Ontario

PLANNING FOR SUCCESSION

CEO PERSPECTIVES

Leading Growth Firm Series

11 REPORT

"I think it's important to nurture the talent that you have within your organization and bring them along as much as possible. That way, you have successors in place."

Jacqueline Howe, President,
Avid Media Inc.

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SPONSORS' MESSAGE

There is increasing recognition in Canada of the importance of growth companies – firms that are poised to become major international players. These companies are important for several reasons:

- They are significant employers.
- They make a major contribution to innovation through their research and development.
- They challenge and develop the service providers that support head offices in Ontario.

For us, growth firms are our future – they are the businesses whose needs will expand and whose success depends, to no small extent, on an adequate network of support services to meet those needs.

We have chosen to become sponsors because the Leading Growth Firm Series explores the issues that are vital to these companies' success as they become large businesses. This report on succession planning addresses issues of importance to every CEO of a growth company.

As service providers, in addition to working with big business, we work extensively with growing firms and have the capacity to help them meet the challenges of growth and international expansion. All of us have clients who face these challenges and, accordingly, we know just how important they are.

We endorse this report, knowing that the issues surrounding the succession of a CEO can have a lasting impact on the economy as well as on the lives of all the people involved in these exciting firms.

Four members of the Leading Growth Firm Series Reference Group from left to right: Lesley Krupa, Market Segment Manager, Hewlett-Packard (Canada) Co.; Dan Lioutas, Partner, Orenda Corporate Finance Ltd.; Aaron Glassman, Partner, Deloitte; Ruth Fothergill, Vice-President, Corporate Outreach, Export Development Canada.

INTRODUCTION

Ontario's leading growth firms[1] are a vital economic asset to the province. For this reason, a change in leadership can affect not only the economic prospects of the firm, but also the local economy. The success of leading growth firms can often be attributed directly to the commitment to growth and drive of their CEOs. Their departure from the firm can be devastating if not handled correctly.

CEOs who are immersed in the challenges of running leading growth firms, however, do not usually spend much time thinking about who will take over when they retire, sell the company or move on. Most of them started the firm and usually own a majority of the shares. For many, they see it as a lifelong commitment, and their firms define them as much as they define their firms.

Nonetheless, the time to pass their firms on to someone else always comes, and when it does, few CEOs find it easy to let go. An unsuccessful succession can do a lot of damage – to the firm, to its employees and to the CEO – so the exit plan is as important as the manner of starting and growing a business.

This report is based on a survey of CEOs of Ontario's leading growth firms (see Survey on CEO Succession Planning, page 18). It looks at succession as a leadership issue and explores how CEOs approach the topic of replacing themselves, the strategies they choose and what they have found works best for their firms. For the purposes of the analysis, the CEOs were divided into two groups:

- Group A CEOs have already completed a succession or are in the process of doing so.
- Group B CEOs have not voluntarily arranged for a successor or are not currently engaged in doing so.

The three profiles in this report provide insights into the different challenges CEOs face in creating and implementing a succession plan. They highlight different perspectives: one CEO is making plans for retirement; the other two CEOs are successors who have taken over a firm and share key lessons they learned and how they will apply these lessons to their own successions.

1. Ontario's leading growth firms employ between 10 and 500 people, have a minimum growth rate of 50% in sales over a three-year period and maintain their global head offices in Ontario.

PLANNING FOR SUCCESSION

As a CEO, the process of choosing a replacement for yourself is extremely sensitive. Not only do departing CEOs have to distinguish between their own interests and those of their companies, they have to determine what kind of CEO will best suit the future needs of the company, knowing full well that it may require someone with a very different skill set.

Preparing for succession is as much a strategic move as it is a formal plan. In many cases, a succession plan cannot be definitive because the succession is some way in the future and the needs of the firm at that time are difficult to determine. Establishing a succession plan can lead to a modification of current leadership strategies with a view to ensuring the elements are there for future succession, and the CEO will have to be able to articulate his or her own career goals.

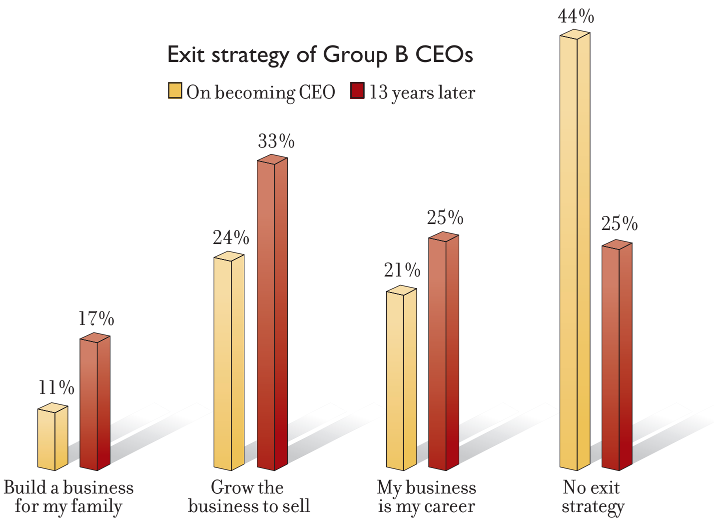
For most CEOs, succession planning is a low priority. Of the Group A CEOs, only 41% had written succession plans, even though they have completed a succession or are in the process of doing so. Of the Group B CEOs, who have not voluntarily arranged for a successor or are not currently engaged in doing so, only 12% have a written succession plan. Of the Group B CEOs who don't have written plans, 38% say that it would be inappropriate at this time and 43% say they intend to do one at some future point.

