Your Family Business *Matters*

Edition 2005 – 02

Don't be a statistic! Succession planning crisis looming

An estimated 500,000 Canadian small-business owners are planning on retiring in the next five years, according to a recently published CIBC World Markets survey. By 2020 it's estimated that half the country's current small business owners will retire. Though these statistics are interesting, an alarming fact that goes with these numbers is that, despite plans to retire, 60% of entrepreneurs aged 55-64 have *not* begun succession planning.

Do you fall into any of these categories: Are you planning on retiring by 2020? Have you started succession planning?

It's not just a personal matter

As the CIBC report points out, whether Canadian business owners have done succession planning is a matter that's of interest to all Canadians because approximately 70% of Canadian businesses are family owned and they represent more than 50% of the country's gross domestic product (GDP). So, if a half-million owners plan on retiring, an estimated $1.2 trillion in assets will change hands by 2010. Given these figures, there's cause for concern if business owners don't begin addressing the issue of their own succession planning.

As the CIBC put it, "The demographic realities of Canada in general, and the small business sector in particular, suggest that succession planning is increasingly becoming a critical issue … faulty succession planning could have significant economic costs resulting from reduced productivity, job losses, premature sales and increased bankruptcy rates."

Transfer plans

Interestingly, the CIBC reports that only about 15% of small business owners (defined as businesses with one to 15 employees, including the owner, and revenue under $5 million in 2003) aged 55-64, have definite plans to transfer or sell their business to a family member, such as a child. Another 40% plan on selling their business to outside interests.

Regardless of whether you plan on transferring your business to a family member or to a third party, succession planning is required. For example, for business owners planning on selling to a third party, steps should be taken to prepare the business before they actually sell. A number of things should be looked after to ensure the highest price on the transfer, as well as to make the transfer as tax effective as possible.

What's Inside...

Your Family Business Matters is published quarterly by BDO Dunwoody LLP on issues of interest to family business owners. This material is general in nature and should not be relied upon nor should it replace specific professional advice.
Comments and suggestions should be addressed to Bruce Ball, National Office by Fax: **(416) 367-3912** or E-mail at familybiz@bdo.ca. We invite you to visit our web site at www.bdo.ca to find out more about our firm and the offices near you. Or call us at **1-800-805-9544**.

Similarly, there are a number of steps business owners planning on transferring the business to a family member should take to ensure a smooth transfer to the next generation.

Other facts and figures

The CIBC report also looked at the sources business owners planning on retiring will draw on to fund their retirement.

RRSPs and other investments play a significant role in the retirement plans of Canadian entrepreneurs, with these two vehicles accounting for more than half of their projected retirement income. The balance will come from selling their business (with about 30% of retirement income coming from this) and pension income (which will contribute about 16% of retirement income).

Given the expected reliance on RRSPs, the CIBC canvassed business owners about their contributions. Clearly, self-employed individuals rely on RRSPs more than regular employees. More self-employed persons own RRSPs than employed persons and the self-employed also contribute more to their RRSPs than do the employed. But, the overall pace at which small business owners contribute to their RRSPs is declining and only 35% of self-employed persons contributed to their RRSPs in 2003, with only 20% of them maximizing their contribution that year.

The report also showed geographic and gender differences in the pace of RRSP contributions by self-employed individuals. Overall, since 1999 the contribution room gap (the difference between the maximum RRSP contribution permitted and the amount actually contributed) grew the most in Atlantic Canada. Only small business owners in Quebec actually increased their RRSP contributions from 1999 to 2002.

The survey also found that during that period the number of women entrepreneurs contributing to their RRSPs increased, as did their actual dollar contributions. In other words, male entrepreneurs are responsible for the overall decline in total RRSP contributions made by small business owners from 1999 to 2002.

The survey also found that from 1999 - 2002 the number of women entrepreneurs contributing to their RRSPs increased, as did their actual dollar contributions.

Though it's dangerous to infer too much from statistics, these figures make you wonder how so many entrepreneurs who are planning on retiring in the next decade will be able to afford to and whether they are doing all they should to make themselves financially able to retire.

Our clients

Because so many of our clients are family businesses, the CIBC report gives us cause for concern and has reinforced our commitment to ensuring that we try hard to persuade clients of the need to engage in succession planning and to not put it off.

