

# ST U I

## SELLER'S GUIDE 1

# FAMILY BUSINESS TRANSFERS

**CTEQ**  
**CILQ** Centre  
de transfert  
d'entreprise  
du Québec



# EQ LQ



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The *Centre de transfert d'entreprise du Québec* (Quebec centre for business succession) mobilizes economic development actors to meet the challenge of business transfers and acts as an independent facilitator to make the market more transparent and foster the longevity of Quebec businesses.



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On behalf of the *Centre de transfert d'entreprise du Québec*, I am pleased to present our guide developed especially for business owners and directors in Québec who wish to transfer their business to a successor.

The guides are designed to help you with your transfer project and will help you understand how to plan a business transfer and identify potential issues so that you will be better prepared for what lies ahead. They explain the process, pitfalls to look out for and best practices to implement when passing the torch to your successor.

These guides were developed with the help of the Ministère de l'Économie et de l'Innovation and National Bank to provide relevant resources to help entrepreneurs with the takeover and transfer process.

In conjunction with your meetings with CTEQ advisors, you can use the tests and exercises in these guides to verify different aspects of the process. Whether you're planning an internal transfer (in the form of a cooperative buyout or a family transfer), an external transfer or a combination of the two, preparing properly and surrounding yourself with experts are the keys to a successful transition.

Since 2015, CTEQ has been guiding Quebec entrepreneurs looking to transfer or take over a business. To foster prosperity in outlying regions, ensure the longevity of local businesses, protect jobs and retain expertise here at home, we urge you to join us in creating connections and encouraging business transfers so that Quebec can thrive economically.



Vincent Lecorne,  
President and CEO of the Centre de transfert d'entreprise du Québec

National Bank was founded in 1859 by entrepreneurs, for entrepreneurs — initially to meet the business needs of a small group of seven people. True to our roots, we now have the privilege of advising business owners as they make important decisions to manage their wealth. These important decisions involve investments, growth, succession, business transfers and disinvestment, among other issues.

So it's with great pride and genuine enthusiasm that I salute the important partnership between National Bank and the Centre de transfert d'entreprise du Québec (CTEQ). This partnership strengthens our constant involvement in the lives and financial success of small businesses.

Entrepreneurs represent a key segment of our clientèle at National Bank – Wealth Management. This collaboration with CTEQ increases our ability to support Quebec business owners with a personalized succession and business transfer process. This is essential to ensuring the financial viability, sustainability and long-term success of the businesses they have created.

Through its expert advisors and publications, CTEQ addresses every aspect of the business transfer process, whether a business is passed on within the family or placed in the hands of an external professional management company. Good planning and informed decision-making are essential for entrepreneurs, who have to deal with multiple tax implications simultaneously, and to establish strong financial leverage after the transfer of a family business.

The new partnership between National Bank and CTEQ is a win-win relationship for everyone: CTEQ, Wealth Management and family businesses. But the greatest benefit will be to our clientèle of entrepreneurs and small businesses, because we are now even better equipped to support them throughout their businesses' life cycle.

We hope you find this guide useful.



Martin Gagnon  
Co-President and Co-CEO, National Bank Financial  
Executive Vice-President, Wealth Management



# INTRODUCTION

# BUSINESS SUCCESSION ISSUES



**The owners and directors of Quebec SMEs are constantly facing and overcoming a wide variety of challenges and concerns.**

**It's all part of life as a business owner!**

**One of the major challenges they'll have to tackle at some point will be to ensure that their business continues to exist even after they're no longer at the helm.**

**There are two guides on the subject of BUSINESS SUCCESSION ISSUES, beginning with this INTRODUCTION, which you can use to start thinking about the future continuity of your business. We encourage you to read the brief texts included in these guides, which present an overview of ALL THE DIFFERENT ASPECTS of this issue.**



### Don't have time?

Too many fires to put out? Urgent problems to deal with? It's understandable that you don't have a lot of time right now to focus on your business's future. That's why we've developed this brief test especially for you.

### Take the test in just five minutes!

In five minutes, you'll know which issues you're most likely to be interested in.

## TEST

1. I'm not too worried about planning for business succession. It'll be easy to find a replacement when I decide I'm ready to leave my leadership role.

T

F

If you answered "True" to this question, you probably don't realize that time is not on your side. There are a multitude of factors currently at play which will sharply limit the number of candidates who are ready to take over your business when the time comes to start the transition. To learn more about these factors, read Chapter 1, *The importance of preparing for succession*.

2. It's not the end of the world if I don't prepare for succession. There are certain people in the organization who will figure things out when the situation arises. I trust them to do the right thing.

T

F

Answering "True" to this question is a risky choice. For ten important consequences of failing to plan for succession, read Section 1.1, *The consequences of failing to prepare for business succession*.

3. My business is family-owned. Obviously, my children will take over for me.

T	F
<input type="checkbox"/>	<input type="checkbox"/>

In any situation, it's often a bad idea to simply go with the first option that comes to mind. This is true when planning for business succession as well. If you answered "True" to this statement, you'd probably be better off looking into all the other options available to you. They are presented in Section 1.2, *Business continuity options*.

4. It could be a good idea to sell my business to one or more members of my staff.

T	F
<input type="checkbox"/>	<input type="checkbox"/>

If you answered "True" to this statement, congratulations! Selling your business to one or more staff members offers a number of advantages. In fact, all of your options have both advantages and disadvantages. To learn more, see Section 1.3, *Detailed options*.

5. Any family members who want to join the business are welcome to do so, regardless of their education and training or the business's needs.

T	F
<input type="checkbox"/>	<input type="checkbox"/>

Problems are likely to await you if you answered "True" to this statement. A family business is a complex system that combines a business, its owners and a family. Preparing for succession will be a perilous journey if there is interference between these systems. For example, family members should never join the organization unless they have the necessary skills and abilities, and only if the business really needs them. To learn more about these different systems, read Section 2.1, *Leadership of a family SME*.

6. It's not easy to plan for a successor. The business really needs me. If I step away for even a few hours, things start falling apart.

T

F

The more dependent a business is on its leader, the less likely the succession planning process is to succeed. If you answered “True” to this statement, your organization may not be ready to plan for succession. Read Section 2.2, *Professionalizing your SME*, for some tips on the subject.

7. Don't come looking for me on the day after I decide to pass leadership of the business to someone else. I'll already be off on vacation or enjoying my retirement.

T

F

Think twice before answering “True” to this statement. The leadership transfer process, especially in a family context, is much longer than you might think. It consists of four stages and can go on for years. Read Chapter 1 of Section A, *The leadership transfer process*, for more on this topic.

8. It's really hard to decide which of my children should take over the business. I love them all equally.

T

F

If you answered “True” to this statement, bear in mind that your choice of successor should be based on a set of criteria that goes beyond the simple matter of love for your family. Read Chapter 4 of Section A, *Choosing the family successor*, to learn how to choose your successor in the context of a family business. You should also take the time to read Chapter 2, *Identifying your successor*, in Section A of Seller's Guide 2. Does the successor absolutely have to be a member of the family? Be sure to consider all your options. . .

9. I intend to keep my staff informed of my business succession plans.

T

F

If you answered “True” to this statement, good for you! The successor’s arrival can have an important impact not only on employees’ attitude, but also on the business’s profitability. To learn more about this, see Chapter 8, *Preparing the staff*, in Section A of this guide; or in Seller’s Guide 2, consult Chapter 6 of Section A or Chapter 3 of Section B, depending on whether the successor is a member of the family or not.

10. My business is one of a kind. It’s gone through its own unique crises, and my family isn’t like anyone else’s. So there’s really no one who’ll be able to help me find a successor. This challenge will be mine alone to bear.

T

F

It’s true that your business is unique. And your family is unique as well. But your business and your family do have certain points in common with other businesses and other families. Certain specialists have helped other businesses prepare for succession and are familiar with the biggest obstacles you’ll be faced with. Why not take advantage of their expertise? Why sentence yourself to making the same mistakes that others have made in the past? Instead, look for assistance relevant to your needs by consulting the *Finding support* section in Chapter 9 of this guide’s Section A for succession within the family, or in Seller’s Guide 2, Chapter 7 for non-family succession, or in Chapter 4 of Section B if there is no succession plan yet. Don’t face this challenge on your own.

11. I don't have to worry about the tax implications that will come with transferring ownership of my business. It's got plenty of money, and can easily handle whatever Revenu Québec wants from it.

T

F

Don't take any unnecessary risks. If you answered "True" to this statement, refer to Section C, *Tax aspects of ownership transfer*.

12. All of my wealth is tied up in the business. Since the business is doing very well, whoever takes it over won't have any trouble paying me.

T

F

Don't underestimate the financing and cash flow problems that may arise during an ownership transfer. Get informed. You can start by reading Section D, *Financing aspects of ownership transfer*.

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So? Has this brief test got you thinking? We strongly suggest that you read the rest of this guide.

### Before you start

It's important to understand that the transfer of ownership and the transfer of leadership. . .

- Are interdependent,
- Are essential to ensuring the continuity of the family business, and
- Do not necessarily start at the same time and do not take the same amount of time to complete.

A business transfer is a crucial step in the life of a business and its survival. It's also a turning point in the lives of outgoing owners. It may well be the biggest challenge they've ever faced, especially in psychological terms.

An extensive process of reflection is needed to prepare for the transfer.

Because the transfer represents an immense delegation of powers and a major transfer of rights, it's definitely preferable not to carry it out on a purely intuitive basis.