This generally low level of succession planning might be understandable in small or young firms; it is somewhat surprising for established firms such as these, with an average of more than 100 employees and where three-quarters of the CEOs have been in their positions for more than a decade.

WHY CEOs MOVE ON

One explanation of the low level of succession planning might be that most CEOs don't see themselves ever leaving the businesses they have built. Of Group B CEOs, 44% say that when they started their businesses, they had no exit strategy. However, by the time the survey was conducted (13 years after start-up, on average), that number had dropped to 25%. Thirty-three per cent of them now want to build their businesses with a view to selling them for a good price compared with 24% when they started out as CEOs.

Of the Group A CEOs, 46% say they became involved in the succession process because they wanted to grow their businesses to sell. Yet, even though almost half of the CEOs in both groups see their businesses as marketable, few CEOs in Group B have written succession plans.



CEO SKILLS AND REQUIREMENTS

The biggest single issue for developing and implementing a succession plan is the desire of CEOs to determine the future course of their firms after they have departed. It is entirely understandable that people who have devoted so much energy, creativity and determination to making their companies succeed would not wish to see their efforts lost by successors who do not understand the CEOs' visions. The more they want to set a course for their successors, however, the harder it is to find the right person and the tougher it is to let go.

For CEOs who sell to another company, it is not a dilemma, because most do not continue with the firm. However, many CEOs sell to associates or other insiders and their perspective is different. Three-quarters of Group A CEOs say they wanted to set the priorities for their successors before departing; the overwhelming majority of them (91%) say they wanted the company to continue growing.

Setting priorities for a successor works only if the CEO understands what he or she personally brings to the table and what the firm needs to continue growing. Eighty-two per cent of CEOs say they have examined what makes their companies successful but only 67% have used this information to target the qualities, personality and skills of their successors – 50% of them wrote a job description for their successors, 25% listed the skills required and 18% described the personality they thought was appropriate. Because the issue is so sensitive, 71% of the CEOs did not consult their management teams. The ability of a successor to work well with the board of directors, employees, management and/or clients carried no significance at all.

Group B CEOs are only slightly less objective about the suitability of their own skills for the needs of their companies. Sixty-nine per cent say it is a good idea to obtain an objective assessment of their own skills in the context of the ideal skills and requirements for their jobs. Not all of them have actually done it, however – two-thirds of them have defined the ideal qualities in a CEO of their firms and one-third have obtained an objective assessment of their own suitability for the task.

CEOs in both groups can be said to embrace delegation enthusiastically – and the proof is in the CEOs' attitudes once they leave their firms. Almost all (87%) said they were ready to go when the time came. The others still would have liked to be involved, as they were concerned whether their former employees were being properly looked after or whether the new CEO was up to speed.

REASONS CEOs MOVE ON	
Want to focus on what I do best and delegate the rest	66%
Have reached retirement age	33%
Want to explore a different side of myself	30%
Want to monetize my assets by selling the business or parts of it	27%
Have another business I want to lead	20%
My plan was always to build value and then sell	19%
Tired	16%
The firm is growing rapidly and my skills are no longer adequate	16%
Bored or lost interest	16%
Will lose a key employee or family member unless I give them the leadership responsibility	14%

PROFILE

THIRD TIME LUCKY

Robert Krycki, CEO, Future Design Inc.

Robert Krycki started thinking about finding a successor for himself about five years ago. He was 55 and his wife wanted to spend more time with him. They own a ranch in Florida with access to the sea and a 16.5-metre powerboat that is his pride and joy. His biggest challenge was to let go.

Krycki had built his company, Future Design Inc., from start-up and earned a global reputation with his Saturn air ring – a machine that governs the final step in the process of making blown-film plastic, which is used in all forms of plastic wrapping, from garbage bags to shopping bags to shrink wrapping. Krycki invented the machine himself and, although it is not patentable, it is used by almost all the major plastics manufacturers in the world. He does, however, have patents on the software that automates the intricate adjustments required to get the blown film just right.

When he first thought about finding someone to take over the business, there wasn't a full management team who could do his job, so he offered his four daughters the opportunity to learn the business and take over. "One daughter came in," he says. "She was in sales and she was unbelievably good. Then she got married and completely lost interest." Recently, his youngest daughter became an employee, learning the ropes, but it is not clear yet if she will want to stay either. "You can't force them to come in," says Krycki.

