SUCCESSION: THE AGE-OLD QUESTION

Spring 2022

TRISTONE

CAPITAL

Succession: The Age-Old Question
Introduction

"Without the right succession planning put to play, we build for the future without a future."

So true, yet sadly all too often something which is neglected, ignored, or left until it's too late.

Succession in every walk of life is essential to ensure the long-term growth, prosperity and stability of an organisation. No more so than in social care – a sector that is rich with established and well-run businesses that deserve to be carefully handed over to new custodians, in order to protect their legacy and ensure the vital work they do for vulnerable individuals continues.

It's a process that should be gradual, well thought through, with lots of knowledge sharing along the way, to make the transition as seamless as possible. However, there are so many instances where the myriad of options that were once available to owners, have unfortunately been reduced by not making succession planning a priority in the years before retirement or departure becomes a reality.

There are a significant number of family-run businesses in the social care sector, which should – but not always – make the decision of who takes over an easier one. But identifying who the successor is, even when it's a family affair, is no mean task.

Some say that the future of organisations is the growth of the people within them. This should form the leading principle when it comes to executing a successful succession plan – right from developing strategic objectives, identifying key areas and positions, understanding the capabilities needed to fulfil those roles, broadening the decision-making process, strengthening the senior leadership team, imparting knowledge and communicating your plan, to evaluating its effectiveness.

Without a clear plan that is openly discussed with the company, succession – and the future of the business – is more difficult to achieve. The aim of **Succession: The age-old question** is therefore to shine a light on the issues that come with succession planning and help guide owner-managers through what can be a challenging and emotive period in an organisation's development.

Yannis Loucopoulos is chief executive of Tristone Capital.

Succession: The Age-Old Question
Our Research

Social care plays an instrumental part in supporting vulnerable and look-after children and adults across the UK. The future prosperity of the sector is vital and the need to protect the professional legacy of homes in every region is key to delivering a quality and sustainable provision.

The aim of **Succession: the age-old question** is, therefore, to look more closely at the issue of succession and continuity in the sector – to gain a clearer picture of the social care landscape, in terms of current leaders and business dynamics, and whether the sector is set to face a problem in years to come without a greater understanding of why it's important to take a proactive approach to succession. The report shines a light on the sector and highlights the key considerations business owners need to make when it comes to passing on their business to new custodians.

So, what has our research told us? Over the course of the last three months we have carefully assessed the data of nearly 200 children and adult homes across England and Wales, to gain a greater insight into the businesses and leaders who are fundamental to the social care sector. By analysing public records, our research has shown that the industry could face a succession challenge in the next 10 years, if young talent is not encouraged into and promoted within the industry.

The research shows that nearly three quarters (68%) of 'people with significant control' (PSC) are over the age of 50, with 40% over the age of 60 and the oldest person aged 78.

The data has revealed that the average age of a PSC is 54, with 68% of owners being male.

For some time, social care has faced a much-publicised skills problem and struggled to attract the best young talent into the industry. With a significant number of social care businesses – in both adult and children's services – being led by people over the age of 50, and nearly half of businesses having a majority ownership structure, it's clear there is a heavy reliance on a small number of people within each business who may be reaching, or at least thinking about retirement.

68%
of PSC are over the age of 50

40%
of PSC are over the age of 60

68%
of owners are male

Traditionally driven by committed and longstanding individuals, who have great passion for supporting and transforming the lives of vulnerable and looked-after adults and children, it's essential that directors protect the culture and ethos that defines their business, by empowering people at all levels to become future leaders and carefully consider succession in a timely way.

13	66%	23%
average age of a social care business	incorporated more that 10 years ago	run by families

According to the figures, 28% of businesses have changed the structure of their business to a limited holding company, with more than half of those companies (53%) set up in 2016 to coincide with the introduction of the Small Business Enterprise and Employment Act 2015, which is aimed at increasing transparency around who controls a business.

The introduction of new UK company law clearly triggered a response from a certain number of social care businesses, which has naturally led to diversification in their ownership model and a move away from a reliance on one person. However, it's essential for all established businesses to proactively address ownership and to consider the options available to them before they become limited.