For all of these reasons, it's better to prepare for the transfer with the knowledge that it should proceed according to a well-defined process, i.e. an ordered sequence of specific activities. This process will take several years.

## CONTEXTUALIZING THIS INTRODUCTION

- One day, the owners and CEOs of any SME will have to step away from their leadership role in the business. The goal is to keep it running after they leave. Replacing the outgoing owner is an important step that carries certain risks for the SME. An extensive process of reflection is needed to prepare for the transfer.

### CHAPTER 1

## THE IMPORTANCE OF PREPARING FOR SUCCESSION

Many business owners falsely assume that it will be easy to find a new leader when the time comes.

Most business owners spend the majority of their lives developing their business, and only a few hours—if at all—preparing for their succession. They act as though this wasn't an important and even urgent concern, clinging to magical thinking and assuming that the issue will resolve itself quickly. Many business owners delude themselves with the assumption that transferring ownership of the business will take less than a year. But those who have already chosen their successor know that it's a long process that can extend over several years.

What most business owners don't realize is that time is not on their side. The succession process takes time.

In many cases, this tendency to neglect the process of preparing for succession has had tragic results for the business. We'll look at the consequences of this negligence in Section 1.1, *The consequences of failing to prepare for business succession*.

When a business shuts down, it's inevitably a crisis for everyone affected by it. Suppliers, creditors, employees and customers all find themselves deprived of an important partner. As for the heirs to the business, they may find themselves facing a period of upheaval that marks the end of the organization and of harmony within the family.

A business shutting down is bad news. But there's worse to come. Quebec is currently at risk of seeing thousands of businesses disappear over the next 10 years.<sup>1</sup>

In Quebec, most SMEs are family-owned. And sources predict that the owners and directors of many of these businesses will be retiring within 10 years. Yet only a tiny minority of them are actively preparing for succession. The others imagine that it will be easy to find a new leader when the time comes. But they're mistaken. For many reasons, the number of candidates willing to take on this challenge will be limited when it's time for the transition.

- Departures. In recent years, businesses have begun to encourage voluntary departures. This has not only reduced their expenses, but also the number of potential candidates for leadership positions in the event of an unexpected crisis.
- Outsourcing. Businesses have also acquired a tendency in recent years to concentrate on their core skills while outsourcing their other activities. This has also reduced the number of internal candidates available when the time comes to find a new leader.

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<sup>1</sup> *Transferring businesses to the succession: a major issue for the Québec economy and the sustainability of SMEs.* Chamber of Commerce of Metropolitan Montreal, June 2014.



- The end of the psychological contract. The days when people joined an organization with the intention of staying until retirement are long gone. People now realize that businesses no longer feel bound to them, and that layoffs are always possible. As a result, their loyalty to their employers has declined. Candidates with good potential are more likely nowadays to change employers if they're made to feel that they're not really destined for bigger challenges.
- Low birth rates. This trend, combined with the aging of the population, means that more people are leaving the workforce than entering it. This will result in massive competition to acquire the services of the most promising candidates.

This means there will probably not be any candidates immediately available if your organization suddenly needs a new leader. If you want your business to outlive your time as its leader, you'll have to accept the need to prepare.

This guide summarizes the business transfer process for SMEs, and offers ideas on how to think about it, plan for it and prepare for it.

## **1.1 The consequences of failing to prepare for business succession**

Imagine how easy it would be in some cases for a life insurance salesman to sell policies to a client's heirs after the client's death. After all, it's often only after a loved one dies that the heirs realize that the "small fortune" that their late family member thought they'd be leaving behind is in fact an immense financial debt and a series of unresolved issues that are likely to cause conflict within the family.

There are many risks to not preparing for succession!

What are the biggest consequences of failing to prepare for succession in a family business?

### 1. Family conflicts

Sometimes, a business founder with several children will give each of them the impression that they'll get to run the business one day, and then never choose a successor, assuming that the children will work it out for themselves after the founder leaves. But this is a mistake, for at least three reasons:

- The children haven't been prepared. Often, they've only carried out tasks that they were assigned to do, or at most worked as a second-in-command. Few of them are ready to take on a new role that involves making decisions.
- While they should be working to keep the organization running, children sometimes waste their time with behind-the-scenes wheeling and dealing to increase their chances of getting the top leadership spot. Encouraging the emergence of "clans" within the organization destroys the unity of purpose needed for sound management.
- Meanwhile, other possibilities (such as turning to a professional manager) are neglected, even when they might be a better option.

### 2. Excessive debt for the organization

If the amount of taxes that will need to be paid upon a shareholder's death has been underestimated, the heirs may end up having to borrow large sums of money to meet those obligations. In certain cases, these loans may strain the organization's ability to compete, and make it far less financially sound.

### 3. Loss of key employees

Conflicts and uncertainty are not a good way to hold on to your best employees. Such employees typically have strong value on the employment market and may prefer to focus on working rather than enduring the negative effects of behind-the-scenes drama. As a result, they often end up choosing to leave the organization rather than being forced to pick a side.

4. Loss of know-how

Failing to plan for your succession exposes your business to the risk of losing the know-how it's built up with great effort over time. Your SME has survived and evolved because you've been able to produce and develop products, methods, procedures and other know-how in a different and unique way. Changing hands without preparation could mean losing a body of knowledge that the business has accumulated over time.

5. A poor choice of successor

If the business finds itself suddenly faced with an internal crisis due to the sudden departure of its leader, successors will often be chosen based on their ability to resolve the immediate crisis, when they should have been chosen for their ability to take on the future challenges that the organization will have to face.

6. Culture shock

Successors chosen hastily from outside the organization will find themselves at the head of a business whose culture and unique history they know nothing about. Just when they should be bringing people together, they run the risk of upsetting or dividing them.

7. Loss of partner support

The sudden arrival of a new leader may sow doubt among the organization's partners. Your financial institutions don't know this person, so the way they see it, the risk associated with their loans has just increased. If your suppliers have any doubts about the new leader's competence, they may turn to your business's competitors. If your employees had a strong attachment to the previous leader, they may become emotionally detached from their work. As for the customers themselves, if they worked with the business because of a special connection with the outgoing owner, they may now turn to a different provider.

8. The business becomes a prison

This is a consequence that we've seen more and more frequently in recent years. Imagine an SME owner whose entire wealth is invested in

the business, and who suddenly learns that she is sick and needs to rest. If no one can replace her as the head of the business and she is unable to sell the organization, she'll find herself forced to keep coming to work every day. Her beloved business will suddenly feel like a prison.

### 9. Loss of business opportunities

Business opportunities may arise every day, but your ability to seize those opportunities may be limited by your failure to prepare your troops. Suppose that a family which owns a business that has been your competitor up to this point, but is now experiencing financial difficulties, offers to sell you the business. This would enable you to improve your competitive position and your profit margins. The problem is that you won't be able to act on this opportunity if no one is able to take on your current responsibilities and you're already not feeling up to the task. You will be forced to refuse this proposal, even if your refusal means that the business will be sold to another group. Because you haven't prepared a successor, you now risk facing the consequences of seeing another, better-prepared competitor appear in your market sector.

### 10. End of business operations

In certain cases, a business owner's sudden inability to perform his functions may quickly lead to the closure of the business. For example, if the owner is the only person with the right to sign cheques, and if he then dies or becomes incapacitated, the risks of financial problems will become a major concern. And as you know, this kind of situation can occur at any time, regardless of the owner's age.

Would your business survive a crisis like this? Probably not. It's important to take the time to look at what options are available to you.

Those options exist, but in order to choose, you first need to learn about them! The options presented briefly in Section 1.2, *Business continuity options*, are detailed in Section 1.3, *Detailed options*.

## 1.2 Business continuity options

As the old saying goes, when all you have is a hammer, every problem looks like a nail. This is known as the law of the hammer. In other words, people who have a problem to solve generally rely on the solution they're most comfortable with.

For example, if you're an enthusiastic and extroverted person, you will tend to present your projects in an equally enthusiastic way and dive into them in a rush. But if the people you're working with are more introverted, they'll need advance notice before you come to them if they're going to give you their full attention. Afterwards, they'll need time to think about your proposals, and more time before they agree to collaborate. On the other hand, if instead of giving them this time to think, you come back with that same level of enthusiasm and insist that they sign up on the spot, you may get a polite response, but the efforts they're willing to put in will be limited.

The same phenomenon is often seen with business owners who agree to consider the option of preparing a successor: an initial option occurs to them, and they then focus on it without asking whether other options might be equally interesting or even better.

Let's take a moment to go through the full list of options available to you.

### 1. Family succession

This type of succession takes place entirely within the family. The business continues to belong to the family (ownership of the business) and to be run by a member of the family (management or leadership of the business).<sup>2</sup> This is the option that many business owners dream of, imagining a pleasant retirement at the head of a dynasty. And it can be an entirely viable one if you prepare for it in the long term.

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2 In the rest of this guide, we will use the term "leadership of the business."

2. Ownership stays within the family; management is entrusted to a professional.

This is known as partial family succession: the business continues to belong to the family, but it is led by a professional manager. This option is often overlooked, because many people don't make the distinction between ownership of a business and leadership of a business. If no family member is available (lack of interest or ability, or if they need time to prepare), this path may turn out to be the most appropriate one for you.

3. Transfer to staff

Why not sell your business to members of the staff? The business would then be in the hands of people who care deeply about its success and who are already familiar with its inner workings. There is another possibility subordinate to this one: the business can be passed on to a group of staff members acting together as a cooperative.