After his first daughter left, he looked for an outside buyer, but he found no one who could satisfy him that they would treat the company and its employees with the care he feels they deserve. So he decided to hire a general manager to "earn his stripes" before selling the company to him.

The first person he hired had worked mainly in large companies, but he persuaded Krycki he had enough experience in small companies that he would be comfortable in Future Design. As soon as he joined Future Design, however, he started layering in the infrastructure of a much larger company, causing profits to tumble. After that didn't work out, Krycki hired another general manager who had a lot of experience in manufacturing and could do the job, but he also tended to build in more bureaucracy.

As he was going through these experiences, Krycki realized that, if he was to ensure the long-term survival of his company, he had to build up his management team before he could bring in a new general manager. He hired an engineer and a trades-oriented salesperson. Together with his financial person, who has been with him for 20 years, they formed his new management team.

Krycki was now ready to change his tactics. This time, he had his own job evaluated by his management team so they could identify what qualities were needed in the new CEO. The management team also underwent psychological tests. Finally, he persuaded a friend in the plastics industry to lead a selection team that interviewed the 55 applicants for the general manager position and came up with a short list of three. "The team chose my third choice," says Krycki, "but he was actually my friend's first choice!" Krycki went along with their decision.

He knows the time has come to start letting go. "My personality is such that, if I ask you to do something, I expect you will do it as well as I did, with the same vision I have. Our board of advisors told me I can't do that any more. 'You have to say what you expect, Bob – what the benchmarks are.' So I'm writing a one-page document saying what I want the general manager to do."

The new general manager is comfortable with the ambiguous role of Krycki's daughter, who may or may not become the majority shareholder and CEO. It's his job to mentor her, although she won't be ready to take over for several years. Krycki doesn't see that as a problem: "Hopefully, I'm going to be around for a long time."

"I pretended to get other people involved, but I don't think I did – I dominated the whole thing myself, and I do not want that to happen again."

Robert Krycki, CEO,
Future Design Inc.

At a Glance: Future Design Inc.

2003	
Sales	$3 million
Employment	25
Growth (2000-2003)	
Sales	52%
Employment	32%
Equivalent annual growth rate (2000-2003)	
Sales	15%
Employment	10%

FOCUSSING ON LEADERSHIP

The attitude of CEOs toward their management teams is a primary indicator of how they will feel about succession. Those who are accustomed to participatory management and the delegation of entrepreneurial authority will find it easier to bring in a new CEO to take over from them. Those who are accustomed to exercising control over their businesses inevitably find it more difficult.

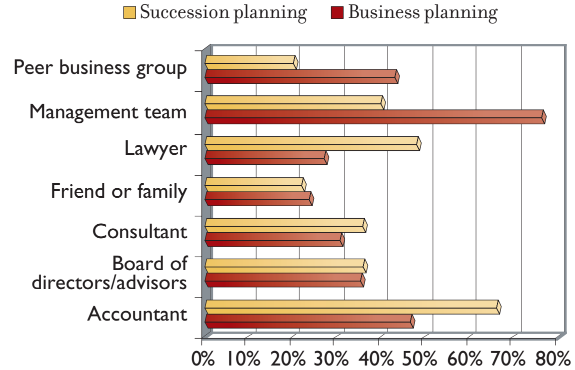
Interestingly, there is very little difference between the two groups of CEOs with respect to their attitudes toward their management teams. About a third run "one-entrepreneur" companies, meaning the CEOs see themselves as the principal strategists, so that their managers and employees follow their leadership to implement their decisions. The remaining two-thirds run "many-entrepreneur" companies, where the CEOs see themselves as the lead strategists and their managers are expected to take initiatives and set strategy within parameters set by the CEOs. A difference between the two groups lies in their assessment of their management teams: 69% of Group A CEOs and 56% of Group B CEOs consider their managers to have no significant weaknesses.

Both groups have profit sharing as well as share ownership among managers and employees, with a greater reliance on share ownership for managers and on profit sharing for employees.

CONSULTING STRATEGIES

When CEOs set out to develop strategies for their firms, they consult intensively. In preparing business plans, only 5% do not consult anyone else. In preparing succession plans, 12% did not seek advice from others. However, who they consult varies according to their needs. When looking for succession advice, CEOs consult primarily their accountants and their lawyers. Only 40% consult their management teams. When preparing their business plans, 77% of CEOs listen to their management teams.