A management buy-out (MBO) is an excellent option for succession planning, but one that is less common in a social care context. The inexperience of senior management in a small business when it comes to running a deal process, negotiating financing, having M&A experience and ultimately being able to execute a successful MBO, makes the move from employee to owner/board member a difficult one to achieve. This is often compounded by the significant contrast in roles post-MBO, such as strategic, fiduciary, operational and directorial responsibilities.

Of course, the alternative option is a new buyer, but this is also fraught with risk – they may have different values and objectives, such as wanting to squeeze margins and cut jobs, and may lack the required care experience. This is not only a potential continuity risk, but also a safeguarding risk.

Another alternative is to engage with an experienced buyer, who understands the nuances of the care sector, respects the cultural integrity and values of a business, while committing to protecting the professional legacy of its owners. These buyers are few and far between, but they do exist.

Selling a care business can be a complex, lengthy and emotive process that needs to be carefully thought through to ensure businesses attract the best suitor and extract the greatest value from the company.

Market View:
Future business planning is key to realising value

An increase in the number of children in care over recent years, combined with a lack of care provision, has shifted the supply and demand balance in the social care sector. This has made the industry increasingly attractive to private equity, giving greater choice to business owners looking at their future options – whether that is growth, acquisition or exit.

However, the number of deals currently taking place is difficult to quantify because of the fragmented nature of social care. There is a handful of large operators in the UK and a majority of single-site or dual-site independent operators with income well below the annual audit threshold.

This means much of the information available about these providers is from limited Companies House information with filing disclosures often months after a deal has happened.

Despite this, there has been a number of notable examples of deals in the sector over recent years, including Graphite Capital's acquisition of Horizon in 2019, G Square's acquisition of Keys Group, August Equity's acquisition of Esland, and Mubadala Capital's recent acquisition of a majority stake in Witherslack Group.

This increasing private equity focus on the sector does create questions for those involved in social care on a daily basis.

Does PE investment shift the focus to driving returns and profits rather than the overall quality of care provision? Or does the investment, financial expertise and potential for increased returns create expansion opportunities at a time when there is a significant and longstanding excess of demand over supply for care beds in children's and adult social care?

The industry is also facing increased Government scrutiny, which has the potential to effect larger private equity backed investment in the short-term. The Competition and Markets Authority's (CMA) review into children's social care provision was announced in March 2021.

This could make larger operators and new investment entrants into the sector hesitant about the future landscape until the CMA publish their findings and recommendations.

The sector also faces staff retention challenges and one remedy to this among smaller providers is broadening the shareholder base beyond the original founders. Long-term incentive plans such as Enterprise Management Incentive Scheme share options are increasingly helping social care companies to retain key staff where applicable.

However, for business owners of all sizes in the social care sector, succession planning as early as possible is vital.

We experience many owners who have unrealistically high aspirations of business valuations, often because of an incomplete or ill-informed understanding of the key value drivers in the sector.

They may have heard about the value potential in the sector but have done little to prepare for a sale so are unable to realise the value they expect. Early planning can often lead to avoidable disruption to business operations as they prepare the business for sale.

One of the most important factors in value is a strong Ofsted report or Care Quality Commission rating. In addition to this, the measurement of outcomes is vital. From our experience, putting care first will always generate increased buyer appetite and above average financial returns over the medium to long term.

For smaller independent providers with consistently strong Ofsted or CQC ratings, stable staff structures and high-quality property estates are also key to realising strong valuation. Demand is coming from well-funded trade buyers wanting to bolt-on additional service provision to capture experienced staff teams and unlock 'back office' cost synergies to improve overall financial performance and long-term viability.

Another key consideration, especially for smaller social care providers trying to achieve a retirement sale, is the time and effort the sale transaction process takes.

Many owners often have a limited senior team around them and no matter how 'light touch' a due diligence acquisition process might be, it is still a significant distraction from day-to-day business operations. This is in a sector which has continual care-related pressures and a high propensity for the unexpected, which can often need senior management input.