4. Transfer to an external party

The business is sold to one or more third parties (new owners who are not family members) who will both own the business and take over its leadership. This is a solution that allows the current owner to cash in on the value of their business. This path may be necessary if the owner's wealth is tied up in the business.

Note that selling the business does not eliminate the need for business succession planning. In order for the business to continue thriving after the sale, a period of cohabitation between the old and new management teams will be necessary.

5. Merger with another business

This fusion may give you the opportunity to get your hands on a skilled leadership team that will take over the management of the new organization. Ownership is then shared between the family and the other owners.

Remember: none of these options releases you from the need to prepare a succession plan.

It may be possible to sell a business and completely wash your hands of it, but this is generally a bad idea because it increases the risk from the buyer's perspective, which reduces the value of the business. A good succession plan, combined with a cleanup of your financial balance sheets, will enable you to obtain the maximum value in case of a sale.

All of these options are detailed in Section 1.3, *Detailed options*, and discussed in these two guides.

For information purposes, let us mention two final options:

1. A specific option that ensures the continuity of the business without bringing a business transfer into play: buying a competitor.

This option allows you to achieve several strategic objectives at the same time. If the competitor that you may be able to buy is fortunate enough to have a skilled management team and knows your business sector well, buying this competing business means that you can acquire some valuable resources. It's even possible that the head of this business will be able to take over the operation of your business in the short term. In addition, because buying a competitor enables you to increase your market share, this option may lead to an improvement in your profit margins, given that it reduces the market competition and improves your buying power with suppliers.

2. An outcome that does not lead to continuity: liquidation.

It's important to understand that not every business can be kept running. Sometimes, liquidation of a business (selling its assets) is a better choice than continuing its operations. For example, a small retail store that has been in business for generations is currently producing only a minimal annual profit, but it's located on land whose value has immensely increased.

### 1.3 Detailed options

When the owner and head of a business (the outgoing owner) thinks about ensuring the future continuity of her business, and of what will happen to the business after she leaves, it is highly recommended that she consider all the possibilities well before starting the transfer, which could take several years.

Those possibilities are:

- A. Family succession,
- B. Partial family succession,
- C. Non-family succession, and
- D. No succession.

#### Option A: family succession

The business wants to continue operating as a family business, in terms of both ownership and management. The family members want to stay on as owners and lead the business.

The business's continuity is ensured by one or more family members, most commonly a son, daughter, niece, nephew, or son- or daughter-in-law.

This solution is attractive because:

- Family members know the business well from having heard their family talk about it, and in many cases, from having worked there.

Plus, this option. . .

- Is a good way to perpetuate the primary values embraced by the business,
- Makes it possible to maintain a high degree of engagement from key employees, especially in cases where the family members are well integrated and fully prepared to take over the business, and
- Enables the outgoing owner to maintain a connection to their business, even after officially handing over the reins to the new leader.

All the different aspects of family succession are covered in [Seller's Guide 1](#).



## Option B: partial family succession

The business remains under the family's full or majority ownership, but leadership of the business is entrusted to an independent person outside the family.

The main advantage of this option is. . .

- The professional manager may know the owner and family members as a result of having worked for the business. (However, he or she may not be familiar with either the business or the family.)

This form of succession will succeed if the manager has the necessary skills and a real interest in seeing the business succeed.

In this case, the family will have to be involved. . .

- On the board of directors, and only on the board, in order to deal with issues within its jurisdiction, in order to avoid pushing the new CEO aside, and
- On the family council, in order to keep watch over the family's interests.

Partial family succession is discussed in Seller's Guide 2.

## Option C: non-family succession

The business is sold to new owners who will also take over its management. These new owners already have a relationship with the company.

This approach is known as an "internal sale."

The family is no longer present in the new business — or, if it is present, then family members work there without exerting a predominant influence with regard to ownership or leadership of the business.

### Selling the business to one or more staff members

The advantage here is as follows:

- The staff member knows the outgoing owner and the business as a result of having worked there.

This option. . .

- Sends the staff an open-minded, encouraging signal,
- Gives the business a chance to hold on to its expertise while also protecting its methods and procedures,
- Ensures that the new leadership team has solid knowledge of the products and services, and knows how to change course if needed,
- Helps maintain an entrepreneurial spirit within the business, and
- Reduces the risks entailed in the transaction, and therefore its costs as well.

There are also certain disadvantages:

- The negotiation process may be longer, since it involves negotiations between employer and employee.
- This choice is not necessarily appropriate for all industries.

### Forming a cooperative

There's another possibility in cases of internal sale: the successor can be a group of staff members acting together as a cooperative.

A cooperative is a legal entity made up of people or companies with shared economic, social or cultural interests who seek to fulfill those interests by joining forces to operate a business in accordance with rules of cooperative action.<sup>3</sup> Here are the major advantages and disadvantages.

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<sup>3</sup> Cooperatives Act (R.S.Q., c. C-67.2), section 3.

According to the principle of cooperation, all members have equivalent decision-making power, i.e. each of them has one vote. The members can receive dividends or share the cooperative's benefits according to their use of the services provided.<sup>4</sup>

Learn more about our cooperative buyout support program: [www.ctequbec.com/programmes/reprise-collective/](http://www.ctequbec.com/programmes/reprise-collective/)

From the business's perspective, the advantages are. . .

- The business survives and maintains a low debt load, i.e. the natural successors (children) do not have to go into debt to ensure business succession, and
- Preservation of jobs, participation in the business's profits, reinforcement of a sense of belonging (motivation) and the right to a say on decisions.

And the disadvantages are. . .

- The possibility that this approach may not be usable in all industries,
- The complexity of the decision-making process, and
- The increased risk of conflict, due to the fact that the managers are themselves employees.

#### Selling to one or more minority shareholders

The advantage is. . .

- The fact that the minority shareholder(s) know the outgoing owner and the business as a result of having been financially involved in it, and sometimes also as a result of having worked there.

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<sup>4</sup> Definition used by the *Ministère de l'Économie et de l'Innovation*.

And this option. . .

- Allows the business to hold on to its management expertise while also protecting its methods and procedures.

### Selling to one or more business partners

The advantages are as follows:

- The partner or partners know the outgoing owner and the business as a result of having been financially involved in it.
- They know the outgoing owner and the business from having worked together as business partners.

These scenarios will succeed if the new head of the business has the necessary skills and a real interest in seeing the business succeed. All the different aspects of succession outside the family are covered in [Seller's Guide 2](#).

### Option D: there is no one available to lead the business and continue its activities

The business is sold to new owners who will also take over its management. These new owners have no existing relationship with the company.

If neither the family nor someone who is familiar with the business is able to step in as a successor, the outgoing owner may decide to simply sell the business.

This is known as an “external sale.” The possibilities are. . .

- Sale to a competitor,
- Sale to a third party, or
- Merger with another business.

The advantage is that the outgoing owner has an opportunity to make a substantial quantity of capital in exchange for their business.

And the disadvantages are. . .

- Loss of jobs or a possible closure, or
- A sudden break for the outgoing owner and members of the family.

All the different aspects of succession outside the business are covered in [Seller's Guide 2](#).

## Useful tips

As business owners consider selling their business, they need to understand that certain moments are better suited to moving forward with their plan:

- When the business is in good financial health;
- When its business sector has a promising outlook.

Finally, here are some other aspects which are beneficial for outgoing owners:

- A minimum selling price has been determined.
- They are working with a good team of expert consultants who skillfully help them to prepare an open and transparent approach to convince potential buyers to acquire the business.
- They maintain a calm attitude toward the business transfer process.

Transactions made in a rush tend to yield the worst results.

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Decisions about the transfer are the family's and outgoing owner's responsibility. We do not favour any of these options in particular.

### CHAPTER 2

# IS YOUR BUSINESS READY?

When should you start thinking about business succession? When does it become a serious issue? Answer: as soon as the business becomes viable and a network of partners (financial partners, suppliers, customers, employees, etc.) start to depend on it. Even at this point, it's possible for a succession plan to be doomed to failure; there are in fact certain organizational prerequisites to any succession plan. Two of them, leadership and professionalization, are discussed in this chapter: Leadership of a family SME (Section 2.1) and Professionalizing your SME (Section 2.2).

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Before we begin, we should note that some organizations simply will not survive their owner's departure. Here are two examples.

- It's more of a hobby than a business. A business that only generates marginal income and which you manage in your spare time (a sideline, in other words) will probably disappear when you leave. Is it a hobby or a business? Do you want it to go on without you? Would it be so terrible if you shut it down today? Answer these questions and don't make any false promises to members of your family (like "This will all be yours one day") if you know perfectly well that the venture won't survive your departure.
- The business will cease to exist if you're not a part of it. For example, if you have an artist's studio and your success is due to your reputation as a painter, then your departure from the organization may well mean the end of the business. It's only worth as much as its liquidation value. The same is true if you yourself are the "product" sold by your organization. If you're a comedian, for example, then even if you've founded a company to support your work, you'll have a hard time selling it if you leave the profession. In cases like these, the concept of succession doesn't apply.

## 2.1 Leadership of a family SME

A family SME is often subject to different forms of interference that disrupt its operations. This section examines the systems that make up a family SME, and concludes that the roles attributed to each of the three systems must be clearly defined and rigorously applied before a business transfer is initiated.

A family business is a much more complex system than it might seem to be at first glance. In fact, it consists of three closely interrelated systems.