Where CEOs go for advice



ORGANIZATIONAL STRUCTURE

	Group A	Group B
Average age of CEO	55	47
Average age of management team	41	41
Rating of management team	3.0	2.8
1 = Needs upgrading		
2 = Some good, some bad		
3 = No significant weaknesses		
4 = Highly skilled		
Entrepreneurial culture		
One entrepreneur	34%	35%
Many entrepreneurs	66%	65%
Profit sharing for		
Senior managers	81%	90%
Employees	92%	94%
Share ownership for		
Senior managers	48%	37%
Employees	28%	20%

THE RIGHT PERSON IN PLACE

Most CEOs say that, when they are planning for their successors, they are not certain who that person will be. They don't know what the requirements of the job will be when they move on and the dynamics of their firms can change in the interim. Even in family firms, there is often doubt as to who will succeed the current CEO – and sometimes even whether it is wise for the next CEO to be a member of the family at all.

The degree of uncertainty diminishes as the CEO approaches succession. Almost all the CEOs who have already completed a succession or are in the process of doing so say that they had a pretty good idea of who their successors would be and only 10% of them say the final choice was not whom they had expected when they started planning for it. When they first started planning their succession, 22% say they did not have a clear idea of who their successors may be when that time comes. Of the ones who did have a favoured candidate, fewer than 6% expect that person to come from outside – 38% mention a senior manager, 36% mention a family member and 15% mention a partner or shareholder.

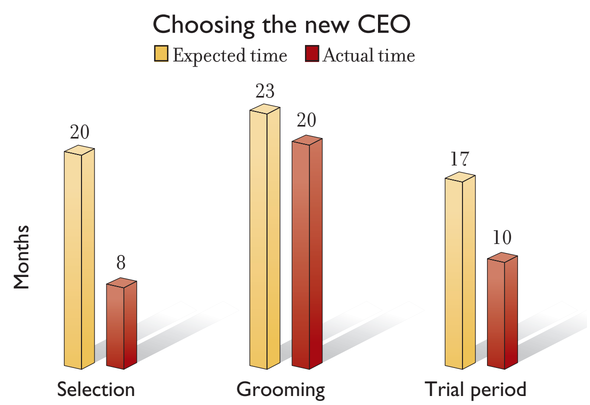
Thirteen per cent of the CEOs who have not voluntarily arranged for a successor or are not currently engaged in doing so say that they have had setbacks in the past in their search for a replacement, mostly because the successors they chose turned out to be unsuitable. CEOs who have gone through a succession and have already moved on did not suffer setbacks on that transition. And 100% of them say that their choice was accepted by their management teams, even though only 18% of them consulted their teams in making their choices.

A SUCCESSION TIMELINE

The time allocated to finding the right person depends on how close the CEOs are to moving on. On average, Group A CEOs took eight months to find their successors. Group B CEOs have more time to make their choices and they expect to take 20 months to find the right person. A few of the replies anticipate more than 10 years for this process.

Once the successors have been chosen, there is still a critical process to groom the new CEOs and, sometimes, help them through a probationary period. CEOs in Group A say it took them, on average, 20 months to groom their successors; Group B CEOs expect it will take them just a little longer, 23 months. Group A put their successors on trial for 10 months and Group B CEOs expect to have a 17-month trial period.

Roughly speaking, Group B CEOs expect it will take, on average, five years to find and groom their successors and complete a trial period. Group A CEOs say it took them a little more than three years to do the same thing. The latter say that the time they allowed was generally adequate, although 23% say they would have liked more time to get their managers to accept the new CEO.



PROFILE

GROOMING THE SUCCESSOR

Jacqueline Howe, President, Avid Media Inc.

It was a case of being in the right place at the right time for Jacqueline Howe when she took over as President of Avid Media Inc. The publishing house, which now has four magazines in its portfolio (*Canadian Gardening*, *Canadian Home & Country*, *Canadian Home Workshop* and *Outdoor Canada*), had been owned by two partners – John van Velzen, who operated the day-to-day business, and Phil Whalen, who was the CEO, but more as a hands-on investor than an operator. Whalen owns several businesses, for which he is the CEO and chairman but not the day-to-day operator.

When van Velzen decided to retire, Whalen took over the day-to-day operations for a short period, but one of his other businesses required his full attention, which meant moving to the United States. Howe was then the vice-president of sales and marketing for Avid Media and an important player on the "very strong" team van Velzen and Whalen had built. Whalen considered bringing in a CEO from outside the company, but preferred to promote from within. "We had a discussion over lunch," says Howe, "and I said: 'If you can bring somebody in here who's going to make you and me a lot of money, then let's bring them in, but if they're not, then I think I should take over this business and run it.'" Whalen told her she had the job. "I think he wanted me to step up to the plate," says Howe.

Howe had been a minority shareholder in one of the magazines, *Canadian Gardening*, and Whalen had encouraged her to roll that holding into a smaller shareholding of the overall company. Then, when he offered her the job of President, he gave her the option to raise her shareholding. Whalen remains the controlling shareholder and Howe has since brought in the key managers as part owners, too.

