

# Succession Planning

Leveraging your life's work

Harold B. Duffett, MBA, CA, CBV

*'Vision Behind the Numbers'*



# Today's Presentation

- ▶ Discuss several key issues in business succession
- ▶ Discuss some of the soft issues the business owner faces
- ▶ Provide the business owner with introductory guidance to develop their own Succession Planning Transition Strategy

*'Vision Behind the Numbers'*



# What is Succession Planning?

- ▶ A process of exploring your options, protecting your hard earned business investment, and choosing the correct exit strategy for you and your family
- ▶ It encompasses estate planning
- ▶ It encompasses retirement planning
- ▶ Not a one time exercise
- ▶ Should be an ongoing exercise

*‘Vision Behind the Numbers’*



# What is being planned?

- ▶ A succession plan is similar to drawing up a Will
- ▶ Accepting and preparing for a major life change
- ▶ Identify personal and family goals
- ▶ Communicate (avoid family conflicts) – family, employees, successor
- ▶ Transfer of your business ownership
- ▶ Myth – it is too early to plan!

*‘Vision Behind the Numbers’*



# SME

- ▶ According to the CFIB, fewer than half of small and medium-sized enterprises (SME's) currently have a succession plan
- ▶ 2008–2009 recession had a profound impact on succession planning
- ▶ Almost a quarter of business owners said they delayed the timing of their exit date between one and four years
- ▶ Unlike government, very few business owners have a pension and must rely on the value of their business to help fund their retirement

*'Vision Behind the Numbers'*



# Small business

- ▶ According to the Federal Government, small businesses are responsible for 42% of the country's private sector gross domestic product
- ▶ According to the Federal Government, small businesses employ more than 5 million people – 50% of Canada's private sector labour force
- ▶ Retirement is the number one reason for business owners planning to exit their business

*'Vision Behind the Numbers'*



# The Stats

- ▶ One-third of SME owners intend to exit ownership within 5 years
- ▶ That figure jumps to two-thirds in next ten years
- ▶ Only 10 percent of SME owners have a formal plan to sell, while 38 percent have an informal plan
- ▶ Over 1,000 Nova Scotian's turn age 65 every month

*'Vision Behind the Numbers'*



# Be Prepared

- ▶ Be prepared – a business sale is fraught with complex considerations
- ▶ Adjust expectation to economic reality– business owner's often think their businesses are worth a lot more than what other people may think
- ▶ It doesn't matter what you think the business is worth – it's what the market says its worth
- ▶ Improve the value of your business
- ▶ Understand the risk factors from a buyer's point of view

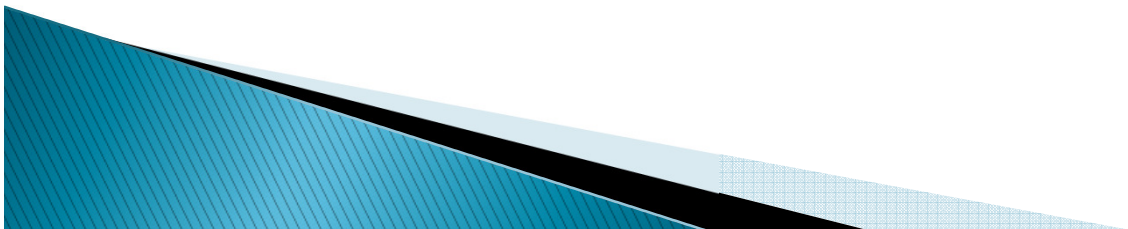
*'Vision Behind the Numbers'*





# Oscar Wilde

- ▶ What is a cynic? A man who knows the price of everything and the value of nothing.....



# Be Prepared

- ▶ Start planning sale
- ▶ Not 4 to 6 months before you intend to exit your business
- ▶ Generally minimum 2 years before, not unusual 3 years before exit
- ▶ Biggest soft issue barrier is the business owner avoids dealing with succession due to a strong sense of attachment to the business

*'Vision Behind the Numbers'*



# Business Valuation

- ▶ Be certain, not sorry
- ▶ Measuring a company's value, called "valuation", is a complex but critical process in certain succession transactions
- ▶ Business value is about the future, not the past
- ▶ A business valuation is an important piece of data underpinning the overall succession plan and strategy
- ▶ Business should be valued by certified professionals before succession takes place