- First of all, there is a business: a dream that has become a reality. One fine morning, a person had an idea. The entrepreneur discovered that customers were not well served by existing businesses, and that there was a way to introduce a product or service offering better value to a particular target clientèle. Or perhaps she had expertise with a certain product or service and decided to make money from it. Armed with her original idea and entrepreneurial skills, this person set out on a new adventure. Much like a living being, a business goes through different stages in its life cycle: creation, development, consolidation, a peak period and a period of decline. Note that these steps are not linear, and that the leadership team's role is precisely to prevent the business from declining. The business, as an organization that operates to produce goods or services for a commercial purpose, constitutes the first system.
- Now, let's turn to the owners. A business belongs to people, and those people influence its development. In particular, the owners set the overall orientation of the business and establish the return on invested capital. At first, ownership of the business is often limited to one person or a couple, but over time, it expands to include other family members or investors outside the family. Ownership of the business constitutes the second system.
- Finally, what distinguishes a family business from other kinds of businesses is, of course, the family. This constitutes the third system. The situations that arise in this third system will be different depending on whether the children are young or full-grown adults.

These three systems are distinct entities operating independently. . . but they can interfere with one another.

In fact, the reality of a family SME is that these systems often find themselves in opposition. This interference leads to disorganization that is harmful to the business's operation and development.

There are four types of interference. Each of them is described below and illustrated with examples.

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To avoid undue interference, all parties involved in a business need to be aware of the duties and responsibilities associated with their role. But how, exactly? By basing their actions on the logic of each system:

- The business, through its chief executive and its staff, carries out its mission to produce and sell a good or service for profit.
- The owners, through the board of directors,<sup>5</sup> decide the overall orientation of the business, including its mission, values, and profitability.
- The family, through the family council, supports its members and ensures that its interests are respected, and monitors the family's wealth.

For example, when working for the business, owners or co-owners must forget that they own the place and start acting as employees. A family member who works for the business also has to act like any other employee. And a member of the board of directors or family council should not interfere in how the business is managed, for example by commenting on the supervision received by the staff.

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5 In the context of a family business, the board often consists of a single shareholder. Even later in the life of the business, the board may not be officially constituted. This doesn't mean that these roles are not being carried out. It's simply that they are generally not distinguished from one another.



By thinking about the nature of the activity in question, people can determine which system they want to make their contribution to, and which specific role they can play within that system. . . if any!

Only under these conditions will the organized systems be effective at supporting the business's operations and continued development.

Which brings us back to our original matter of succession: no family business is ready to prepare a succession plan if the people involved are not first aware of the role or roles they are supposed to play. Unless these roles are respected, there is a risk that one system will interfere in another's activities.

You must clearly define and rigorously apply the roles assigned to each of the three systems before starting to prepare a succession plan.

Let's first note that in today's business environment, it is important for you to have taken basic management training and acquired conflict management skills if you're going to prepare a succession plan.

Now let's turn to our description of the different types of interference mentioned above.

#### 1) Family interference in the business

Family interference in the business occurs when the business is run like a family. In fact, these two systems are quite different.

- With regard to staff recruitment, family members have an advantage from the moment they're born: they can work for the business by default, and this option is available to them for life. In a non-family business, a new staff member is hired if there is a need and if the person has the necessary skills. The need for the new staff member ends as soon as the need goes away. In a family business experiencing this form of interference, all family members are welcomed with no concern for either the organization's needs or their personal skills.

- With regard to priorities, all members of the family are entitled to their own long-term objectives as long as they don't get in any other family member's way. In a non-family business, there is one long-term objective and everyone has to focus their efforts on achieving it. In a family business experiencing interference, family members expect the business to support their personal needs.
- With regard to performance evaluations, in a family, the objectives are personal and unofficial, since family members are accepted with little regard to their performance. In a non-family business, employees are responsible for attaining the objectives assigned to them. In a family business experiencing interference, family members have no specific objectives, so their performance cannot be evaluated.
- With regard to rewards, in a family, rewards take the form of love, support and encouragement. In a non-family business, rewards are more likely to take the form of raises, promotions and increased autonomy. In a family business experiencing interference, rewards are given automatically with no regard for performance, so that the children feel loved and supported.

The indicator that can be used to detect this type of interference is that the business runs as though it only existed to satisfy the needs of family members. If this type of interference exists in your family business, the succession plan is likely to be sabotaged, no matter how much effort you put into implementing it.

### II) Business interference in the family

Business interference in the family occurs when people act as though the family was only there to satisfy the needs of the business, with no regard for the family members' needs. One common example is when children are hired by the business at salaries far below the market average. The owners explain these conditions to them by saying that the business will be theirs some day and that their current pittance will serve as an investment.

Business interference in the family also occurs when family members who would prefer to be doing something else are forced to join the business because “we need them.”

### III) Owner interference in the business

In some cases, shareholders in a business also make decisions based on a short-term vision that will cause the business to fail in the medium term. For example, the shareholders might vote to turn down a technological investment that is essential to keeping the business competitive, simply to avoid a reduction in dividends.

### IV) Interference by the owner themselves

At the centre of the business’s operations is the owner. If this sounds like a truism. . . it is. But we’re emphasizing it all the same in order to highlight the fact that the owner generally works in almost every area of the company.

That entails. . .

- Planning business activities, obtaining resources, coordinating and monitoring countless activities while also managing people;
- Overseeing sales and production while monitoring finances at the same time;
- Managing professional relationships and ensuring that all of these different areas of activity are in sync;
- Determining overall guidelines for the business and the resulting strategic objectives, and managing the day-to-day details.

. . .All while watching out for the family’s interests as well.

This is the reality of any small business: the owner has to take care of everything! But over time, this “management model” will lead the owner to develop habits that may cause problems for him or her.

For example, at some point the owner will start looking for assistants to handle some of the tasks on an increasingly unmanageable to-do list.

But delegation is hard for entrepreneurs who are used to doing everything themselves. Owners will have a hard time delegating activities to their new assistants, because they're used to relying solely on themselves. They will accordingly tend to "review" everything that their assistants are supposed to handle, short-circuiting the assistants' work as supervisors and gradually erasing their role, which will lead them to look elsewhere for work.

## 2.2 Professionalizing your SME

Can your business keep running when its leader is away?

Professionalizing the organization means developing tools (e.g. a mission, objectives and procedures set down in writing) that will allow the business to keep running smoothly even if its director needs to be away for a little while. The more professionalized an organization is, the less dependent it will be on its leader for its day-to-day operations, and the more likely the succession planning process will be to succeed.

There are SMEs that rely so heavily on their leaders that they can no longer function if the leader steps away for even a moment. In such organizations, the CEO's grip is so complete that the resulting dependence makes it very difficult to develop a viable succession plan.

Can your business go on without you for a day? A week? A month? Could someone even open the shop if you had an accident one morning? Could someone sign the pay cheques if you had a stroke this afternoon? Can you go on vacation for a week without worrying about your business the whole time?

Here are a few statements that describe a professionalized organization.

1. It's more concerned with profit than sales. If an activity isn't profitable, it is eliminated.
2. It uses budgets and financial forecasts.
3. It can replace key employees who quit their job because it is constantly training its staff in order to mitigate this type of risk.

4. It is led by a team of skilled managers, rather than a single person who wants to be a hero.
5. It makes a point of defining all roles and functions within the business.

In a professionalized organization, there are entities that can act as a counterweight to the leader's desire to stay in his role, and can even show him the door if necessary. This allows the business to avert any last-second hesitations or fear of passing the torch — two emotions that occasionally turn a leader into a monarch desperately clinging to power. And in cases like these, when does the monarch finally vacate the throne? We all know the answer: either when he dies, or as a result of a coup d'état. Of course, most businesses can't afford to lose their leader without preparation or as part of a long legal battle. So it's better to professionalize your organization.



## SECTION A

# LEADERSHIP TRANSFER FOR SUCCESSION WITHIN THE FAMILY



## INTRODUCTION TO SECTION A

- SME owners all have to leave their position as the CEO some day. The goal is for the business to be able to continue its activities. There are two key aspects to replacing the outgoing owner with a new owner: the transfer of ownership and the transfer of leadership. This important step poses certain risks for the SME.  
An extensive process of reflection is needed to prepare for the transfer. This collection examines the associated issues and prepares you to take the necessary actions.
- Section A discusses the transfer of leadership at SMEs for succession within a family, when family members want to retain ownership and control of the SME.
- We use the term “family successor” to refer to the person who will replace the current CEO, i.e. the current owner, who is often a sole proprietor or co-owner of the business.



## CHAPTER 1

# THE LEADERSHIP TRANSFER PROCESS

Family succession involves both an inheritance (ownership of the business) by the descendants (the family), and the operation of the business itself (its leadership and how it is managed).

In short, there are three aspects involved: ownership, leadership and the family. (Non-family business succession includes just two elements: ownership and leadership.)

We discuss this type of succession in [Seller's Guide 2](#). Sections A and B cover the most essential part of the transfer, namely the transfer of leadership, while sections C and D focus on the transfer of ownership.

Let's make it clear from the outset that the transfer of ownership and the transfer of leadership. . .

- Are interdependent,
- Are essential to ensuring the continuity of the family business,
- Do not necessarily start at the same time and do not take the same amount of time to complete.

For example, the transfer of leadership may well start when the current owners first start to get their children interested in the business, and it ends when they retire. The transfer of ownership, on the other hand, begins when the current owners first start to plan for it and ends when they sign a legal document.