Small business owners also need to formally assess their retirement plans and work out what they need. It is often better to plan ahead with a pensions or wealth review and work backwards to assess price, and then map that against the business's possible current value. That will allow owners to work out a plan to improve the business to achieve its optimum exit value and 'saleability' when the time comes to sell.

Market view: Key Considerations

- A demand for care and a lack of provision has shifted the supply and demand balance in the sector, bringing social care increasingly into the focus of private equity
- Putting care first will always generate the best financial returns when a business owner is looking at succession
- Planning ahead is key to realising value and avoid business disruption before and during the transaction process

Simon Carruthers is corporate finance director at MHA Moore and Smalley's Manchester office.

Succession: The Age-Old Question

How To Sell Your Care Business

Selling a care business can be a complex, lengthy and emotive process that needs to be carefully thought through to ensure you attract the best suitor and extract the greatest value from the company.

All too often, we hear of instances where people fail to get their house in order in good time and underestimate the effort and planning that is required to complete a successful sale. If you add into the equation the emotional pressure of parting with a business – one that you've put your heart and soul in for many years – then it's imperative to take the time to prepare and get the most out of a challenging process.

So what are the key things to consider when preparing your business, and more specifically a care business, for sale?

Ensure it's ready for sale – ideally, create a 'data room' with all the information that you think a prospective buyer would need in order to make an informed decision. If you are using a broker, they should guide you through what will be required. Broker or not, you should ensure that you can easily access:

- **Accounts** – previous year statutory accounts and YTD management accounts if you run them
- **Regulatory reports**
- **Contracts with suppliers and customers** – in particular, take note of any contractual consents that may be required. Change Of Control clauses are common in Local Authority agreements and a new owner will look to ensure the customer has agreed to the change of control.
- **Property related information and contracts**
- **HR files**
- **Taxation history**
- **Insurance information**
- **Details of any borrowings your business may have.**

Understand your numbers – a lot of business owners want to sell their business, but they struggle to understand the numbers in the balance sheet and in the profit & loss. You're not expected to have auditor level knowledge of the numbers involved, but a basic understanding of each will always be beneficial. Also getting to grips with realistic projections helps to remove uncertainty in your buyer's mind.

Business valuation - brokers will tell you it's worth as much money as they can credibly get away with. By raising the price they get you to sign the contract, but often don't make a sale. They'll proceed to tell you that your business is worth 8x, 10x 14x times its profit. In truth, the business is worth what a buyer is willing to pay and that's it. If there's a large gap between a buyer's valuation and the broker's valuation that you're unwilling to bridge, the buyer will simply walk away. There are plenty more deals just around the corner.

Adjusted EBITDA – too often brokers or business owners adjust their accounts incorrectly, providing an inflated and misleading representation of the business's financial performance. Make sure any adjustments are reflective of the true state of the business. For example, if the business is owner managed, simply adding back in your salary, because you are leaving the business, is not necessarily reflective of what the business will need to function. It will need a replacement and therefore it should be adjusted at an appropriate market rate.

Ensure the property portfolio is ready – are your property leases in order? Are there any potential issues with the freeholds that should be brought to the buyer's attention early? If freehold is held outside of the company (e.g. in your own name or in a separate company you control), make it clear whether the property is to be included in the sale and, if not, under what terms do you expect to lease the property to the company. In addition, is the property insurance that's in place suitable?

Be prepared to answer the buyer's questions – before you sell your business, you should be ready to answer a lot of questions from potential buyers. First of all, most buyers will want to know why you're looking to sell the business. Are you selling the business because you plan to retire, or are you selling it because the business isn't profitable? You should also be prepared to answer in-depth questions about your company's history, how you came up with a valuation and whether your business can run without you. Be as upfront with potential buyers as possible, and don't try to gloss over your business's flaws. If your company has an underlying problem, prospective buyers should hear about it from you.

