

Legacy Matters

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Business Succession: *It's never too early to start planning*

STRATEGIES – MASTERSERIES. THIS IS ONE OF A SERIES OF ARTICLES PREPARED FOR CIBC GLOBAL PRIVATE BANKING & TRUST. THE SERIES IS WRITTEN BY PROFESSIONALS IN SUCH FIELDS AS TAXATION, TRUSTS, AND ESTATES.

Whether retirement from your business is imminent or years away, it's never too early to start making plans for the future. A business succession plan allows you to take steps to help preserve the value of your business that there is a smooth transition to new ownership.

Business owners should ask themselves, "What do I want for my future, my family, and my business?" Your plan needs to cover all contingencies, not just retirement.

Hope for the best, plan for the worst

The best-case scenarios reflect your personal goals – do you want to continue working full-time indefinitely, or retire in five years and leave the business to your children? You need to consider how your personal goals will affect the future of your company, and make that the foundation for your business succession plan.

Unfortunately, you also have to plan for the worst-case scenarios. If you became incapacitated tomorrow and were unable to work, you would want to know that your family and your business would be secure. You need to ensure that you are not the only person who holds key information about the business, its customers, and key processes, so that the business can continue successfully without you. You may also want to establish a cash contingency fund or take out insurance to add a financial "cushion" for the business during any time of transition.

Your business succession plan should address the following:

Ownership issues. Do you intend to sell your business to a third party, leave it to family members, or wind it up? Having your business properly valued will help clarify your options.

Management issues. Who will run your enterprise? Developing a management succession plan now allows you time to groom a successor and pass on the information and skills needed to carry on the business successfully.

If your business is family-run, emotional ties may make these decisions more difficult. You may want to consult an external professional (such as a lawyer, accountant, or other estate planning specialist) to help you.

Tax implications. Capital gains taxes arise when a business changes owners, including the change of ownership that occurs on death. If your business is a qualifying small business corporation, your shares may be eligible for a capital gains exemption of up to \$500,000.

If your business is larger, or does not qualify for the exemption, the deemed disposition at death may trigger a sizable taxable capital gain. Unless there are sufficient liquid funds to cover the estate's tax liability, your family might be forced to sell the business. Alternatively, insurance can provide funds to pay taxes.

One possible solution is to institute an estate freeze while you are alive. This allows you to freeze the value of the business at the current date (cont...)

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Business Succession: It's never too early to start planning (Cont...)

and the amount of capital gains taxable on a subsequent sale or upon your death. Future capital growth in the business accrues to your children.

Buy/sell agreements

If you are a co-owner of a closely held corporation, you and the other shareholders should consider implementing a buy/sell agreement. This legally binding document establishes the conditions by which one owner can purchase the other owner's shares. It plays an important role in protecting the remaining owners when one owner dies, become longer wishes to participate in the business. Partnerships face similar business continuation issues, and partners should also consider implementing a buy/sell agreement.

Review your plan regularly

It's important to review your business succession plan at least once a year to make sure that it accurately reflects your current wishes and situation. Here are a few examples of situations in which you may need to make changes to your business succession plan:

- **Your personal or business goals have changed.** Do you want to retire earlier? Has your choice of successor changed?
- **Tax laws have changed.** For example, if the \$500,000 lifetime capital gains exemption is amended or your shares no longer qualify for it, you will need to revisit your strategies.
- **The nature of your business has changed.** Perhaps you have taken advantage of a favourable purchase offer for all or part of the business from a third party, or you've expanded the business into new areas. If so, your original business succession plan may no longer be appropriate.

A buy/sell agreement usually includes the following details:

Triggering events. What events trigger the right of one shareholder to buy the other shareholder's shares? Triggering events typically include death, retirement, and disability, but they should be specifically identified

and carefully defined in the buy/sell agreement.

Whether the purchase is compulsory. Once the triggering event occurs, is the other shareholder required to purchase the shares, or just given an option to do so? A mandatory purchase provides greater certainty to your planning.

Valuation method. How will a price be determined for the shares of the company? The shareholders may agree on the value of the business on an annual basis, or a defined method of calculation may be used, such as a multiple of earnings.