*'Vision Behind the Numbers'*



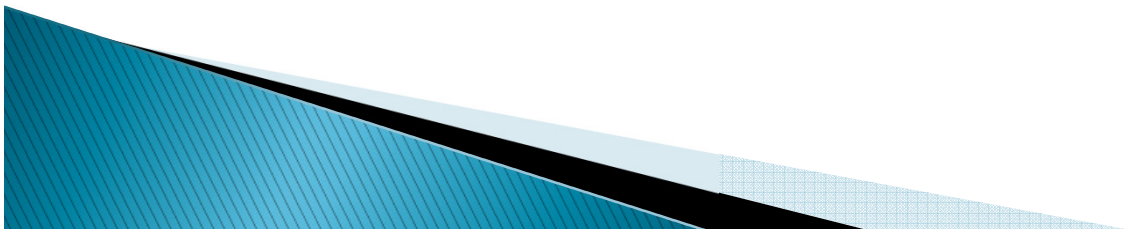
# Business valuation, business pricing

- ▶ Truths for buyers to keep in mind
  - All business valuations are merely opinions, not fact
    - ultimate value is determined by the marketplace
  - Terms and conditions can dramatically influence price
  - Value is almost always in the eyes of a beholder – same business will have a different value based on the needs and requirements of the potential buyer
  - Supply and demand changes constantly influence value and price
  - Value can depend on the experience, education and thoroughness of the appraiser
  - Buyers are buying a future income stream



# Business valuation, business pricing

- ▶ The reality is that business are bought and sold by human beings – enough said!



# Factors that positively influence “Value”

- ▶ Tangible asset value
- ▶ Proven track record of profitability
- ▶ Proprietary technology
- ▶ Niche markets
- ▶ Barrier to entry
- ▶ Strength and depth of management

*‘Vision Behind the Numbers’*



# Factors that diminish “Value”

- ▶ Reliance on a few customers
- ▶ Reliance on a key employee
- ▶ Outstanding litigation
- ▶ Business risks
- ▶ Economy and industry risks

*‘Vision Behind the Numbers’*



# CICBV

- ▶ Only one professional body recognized by the Courts in Canada and the Canada Revenue Agency to perform a business valuation
- ▶ The Canadian Institute of Chartered Business Valuators (CICBV) are financial professionals who have the designation CBV (Chartered Business Valuator)

*'Vision Behind the Numbers'*





# Options

- ▶ Keep business in the family
- ▶ Select and groom a successor
- ▶ Management buy out
- ▶ Sell the business
- ▶ Finance the sale?

*'Vision Behind the Numbers'*



# Keep business in the Family

- ▶ Generally, always the first choice available
- ▶ Intergenerational transfer accounts for 60% of successions
- ▶ Stats indicate 90% of these transfers fail!
- ▶ An ESTATE FREEZE is commonly used – involves a reorganization of the business share capital
- ▶ May involve the creation of a family trust

*‘Vision Behind the Numbers’*



# Management buy-out

- ▶ Buyer is an employee or a group of employees
- ▶ An estate freeze is commonly used
- ▶ May involve setting up a holding company
- ▶ Biggest obstacle is whether this buyer group have the necessary financial resources to purchase the business

*'Vision Behind the Numbers'*



# Selling the business

- ▶ Shares or assets being sold
- ▶ Marketing business for sale
- ▶ Negotiating the deal
- ▶ Cost of sale in open market – say 5% to 10% of selling price
- ▶ My advice – stay at arms length during the sale process, let the people with the training, experience and wisdom lead to a successful sale

*‘Vision Behind the Numbers’*



# Taxation

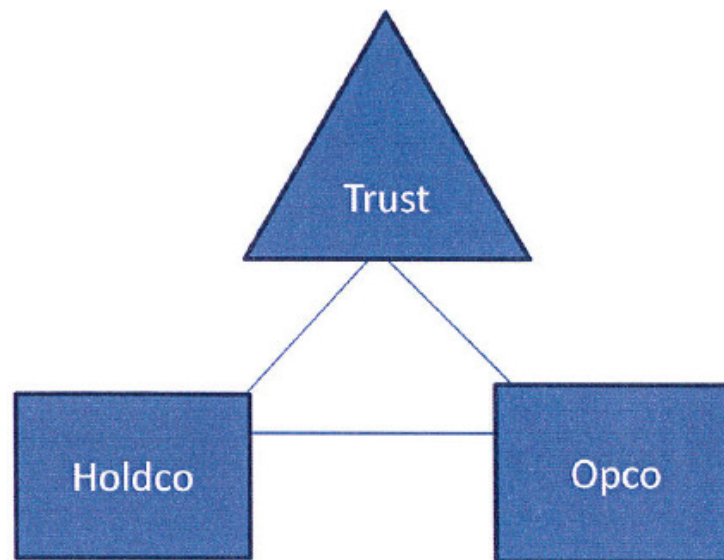
- ▶ Tax is a critical component of any succession plan
- ▶ It should not drive the process
- ▶ Asset or share purchase
- ▶ Buyer prefers an asset purchase because the buyer is able to limit liabilities assumed and from a taxation perspective able to depreciate the value acquired
- ▶ Vendor prefers share sell because of taxation advantage capital gains exemption (\$800,000) in 2014