Be open minded in structuring the deal – if you really want to sell the business, there's always a deal to be done. The key is being open minded to how the deal is structured, to get what you want. Your focus shouldn't be on 'How' the deal is done, but rather, to reach that finish line. Remember that your business is an unknown quantity to a buyer, and it may be the first time they've come across the business. There's a significant level of risk to a buyer, and this perceived level of risk increases, the smaller the business is.

Use professional advisors – having a team of professional advisers around you can save you both stress and money in the long run. Selling a company can be complex and having a deal team (lawyer, accountant and corporate finance advisor) with the relevant expertise not only gives you the best chance of getting a deal over the finish line, but they will also ensure it is done appropriately and can save you money in the long run.

Address transitional issues – a key consideration, often neglected during the course of the sale, is the transition process. The buyer may request that you remain in the business for a period of time after completion. Alternatively, the buyer may not want you around at all, preferring to bring in their own people. It's important to address this early in the discussions so expectations are managed and, if necessary, a transitional arrangement can be mapped out. Ensure all your standard operating procedures are documented. If you are the Responsible Individual or Registered Manager, have you identified someone in the business who may be able to step into that role as you transition out of the business? Of course, if you're to remain in the business after the sale goes through, this is an added incentive to maintain relationships and avoid unpleasant exchanges during negotiation.

Don't neglect your business during the process – one of the biggest mistakes you can make is to start focusing on the deal and ignoring your business. This is a costly mistake to make because the deal isn't done until all the paperwork is signed by all parties. If revenue or profit suddenly declines in the months leading up to the sale, the buyers could ask for a lower price as you near completion. It should go without saying that it's essential to ensure the standard of care and support is the best it can be at all times. So, in the months leading up to the sale, make sure it's clear who is focused on running the business and who will be negotiating the sale.

Done in a professional and organised manner, the sale of a business can be successfully accomplished for the benefit of everyone involved and, importantly, the legacy and value of the company is protected and sustained under the guidance of the new ownership.

Succession: The Age-Old Question
The importance of finding the right suitor for your social care business

Selling a business can be an extremely emotive process – handing over responsibility to someone new, after years of hard work. With your 'name above the door', so to speak, the success (and sometimes failures) of the business are yours to bear, so ensuring the reputation and professional legacy of the setting is protected – not to mention the level of care given to service users – is of absolute importance.

It's vital to find a suitor who understands care values, has a deep knowledge of the complexities of the industry and, most importantly, understands the vital role of safeguarding.

Social care needs to be influenced by inclusive, emotionally intelligent leaders. This means effective social care is dependent upon very high standards of production, commercial skills and an ability to challenge, combined with an emphasis on inclusion and empowerment. Finding this blend in a potential acquirer is a difficult task, but an essential one to achieve.

As we know, practitioners in the industry manage high risk and exceptionally difficult situations on a daily basis and need to be able to make complex and difficult decisions. This combination of risk management, balanced decision-making and emotionally intelligent execution, is key to creating an effective and sustainable social care business.

What's more, social care environments need shared meanings, understanding and values, but also to be based around the legal and ethical principles of safeguarding law and best practice, and an ability to be challenging and reflexive. Leaders of social care businesses must be seen to be living the values of the organisation – this is important not just for employees, but the individuals that we care for and support – the unwavering foundation of any social care setting.

Rob Finney, Chief Operating Officer (COO) at Tristone, has more than 25 years' experience in the social care sector. Having managed unregulated 16-plus provision, children's homes and fostering services, as well as managing/ commissioning children's placements for local authorities, he's experienced first-hand the importance of finding the right suitor for a social care business to help maintain the qualities that are so critical to a well-functioning sector.

Why is it important to find the right suitor for your business?

"How much importance you place on this decision often comes down to how you think about the provision of care. On the one hand you have businesses that are driven by profits, regardless of the quality of care and, on the other, you have ethical businesses that are centred on making a difference to the generations to come and committed to changing the life experiences of children in care.

"Finding the right suitor for your business is like being part of a family and the responsibilities that come with that – embracing the word 'family' and embracing the nuances of family life.