Funding. How will the shares be paid for? Typically, there are three methods of providing the cash to carry out the buy/sell provisions. Owners can set up a pool of assets for this purpose, they can borrow against the assets of the business when needed, or they can arrange for applicable insurance coverage. There are a number of different methods to structure insurance to provide the necessary funding. Each method provides different advantages and tax consequences.

An integrated approach

Your business probably represents a significant portion of your total net worth. As a result, your business succession plan will also have a major impact on your personal estate plan.

It's important for the two elements to work together. For example, if you plan to leave the shares of your business to one of your children upon your death, you might want to leave non-business assets of equivalent value to your other children.

Like your business succession plan, your estate plan should be reviewed and updated regularly so it keeps pace with your changing needs.

Professional advice can be very helpful in making your estate plan and business succession plan work in harmony to achieve your objectives – today and in the future.

Upcoming Events & Programs

This September the Business Families Centre at the Sauder School of Business at UBC launches its second year of educational programs with seminars and events specifically designed to develop leadership expertise for family businesses. Our new program direction is introduced by the inaugural Outstanding Lecture Series with the remainder of the year's programming providing more depth on the critical success factors for family enterprises. Join us on this journey of learning and exploration of leadership success for family businesses.

Outstanding Lecture Series

Maintaining Success: Leadership and Entrepreneurship in Family Enterprises

Dr. Alden G. Lank (Inst. for Management Development, Lausanne, Switzerland)

Dr. Daniel F. Muzyka (Dean, Sauder School of Business, UBC)

November 18, 2003

Reception: 4 to 5:30pm

Lecture presentation; 5:30 to 7pm

Location Sheraton Wall Centre Pavilion Ballroom

Navigating the Business Family Relationship: The Road Map

This two-part seminar provides business family members with insights, ideas and strategies for running their business more effectively and managing transitions. You will develop your knowledge and skills as you participate in a video case study of a family business. You'll engage in thought-provoking discussions, share ideas with other business families, and learn from the experience of experts in the family business field.

Presenters: David C. Bentall, Dr. Nancy Langton and Judi Cunningham

**Road Map – Part One November 21-23, 2003
or April 16-18, 2004**

Road Map – Part Two October 15-16, 2003

Strategic Planning for Family Businesses

All businesses face the constant challenge of planning strategically for their future. Determining both the internal and external threats and opportunities can be a complex process. However this is more complex for family businesses, which need to balance parallel planning processes for both the business and family. We will discuss some of the classic strategic planning issues, the additional complexity raised for family businesses, the role of networks in family business strategic planning, and measures of success for family business succession.

Presenters: Dr. Marc-David Seidel and Dr. Nancy Langton

March 3-4, 2004

Building an Effective Board

Creating an effective board for a family business can be one of the most important steps towards family harmony, business effectiveness, and successful succession. Learn how to attract and select a strategic, powerful board for your enterprise.

Presenter: Marjorie Engle (Allen, Gibbs and Houlik)

April 1, 2004

Plan Ahead for 2004!

Don't miss the Gala Family Legacy Dinner Series.

The BFC is thrilled to welcome the Shaw Family of Shaw Cable as the feature family at our gala event celebrating families in business. This informative evening with JR, Heather and Jim Shaw will explore the Shaw family story and provide insights into how they have created a successful enterprise and family legacy. This evening reception, dinner and informational program is presented for your whole family to enjoy.

**Pencil this date in your calendars – May 11, 2004
4:30 pm to 9pm**

This article is intended to provide general information only and should not be construed as specific advice suitable for individuals. Since a consideration of individual circumstances and current events is critical, anyone wishing to act on information in this article should consult a professional. This article reviews Canadian federal tax laws only, unless otherwise stated. Provincial tax laws may also apply and may differ.



Words from *the Chair*

The Business Families Centre: *What's in a name?*

Perhaps, in reading our name, you might think we have made a mistake. Maybe “The Family Business Centre” is what you would expect us to be called. However, this is no mistake. Our focus is business families, and this means more than just family businesses! To really understand our purpose at the Business Families Centre, let's look at some of the reasoning that went into our name.

Today, I am told, there are over 350 institutions in North America where you can get an MBA. Presumably you could learn something at one of these schools that would be helpful to a family business. However, nowhere today in North America can you take an MBA in the dynamics of a *business family*.

