

Business owners can save themselves a lot of headaches if they take some time to prepare for their eventual exit

By René Lewandowski

Planning *for* \$UCCESS

Claude Lavoie had always dreamed of having his own business. But he never expected to end up taking over Menuiserie Gaston Lavoie, the cabinet company founded by his father in 1946. After managing an auto-body shop and taking courses in business administration at the University of Ottawa in the 1970s, young Lavoie had his sights set on launching his own metal processing company — until his father died prematurely of brain cancer in 1979.

As if dealing with the loss of a beloved parent wasn't enough, Lavoie suddenly found himself saddled with a company that neither he nor his four siblings wanted. And his father had left no succession plan.

Illustration by MICHELLE THOMPSON



"We weren't prepared and we didn't know what to do," he says.

Now, more than a quarter-century later, has anything changed with succession planning? Do business owners ever wonder who is going to take over when they leave? Going by the numbers, the answer seems to be no. According to a 2006 survey by the Canadian Federation of Independent Business, even though almost two-thirds of small business owners plan to exit their businesses over the next 10 years, only 10% have a formal plan in place to sell, transfer or wind down their operations. Slightly more than one-third (38%) have an informal plan — some vague idea of how they intend to prepare for the transition. But more than half (52%) have no plan at all.

"It's quite alarming," says Richard Fahey, CFIB's acting general manager for Quebec. In his view, ignoring the long term is a surefire recipe for disaster. In many cases, it means the business will have to be sold at a discount if it is undervalued. As many owners have no other retirement fund beyond the business itself, the risks are huge.

Problems can also arise when successors are not groomed properly. The business could run into financial difficulties, and could even go bankrupt and have to close down. This is especially true for family-owned businesses, where a lack of planning is one of the main reasons why 70% of intergenerational transfers do not survive into the second generation and 90% do not survive into the third. Given that almost 60% of employed Canadians work for a small or medium-sized business and that 80% of businesses are family owned and/or operated, the entire economy stands to suffer.

Conscious of these and other worrisome stats, the CICA recently published a guide that serves as a wakeup call. *Succession Planning Toolkit for Business Owners: Leveraging Your Life's Work* (www.cica.ca/businessowners) was coauthored by Luanna McGowan, former national partner at PricewaterhouseCoopers, Corina Weigl of Fasken Martineau DuMoulin and David L. Wilton of Scotiabank. It includes useful tools and techniques, including a step-by-step guide for drawing up a succession plan, as well as horror stories about owners who didn't plan — or didn't plan well enough.

Lavoie's father is a case in point. After he died, the family decided to sell the company. But the recession of the early '80s was just starting and potential buyers weren't lining up at the door. The family decided to hold off in the hope of getting a better price when the economy improved. In the meantime, Lavoie was entrusted with running the company. It was the beginning of a harrowing journey — one that would last three years.

Pursued by the tax authorities for \$8,000 in unpaid business taxes and harangued by an overzealous safety inspector, Lavoie began to buckle under the pressure. Worse still, his inexperience led him to make a number of mistakes that cost the company dearly. For example, he often set his prices too low when bidding on contracts, thereby harming profitability. Result: 18 months after he took control, the company was on the brink of collapse. "If things had gotten any worse, we would have been forced into bankruptcy," he says.

Lavoie's father died prematurely, but even if he had lived longer, he might not have done a better job of planning. As Fahey

points out, one of the biggest challenges facing business owners is realizing they will have to retire one day. "Many people have trouble letting go," he says.

No one knows that better than James Littlejohn, a 57-year-old farmer from Wallacetown, Ont. Littlejohn worked on his father's farm for 28 years in the hope of succeeding him. "But he didn't want to retire," Littlejohn says. Even when the father was elderly and ailing, he refused to relinquish control — despite the insistence of his 10 children. The company suffered as a result. In 2001, the father's executors finally took over, but only after a medical report was issued declaring him incapable of making decisions. "It

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was heartbreaking but necessary," says Littlejohn, who officially took over the farm in 2006 after his father's death.

So much time and turmoil could have been saved if only Littlejohn's father had looked ahead. After all, succession planning is a bit like investing in RESPs or RRSPs: the sooner you start, the better. Some experts recommend a minimum lead time of 10 years. If necessary, the authors say the process can be completed in two or three years in fast-track mode.

But what purpose does succession planning serve? In broad terms, it allows business owners to explore all available options with a view to protecting their investment and selecting the best exit strategy for themselves, the business and their family. It also sets out a vision for the future. To paraphrase the guide's authors, a succession plan is a bit like a roadmap, encouraging people to make necessary decisions and take timely action.