Succession is a crucial step in the life of a business and its survival; it represents an immense delegation of powers and a major transfer of rights. And nowadays, it's far better if these major changes in the life of a business are carried out not on a purely intuitive basis but according to a well-defined process, i.e. an ordered sequence of specific activities.

## The leadership transfer process

The process begins well before the family successor's arrival at the head of the family business, and ends when the outgoing owner has fully stepped down from that role. Here are the stages in the process:

Stage 1	Stage 2	Stage 3	Stage 4
Initiation	Introduction	"Joint rule"	Disengagement

Let's take a brief look at what's involved in each stage of the process.

## **Stages of the process**

### Stage 1 – Initiation

The potential family successor, say a daughter, familiarizes herself with the business while the current owner is still fully in charge of the business.

During the initiation stage, the current owner's primary concern is with the overall ongoing operations of the business, which he often manages on his own.

Most of the time, parents bring their children to the workplace even when they're still quite young, and they inevitably talk shop around the dinner table. During this stage, the potential family successor will show an interest in her parents' business, just as parents will choose who will be their successor.

Even if the potential family successor doesn't have an obvious place in the business, it's at this stage that she is initiated and develops a positive perception of the business owner. Note that there may be a perfect match, or no match at all. If there are many potential successors within the family, this situation will lead to other topics of discussion between the current owner and his successors, and between the successors themselves.

## Stage 2 – Introduction

The potential family successor gets a job in the business.

The introduction stage starts when the current owner brings the potential family successor into the business.

In most cases, the potential family successor initially takes on a part-time or seasonal position which allows her to get familiar with the business. Whatever her status, the potential successor is in a learning phase and acquires technical knowledge of the business.

In some cases, she may learn some management skills. Through observation, she has access to various know-how and ways of taking on responsibilities and exercising authority, even if she is herself more often limited to a subordinate role, e.g. as an order clerk. She doesn't participate much in operational decisions, and not at all in strategic decisions.

## Stage 3 – “Joint rule”

The family successor joins the current owner in a management role.

This period of “joint rule” is considered to be the key turning point in the process.

At this stage, the family successor (or the new leadership team, in some cases) establishes herself in her new role within the business. She will take on this new role gradually, and ideally through a complete and well-defined process.

The current owner ensures that his family successor is involved in decision-making as he steps back from his existing role. During this period, which may last anywhere from two to 12 years, the two leaders work side-by-side to carry out the transfer of responsibilities and authority, until the family successor becomes fully autonomous in making decisions involving the business.

The current owner may be personally involved in training the family successor. Even if the successor is familiar with the business as a result of having worked there, it's at this stage that the current business owner ensures that the family successor is acquiring the necessary skills to replace him at the head of the business. And finally, this is the period when the family successor has to prove her abilities and settle into her new role. All too often, this stage is carried out without detailed planning, but a structure for the takeover should be established, along with an agenda and a timeline.

We use the term “rule” by analogy with a king's time in power. And since this period involves two strong personalities in charge, or two “rulers,” we describe it as “joint rule.” This sharing of power creates an important moment in the process: one ruler is trying to step into her role as the other prepares to withdraw from his own!

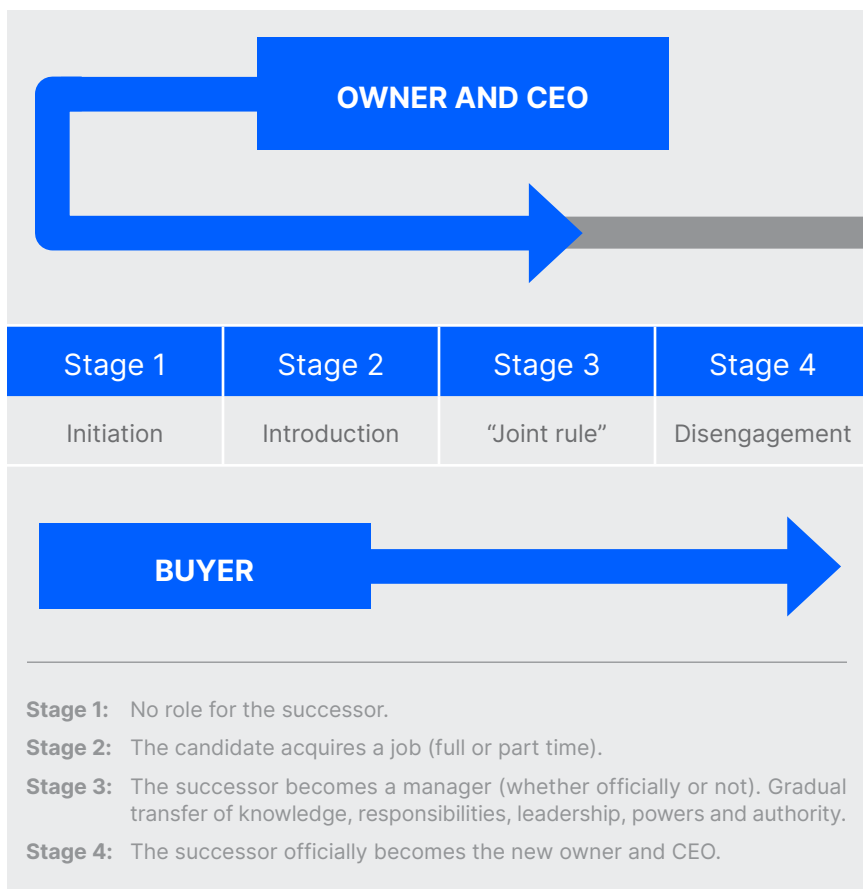
### Stage 4 – Disengagement

#### The outgoing owner yields his role to the family successor.

The final stage of the process, disengagement, is characterized by the family successor's official start as the CEO, the outgoing owner's withdrawal from that role, and the complete transfer of responsibilities, leadership, authority and, in most cases, ownership.

The figure below shows the dynamic of the business transfer.

Figure 1: Overview of the transfer process<sup>6</sup>



**Warning!**

The transfer doesn't always go smoothly. The process may stagnate in the third or fourth stage: The current business owner may refuse to give up his position, and the family successor may be unable to fully take over her new role as a result. Unfortunately, the transfer is not complete until the outgoing owner has accepted that he has to relinquish his position completely.

<sup>6</sup> Adapted from the model developed in 2004 by Louise Cadieux at UQTR. In the original model, Stage 2 is called “Integration” and Stage 3 is “Shared rule.”

### Outcomes for the outgoing business owner

Just because the outgoing owner no longer occupies his old role doesn't mean that he needs to break off all contact with the business. There are many examples of how this can work. In addition to acting as a coach during Stage 3, the outgoing owner has a few options:

- He can maintain his right of review for strategic decisions as the chair of the board of directors.
- He can take on a new, less demanding role within the company without encroaching on others' roles. For example, if the outgoing owner's natural preferences tend toward the marketing side, he can become a sales consultant. If he is more interested in technical organizational issues, he can advise the leadership team on issues relating to production equipment.
- In agreement with the new leadership team, he can implement strategies that he didn't have the chance to act on when he was running the business on his own, such as acquisitions or developing new markets.

## CHAPTER 2

# THE MAIN CHALLENGES FOR THE OUTGOING OWNER

When the outgoing owner first started out in business, he was most likely seeking personal accomplishment and recognition, and he also wanted to become independent.

His first challenge is to accept that he won't be around forever!

Having been in charge of his business for many years, the outgoing owner has formed an attachment to the organization, and strongly identifies himself with it. Of course, he sometimes thinks about the vague and unpleasant possibility of having to someday let go of those strong feelings of grateful recognition from his family and community, which have strengthened his personality throughout his years of success with the business. Just at the thought of having to leave his position someday, he may suddenly feel consumed by feelings of failure or shame. Business owners who have taken on countless challenges and overcome many obstacles may now feel helpless and more alone than ever.

Even so, having successfully paid for their own needs and those of their family through the very business activities they are now preparing to leave behind, they will have a strong desire to ensure a similar level of income after they stop running the business. Their primary concern will be to maintain the quality of life that they've achieved through their business activities, even if they're no longer at the helm. Ideally, outgoing owners will have had the foresight to ask for financial planning a few years before the sale or transfer process begins.

A series of questions now arise as outgoing owners are faced with the need to distance themselves from their business:

- How can I be sure that the business I have led will continue to prosper once I'm no longer in charge?
- How can I pass along my hard-won knowledge, built up over many years, so that the business can continue to prosper?
- And another question, often not asked aloud: Who will give me the recognition and appreciation I've enjoyed until now?

An outgoing owner's second challenge lies in accepting the arrival of their replacement.

After many years as the main person in charge, the arrival of a family successor may be a totally new experience and a personal challenge for them. Up to this point, owners may have been able to recruit everyone they worked with, and assign them to tasks that were needed for their business's success. But now, they're faced with finding their own replacement!

A series of equally worrisome questions arises in connection with this process:

- How can I be sure to choose the right person to replace me?
- If more than one of my children are interested in taking over, how can I determine which one will take my spot as the CEO of the business?
- How will I integrate my family successor into my network of business contacts?
- How can I ensure that he or she is accepted and respected by members of the organization? By our suppliers? By our customers? And of course. . . by other members of the family?

A first practical solution

Transferring leadership of the family business is more likely to succeed if outgoing owners take the following actions:

### With their friends and family

- Clearly announce their intention to step down from leading the company
- Clearly express that they want one of their children to take over for them



#### With their family successor

- Agree to prepare and guide their successors throughout their learning period
- Encourage an “adult-to-adult” approach to communicating with them, especially on the business’s premises
- Let them make their own choices, especially if they are planning on a career in the family business
- Pay close attention to the good decisions they make
- Publicly acknowledge their skills.