*'Vision Behind the Numbers'*



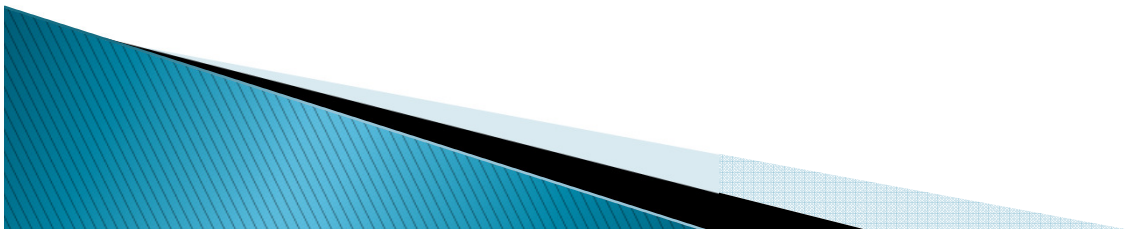
# Business structure

- Mr. Did-it-right set up the following structure several years before retiring.



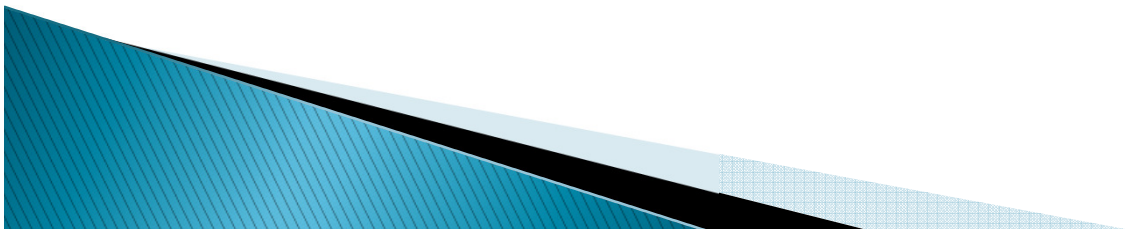
# Business structure

- Mr D's spouse and two adult children are beneficiaries of the family trust.
- Mr. D has accumulated \$1M in passive investment assets within his holding company.
- Mr. D's has an offer from the management of the company to purchase his interest for \$2M.



# Business structure

- By allocating the gain among his family members Mr. D's sale of his operating business for \$2M is fully sheltered from capital gains tax.
- Going forward Mr. & Mrs. D draw \$70,000 per year dividend income from Holdco. Their combined personal tax bill at the end of the year is less than \$3,000.





# Earnouts

- ▶ Favours the buyer
- ▶ Post closing targets proves the value of the business
- ▶ One time purchase price generally analogous to a no-return retail policy
- ▶ Taxation of Earnouts can be complex

*'Vision Behind the Numbers'*



# Human Relations

- ▶ More than just money changes hands
- ▶ Legal and HR challenges over dealing with employees
- ▶ Negotiate up front the obligation with respect to employees
- ▶ Share transaction – buyer picks up employee liabilities including severance obligations
- ▶ Asset transaction – you don't have to take any employees you don't want
- ▶ Often see Vendor “terminate” all employees by giving due notice
- ▶ Very complex matters, get legal advice

*‘Vision Behind the Numbers’*



# Sticking around

- ▶ Buyer benefits from vendor “sticking around”
- ▶ Provides for an orderly transition
- ▶ Previous owners often know how to grow the business best
- ▶ How long? Not so long that the value of the involvement of the old owner becomes a drag on the new owner
- ▶ Per PWC study, first 3 years after a company is acquired, see about 30% drop in sales and revenue

*‘Vision Behind the Numbers’*



# Financing the Succession Plan

- ▶ A key issue for the business owner is financing the change of ownership
- ▶ Consider what is being sold – more than likely a vendor take back note on a share transaction
- ▶ Consider whether the owner is staying on in the business
- ▶ Financing can be risky, depends on future success of the business in the new owner's hands
- ▶ Consider what remedies you have if debtor defaults
- ▶ Stats indicate approximately 25% of VTB are not repaid

*'Vision Behind the Numbers'*



# Wrap up

- ▶ There are no cookie cutter solutions to the succession plan
- ▶ Every business has unique circumstances and characteristics
- ▶ It is important to ensure that your succession plan and your estate plan are harmonized
- ▶ “Failing to plan is planning to Fail”

*‘Vision Behind the Numbers’*





# SUCCESSION PLANNING

THE BOTTOM LINE & THE LAWYERS WEEKLY | VOL. 3, NO. 2 | 2013

**GAP:**  
SUPPLY TO  
OUTSTRIP  
DEMAND  
..... SOON

**MAP:**  
FOLLOWING  
A NEWFOUND  
PATH WHEN  
YOU FINALLY  
GET WEALTHY

**TRAP:**  
DELAY WILL  
HURT THE  
ONES YOU  
CARE ABOUT  
THE MOST

FREE

# Q & A

- ▶ Thank you
- ▶ Harold B Duffett MBA, CA, CBV
  - 678-1125
  - [harold@kentandduffett.ca](mailto:harold@kentandduffett.ca)

*'Vision Behind the Numbers'*

