

Family Business Law

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Successful Succession

In a June 2005 member survey, the Canadian Federation of Independent Business concluded that more than 40% of business owners surveyed intend to leave their businesses in the next five years, and more than 70% within the next 10 years. In addition, approximately two-thirds of the businesses surveyed did not have a formal succession plan, and two-thirds of those businesses without plans thought it was too early to plan for succession. These statistics are frightening considering most family business owners hope to see their business remain in the family. Recent Canadian studies have found that only 30% of Canadian family-owned businesses make it to the second generation, and only one-in-ten make it to the third generation.

A Comprehensive Approach

Successful succession of a family-owned business requires a comprehensive approach that gives proper weight and consideration to all stakeholders. The owner-operator – who has probably devoted much of his or her life to the business – often defines value and success differently than his or her spouse, children, management and employees. It is essential to align the vision of the owner-operator, so far as possible, with the interests and expectations of the parties the owner-operator will rely on to realize that vision. In those cases where the competing interests of stakeholders cannot be aligned, proper communication, understanding and tactful management of all parties' objectives are vital to preserve relationships and avoid expensive and disruptive conflicts during the formation and implementation of the succession plan.

Leadership transfer is often the most contentious issue facing family-owned businesses, especially where a generational transfer is the desired succession plan. It is often the case that the children of the owner-operator expect to be placed in roles or positions which do not match their individual skills and qualities. In such cases, the owner-operator must assess what role their children can realistically play while being mindful of such children's expectations and feelings. A contrary scenario commonly occurs where members of the second generation have been running the business for some time (with or without the help of qualified managers and professionals) and the original owner-operator is unwilling to address the need for a succession plan and the formal transfer of control.

These issues are emotional minefields, which require a proactive and sometimes formal approach to the communication between family members. At a minimum, the interested parties should have an opportunity to express their visions and expectations before determining successors and embarking on a strategic plan for leadership transfer. With the assistance of a trusted professional to mediate the discussion, this could be as easy as holding a family meeting with an informal understanding amongst the parties that the topics to be discussed will be difficult and contentious. Sometimes, a more formal

communication plan is required. An example of such a plan is a "Family Charter", which sets out both a united vision for the business and specific rules with respect to resolving family disputes. When dealing with larger and more complicated businesses, the appointment of an outside advisory board may help to ensure objective guidance and decision making are applied when conflicts arise.

Knowing Your Options

There are a number of options available to business owners who are beginning to contemplate an exit strategy, and each has its benefits and drawbacks. Many owners consider family transition to be the preferred option as it provides a legacy to future generations who have some knowledge of the business, the industry and the owners' vision for the future. Since children often do not share the same interests and values as their parents, and may not have the expertise that comes with years of operating the business, the parents/owners should be able to rely on their professional advisors to provide an objective analysis of the potential for a successful family transition.

Other options include management buy-outs, and selling to unrelated parties. The management buy-out is an appealing option because the owner can be confident that the business will be left in the hands of trusted people who have existing relationships with customers. The negotiation and implementation of a management buy-out requires finesse in order to achieve fairness while maximizing value for the owner in light of existing relationships and loyalties. Selling to unrelated parties also appeals to owners as it provides certainty and finality. Sound advice, attention to detail, an up-to-date valuation and strong advocacy are crucial when dealing with unrelated parties, as sophisticated buyers will vigorously review business records and the company's history to ascertain the value of their investment.

Start Early

Succession planning is a process which benefits from foresight and planning. There are a number of stages to succession planning, including clarifying and documenting intentions, identifying successors or buyers, training successors, and transitioning to new management. As a minimum, owners

should begin formalizing their succession plan 5 to 10 years before their intended transition and exit.

Legal guidance is required throughout the process of succession planning for: family communication and conflict resolution at the plan's fruition; corporate reorganization and the use of shareholders agreements, trusts and holding companies to ensure proper implementation and a tax-effective change of control; and proper estate planning, including Wills and Powers of Attorney, to ensure that value is protected and enjoyed by the intended persons into the future.

Pallett Valo LLP Family Business Law Group

At Pallett Valo LLP, client service is a family affair. We have been there for many of our clients since the beginning, and have witnessed their businesses grow and evolve. We have seen their children become adults, and take part in the family enterprise, or find their own path, and throughout we have provided our clients with the piece of mind that comes with sound, objective advice to guide them through important decisions.

A comprehensive approach to succession planning requires multidisciplinary expertise. The Family Business Law Group of Pallett Valo LLP provides our clients with the legal expertise necessary to guide and protect them during this process, while working with the clients' accountants, banks, and financial advisors, and consulting with trusted experts to ensure our clients realize the full value of a lifetime's work, and have the opportunity to preserve and protect their legacy. Managing the development and execution of a succession plan often requires special skills and understanding, making business coaches and mediators invaluable tools which the Family Business Law Group may call on as part of our comprehensive and multidisciplinary approach.

The Family Business Law Group of Pallett Valo LLP has the expertise to guide family business owners through the process of succession planning, and our right-sized-thinking approach ensures our services will be tailored to the individual needs of our clients. We're in the Family Business™.

Other Services

While succession planning is a significant issue facing today's family business owners, the Family Business Law Group of Pallett Valo LLP provides its clients with the best advice and guidance on many issues facing family-owned businesses, including:

- Acting for purchasers and vendors in the sale or purchase of businesses;
- Implementing estate freezes and other corporate/estate planning strategies;
- Corporate organization for effective creditor and tax planning;
- Resolution of disputes involving shareholders, directors, and management; and
- Facilitating partner, shareholder, and family member buy-outs and reorganizations

If you have any questions about succession planning or any other topics relevant to your family-owned business, contact one of the following members of Pallett Valo LLP's Family Business Law Group:

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