#### With themselves

- Accept that they will need to pass on the knowledge they’ve acquired over the years
- Be receptive to new ideas and to others’ opinions and advice, while also recognizing their own limits
- Accept taking on a new role before their family successor is fully in place
- Accept the need to gradually reduce their role, and to eventually step aside

#### And especially if the outgoing owners. . .

- Are able to develop a new personal project to focus their energy on in the future, whether that project involves leisure or business activities

#### So that they can. . .

- Continue to feel useful and valued
- And be reassured by acknowledgement of their skills and interests, especially once they’ve left their leadership role for good

#### A second practical solution

Another aspect to consider is the relationship between the outgoing owners and their family successor.

The quality of the relationship between them and their family successor is of critical importance. The transfer will need to take place in the context of a business relationship. This means that you will have to establish an “adult-to-adult” relationship, rather than a “parent-child” or “employer-employee” relationship.

With this attitude, both of you will be able to . . .

- Establish two indispensable aspects of a healthy business relationship: mutual respect and trust, and
- Respect the pace of two distinct processes: the outgoing owner's disengagement from the business and the family successor's learning process.

## CHAPTER 3

# THE MAIN CHALLENGES FOR FAMILY SUCCESSORS

For family successors, taking their parent or relative's place is a consequential step, and the challenges that await them are considerable. How will they ensure that they are fully recognized as the CEO? How can they be sure that they will have the necessary skills? These are the two basic challenges faced by a family successor.

One of the factors that may give family successors pause in their decision to take over the family business is the need to prove that they're able to do something on their own, and thus to have their own identity. Before making a final decision, family successors should feel confident in their answers to the following questions:

- What are my goals? Career goals? Life goals? For the next five years? For the next 10 years?
- Am I interested in the family business? Am I ready to give it my all?
- Am I willing to work with members of my family who also work for the business?
- Will I be able to work on the business's premises with my parent or relative who's preparing to transfer the business?
- Do I have the necessary skills to work for this business?
- How will my contribution be of use to the business?

From the moment family successors choose to lead the business to ensure its continuity, they will have to accept the need to deal with certain challenges involving the people around them. Let's take a closer look at those challenges now.

## Challenges involving the business's employees

Everyone on staff expects successors to work harder. Watched from all sides, they have to prove themselves both to the staff and to their parent. For a period that may last from two to five years, they need to understand that there will be little room for error, and that they will most likely have to deal with certain preconceptions from employees or managers whose ambitions within the company may be imperilled by a successor's arrival.

While certain employees were already around when the family successor was born, others simply know them as their boss's son or daughter. For those who have watched them grow up with the business, there's a feeling that family successors need to *deserve* the role that's being prepared for them.

For some, seeing a family successor train and make courageous efforts to earn a right to this new role is an encouragement to join in the adventure themselves.

Others will perceive it as a threat.

One way or another, the family successor's process will serve as an example. In most cases, the successor will have to fight to establish his or her credibility.

Sidebar 1 How others see you

Adapted from Mossoux, 2004, by Louise Cadieux, UQTR, 2005

It's important for successors taking over a business to gain the trust of its employees, and that of its major partners and customers.

To do this, they will need to acquire certain skills, and also realize that the family and business are affected by a variety of different interests.

Armed with this awareness, they can learn to anticipate the legitimate and sometimes contradictory expectations of each of the different stakeholders they will have to interact with.

Professional and business challenges

Successors must be sure they have the necessary skills to take over the business. How can they acquire the knowledge they need to take the reins from their parent? Where can they find the necessary resources to develop that knowledge and those skills? How will they ensure that they are fully recognized as the CEO?

In the course of the transition, successors will have to bear in mind that, before the outgoing owner passes the torch to them for good, they will first need to . . .

- Convince everyone of their commitment to the organization,
- Start establishing their credibility (work experience in different types of jobs within the family business or another organization may help with this),
- Take their place as the CEO (often by showing that they are credible and trustworthy),
- Develop trusting relationships with business networks, and
- Improve their abilities to effectively manage the business they are about to take over.

All of these things take time—not just a few months, but typically two to four years. This is normal, and there's no need to see it as an overly daunting or insurmountable challenge. On the contrary, it's an exciting opportunity to acquire new knowledge and skills on the job.

### A first practical solution

Transferring leadership of the family business is more likely to succeed if family successors. . .

- Have been able to identify their strengths,
- Plan to develop their skills accordingly, and show that they have the necessary potential to run the business,
- Have accepted the need to start at the bottom and to develop their knowledge by working in a variety of different roles within the family business,
- Are adequately prepared in terms of their training (the level of formal education depends on the complexity of the business and the specific industry),
- Are adequately prepared in terms of relevant work experience,
- Are committed to earning the respect of the business's employees and of their family members, whether or not they work for the business,
- Maintain a high degree of engagement with the business, notably by working to perpetuate the family's values within the organization,
- Accept the need to collaborate with the outgoing owner, and
- Recognize the importance of the roles that the outgoing owner may take on, both during and after the successor's entry into his or her own role.

### If there is more than one family successor

In a business that has more than one family successor, they will have a greater chance of success if they have. . .

- Agreed that only one of them will act as the leader,
- Accepted that there will be a special connection between this leader and the outgoing owner,
- Clarified their individual roles within the leadership team, after having considered their different strengths and weaknesses and identified how they complement one another.

## A second practical solution

Another key element is the relationship to be established between the outgoing owners and their family successor (or the leader of the team of family successors).

The quality of the relationship between the outgoing owners and their family successor is of critical importance.

The transfer will need to take place in the context of a business relationship. This means that you will have to establish an “adult-to-adult” relationship, rather than a “parent-child” or “employer-employee” relationship.

With this attitude, both of you will be able to. . .

- Establish two indispensable aspects of a healthy business relationship: mutual respect and trust, and
- Respect the pace of the distinct processes at work here: the outgoing owner’s disengagement from the business and the family successor’s learning process.

CHAPTER 4

CHOOSING  
THE FAMILY  
SUCCESSOR

It's common for children to work at their parent's business while they are at college or university or during the summer, on either a full- or part-time basis. Through this experience, they become familiar with the business.

These early learning experiences are generally acquired not in managerial roles, but as regular employees, and therefore outside the scope of management decisions affecting the business. The reality is also that family members rarely work for a business with the specific goal of taking it over until the owner explicitly raises that possibility.

Even if a child has become familiar with a lot of the internal workings of the business, when the time comes to choose a family successor, business owners will necessarily have to take a number of other issues into account to ensure that they leave their business in good hands.

In some cases, more than one child may be able to take over the business. Even so, only one of them can be named to the top leadership position. How should you go about choosing your family successor? What criteria should you base your decision on? Let's start by considering the ideal profile.



## The profile of an ideal successor

Taken from Poza (2004) and adapted by Louise Cadieux, UQTR, 2005

### The successor. . .

- Knows what his or her strengths are and has learned to use them wisely
- Enjoys taking on a leadership role
- Is able to maintain good relationships with other members of the family, whether they work for the business or not
- Has earned the respect of the staff, suppliers and customers
- Is not only familiar with the business and the industry, but has a passion for them
- Has skills and abilities that align with the business's needs
- Has sufficient education and training
- Has acquired experience either outside the business, or by occupying multiple roles within the family business

### The successor can rely on. . .

- A member of the previous generation, whether this is a parent, a manager or a member of the board of directors whom everyone trusts
- The cooperation of competent managers with whom the successor will work closely

### And the successor will commit to. . .

- Respecting the business's values and focusing his or her energy on the future of the business and of the family

## Skills

To make an informed choice, business owners must be sure that their successor has four different types of "skills." First, consider essential basic human qualities; then look at technical skills and management skills, including the ability to provide inspiring leadership; and finally, complete your evaluation by considering his or her business abilities and knowledge of the family SME.

Let's take a closer look at each of these qualities.

## 1. Essential basic human qualities

- Open-mindedness, which implies confidence, determination, perseverance—and, importantly, the ability to acknowledge mistakes
- A creative spirit
- Analytical skills and the ability to see the big picture

Acknowledging one's own mistakes is an excellent indicator of openness to others and the ability to establish credibility.

## 2. Technical skills

Detailed knowledge of the product or service offered by the business and the broader industry is highly desirable if the successor is to run the business successfully. One indicator for this is an ability to clearly explain what the business's operations consist of.

## 3. Management skills

Your business operations depend on the synchronization of three dynamic aspects: selling, producing and collecting payment, all in close connection with the search for funding and analysis of your accounts. This high-level view of the business's operations indicates an ability to manage the overall coordination of its activities.

- Solid management training has become essential to running a modern business. This training must be matched by decision-making abilities, which are acquired with experience.
- Management also includes the ability to inspire others, i.e. leadership. Leadership can manifest itself in different ways.  
Leaders. . .
  - Express their opinions, feelings and vision,
  - Never go against the business's values in their actions or decisions,
  - Listen to, consult with and unite their team around common goals (they enjoy teamwork),

- Naturally choose the right people to work with and are therefore able to build a team and delegate tasks to establish “shared leadership”, the modern approach to running a business, and
- Act as an inexhaustible source of positive energy to establish relationships, build their social and business networks, and become an asset to the community.
- Familiarity with the unique dynamic of the family business is a definite asset that will allow successors to exercise their leadership more skillfully and securely as they work to earn the confidence of family and staff.