As the CIBC pointed out, the role of advisors to business owners at this point is crucial: "Professional advice and diversifying sources of income can help ensure a worry-free transition to retirement for Canadian entrepreneurs," and, by extension, can help "avoid creating a negative ripple effect throughout the Canadian economy."

Succession Planning – A Process

Succession planning is not a one-day event. It is a process that must be tailored to your unique circumstances. A skilled advisor can help you navigate the process from start to finish. If you have not begun the succession planning process but think you should, or if you would simply like more information about succession planning, contact your BDO advisor.

What's fair?

Most parents try very hard to treat all their children alike. Doing so makes perfect sense, since each child comes into the world innocently and is equally deserving of the parents' time, attention and money. When the children are very young, treating them equally is usually pretty easy: if Terry gets a lollipop, so does Chris. Even as they grow older, though they might not both get the exact same thing – most parents make an effort to treat their children evenly. So, for example, if Pat gets a drum set, Sydney might get a play station.

For most families there comes a time when the adult children go their own way in terms of career choices and making a living, so parents usually are no longer as concerned with treating them financially equally. (Of course, there could still be the issue of what the children will inherit, but we're not concerned with the division of estates here.) But, when there's a family business that the founder will eventually pass on to members of the next generation, the issue of how to divide things between the children naturally must be considered.

Not a stand-alone decision

Consideration of how to divide up the asset that is the family business overlaps with the basic issue of business succession. Before a parent can focus on dividing the asset among the children in a way that seems fair, he or she must have a realistic understanding of the future role of each child in the business. That means that questions about whether each child will be active or inactive in the business must be considered.

If all the children are active in the business the issue of who will play what role will often determine the stake each child should have in the future. Creative solutions that allow multiple children to remain active include things like splitting the business into different divisions or along business lines, with each child taking over one of these lines. Or, for example, if the business has a manufacturing component and a real estate component, it may make sense to create a separate real estate holding company and put one child in charge of it. (This last strategy also works in situations where some family members are active and some inactive. For example, the real estate holdings can be given to inactive family members and the active members can be given the assets used in the active business.)

Another alternative parents sometimes favour when two children are active in the business is the idea of co-chairmen. Though the idea is not unprecedented, most experts warn against such structures because of the possible friction and because it is generally thought that businesses run best when one person is in charge.

When some children will be active in the business and others will not be, a useful way of analyzing it is not to focus on how to divide the business *per se*, but on how to put in place a structure that would – at the end of the day – ensure that each child ends up with something of (roughly) equal value. So, for example, if one of the founder's children is (and will remain) active in the corporation and another child is not active, rather than simply giving each child 50% of the shares, the shares could go to the active child and an insurance product could be purchased to create an instant estate that can be given to the inactive child.

Equal isn't always fair

When analyzing what might be fair, it is important to focus on more than just the monetary aspects of a planned division. For example, equal ownership of shares can make decision-making difficult, as agreement will be required. Founders who have been the sole owner often fail to realize that part of the business' success likely came from their ability to make changes rapidly and decisively. With an equal ownership structure the next generation won't necessarily be able to make the quick decisions that the founder had the luxury of making.

As well, in cases where the founder feels strongly that both active and inactive children should receive a direct share of the business (whether it's an equal share or not), the founder should consider that the burden on the children that remain

But, when there's a family business that the founder will eventually pass on to members of the next generation, the issue of how to divide things between the children naturally must be considered.

What's fair?, continued from page 3

active in the business will be greater because every decision (whether a success or failure) will impact all the other children. Is that fair?

Equal ownership can also lead to animosity between siblings, regardless of whether the children are active or inactive in the business. If, for example, all the children are active, some could feel that others are not working as hard. Or, if some children are active and some are not, the active ones could resent that they have to share the growth arising from their efforts with other family members who are inactive owners.

The decision is difficult

Grappling with business succession issues involves many difficult choices. When you're considering a fair way to divide the asset that is your family business, remember that your analysis should go beyond strictly monetary issues.

Primer on Running a Family Meeting

We've all suffered through poorly planned or poorly run meetings – the kind that seem to lack focus or purpose, which is probably why so many people will tell you they hate going to meetings. But, a well-run meeting can be one of the most effective ways of:

- ensuring that people are informed of what's going on;
- sharing ideas;
- seeking input; and
- helping keep people motivated and committed.

