Houser Henry & Syron LLP

LegalSpotlight

What's Your Game Plan?

Planning for a Successful Succession for Your Business

2nd edition

Sooner or later, every business leader hands over the reins. But for founders and owners of family businesses, managing a successful transition is difficult and risky. Whether you plan to keep your business in the family or to sell it to someone else, here are some important considerations.

WHAT IS BUSINESS SUCCESSION AND WHY DOES IT MATTER?

Business succession is the transition from one owner to the next. Management expert Peter Drucker describes it as "the final test of greatness" for business leaders.

There is a different plan for every company but you will have three basic options when exiting your business:

- **Sale to an outsider:** This offers the greatest opportunity for you to maximize your return on investment. However, the price will depend largely on whether the business is viable after the owner leaves.
- **Transfer within your family:** A transfer to the second generation is successful in only 30% of cases. Just 10% of family businesses successfully reach the third generation.
- **Sale to management:** This possibility offers continuity, familiarity and the highest chance of success. The current management team in any business should have a very clear idea of the strengths and weaknesses and how to solve them. However, management usually will have difficulty financing the purchase and may also lack entrepreneurial drive.

The chances of success are greatly improved if you follow a clear and well prepared plan.

Succession planning can maximize the sale price and your retirement income, to result in less tax and enhance financial stability of the business.

- It protects a business from sudden disruption, such as the death or disability of the owner, and it advances the owner's long term plan for transfer.
- A well-developed strategy will also reduce tension within the owner's family, protect the interests of employees and other stakeholders.
- Despite these benefits, over half of business owners do not have a succession plan and only 9% have a formal written plan according to the Canadian Federation of Independent Business.

OBSTACLES TO SUCCESSION

Most business owners realize their need to plan their exit but they procrastinate. Too few owners actually develop a plan and implement it.

Owner's Reluctance to Change. Some owners shrink from discussion of mortality. Owners might worry about diminished stature in their family, profession or business community. Owners might not have an attractive plan for retirement.

Often an owner is unwilling to give up control or to decide on a successor. 29% of business owners say they have no time to deal with succession planning. A further 21% cannot find good advice or the assistance they need to begin planning. 13% do not want to think about leaving[1]. Often the owner believes the business depends too much on him or her to allow somebody else to take over[2].

Finding a buyer (56%), valuing the business (54%), and financing for the successor (54%) are reported as the most common barriers to success for business owners[3].

Avoid the "do nothing" strategy. Absent a succession plan, an owner or his or her estate may be forced to sell at a significant discount, sell to an inappropriate or unprepared successor, or close the business entirely.

As well, when a business owner fails to plan, his or her business is more vulnerable to a sudden shock or disruption, such as a health crisis or a loss of a key customer.

WHAT ARE THE KEY ELEMENTS TO AN EFFECTIVE SUCCESSION PLAN?

Business succession should be led by the owners or by the senior family generation.

A successful plan should also incorporate these features:

- **Commit to Change:** Is the owner ready and willing to leave the business? Does the owner have a pursuit or interest to look forward to after retirement? Work with your financial advisor to determine whether your resources will meet your needs.
- **Start now:** Planning and execution always takes more time than expected. Start the process at least 10 years before the transfer. Involve family members, including those not involved in the business. Consider using an experienced facilitator to keep meetings on track and productive.
- **Get help:** Seek advice and input from independent advisors. Consider using an advisory panel of stakeholders and experts to help select, train, mentor and evaluate successors.
- **Communicate:** Owners should involve their spouses. Communicate about the succession plan and process with both active and non-active stakeholders. This will help to build realistic expectations and develop consensus. Open and regular communication can take place in different ways but family meetings are often best.
- **Be fair and realistic:** Fairness helps avoid tension and mistrust in the family. Being fair does not mean treating everyone equally. Compensate those who work in the business fairly. Make realistic assessments—with outside expertise, if needed.
- **Work together:** Develop a shared vision for the business. What will it look like in 5 or 10 years?
- **Be comprehensive:** Build a flexible succession plan that can accommodate change. Sometimes the chosen successor does not succeed. If not, what's plan B?

GROOMING SUCCESSORS

Many founders are reluctant to stand aside and allow a family successor to take charge and prove himself or herself.

Even when the founder is willing, it can be difficult to choose a successor. Being clear-eyed about a successor is especially difficult when the candidate is a son or daughter.

To choose and prepare a successor, consider these suggestions:

- **Education:** Candidates need a solid business training to run a modern business.
- **Get help:** Trusted outside advisors can mentor and evaluate potential successors.
- **Outside business experience:** Encourage candidates to seek experience somewhere else to obtain credibility, experience and leadership skills.
- **Communicate values:** Work ethic, resilience, co-operation and education are important values. What values matters to the owner's family?
- **Motivation?** Consider what is the true motivation of the child to enter the business? Is it for prestige? Or because he or she has no other attractive prospects?

PREPARING THE BUSINESS FOR TRANSFER

Every buyer or successor will want a business in strong shape. The owner and his or her advisors must evaluate dispassionately the business's key strengths and weaknesses and then tackle the key weaknesses. This can sometimes take several years.

Owners need to see the business as a prospective buyer would. Buyers will look at:

- The history of revenue, profitability and cash flow;
- Management depth and competence and succession plan;
- Technological capability and expertise;
- Quality of customers and business cycle;
- Dependency on a few customers or a few products;
- Resolving outstanding litigation;
- Remediating environmental contamination; and
- Debit/Financing.

For a fuller discussion, please refer to our booklet "Buying and Selling a Business".

IMPLEMENTING THE SUCCESSION PLAN

As a business is being prepared for transfer, the features of the succession plan and possible successors will become clearer. So will the means of implementation.

There may be opportunities to minimize taxes. It is not uncommon for an owner to freeze the value of their interest and transfer the growth in future value to the owner's children. It may be appropriate to use a trust to hold a business interest for the owner's family. Business owners can also use a separate Will for their business shares to minimize probate tax.

SUMMARY

Whatever an owner's intention for transferring a business, starting early to develop a clear succession plan is the first step.

With careful and early preparation and help from advisors, you can develop a successful succession plan.

The payoff of success is huge

1 Canadian Federation of Independent Business, Passing on the Business to the Next Generation, (November, 2012) at p 7.
2 Ibid at 5
3 Ibid at 5

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Since 1934, Houser Henry & Syron LLP has provided legal services to private businesses, helping them deal with the complexity that comes with growth and success. We understand the needs of mid-sized businesses and their owners and managers and we have the breadth of expertise and the depth of experience necessary to meet those needs.

For more information, please contact one of the lawyers with our firm. You may also wish to visit our website, www.houserhenry.com, for an overview of our team and our services.

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