"Finding the right suitor for your business is like being part of a family and the responsibilities that come with that – embracing the word 'family' and embracing the nuances of family life."

If you're the head of your family, you place significant importance in caring for those people in your family and making sure everyone is happy and content. You have a duty to succession plan and it's exactly the same in a care environment. If you don't treat your business and the people who you care for like family, then the consequences of your succession decision should follow you."

Why should people feel that sense of responsibility?

"Those children's homes that place the needs of children at the centre of everything they do, those that are committed to helping children grow and providing stability for looked-after children, clearly have a value base. Because of that they will fundamentally do the right thing and meet the needs of those children when it comes to succession and think about what happens if..."

What are the key traits to look for in a potential buyer?

"Fundamentally, they need to have a belief in the care system. There should be a genuine motivation to save children and make the world a better place, where you care for children and understand the long-term relationships children have with the care system. It shouldn't be driven by a desire to enter a highly charged business environment.

"Business owners don't have to be the matron; they need to understand the context of why children are living their life in care, rather than simply chasing the money. Unfortunately, however, some people are ruthless when it comes to selling their business."

What are the non-negotiables when it comes to selling a business?

"It's all about quality of care, not just where children sleep and eat. It's about valuing the aspirations of young people and helping them to achieve their aims. Success comes in different forms for children, whether that's quality of life, education, or succession planning for life beyond a children's home – they're the moral and ethical values you must look for; that's what strong reputations are built on.

"It's not about passing your business on to the highest bidder. You want somebody to place children at the centre of what you do and for your approach to succession planning to pervade throughout the whole business. Importantly, it's not just about placing value in the relationships you have with vulnerable children, but with everyone around them – really good, demonstrable relationships with all stakeholders. You need to impress upon your successor about the importance of those relationships and why they need to work."

What can go wrong?

"The biggest risk is we lose a valuable resource. The sad reality is that we need more of that kind of provision, rather than less of it.

"For those people who have put their heart and soul into running a children's home, they run the risk of losing all their life's work – something that must be devastating to see, if your business subsequently fails. In turn, demoralised staff will go elsewhere. The danger then is that demoralised attitude spreads to other settings, as they carry the curse of something going wrong again.

"For any care provider, you need to have a business plan, procedures, standards and expectations, which form the foundations of your business, while promoting a learning environment amongst your staff. If you inject self-esteem into your workforce, then it naturally flows into children in their care. When you're buying or selling a business you need to have the courage to demand those high expectations and ensure those qualities are in abundance.

"You're selling a business about care and that's what it should all boil down to."

Rob Finney is the Chief Operating Officer of Tristone Capital. Rob has been employed in social care for over 20 years and has held a number of roles in both the private and public sectors. The main focus of his work has been concentrating on the needs of Looked After Children in residential, foster care and adoption and the commercial as well as the quality assurance relationship between local authorities and the independent sector.

Succession: The Age-Old Question
The Future of an Ageing Social Care Sector

When you look at the findings from our '**Succession: an age-old question**' research, there's an all-to-familiar picture emerging of the sector. Whatever region of the country you look at, whatever kind of social care establishment you analyse, the theme of age is increasingly common. Whether that's the age of the business, or the age of those in charge of running the setting, the figures are growing and show an industry that is reaching a critical point in its maturity.

So what do the figures say? According to our research:

74%
of PSC are over the age of 50

26%
of PSC are over the age of 60

54%
average age of a PSC

When you look at businesses, you can see a similar trend, with the average age of a social care business 14, with 70% incorporated more than 10 years ago.

When you look at the findings from our '**Succession: an age-old question**' research, there's an all-to-familiar picture emerging of the sector. Whatever region of the country you look at, whatever kind of social care establishment you analyse, the theme of age is increasingly common. Whether that's the age of the business, or the age of those in charge of running the setting, the figures are growing and show an industry that is reaching a critical point in its maturity.