As you have no doubt noticed, three of the four points above revolve around one central theme: communication. Most good businesspersons will tell you that open and free-flowing communication is crucial to the functioning of their business. Naturally, this is as true in family businesses as in any businesses.

Most good businesspersons will tell you that open and free-flowing communication is crucial to the functioning of their business.

Since families are emotion-based and businesses are task-based, for family businesses, it's important that family meetings be held. Family meetings provide a way of addressing issues relating to the business, as well as issues relating to how the family is functioning as a family. According to Sharon P. Krone, founder and dean of the Family Business Communications Institute at Loyola University Chicago, the purpose of a family meeting is to allow families to learn together, to discuss, to plan and to preserve family values and traditions. Furthermore, according to Krone, family meetings are helpful in promoting cooperation among family members and they improve the chances of a successful transfer of leadership to the next generation.

While it's not unusual for family businesses to hold business meetings, far fewer hold regular family meetings. If asked, however, most family business owners would tell you that they do hold regular family meetings. That's because many consider the Sunday family dinner a "family meeting" or they consider strategy meetings with family managers at the office, "family meetings". But, such get-togethers don't really count as "family meetings" because they usually only involve family members who are directly involved in the day-to-day running of the business and they tend to focus on the business tasks at hand, rather than deal with matters of interpersonal family communication and family relationships.

Dynamics of family meetings

The dynamics of family meetings are very different from the dynamics of most other meetings because family members all have emotional baggage of some sort, and there are often tacit family rules about topics that are to be avoided. To help overcome these hurdles, it's important that family meetings be carefully structured.

Here then, are some ideas and tips for running productive family meetings. (These suggestions were culled from, "So you're planning a family meeting," by Mike Cohn, <u>Family Business</u> magazine, Autumn 2001, "How to run your own family meetings," by Sharon P. Krone, <u>Family Business</u> magazine, Summer 1997, and "Savoring the family meeting," by Lidia Bastianich, <u>Family Business</u>

… because of the sensitive nature of family relations, the facilitator must be someone with a high level of sensitivity, finesse and courage.

magazine, Autumn 2004.)

Consider what family members should be involved – since one of the purposes of a family meeting is to keep people in the loop, generally speaking, the more inclusive the meeting the better because excluding people can make them feel insignificant.

So, unless there's a good reason not too – in-laws and others who have a stake in the business (even an indirect stake) – should be included. It's important to remember that one of the most effective ways of gaining buy-in and support of other family members is by including them and encouraging them to participate.

Consider where the meeting should be held – it's a good idea to hold family meetings off-site – meaning not at the business location and not at the home of a family member. One reason for choosing an off-site location is neutrality – no one has home-court advantage (so-to-speak) and there are fewer distractions. (No one has to leave to fix a child a snack or to take a call!) Indeed, it's a good idea to have a rule that cell phones are turned off and that unless there's an emergency, baby sitters are not to interrupt.

In terms of picking a location, a nearby resort is a nice choice if family members want to combine the event with some rest and relaxation. Also make sure the location is comfortable to all participants – have refreshments and other things that show that the needs of all the participants were considered.

Determining who will "run" the meeting – great care should be taken in determining who might run the meeting. Though the founder might seem like a logical choice, the founder may be intimidating to some family members (for example, younger members) and therefore his or her running the meeting may stifle communication. Indeed, the role of the person running the family meeting is really more that of a facilitator. And, because of the sensitive nature of family relations, the facilitator must be someone with a high level of sensitivity, finesse and courage.

If no family member is ideally suited to act as facilitator, consider hiring a professional who is skilled in stimulating discussion and who is able to neutrally raise issues. Another good alternative is co-facilitators that might be nominated by family members before the meeting. This solution can prevent one person from dominating the meeting, while providing an opportunity for each facilitator to voice his or her own opinion.

Preparing topics in advance – a written agenda should be prepared and it should include a reasonable mix of business topics and non-business topics – to allow everyone to feel they can participate. It's a good idea for the person creating the agenda (typically the facilitator) to canvass family members about topics they wish to have on the agenda. Doing so in advance – and inviting family members to raise topics – helps prevent people from blindsiding others with no warning at the meeting itself.

If presentations or reports are to be made, consider giving out assignments to different family members in advance. This helps ensure participation by a number of people (rather than having all the business information simply given by the founder, for example), and helps ensure the topics are thoughtfully and thoroughly addressed.