There are many factors to consider in succession planning (see "What is a succession plan?" p. 25), but the first step is to explore options. Business owners usually have three choices: transferring control to the successors, selling the company or transferring ownership to the existing management team or employees. All of these options should be weighed carefully, as the ultimate decision will have implications for the future of the company, as well as customers, suppliers, employees and family members.

"Succession planning should be considered on a case-by-case basis," says Louise St-Cyr, a professor and chair of small business development and succession at HEC Montreal. In some cases, she says, the issue of viability is relatively unimportant, while in others it should be top of mind. "Succession plans should reflect the owner's personal values and goals," she says.

If owners are planning to transfer ownership to their children, a number of questions must be answered, especially if several children are involved. For example, who is interested in running the business? Who should take over? How should they be groomed? What kinds of additional training do they need? According to St-Cyr, people often forget to share their thoughts — if they talk to each other at all.

Broken lines of communication can be the source of bitter conflicts, especially in large families where several children may



be vying for the top job. It can also lead to bizarre legal entanglements. That's what happened with Viacom, the US telecommunications giant controlled by the high-profile Redstone family. Over the past 35 years, family members have been embroiled in a series of lawsuits with each other. In February 2006, Brent Redstone, son of Viacom board chairman Sumner, sued his father for allegedly

mismanaging millions of dollars relating to a Viacom subsidiary. More recently, the *Los Angeles Times* reported that Sumner's nephew, Michael D. Redstone, had accused his uncle of seeking to cut him and his late sister out of his stake in the business, which could be worth more than US\$1 billion.

To avoid such imbroglios, McGowan recommends establishing a family council — a forum where all family members can share opinions and ideas. The respective roles of all participants before and after the ownership transfer should also be clarified. That is the approach taken by Joseph Sorbara, the 65-year-old chair of Sorbara Group, a real-estate firm based in Vaughan, Ont. Three years ago, with the assistance of his sister and two brothers, including Gregory, Ontario's minister of finance, Sorbara established a family council made up of the four siblings (all of whom are co-owners), as well as their spouses and their 17 children. "We wanted to foster an environment of understanding," he explains.

The family council meets twice a year. (Sorbara points out, however, that "as long as Gregory is a minister of the government, his membership is suspended and he does not attend or participate.") Among other initiatives, the council has brought in hiring rules for family members. For instance, employment for family members is not guaranteed; an opening must be available and the applicant must have the required skills. A high-school education is the minimum for entry-level positions, while a university degree and experience with another company are preferred for

WHAT IS A SUCCESSION PLAN?

A succession plan is a strategic document that sets out a process and a multistage timetable to allow a business owner to withdraw with complete peace of mind.

Name of the successor(s). Whether the successor is a family member or an outsider, the sooner you identify him or her, the more support you can give. If there are a number of potential candidates, identifying them early will enable you to assess them more effectively. "You need time to groom your successor," says Louise St-Cyr.

How the successor(s) will be trained. What skills do they have? What gaps are there? What type of training will be required to get them up to speed? Will coaching be needed?

Roles of other managers during the transition. What are their skills? Will existing managers take kindly to the successor's appointment? If several children are involved, will they agree to play a supporting role? Who will be responsible for what?

Distribution of ownership. How many people will be entitled to an ownership interest and what will their respective shares be? Most important, who will control the voting shares? Although these decisions are the business owner's responsibility, it is best to discuss them beforehand, Luanna McGowan says.

Mechanism for the transfer of company shares. This is a complicated process, so seek the assistance of a specialist.

Legal and tax considerations. Should company assets or shares be sold? Is there a shareholders' agreement or a family trust? "There are numerous legal and tax considerations," Corina Weigl warns. Ignore them at your peril.

Financial considerations. How much is your company worth? How will the sale be financed? To answer these questions properly, consult a business valuation specialist.

Retirement considerations. What are your postretirement goals? How much income will you need? According to David Wilton, "The decisions you make before selling your company will depend on how you answer these questions."

Dispute and problem resolution process. Establish a family council — it's a good way to avoid arguments.

Timeline. When do you plan to retire and sell the company? When will your successor take over? What steps will be required and when will they be taken?

Contingency plan (plan B). If your plans do not work out, do you have a contingency plan? If not, make one now. You can prepare for the future, but you never know what it might hold.

DOs and DON'Ts of succession planning

DON'T

Ignore the need to plan. As Betty Hansen, president of the Crossroads Planning Group, advisers to family businesses, puts it: "If you don't attempt to control events, they'll end up controlling you."

Forget time flies. Because people are living and staying healthier longer than ever before, we tend to forget that our time is still finite. However, if we ignore the passage of time, we may neglect to make key decisions or take steps to ensure the ongoing viability of our business. And when we finally get around to it, it's often too late.