So what do the figures say? According to our research, nearly three quarters (74%) of 'people with significant control' (PSC) are over the age of 50; 26% are over the age of 60; with 77 the oldest age of someone in charge, making the average age 54. When you look at businesses, you can see a similar trend, with the average age of a social care business 14, with 70% incorporated more than 10 years ago.

An ageing sector is both positive and negative. Social care is rich with people who are passionate and committed to the cause; people who have dedicated their lives to creating settings that care for some of the most vulnerable individuals in society. The sector needs businesses that are established and instil confidence in both service users, relevant stakeholders and external agencies, such as Ofsted, the CQC, local authorities and allied professionals. This is not a fast-paced industry driven by ever-changing innovation, like sectors such as digital and technology; this is a marketplace that requires experience, sensitivity and compassion – all things that come with age.

While the makeup of social care is one that exudes consistency and durability, there comes a point when fresh talent is needed to steer the sector through anticipated reforms and, more importantly, to take over the reins from departing founders. That transition, set against a backdrop of considerable change that is expected from numerous independent reviews, needs to be considered and done in plenty of time. Leaving and handing over the keys on the same day is not good for the future prosperity of social care.

So what does the future look like for an ageing sector?

People

There is clearly some work to be done to encourage talented individuals into the industry and inspire and incentivise them to become future leaders. Identifying those people who have the potential to succeed is crucial – the earlier the better – so they can be supported through their career journey and armed with the skills and mindset required to take the business on to the next chapter.

Recently, leaders in the adult social care sector came together for the first time to set out what they felt should be included in a national workforce strategy/people plan. This is designed to encourage a 'health and care workforce to continue to collaborate and deliver together', while supporting staff, and ultimately the people and families who draw on the services.

Together, leaders of the Association of Directors of Adult Social Services (ADASS), Care Provider Alliance (CPA), Care and Support Alliance (CSA), Local Government Association (LGA), Skills for Care, Social Care Institute for Excellence (SCIE) and Think Local Act Personal (TLAP) have come together to set out how the Government can reform social care and its workforce so that it is fit for the 21st century. As Angela Buxton, executive director of people at the learning disability charity Mencap, said: "Care workers are the foundation of a high-quality social care system."

The strategy looks at staff recognition, value and reward; investment in training, qualification and support; career pathways and development; building and enhancing social justice, equality, diversity and inclusion in the workforce; and effective workforce planning across the whole social care workforce.

While this strategy focuses specifically on adult social care, it resonates with the entire sector, and shines a light on the value of people within the social care environment.

Independent reviews

Change is coming. Several bodies have been tasked with looking at various elements of the industry, with the aim of implementing far-reaching reforms – whether it's the eagerly anticipated independent review of children's social care, the CMA's Market Study into the same segment of the market, or the DfE's announcement that it's going to ban placing vulnerable children under the age of 16 in unregulated accommodation, as part of a series of reforms to drive up standards in children's social care.

Initial findings from the Government's independent review have already been published. It's fair to say that the industry was sceptical about what the report would include, whether it would go far enough, and whether it would demonstrate a deep enough understanding of the difficulties the sector is facing.

While the initial recommendations may be uncomfortable reading for the Government, it's this level of challenge that is needed to drive long-term improvement and to meet demand.

There are many reasons why professionalising the sector will bring a multitude of positive outcomes for social care. Whether that's by ensuring the highest quality provision for each and every individual, or by encouraging a value-based proposition within all settings. Many of the headlines that continue to dominate the news have unsurprisingly shone a light on those who are getting it wrong. Within any sector, within any organisation, there is going to be a certain amount of bad practice. However, it's only by focusing on those providers that are already working tirelessly to achieve the sector's ultimate aims that we can ever gain the momentum needed to achieve tangible change in the sector – an ageing industry, or not.

Tristone Capital
Contact Us

If you would like to discuss any of the topics, or insight contained within this report, or you are in a position where you're considering succession planning and would like to discuss your option, contact us on the following details.

Phone: 0161 416 6141

Email: succession@tristone.capital

Address: Tristone Capital, 3 Hardman Square, Spinningfields, Manchester, M3 3EB.