#### 4. Business skills

Broadly speaking, the entrepreneurial personality is characterized by originality and a non-conformist mindset. A family successor with these qualities will. . .

- Be the first to seize opportunities, i.e. to take advantage of chances to create, improve or develop something that can lead to business projects,
- Be capable of reflection and able to inspire the leadership team,
- Have an exceptional ability to deal with complex and difficult issues, and
- Be driven by a healthy appetite for risk.

In people with these qualities, you can sense a constant desire to create value. There’s no such thing as an insurmountable obstacle. If they fail, the experience is immediately transformed into a source of new energy to take on a new project. The more things they achieve, the more their energy grows to find the next achievement to pursue. Not only do they always have some project under way, but they’re constantly looking for a new one, without waiting to finish the one that’s currently in progress.

Their keen social sense prompts them to reach out to people, to understand their needs and to create motivating conditions.

Now that you understand the characteristics of an ideal family successor, you will be able to make a less arbitrary choice.

### Practical solution

Follow the steps below.

- 1** Take some time beforehand to give some serious thought to the strategic issues that the organization will have to deal with in years to come (growth, expanding market, competition, development of new products, etc.). Then, with the criteria from this chapter in mind, prepare a detailed list of the skills that the family successor will need to have in order to take on these types of challenges.
- 2** Now use your list to evaluate each of the potential candidates.
- 3** Discuss your evaluations with your acquaintances. These conversations will provide you with other useful information that you can use to make comparisons and improve your evaluation process.
- 4** Carefully monitor the candidates' progress and performance at work. If they are working in the business, this appraisal will obviously be much easier, and the chances of success will be higher.
- 5** Make the most informed choice possible!

## CHAPTER 5

# PREPARING THE OUTGOING OWNER

For business owners, disengaging from their leadership role within their business should mean starting something new and initiating another major life project in order to play a new rewarding role.

Of course, even when we think we're ready, there will be some roadblocks in the path ahead.

### What to do?

Embarking on a new stage of your life is usually somewhat unnerving, and comes with its fair share of disruptions. You'll have to abandon certain habits, and adopt new ones at the same time.

Even if outgoing owners don't talk much about it (or at all), they may tend to see this as a dark stage in their life, as they come to realize that they have to give up the thing that has basically defined them up to this point. They are likely to be scared of losing what was most rewarding to them, and the framework of activities that every other aspect of their life was predicated on. That's a lot to give up! And an outgoing owner will want to protect these "assets".

This sense of giving up something important will cause feelings of fear, although the outgoing owner will generally be able to hide them. It's completely normal to have such fears. But if they become too firmly entrenched, they will cause resistance to the calm reflection that could potentially move the process forward. The more time outgoing owners spend in their own head, thinking about having to give up their role, the more they will struggle with insecurity. Paradoxically, their usual creativity, which has allowed them to overcome countless difficulties in their life as a business owner, now seems to fail them. They feel more and more isolated. They are consumed by doubt. They may feel utterly lost for the first time in their life.

So what to do? The answer is that they need to find the strength to think clearly again and determine the next stage in their life. Of course, this is far easier said than done, but there are ways to achieve it.

### Practical solution

The first effort to be made in this situation should be focused on eliminating those fears. Outgoing owners can dispel their fears by drawing on a habit that has served them well throughout their life—that of building or creating something. This time, though, that habit will take the form of a pencil-and-paper exercise! Take the time to get answers to the following questions down on paper:

- How far along am I with my life goals? What can I still do, but outside of the business?
- What kind of life can I aspire to in the next five years? The next 10 years?
- Do I still have the same need to take on new challenges? If so, what kinds of challenges will they be? Will I have the courage to reduce the scope of my new challenges?
- Will I still have the same need for recognition? If so, how else can I fulfill that need?

This exercise may seem pointless to some, but do it anyway! The goal is to define a new life project for yourself.

Sharing your concerns, hesitations and worries with one or preferably two trusted people can be a big help in successfully completing this exercise. The outgoing owner will be well served by getting competent help. (See Chapter 9, *Finding support*.)

### Another practical solution

Sharing leadership of the company during the period of “joint rule<sup>7</sup>” can not only help outgoing owners to reflect on their next steps, but also encourage

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7 The concept of “joint rule” is described in Chapter 1, “The leadership transfer process.”

them to agree to take small steps toward the arrival of their family successor and, gradually, their own transition to their new life project. If both outgoing owners and successors stick to this shared system, the former will naturally find themselves taking concrete actions that will help them adapt to their new orientations in life. Here are a few suggestions for concrete actions you can take:

- Reduce the amount of time you spend on the business's premises, while still keeping an eye on its main activities.
- Let the family successor make his or her own decisions—and mistakes.
- Ask for activity reports on a regular basis and analyze them in detail. Limit yourself to strategic interventions, and only when needed.
- Evaluate the family successor's learning process on the basis of these same reports.

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#### The outgoing owner may experience a slump after leaving.

The moment outgoing owners officially leave their position (whether or not all the papers are signed yet!) doesn't mean that the process of disengagement is over. Quite the contrary. Outgoing owners are likely to experience a "slump" at this point, during which they may feel disoriented and unsure what to do next. During this time, they may tend to feel useless and powerless, incapable of accomplishing anything new. In some cases, it may take them several months to recover. This process is completely normal.

Not everyone experiences this moment in the same way.

Outgoing owners should look back with confidence at the results of the pencil-and-paper exercise recommended earlier—and trust in those results. Of course, that doesn't prevent them from changing their answers if needed. The main thing for outgoing owners to remember is that these are new aspects of their life which belong to them and are genuinely important.

### Outgoing owners can move forward with reorganizing their life.

Once they've thought about their skills, their new areas of activity, and their new focus of interest (even if those interests still revolve around the activities of the business), and decided on some realistic and motivating new goals, they will be ready to reorganize their life and draw satisfaction from it.

### The path to acceptance is ready.

When outgoing owners have successfully organized their new professional lives and become accustomed to their new daily routines, they will be ready to accept their situation. Once this condition of self-acceptance is met, they will be able to fully accept their family successor and recognize his or her qualities.

This period is an integral part of the disengagement stage, which is primarily psychological in nature. At the same time, feeling happy and proud to have ensured the continuity of their business, outgoing owners are even likely to find a new path to follow in life. This new state of mind, which will encourage them to reclaim their personal time and begin changing their main activities, will gradually distance them from the new realities of their former business, which is now in someone else's hands.

In short, for a business owner, disengaging from a leadership role in a business is not just a matter of "retiring." It may mean preparing two major projects at once: ensuring the continued prosperity of the business, while also establishing a plan for a new professional life.

Figure 1 shows the two stages of the transfer process<sup>8</sup> as they relate to the outgoing owner's changing role.

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<sup>8</sup> See Chapter 1, "The leadership transfer process," for a complete description of the process.



Figure 1 From “joint rule” to outgoing owner’s disengagement in the context of family succession  
Adapted from the model developed by Louise Cadieux, UQTR, 2005

Evolution of the outgoing owner’s role				
Stage 3: “Joint rule”	Stage 4: Disengagement			
	Slump period	Reorganization	Acceptance	Distancing
Gradual period of half-work, half-departure	Gradual progress toward complete departure from leadership role			
Outgoing owner gradually steps away	Stepping into new role (e.g. as chairperson)			

**Preparation takes time!**

These two stages of the process cannot be completed overnight. They will take at least two years, and may continue for as much as ten more.

Practically speaking, disengagement begins when the family successor first appears on the scene, and only ends when the person at the centre of the process, namely the outgoing owner, has fully withdrawn from his leadership role.

**Conclusion**

From the moment the family successor begins to take over her role, the outgoing owner will start a new stage in his life.

The outgoing owner and the family successor will work side-by-side and become familiar with each other’s management and decision-making styles. At the same time, they will learn to appreciate each other as people and as teammates, and to accept each other’s strengths. As the family successor gains confidence and takes on a larger and larger role, the outgoing owner will feel at ease with stepping away from his own role, having found a new life project that will continue to make him happy.

CHAPTER 6

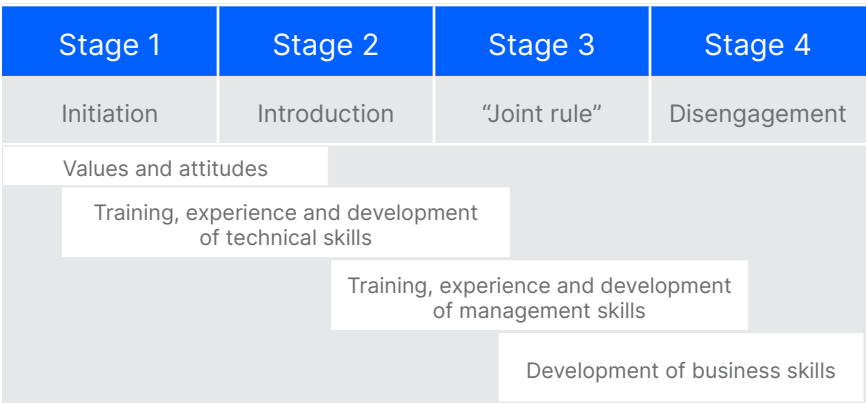
PREPARING THE FAMILY SUCCESSOR(S)

Preparing the family successor

In the context of a family succession, the process of preparing the family successor doesn't happen overnight. In fact, it is a long process that may begin as soon as the outgoing owner starts to achieve success with his new organization, and may continue until the moment he steps away from his leadership role in the business!

