

TABLE OF CONTENTS

Introduction.....3

 A comprehensive succession plan is a must for every family business.....4

 Family must come first — even when wealth is top priority.....6

 Succession planning can be made less daunting by listing the steps
 and assembling the team.....7

 Here are the 7 key steps to creating a succession plan:.....7

Step #1: Determine the type of ownership transfer.....9

 The succession plan starts with deciding who is getting the business.....9

 Sidebar: What if the successors are less than great?.....12

Step #2: Create an emergency succession plan.....14

 Every business really needs two succession plans.....14

 Key-person insurance is...key.....15

 Gather critical information for emergency situations.....16

Step #3: Get an independent business valuation done.....18

 Knowing what the business is worth is a key part of any succession plan.....18

Step #4: Determine how the transfer will be financed.....20

 The method of financing the ownership transfer must be clearly documented.....20

 A buy-sell agreement is central to financing the succession.....22

Step #5: Minimize the tax hit and business losses.....25

 Experts must be called in to help minimize taxes and other financial hits.....25

Step #6: Create a formal transition plan.....27

 Managing the transition process is a vital part of succession.....27

Step #7: Schedule regular reviews and updates to the plan.....29

 A good succession plan is reviewed regularly to accommodate changing realities.....29

The most important step is getting started.....31

 Planning can be started by the next generation or other shareholders,
 as well as the owner.....31





INTRODUCTION

Historically, the strong tradition of the family firm going to the eldest son has often stood in place of proper succession planning. But with generational changes, father-son succession has given way to more complicated, less proven forms of the process. In a recent major study, **only 12% of family-business leaders worldwide** said they planned to pass their businesses to their first-born son, while approximately **three-quarters said they would use either interest in the firm or qualifications as their main criterion.**¹ In fact, **only about one-third of today's North American family-business owners intend to keep the business in the family at all.** This figure drops to a global low of 31% in Canada.²

A change of ownership outside of the family calls for different planning approaches and techniques. A combination of greater life expectancy and a strong trend toward earlier retirement also means that the term “succession” refers to a transfer of ownership between living people. It is no longer just what happens to the business on a current owner's death.

For family-owned businesses facing a change of ownership, the saying “Failing to plan means planning to fail” is truer now than ever. However, **only one-third of family businesses in North America have any kind of succession plan, and only 18% have a clearly documented one.**³ Failing to plan for the transfer of ownership has never been

a great idea: many of the family firms that fail go under for exactly this reason. And the chances of succeeding without planning are getting slimmer with every year that passes. Given all these factors, it is time for family-owned businesses to stop counting on tradition and luck to see them through succession and start getting serious about the process. And, as with all future planning, the time to start is yesterday.



It is time for family-owned businesses to stop counting on tradition and luck to see them through succession and start getting serious about the process.

A COMPREHENSIVE SUCCESSION PLAN IS A MUST FOR EVERY FAMILY BUSINESS

The outcomes of a poor or absent succession plan can be dire. An unprepared or unmotivated successor can lead the business astray or make the current owner stay on longer than desired out of fears that this will happen. Family fighting over the succession can wreak havoc with both the family and the business. Failure to purchase life insurance can leave the business open to financial disaster and leave a surviving spouse unable to access assets from the business. Shareholders, whether family or non-family members, can revolt against the successor and block succession intentions. Lack of tax planning can mean a devastating financial hit to the retiring owner; or, conversely, the intended successor might not be in a position to finance the transfer, forcing the business to be sold.

In short, there are a great many routes leading to undesirable outcomes, including the worst-case scenario: the liquidation of the family business at “fire sale” prices.

However, while the absence of a plan can have these negative results and more, the presence of one does more than stave them off. It has many important benefits, including

- ▶ Giving the owner and other shareholders a clear, attractive, and controlled way to exit the business
- ▶ Allowing the current owner to retire comfortably and maintain his or her accustomed lifestyle
- ▶ Giving shareholders peace of mind and lenders confidence through use of disaster-mitigation elements such as key-person life insurance
- ▶ Establishing a way to finance the transfer of ownership
- ▶ Minimizing taxes and other financial hits from the transfer
- ▶ Helping to preserve family harmony, wealth, values, and legacy over multiple generations

It is safe to say that business owners who “let the urgent be the enemy of the important” by failing to prioritize a succession plan are sacrificing the long-term health of their firm—and potentially their own financial well-being—for the short-term operations of the business.



FAMILY MUST COME FIRST—EVEN WHEN WEALTH IS TOP PRIORITY

Owners of family firms who are starting to create a succession plan have the tricky task of balancing multiple sets of needs: the family's, the company's, other shareholders', and their own financial and emotional needs. Most of them—a remarkable 88%, in a recent Deloitte survey—believe that the interests of the business should take precedence over those of the family when it comes to making important decisions regarding succession.⁴



Experts on multigenerational wealth preservation disagree sharply. They contend that if there is one lesson they have drawn from studying successful family businesses, it is that family members and relationships must take top priority. This is the case even when the business is viewed primarily as an asset or a source of income, rather than a matter of family identity or legacy.

The simple reason for this is that when family businesses successions fail, most do so because of the family element, not the business element. In fact, **researchers have found that when wealth-transfer fails, a full 70% of the time it is because of family factors**—specifically, either lack of a family mission and vision or a breakdown in trust and communication among family members. **A further 25% of failures arise from failing to properly prepare the successor.**⁵ These statistics support the conclusion of a major recent report on family business succession:

The research on family business continues to indicate that far too much attention is allocated toward the technical components (tax, trusts, insurance, shareholder

agreements, wills) of the succession process and far too little to the non-technical components (e.g. wishes and aspirations of the family members, family harmony, family legacy, family dynamics, integrating and preparing the next generations).⁶

Even a non-expert can readily see, through high-profile failed or turbulent successions ranging from the Mondavis to the Rogers family, that poor family relationships can threaten even the best-laid financial and legal plans. Conversely, when a strong family-governance system has created strong lines of honest communication and family-member collaboration, the financial and legal aspects of the succession plan fall into place with relative ease.

SUCCESSION PLANNING CAN BE MADE LESS DAUNTING BY LISTING THE STEPS AND ASSEMBLING THE TEAM

There is no getting around it: Succession planning is a major undertaking. It involves significant time and ongoing effort from a team of people. Managing the family element in itself is a daunting, often fraught process, and is easier said than done. And even if only 5% of succession failures can be attributed to inadequate or erroneous financial and legal planning⁷, there is no denying that these elements are vitally important, highly complex, and often overwhelming.

As with any large task, the key is to break it down into manageable components and then lay out a systematic process.

HERE ARE THE 7 KEY STEPS TO CREATING A SUCCESSION PLAN:



The business owner does not need to face this mammoth project alone. In fact, he or she cannot—and should not. Succession planning that works is an ongoing process of collaborating and communicating with others.

The succession-planning team includes the following:

- ▶ The current owner(s)
- ▶ Family members, including those who are not actively involved with the firm
- ▶ Any other partners or shareholders
- ▶ Board of directors
- ▶ Advisory board
- ▶ Top executives
- ▶ Insurance experts
- ▶ Tax experts
- ▶ Financial advisors
- ▶ Legal experts
- ▶ Chartered Business Valuators
- ▶ Family-business therapists, advisors, and coaches

Drawing on a variety of strengths and, most importantly, learning to communicate thoughts and assumptions rather than keeping them private, will lead the business owner to a satisfying process and an effective end result.



When a strong family-governance system has created strong lines of honest communication and family-member collaboration, the financial and legal aspects of the succession plan fall into place with relative ease.