Fail to groom a successor. This often stems from the point above, and it's a major error.

Hold on for dear life. This happens all too frequently because people refuse to think about their exit, says Weigl. But if you dodge the issue for too long, "you might not have time to give the next generation the moral and technical guidance they need."

Keep everything to yourself. It's true that doing nothing is often the easiest course of action. But failing to communicate can be like a viper's nest: things get harder and harder to untangle as time goes by.

DO

Build trust. Rule No. 1, according to Hansen, is to have an attitude of trust and respect with family members and management. This should be an integral part of the environment, she says. If it is lacking, it is difficult just to adopt it, as in "We'll do it now."

Communicate. It's been said before, but it bears repeating: don't forget to share your ideas. The best way is to establish a family council, says Hansen. Make sure your advisers — e.g., lawyers, accountants, bankers, etc. — are aware of your plans. These advisers should make up a revolving team, with different advisers coming into play at different times.

Start early. Are your children still in school? Start by talking to them casually about your business — this will enable you to gauge their interest. The earlier you start planning, the better the results will be.

Put it down in writing. This is a difficult but necessary step: the plan will serve as a roadmap for the future. As Hansen notes, your plan should be flexible: after all, life is full of surprises.

Prepare your successor. You will have to find a way to delegate responsibilities to your eventual successor(s). This may not always be easy, but it's the best way to ensure proper training. Successors must eventually learn how to make decisions and hone their judgment.

managerial positions. "Having clear rules avoids lots of problems down the road," says Sorbara.

The family brings in an external consultant (also known as a facilitator) to moderate the family council meetings. "It allows us to be more objective during our discussions," Sorbara says. According to McGowan, bringing in a CA, lawyer or other specialist is often helpful, especially in the initial stages, to provide specialized advice and technical expertise. "The facilitator must have good interpersonal communication skills — that's the most important thing," she says.

Sorbara and his business partners are working on a plan for selecting a successor, and four of the children are currently in the running. Since September 2006, the children and other managers have been taking part in workshops aimed at familiarizing them with the company's different departments. For example, they have gone with senior managers to visit Sorbara Group properties and meet with the tenants. Over the next few months, they will be asked to solve simulated business case studies along the lines of those taught in business schools. But they must also demonstrate that they have the necessary leadership skills to run the company. "Otherwise, we'll select an external successor or successors," says Sorbara, who hopes a decision will be reached within two years.

A succession plan can thus be used to groom potential successors. The transition period represents an opportunity to assess their skills — and their shortcomings. Additional training might

be required or, in certain cases, a personal coach might be assigned, says St-Cyr.

An increasingly popular approach is what family-business consultant Denise Paré-Julien calls "shared responsibilities." For a few years, the owner and the successor run the company together and share duties. This allows successors to become familiar with all aspects of the business and to be introduced gradually to the company's clients, suppliers, bankers, lawyers, CAs, etc. "It's absolutely essential that these people be given enough time to groom the successor," says Paré-Julien, who also heads the Montreal chapter of the Canadian Association of Family Enterprise.

At the Jean Coutu Group (PJC) Inc., management responsibilities have been shared for many years. Even though Michel and François-Jean Coutu have held various senior management positions, their father has always remained in the picture. Last year, when the company was having some trouble with its business in the US, which affected the stock price, the father took over as CEO again and sold the US stores to Rite-Aid, a US pharmacy chain. He has since gone back into retirement.

Successors may also come to the rescue. This was the case with James McKenzie, 51, president of Monk Office Supply in Victoria. In 1982, when McKenzie was working as an engineer, he got what he describes as a compelling call from his father, the company's owner. Monk Office Supply was in dire financial straits, and the father was going to close it down unless his sons stepped in. "It

was more life support than a succession plan," says McKenzie.

McKenzie, his brother and father worked up to 80 hours a week to turn the company around. They worked together well — so well that McKenzie's father sold his interest in the company to his sons and retired worry free. After that, McKenzie bought out his brother. Since then, sales have risen by a factor of eight.

Whether the company remains in family hands or is sold to outsiders, financing remains one of the thorniest issues in succession. Securing financing is the buyer's responsibility (at least in theory), but according to Wilton, director, small business banking at Scotiabank, owners must also understand the obstacles facing the buyer. It can help if they are familiar with the various options, such as debt financing, leasing and lines of credit.

In some cases, it is better to sell at a lower price to a serious buyer with sufficient financial backing and a good credit history than to chase after the best offer from a buyer who may have trouble coming up with the necessary funding.

In family businesses, the seller will often make a loan to the buyer (also called the balance of the purchase price). That is how McKenzie and his brother acquired Monk Office Supply in 1987: they put down some cash up front, and for the rest, their father agreed to be paid from the company's future profits. Everything went so smoothly that McKenzie decided to buy out his brother using a similar approach three years later. "I paid him 30% up front and the balance over three years," he says.