This is amazing especially if you consider the fact that between 80-90 per cent of businesses in North America are appropriately classified as family businesses!

Notice that in the phrase “Family Business” the noun is “business” and hence the focus is one the company. In the phrase “Business Families” the noun is “*families*” which underscores its importance in our work and as the focus of our attention. We are clear, that we are not just here to support business; we are here to help families as they seek to manage the unique interplay between business issues and family relationships.

Many of the Business Families Centre's active supporters (Board members and Founding Families) have active family businesses – but not

all. Many in fact are business families who have had a family enterprise but no longer do, nonetheless, the need for communication, decision making and collaboration within the family unit remains vitally important.

Our aim is to serve those families who currently have a family business as well as those who may not.

One of the long-term goals at the Business Families Centre is to fill the void in post-graduate level business studies by offering an MBA in Business Families Studies by 2010. Along the way, as we build towards that goal, we are offering courses for business families and their advisors in collaboration with Executive Education at the Sauder School of Business at UBC.

In parallel with this, we have begun some research initiatives to enable us to add to the body of knowledge related to business families. Particular areas of interest which we will be examining include: the transfer of social networks; the key success factors for smooth intergenerational transfer in ownership; and how gender differences impact succession.

A business family ...

... is one that has a social or economic focus derived from an existing or former family-controlled business.



Succession Planning

Family enterprises are a significant economic force. They employ over 50% of workers, create 75% of jobs and account for more than half of the gross domestic product in North America.

Within the next 15 years, three-quarters of family business leaders will retire, initiating the largest asset transfer in Canadian history. Only a third of family-owned businesses are successfully transferred from the founding generation to the next and just 10 per cent make it to the third generation. Despite these alarming statistics, research indicates that over 75% of family firms have no succession plan in place (Gordon Pitts - *In the Blood, Battles to Succeed in Canada's Family Businesses*).

A recent survey of close to 300 top level executives in Canadian family owned and operated firms¹ shows that the dominant concerns of family business leaders include:

- (i) managing family involvements in the business;
- (ii) succession;
- (iii) relationships with nonfamily managers; and
- (iv) post-succession planning.

Chances are these are your concerns too.

As a family business leader you are, without a doubt, committed to the preservation of your family

legacy for future generations. Like numerous family business researchers and consultants, you have concluded that succession planning is the cornerstone of stewardship. Like many other family business leaders you are now faced with the question "Is our business prepared for leadership succession?" and you may be wondering how to safely wade into these potentially turbulent waters. After all you are dealing with a family – not just a business.

One place to start is the check list for planning for business continuity through a leadership succession (see Table One). Clearly, this is a process that could take time to unfold and careful attention to do right. Fortunately there is a broad spectrum of assistance available to you, your family and your business.

The Business Families Centre is committed to assisting business families preserve the valuable legacy of family businesses. One of the cornerstones of our programming is the Road Map course. This two-part seminar series focusing on relationship and communication issues unique to the family business enterprise is designed to provide business families with insights, ideas and strategies for managing transitions. Here is where you and your family can start your journey into next generation leadership.

Planning for Business Continuity: A Checklist

- ☐ Develop children's values and capabilities
- ☐ Create lifelong financial security for parents
- ☐ Finalize the family's mission statement
- ☐ Finalize the owners' estate plan
- ☐ Finalize the business's strategic plan
- ☐ Select a successor
- ☐ Plan successor's personal development
- ☐ Map career paths for other family members
- ☐ Transfer ownership and control
- ☐ Build a family team of owners
- ☐ Write participation policy for family members
- ☐ Retain non-family managers
- ☐ Install outside directors
- ☐ Prepare for retirement
- ☐ Prepare contingency plan for succession in crisis
- ☐ Develop a new management team

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In the end, once all the planning is done, the success of a new leader will depend on the ability of the older generation to let go– and the ability of the new leader to move forward in their own way. Two quotes come to mind:

"The final test of greatness in a CEO is how well he chooses a successor and whether he can step aside and let his successor run the company."

Peter Drucker

"What you have inherited, you must earn to possess"
Goethe

¹ Chau, J.H., Chrisman, J.J. and Sharma, P. (2003) Succession and Nonsuccession Concerns of Family Firms and Agency Relationship with Nonfamily Managers. Family Business review 16(2), 89-107.