When she became President, Howe's biggest concern was her lack of experience on the financial side of the business. "I'd seen the operating profit sheets for years and years," says Howe, "but it was a whole new world for me looking at a balance sheet and managing cash flow and all the rest of it." The vice-president in charge of finance was doing a good job, but Howe had to master the discipline if she was to be effective as President. She signed up immediately for a six-week course on finance and had three months of intensive mentoring from Whalen before he left for the United States. "It was brutal," she says, "but it was worth it."

Howe now sees the disparity in her and Whalen's skill sets as an advantage in the transition to a new CEO. "If we had both had the exact same skill sets, I often wonder how successful it would have been," she says. "We might have had to work that much harder to separate ourselves in the transition process. I had to replace myself when I took over the business and one of the toughest things was hiring my replacement, because I know that area of the business extremely well and am probably a little more critical of it."

Whalen's unexpected departure for the United States meant that Howe had to start her new job without a support system. She and Whalen talked once a week, but his absence made it a clean break in the leadership, so there was no uncertainty in the management team about who was in charge.

Avid was profitable when Howe took over, but barely. She and Whalen set themselves the objective of making the company more profitable and building up its value, then selling it. "We had a five-year goal in mind," she says. "It was never Phil's intention to pass this down through his family and I wanted to realize my personal investment in the business, so the goal was to sell it." They cleaned up the portfolio, selling the most unpromising magazine and buying *Outdoor Canada* and *Century Home* (now called *Canadian Home & Country*). This improved the profit margins enough that, at the end of the five years, they decided not to sell. "We sat down and took a hard look at it, and, I thought, why would we sell it at this point? We haven't realized our investment, we're still investing heavily in one title, and I'm having a lot of fun! And Phil's happy because his investment is providing a good return!"

Howe has no exit strategy now. She is not planning to move on for perhaps another 10 years and she will think about succession when she is ready. In the meantime, she has built a strong management team. "I think it's important to nurture the talent that you have within your organization and bring them along as much as possible. That way, if the time comes – because sometimes these things are unexpected – you have successors in place. I think you owe it to your key managers to try and bring them along. In that way, I hope to also give them the incentive to stay if somebody offers them a job."

At a Glance: Avid Media Inc.

2003	
Sales	$16 million
Employment	64
Growth 1998-2003	
Sales	129%
Employment	73%
Equivalent annual growth rates (1998-2003)	
Sales	23%
Employment	15%

"Phil [my predecessor] gave me counsel and advice, but he always said: 'You're running the show, so it's your decision what you do.' I think a lot of people would find that hard to do."

Jacqueline Howe, President,
Avid Media Inc.

FINANCING THE SUCCESSION

Two-thirds of Group A CEOs own or owned controlling interests in their businesses; after the transition to their successors, almost 25% still owned a controlling interest.[1] This means that more than 33% of those with a controlling interest retained their control, while 23% reduced their stake to a minority interest and 40% sold all their shares.

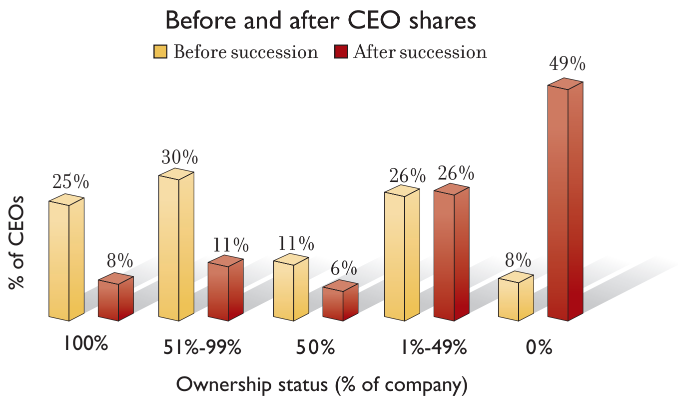
Of the CEOs who initially held a minority interest, 43% continued to hold at least some of their shares and 57% sold all their shares in the transition.

The change in ownership naturally depends, to a degree, on the other owners prior to the transition. The CEOs who had a controlling interest in their companies owned, on average, 80% of the shares. The balance was held primarily by family members (9%) and partners (8%), with the remaining 3% held by a variety of other shareholders, including managers (1.3%).

The CEOs who did not have a controlling interest in their companies are clearly a very different group. They owned, on average, only 20% of the shares. The balance was held mostly by their partners (31%), other companies (21%), private and venture-capital investors (13%) and employees (8%), including managers. The CEOs' family members averaged only 1% ownership.

As a result of these distributions of shares, controlling shareholders were more likely to sell to insiders, while non-controlling shareholders were more likely to sell to other companies or investors.

Overall, 23% of the CEOs did not change their ownership position when they ceased being CEO. Coincidentally, the same percentage (23%) still owned a controlling interest, while almost half owned no shares at all after the transition.



The data on shareholdings by owners other than the CEO is less reliable after the transition, but 24% of the respondents said that investors or other companies owned parts of their businesses after the transition.