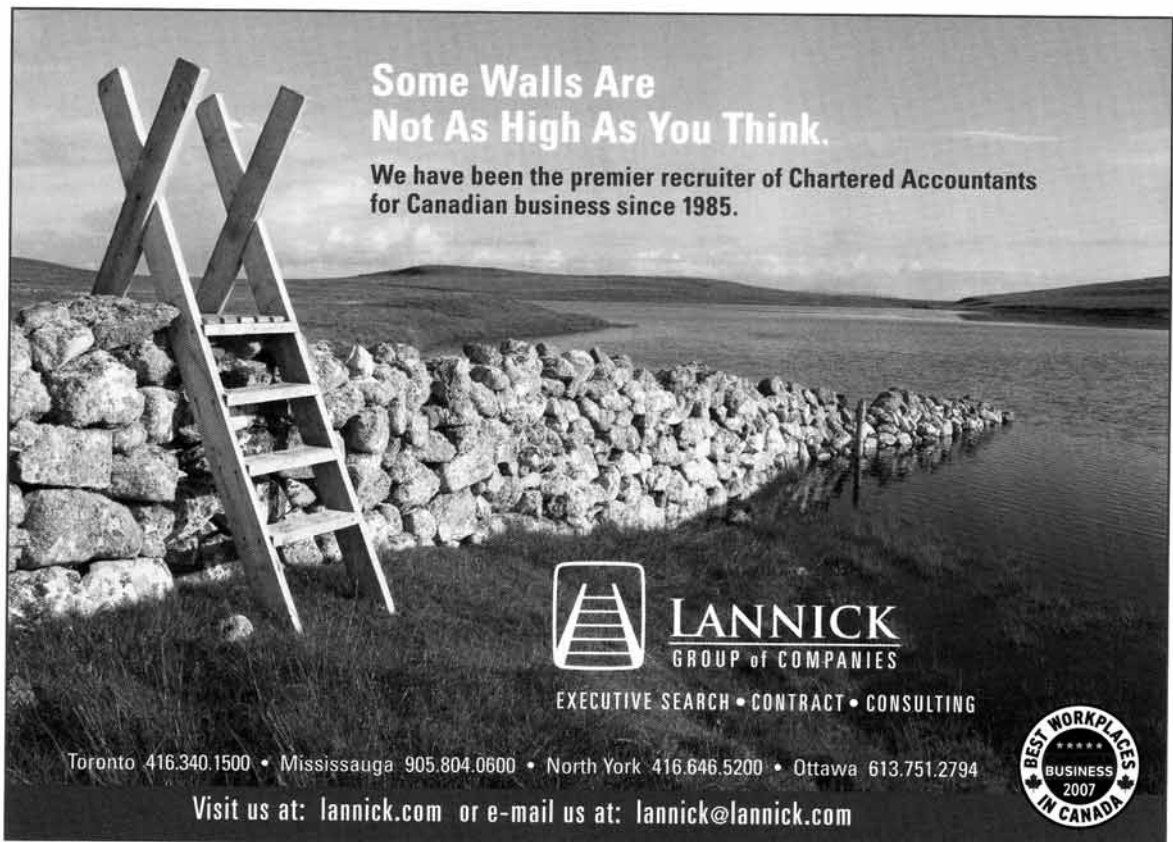
Children whose parents haven't done their planning are sure

to learn from that mistake. McKenzie drew up his own succession plan five years ago. Since his four children will still be too young to take over when he wants to retire, he will look for a successor in the next few years. Eventually, though, he would like his children to either take over the company or own it.

Fortunately, things worked out for Lavoie. Thanks to a good dose of perseverance and an understanding bank manager, he overcame his initial hurdles — among other things, he paid his overdue taxes with his life insurance and line of credit. He also moved the company from Gatineau to Ottawa. Once it was on solid footing again, he decided to buy out his partners. Today, Menuiserie Gaston Lavoie Cabinet Shop Ltée/Ltd. is in excellent financial shape, with almost 30 employees and annual sales approaching \$3 million.


Like McKenzie, Lavoie has learned from his experience. Although he has no children, he drew up a succession plan three years ago with the help of his CA. Three possibilities are under consideration: liquidating the assets (unlikely), selling to an outsider or selling to key employees (Lavoie's preferred option). Everything has been taken into account, including potential successors (he has five employees in mind, with two in particular), financing methods and the tax and legal consequences of a potential sale. For now, Lavoie is not quite ready to lay down his carpentry tools for good. Still, every now and then, he reads over his succession plan. "Just to refresh my memory," he says.

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