Ground rules – it's a good idea to make sure participants understand – and agree to – certain ground rules at the start. Things like asking the participants to agree to be respectful of others who are speaking (in other words, no interrupting), asking participants to listen to each other with an open heart and open mind, and promising to keep to the timetable, are all useful ways of ensuring civility. The idea behind the rules is to create an atmosphere where people feel safe participating and voicing their opinions and feelings.

Take the plunge

Because the potential benefits of regular family meetings are clear, if you don't already hold them, you should consider initiating them. But, if you do schedule one, remember that running a successful family meeting requires more planning than the typical business meeting, where merely having an agenda is usually sufficient.

Q & A

In this section we offer food for thought – based on our experience (and what we've gleaned from others who may have faced similar issues) – about specific situations you're facing or questions you may have.

Question

A family business owner's daughter and son are both involved in the family business and hope to continue after the founder steps down. The daughter asked for comments on the following:

My brother and I are both active in our father's cigar importing business and we are interested in continuing the business when my father retires. Over the years many relatives (none of whom are active in the business) have made comments that imply that they expect my brother to eventually take over the business. I don't know if people make this assumption based on the product (cigars) or simply based on stereotypes, but thankfully my father and brother don't seem to share this view. I'm confident that in our case, the ultimate decision of who plays what role in the business after Dad retires will be decided based on objective criteria. In the meanwhile, I'm wondering whether there's any evidence of successful cross-gender successions – you know, cases where daughters take over from fathers, or sons take over from mothers.

Answer

As a matter of fact, there are many famous examples of successful cross-gender successions, including Playboy's Hugh Hefner and daughter Christie, Estee Lauder and son Leonard – and perhaps Canada's best example: Magna's Frank Stronach and daughter Belinda. There are many theories about why cross-gender succession often works very well in family businesses. One theory is that the traditional rivalry issues that typically arise in father/son and mother/ daughter relationships, such as where one party ends up feeling threatened or superseded by the other, do not exist in cross-gender relationships.

Another theory is that there is often a special bond between fathers/daughters and mothers/sons. (You know, the bond that is the basis for the "daddy's little girl" and "momma's boy" expressions.) Because sons and daughters often feel protective toward their opposite-sex parent, they often serve comfortably as stewards and cheerleaders, especially if given authority to take action when needed. As a result, the child feels fully empowered and fulfilled without having to push the parent aside, as is often the case with same gender succession.

The father-to-daughter dynamic is often characterized by patience. Daughters often have an ability to negotiate through complex relationships, issues and emotions. This skill helps their fathers and other employees develop trust in them. As well, daughters generally realize the need to prove themselves (in the eyes of their fathers and also within and outside the company) and so they don't generally enter the business with a sense of entitlement. Indeed, daughters often seem tolerant (and even fond of) their father's foibles, unlike many sons who can't wait to push a stubborn father out the door.

The mother-to-son dynamic is less common and generally thought more complex. Some psychologists theorize that this dynamic hinges on how the mother originally reached the top. If she inherited the business, the mother may be more tentative or conflicted about her abilities. In such cases the son may be compelled to protect and support his mother. If the mother created the business, it's likely she is confident and assertive, in which case the son is likely to accept that he must remain in his mother's shadow.

Great respect and trust that opposite-sex parents and offspring often feel for each other is the cornerstone of successful cross-gender successions. Only you and your family can assess the relationships of those involved, so don't let comments by outsiders (especially those based on outdated stereotypes) unduly influence the succession process.

10 Commandments for Children Working for the Family Business

Though bad behavior on the part of any employee can have a negative impact on a family business, children employed by the business sometimes seem to get away with things that might not be tolerated if done by other employees. To help prevent the chances of this happening, here's a list of 10 commandments children employed by a family business should live by.

Children hired by the business should:

1. seek no special treatment,
2. arrive with an excellent education,
3. be dependable and reliable,
4. be ethical and honest,
5. respect and obey the family patriarch/matriarch,
6. work very hard,
7. display a cheerful and confident attitude,
8. communicate forthrightly,
9. stay clear of substance abuse, and
10. not engage in sexual harassment.

Though this list is nothing but common sense, it's a good idea to adopt these commandments to remind children engaged in the family business they'll be held to the same standards as all employees.