Since the most important buyers of these CEOs' shares were insiders, rather than other companies, the financing of this transfer of ownership is often one of the biggest hurdles to a successful succession. Only 10% of the transfers of ownership were paid for with the shares of the purchaser. Another 23% involved no change of ownership, so almost two-thirds of the transitions involved changes in ownership that had to be paid for by successors who usually

1. Because the data for Group A includes CEOs who are in the process of implementing a succession as well as CEOs who have completed a succession, the "post-succession" data for the former is what they say they intend to do.

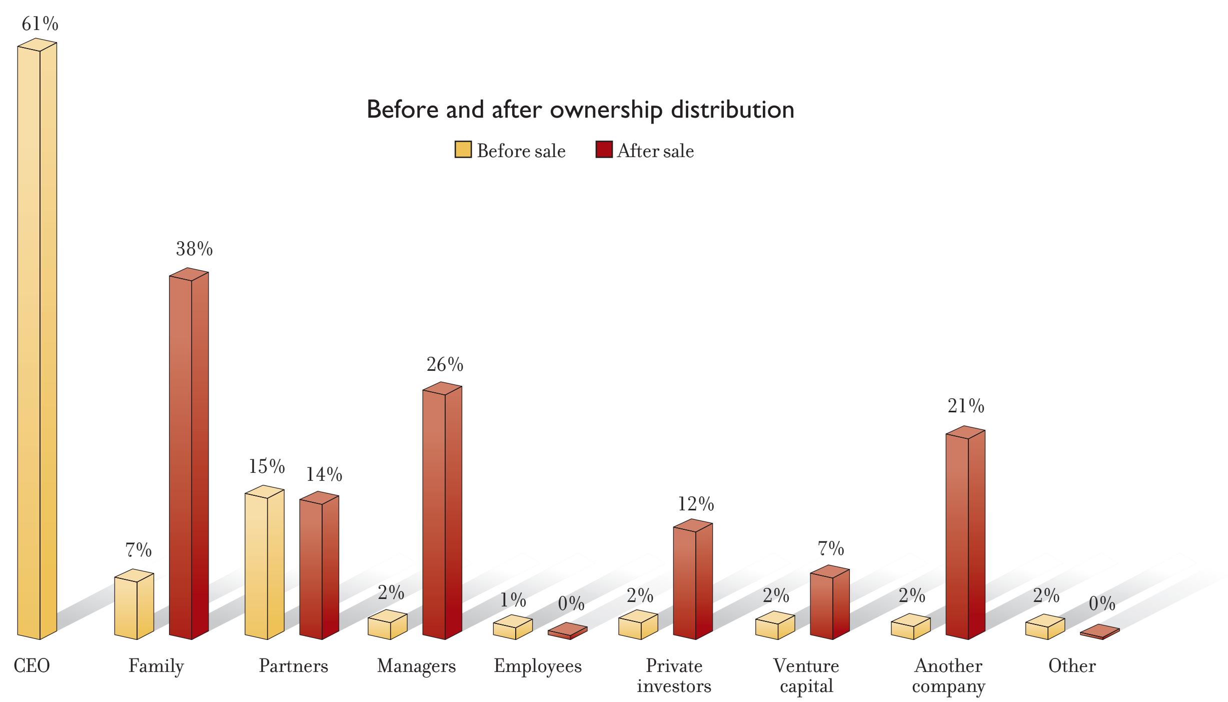
did not have enough money to buy out the departing CEOs easily or quickly.

As the chart below shows, 38% of the new owners are family members and 26% are managers – and this, despite the managers' average holdings before the succession of only 2%.

Private investors, venture-capital firms and other companies, between them, were buyers in 40% of the firms that transferred at least some ownership. About half of these were other firms in corporate purchases.

For 80% of these businesses, all or part of the departing CEOs' shares are bought out of cash flow over a period that averages 3½ years. Only one in five are bought out immediately.

In settling on a price for the CEOs' shares, more than half (55%) negotiated a price that suited both parties. Another 40% either used the valuation that had been used on the most recent financing deal or the price was a given, perhaps because a buy-sell agreement was triggered. Fewer than 5% packaged their companies to obtain the best price.



Roger Woeller, CEO,
WESA Group Inc.

PROFILE

GETTING MANAGEMENT BUY-IN

WESA is a collection of companies engaged in environmental engineering – hydrogeology, industrial hygiene, occupational health and safety, air quality, building sciences and contaminated lands. The group currently has nine partners and is expecting to add two more this year – and, of course, the CEO's role extends well beyond strategy. "I used to say my job was vice-president of damage control," Woeller says, laughing, "from both a technical and a human resources perspective. Often it's two rival personalities or two rival ideas that require mediation. But it doesn't happen very often."

