

# Mid-Market Investment Banking

## The Importance of Succession Planning

According to the Canadian Federation of Independent Business, only three in ten family-owned businesses survive the transition from founder to the second generation. A well thought out, comprehensive succession plan can ensure your business continues to thrive once you transition out of the business.

If you haven't started planning for succession, you are not alone. Research reveals that only 10% of small and medium business owners in Canada have a written, formal succession plan, while approximately another 40% have an informal succession plan<sup>1</sup>. That leaves approximately half without any succession plan in place. Contrast that statistic with the expectation that almost 80% of Canadian family-owned businesses are expected to lose their leader to retirement in the next 15 years and the result is that the majority of businesses will face succession issues that require significant planning over the next several years.

### Why Do I Need a Succession Plan?

Pro-active management of the succession process will reduce the impact of untimely events which can result in a sudden change in your ability to operate the business, and ensure you are in control of the future direction and legacy of your business. It is never too early to start planning; some of the benefits of a succession plan include:

- Increases your opportunity to maximize value and minimize future tax liability
- Greater flexibility, choice, and control
- Improved harmony amongst employees, customers, suppliers and business partners
- Ensures the future stability of the business
- Reduces the potential for conflict within the family
- Peace of mind

In short, a succession plan will greatly improve your chances of getting what you want for your future, your family and your business.

### Set Succession Objectives

Before developing a detailed succession plan, it is important to consider some fundamental questions to determine your objectives with respect to the transition of your business:

- When do you want to retire?
- Who will take over management of the business when you exit?
- Do you want to transition ownership to the next generation of family?
- What value do you expect to achieve for the business when you decide to exit?

The answers to these and other fundamental questions can help form the key objectives that will ultimately shape the succession plan for your business. It is important to note that succession planning is a long-term fluid process that evolves and changes as your objectives and your business change over time.

An effective succession plan needs to address two key components:

- Management succession
- Ownership succession

Each of these elements is of equal importance and often one impacts the other.

### Management Succession

How important is your day-to-day involvement to the success of your business? Preparing the business to be successful upon your exit is a key challenge many business owners face. The planning and execution of transitioning management of the business is a process that takes years to complete.

A management team must be identified and groomed to operate the business independently of the current ownership. This team may consist of family members or the existing management team or outside professionals. If family members are a part of the management succession plan, it is important to take a step back and objectively evaluate how best to structure your family's involvement in the future of the business given each family members' skills and desires. Each family member should be consulted for their opinions and expectations in order to avoid making inaccurate assumptions and creating potential future conflicts.

In order to provide for a smooth transition and give you comfort that the business will continue to thrive beyond your departure, management teams must be in place for sufficient time to allow them to transition into leadership roles successfully.



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## Ownership Succession

Many times, the decisions made regarding management succession of the business directly impact the direction for the ownership transition. If the next generation of family is actively involved in the operations, it may be natural to transition ownership within the family if your value expectations can be met.

Family transition is not the only option for ownership succession; more and more, business owners are turning to outside parties to transition ownership of their business. In fact, approximately two-thirds of business owners with a succession plan expect to sell their business to a third party<sup>2</sup>. Many alternatives exist, including a management buyout, a private equity buyout or an outright sale to a strategic buyer.

## Components of a Succession Plan

Your succession plan will be unique to your own business and personal circumstances. However, there are some common elements that should be considered when developing a succession plan, including:

- Short and long-term stakeholder objectives
- Strategic business plan
- Future lifestyle / income requirements
- Corporate structure
- Management development plan
- Shareholder agreements
- Tax planning
- Estate planning
- Exit strategies / timetable
- Contingency planning

A team of professional advisors are important to help you ensure that the succession plan is formulated and executed in the most efficient and effective manner from a financial, legal and tax perspective.

Ideally, you should treat succession planning in much the same way as a business plan. It should be developed early in the life of the business and then continually revisited and updated in order to ensure the plan remains relevant given the current situation of the business and your objectives.

<sup>1</sup> Canadian Federation of Independent Business Survey, 2006.

<sup>2</sup> CIBC Economics: Are Canadian Entrepreneurs Ready for Retirement, 2005.

