; May, 2020.
- "When Does a Small Business File for Bankruptcy? And 8 More Questions," *New York Times*; June, 2020.

Organizational Resources

- Democracy at Work Institute: institute.coop
- Gellert Family Business Resource Center: usfca.edu/management/centers-institutes/gellert-family-business-resource-center
- Harvard Business Review: hbr.org/topic/succession-planning
- International Business Broker Association: www.ibba.org
- La Cocina: lacocinasf.org
- Manufacture San Jose: mfgsj.org
- Minority Business Development Association: mbda.gov
- National Association of Business Brokers: businessbroker.biz
- National Association of Consumer Bankruptcy Attorneys: nacba.org
- National Center for Employee Ownership: nceo.org
- Project Equity: project-equity.org
- SFMade: sfmade.org
- The Working World: theworkingworld.org

THE BAY AREA URBAN MANUFACTURING INITIATIVE is a collaborative effort of over 31 Bay Area cities and counties—including Alameda, Antioch, Berkeley, Brentwood, Concord, Contra Costa County, Emeryville, Fairfield, Fremont, Hayward, Livermore, Milpitas, Morgan Hill, Napa, Newark, Oakland, Oakley, Petaluma, Pittsburg, Pleasanton, Richmond, San Francisco, San Jose, San Leandro, San Rafael, Santa Rosa, Sonoma County, South San Francisco, Union City, Vacaville, and Vallejo, and facilitated by SFMade—to encourage sector specific regional connections and to preserve the Bay Area's strong manufacturing ecosystem.

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