Woeller has been CEO for almost three years, having taken over from his predecessor in 2001 after a succession process that proved to be difficult. His predecessor, who founded the firm in 1976, had a more traditional, top-down style and, while that style made the company very successful for almost two decades, it became unworkable once the firm reached about 40 employees. It took almost a decade to resolve the impasse. Eventually, the former CEO left. "It could have been done better," says Woeller. "There was a tremendous amount of institutional as well as scientific knowledge that walked out of here. This is a professional services firm and that's a loss." But it was a choice of one walking out or many.

Woeller was the firm's first employee in 1976. He has played a critical role in changing the leadership culture of his firm since he took over. Woeller is determined that, when it comes time for him to leave, it will be on good terms. He says the biggest lesson he learned from his first transition was the need for succession planning. Even before the new group took control, the partners spent many hours in two weekend sessions working out where they wanted to take the firm – both in terms of its growth and in terms of the future succession.

The biggest challenge is financing it. When Woeller became CEO, the remaining partners bought out the majority holding of the former CEO. "We did it the scariest way possible," he says. "We borrowed some money and we put in substantial amounts of cash. It was like going out and buying your first house; it's the same feeling – you wake up, you know you're way out there and you just hope nothing awful happens." He doesn't want that to happen when the younger professionals buy out the partners Woeller's age. They haven't worked out the details yet, but the intent is to have the company support the new shareholders, whose loans will then be paid down out of future profits, while the original partners decrease their shareholdings through sale and dilution.

Whatever they decide, it will be a collaborative process. "We have to get together as a group," says Woeller, "and we have to listen to the next tier, who want to buy our shares. We can't put a plan on the table and tell them that's the plan. It has to be a plan that's good for them as well as the original partners."

One of the most delicate aspects of a buyout is valuing the company. Last time around, Woeller and his partners hired a consultant, who started out as a financial advisor for the company valuation, but who finished by playing an essential role in the transition. Not only did his banking contacts facilitate the loan to buy the firm, but he handled all the documentation, reporting and paperwork for the deal – which is now proving useful to Woeller as he lays the groundwork for his own succession. Finally, through the sometimes difficult negotiations, the consultant acted as the point man for the remaining partners. "I won't call him our negotiator," says Woeller, "but he could afford to ask the difficult questions. We were operating a business throughout this period and the negotiating process detracts from productivity."

It is still unclear, however, who is most likely to take over as CEO in five or 10 years, when Woeller expects to step down. The organizational structure of WESA, which gives its partners overlapping geographic and technical responsibilities, means several of them could handle the CEO's job, but who will get the job depends on what the demands of the firm are at the time the next CEO is appointed. "It's a positive feature as long as you have the right person, but if I left, would they put another CEO in place? Maybe not."

"The biggest lesson I learned from my first transition to CEO was the need for succession planning."

Roger Woeller, CEO,
WESA Group Inc.

At a Glance: WESA Group Inc.

2003	
Employment	85
Growth (2000-2003)	
Employment	107%
Equivalent annual growth rate (2000-2003)	
Employment	27%

Sales figures are not available.

SURVEY ON CEO SUCCESSION PLANNING

A total of 169 CEOs of Ontario's leading growth firms responded to the survey, which was sent to 1,500 CEOs across the province (a response rate of 11%). Together, the respondents represent a sizable component of the provincial economy, with total sales of more than $3 billion and almost 18,000 employees.

CEO respondents are experienced and their firms well established. Younger and smaller firms meeting the criteria proved less likely to respond to a survey about succession, as expected.

CEOs who have already completed a succession or are in the process of doing so (Group A) are older and more experienced than their counterparts in firms that have not voluntarily arranged for a successor or are not currently engaged in doing so (Group B). Group A CEOs have held their jobs for an average of 18 years compared with 13 years for Group B.

Both groups are heavily concentrated in manufacturing (59%) and services to business (20%). This differs from the general population of leading growth firms, 23% of which are in manufacturing and 15% in services to business.

These firms are heavily committed to exporting – only 18% of them do not export at all and the ones that do export are well diversified in world markets. More than 40% of their sales are outside Canada and about 83% of their exports go to the United States, which is slightly lower than the average for the country.

CEO respondents could choose multiple responses to many questions, therefore, the numbers in some of the charts in the report do not add up to 100%.

QUICK FACTS

Group A are those CEOs who have already completed a succession or are in the process of doing so.
Group B CEOs have not voluntarily arranged for a successor or are not currently engaged in doing so.

	Group A	Group B
Respondents	65	104
Firms' sales ($ million)		
All firms combined	$1,400	$1,700
Average per firm	$22	$16
Employees		
All firms combined	7,900	9,800
Average per firm	121	94
CEOs' ages		
45 or less	13%	43%
More than 45	87%	57%
Age of their firms		
10 years or less	6%	28%
11-20 years	37%	36%
More than 20 years	57%	36%
CEOs' tenure		
10 years or less	26%	44%
11-20 years	35%	41%
More than 20 years	39%	15%
Exporters		
% of respondents	82%	82%
Sales to the United States	35%	36%
Non-U.S. sales	8%	6%
How the CEOs got there		
Founded the firm	62%	65%
Bought it	15%	15%
Inherited it	9%	7%
Appointed to firm	14%	13%

STEPS FOR SUCCESSION PLANNING

Based on the survey findings, the experiences shared by CEOs in this report and considerations from the Baker & McKenzie checklist (page 20 and 21), following is a list of suggested steps in succession planning.

Step 1: Prepare a written succession plan.

It's not necessary to decide on a successor right away, but it is a good exercise for examining long-term goals and giving some thought to the match between the firm's needs and the CEO's skill set. In particular, it is important to know if the intention is to sell to an insider or another company. On all counts, it makes for a better business plan when the timing and the nature of the ultimate transfer of control to another CEO are on the agenda.

Step 2: Allow for lots of time.

A sale to another company might be done quickly and efficiently, but with a sale to an insider, it takes at least three years to "install" a new CEO once an incumbent has decided to move on. CEOs need to allow for more time than that, however. They need to have their businesses and their management teams functioning at peak effectiveness in order to maximize the value of the business to a potential buyer. Also, no one wants to sell in a down market or just after they've lost a big client, so allowance must be made for external events that can influence the timing.

Step 3: Build a management team consistent with the CEO's own plans.

A CEO who intends to stay as long as possible will not need the same team as one who is planning to leave. The quality of the management team is a key consideration when the time comes to prepare for succession.

Step 4: Be clear on what is required from a successor.

It is vital for everyone to know how much departing CEOs want to stay involved – and that they stick to what they say. It's a good idea to take the time to do an objective assessment of why the business has been successful and what it needs to continue being successful after the succession. Be ready for this assessment to change continually. When CEOs are ready, this will give them the data that enables them to define what skills, attitudes, connections and personalities their firms need in their replacements.

Step 5: Get professional advice on how to structure the deal.

There are many ways to finance the purchase of the departing CEOs' shares. CEOs should be sure they have maximized the security of their ongoing investment if the purchasers commit to paying them out of future profits.

Nurhan Aycan, Partner, Baker & McKenzie

CHECKLIST FOR SUCCESSION PLANNING

When planning for succession, there are many issues to consider. Following is a set of guidelines provided by the law firm Baker & McKenzie to help you through the process.

CONSIDERATIONS ON SALE

❑ **Engage a company accountant or business valuator**

- ❍ Determine value of the business.

❑ **Legal matters to consider**

- ❍ Consider provisions of any shareholder agreements or voting trust arrangements.
- ❍ Conduct due diligence as to the effect of change of control on contractual relationships.
- ❍ Consider corporate governance issues.
- ❍ Consider dispute resolution mechanisms.
- ❍ Assess benefits of transfer of assets (e.g., impact of potential claw-back of depreciation) versus transfer of shares (e.g., potential to maximize lifetime capital gains exemption).
- ❍ Consider segregation of certain assets not to be included in any sale (e.g., a division, intellectual property, etc.).
- ❍ Assess any Competition Act issues in case of an acquisition by a non-Canadian.

❑ **Financing considerations**

- ❍ Evaluate effect on the business if leveraged financing is used to purchase the business.
- ❍ Consider any vendor take-back financing and terms, including security over assets or pledge of shares.
- ❍ Consider other financing alternatives (e.g., earn-ins or earn-outs).

❑ **Tax planning**

- ❍ Consider tax liability/capital gains issues.
- ❍ Consider tax liability for buyer.
- ❍ Consider setting up a holding company prior to disposition to maximize lifetime capital gains exemption, if available.
- ❍ Consider any tax issues relating to payments for royalties or intellectual property retained by seller group.

CONSIDERATIONS ON LEADERSHIP CHANGE

❑ **Employment issues**

- ❍ Company leadership and long-term vision of corporation.
- ❍ Corporate culture.
- ❍ Family control (if applicable).
- ❍ Contingency planning in case of death or disability of incoming CEO.
- ❍ Integration with existing staff and management.
- ❍ An employment contract for the successor CEO should include the following:
  - Provisions dealing with conflict resolution.
  - Non-competition/non-solicitation provisions upon cessation of employment.
  - Confidentiality provisions.
- ❍ Devise compensation package for incoming CEO:
  - Consider salary, dividends, stock options and pension plan.
  - Bonuses and/or incentive-based pay arrangements; deferred profit-sharing plans.
  - Income splitting.
  - Fringe benefits (e.g., private health insurance, retiring allowance, company car).
  - Severance packages.

OTHER CONSIDERATIONS

❑ **Estate planning**

- ❍ Make a will – designate beneficiaries.
- ❍ Consider setting up a family trust.
- ❍ Consider setting up a testamentary spouse trust.
- ❍ Consider an estate freeze.
- ❍ Take steps to minimize probate fees.
- ❍ Consider level of life insurance.
- ❍ Consider any key man insurance policies.
- ❍ Consider effects of foreign estate taxes.

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