The figure below summarizes the process involved in adequately preparing the family successor, shown within the framework of the transfer model (as defined in Chapter 1, [The leadership transfer process](#)):

Figure 1 Preparing the family successor from Louise Cadieux, UQTR, 2005



Overview

In the course of her years of training, the family successor will go through various partially overlapping stages.

- Starting in childhood or adolescence, she will have been initiated in the values and attitudes held by the family. (These values and attitudes are rarely put down in writing.)
- Work experience within the business allows her to connect with its day-to-day realities and improve her knowledge of the products and services it provides.
- Once the family successor has made her decision to take over the business, developing a management and business style becomes the top priority.

Preparing the family successor is a long-term process.

#### Details

##### Values and attitudes

At first glance, values and attitudes may not seem like a particularly important or interesting factor. But this impression is deceiving. In fact, if they are respected, they make a key contribution to the business's distinctive strengths. But if they are flouted, they are likely to cause overt or latent conflict, at least among the management team.

The family successor should model her attitudes and behaviour on the values embraced by the business.

To be able to respect these values and ensure that others respect them as well, proper preparation will involve. . .

- Accepting that she will have to start at the bottom rung in the family business,
- Accepting that she will have to work harder than others,
- Learning to transform criticisms into opportunities to learn and improve, and to react positively to difficulties, regardless of their source,
- Taking part in personal development programs (courses in leadership and human relations), and
- Travelling, having new experiences and interacting with people in both her personal and professional life who are likely to share their skills and help increase her confidence in her own judgement.

### Training and experience

It is common for family successors to work for the business while completing their studies. If they're lucky, they will take on more complex roles in production or customer service, for example. Even if nothing has been decided with regard to succession at this point, these "internships" will allow them to acquire experience and develop their knowledge of the products or services offered by the business.

Education and training are essential nowadays, and continue throughout our careers. They should include studies focused on business in general, and on acquiring knowledge specific to the industry in which the business operates.

After that, family successors will be well-served by seeking out the following experiences:

- Working in the industry in which the family business operates<sup>9</sup>
- Working in larger businesses
- Completing projects or tasks that will allow them to develop their leadership abilities

### Management and business skills

On the one hand, family successors will need to improve their ability to communicate, to work with a team, to manage their time, and to understand the decision-making process in order to increase their confidence in their judgement. On the other hand, in order to be able to see to the business's development, they will also need to strengthen their ability to recognize business opportunities and future prospects after gaining an appropriate understanding of the business's environment, and to communicate that understanding.

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<sup>9</sup> Experience in a different industry is still relevant, but not mandatory.

## The outgoing owner's contribution to preparing his or her successor

It is essential that outgoing owners and their family successors have a good relationship. In order for the succession to succeed, this relationship must be maintained with simple actions and gestures. The things that outgoing owners absolutely must do in their interactions with their family successor are discussed below.

### Personal behaviours to adopt with successors

- Respect their individual differences and the pace at which they learn.
- Congratulate them when they succeed.
- Allow them to take on new challenges.

### Professional behaviours to adopt with successors

- Treat them as a member of the staff so that they are perceived as being engaged in specific efforts to earn the position, not as having privileged status as a family member.
- Pay them a fair salary equivalent to what they could earn in other similar businesses.
- Give them responsibilities that they are capable of fulfilling.
- Give them the chance to make their own decisions and be responsible for the consequences.
- Have them work in the largest number of departments possible: accounting, production, human relations, sales, customer service, etc.
- Allow them to gain experience as sales staff or a representative, while giving them the freedom to measure their successes, failures and progress.
- Show little tolerance for ignorance of certain knowledge relating to financial management. An effective business leader should, at the very least, be able to understand the accountant's analyses.
- Strongly encourage them to read about the industry in which the business operates, and to attend conventions or trade shows.
- Encourage them to participate in training and development programs relating to their work.

### Business behaviours to adopt with successors

- Put them in contact with the business's suppliers, bankers, lawyers, accountants, etc.
- Encourage them to interact with your network of business contacts.
- Publicly acknowledge them as the future CEO.

### The outgoing owner's contribution to preparing the succession team

Within a team of multiple family successors, only one will occupy the top leadership role. Of course, this means that at least one member of the team must have the qualities considered indispensable to lead a business that is about to experience a major shift.

Besides the points listed above, which also apply to each member of the family succession team, the additional points below are ones to which the outgoing owner should pay particular attention.

To ensure the successful establishment of the family succession team, the outgoing owner must be sure that all of the successors. . .

- Have the same motivation,
- Have the same level of commitment to the organization,
- Share the same management philosophy,
- Know how to manage conflicts constructively,
- Are able to distinguish the two worlds they all share, the family and the business: in their private lives, they are brothers and sisters, and at work, they are colleagues,
- Will be able to share tasks according to their various strengths, skills and interests,
- Understand that the team can only have one leader, and
- Accept that there will be a privileged relationship between the leader and the outgoing owner.

## Other issues

Finally, here are a few other points that the family successor and the outgoing owner will have to take into account in order to ensure a successful business transfer.

Before the transfer period:

- All staff will need to be made aware of the changes that will be made to the company, and reassured about the impact of those changes.

During the transfer period:

- The “changing of the guard” should proceed gradually, staying focused on the goal of building on past achievements to optimize the present.

During and after the transfer period:

- The leadership team must ensure that the business continues to provide its customers with products of impeccable quality.
- The leadership team must be focused on remaining competitive, flexible and vigilant, while remaining true to the organization’s values.
- The leadership team must continue to listen to customers’ needs and put mechanisms in place that will allow them to predict any negative reactions and to react as quickly as possible.

CHAPTER 7

PREPARING  
THE FAMILY

The business transfer affects every member of the family!

The business transfer affects every member of the family, whether or not they are involved in the business. This becomes clear when looking at each family member's concerns during this important transition period.

First of all, it is important to understand the different stages of a person's life, which vary immensely!

- In their twenties, people at the start of their career. At the same time, they're leaving the family home and starting to form their own family.
- As they approach their forties, they are advancing in their career and have children, at the same time as they begin to question various aspects of their current life.
- In their sixties, now retired or close to retirement, they have grandchildren with whom they can develop a special relationship now that they have more time.



The figure below summarizes this process.

Figure 1 Stages of individual and family life  
from Louise Cadieux, UQTR, 2005

Age	17	22	28	33	40	50	55	60	70
Life stage	Childhood / Adolescence	Young adult				Mid-life			Old age
Career stage		Young adult	Young adult	Career stabilization			Retirement		
Family life stage	At home	Move out Form a family	Family with children and teenagers	Children move out			Senior family		

This overview highlights the fact that the different members of a family are rarely experiencing the same thing at the same time. For current business owners, two periods are especially worth noting:

- Reflection: In their forties, they have already started to think about the long-term future of their business.
- Action: In their sixties, where they really feel the urgent need to enter into a new stage in their life.

But while the business owner is making progress and accomplishing goals, the potential family successor and the other members of the family may have very different concerns, as shown in Figure 2.

Figure 2 Primary concerns at different stages of life from Louise Cadieux, UQTR, 2005

22 years / 45 years	45 years / 65 years
I've got my whole life ahead of me.	I want to accomplish important things while there's still time.
People are eager to become skilled and independent (partner, parents and work).	People are most concerned with their relationships (family, friends, etc.).
I want to succeed in life.	I want my life to be a success.

Repercussions for the spouse, and a practical solution

How will a spouse or partner react to the business owner's new life project? Of course, spouses may be very concerned about what will happen to the family's estate, the business, and members of the family. Or they may be worried about conflicts that could arise between brothers and sisters, or between the business owners and their children.

But their main concern will likely be the consequences of re-organizing their life together. How will my spouse manage to adjust? If my spouse stops working for the business altogether, will he or she be able to handle living with me all day long—as a lifelong business owner who's extremely active and always looking for new challenges to take on? What will our life together be like in the years to come?

The answers are simple, as long as the process is started before the outgoing owner completely steps down as the CEO: owners and spouses must work together to define a shared vision of their future. This means preparing a list of . . .

- What they want to do,
- What they don't want to do,
- Activities they want to do on their own,
- Activities they want to do as a couple,
- New activities they want to do as a couple,

- Each spouse's expectations of the other, and
- Their expectations of their children.

Example of diverging interests at different stages of life. A husband and wife are twenty years apart in age. While the husband, at age 65, is ready to transfer the business and do something else, his wife may be thinking about projects she'd like to do while she's still in her prime.

The wife has often been involved in the life of the business, whether directly or from a distance. During all the years in which she supported her husband, she made a place for herself and identified strongly with the business, especially when her efforts gave her a special status. Under these circumstances, there's a strong likelihood that the wife will show some resistance when the business owner starts to step aside.

Nevertheless, letting go may be easier if the spouse understands the importance of the roles they may be able to take on during the transfer process. For example, a spouse can contribute to the business's long-term success by acting as . . .

- A mediator in situations of potential conflicts, especially when they involve members of the family,
- A facilitator between the business owner and other members of the family, and
- A messenger to communicate the owner's intentions, thereby ensuring excellent communication with family members.

In ways like these, your spouse can find an important role to play in the process.

#### Repercussions for the owner's children, and practical solutions

How are they likely to react when one or more of them are chosen to run the business?

One thing is for certain: Some of them will want to work in the business. Others won't. In either case, the parents will have to respect their choices.

To ensure that the transfer goes smoothly, everyone must be sure to understand and respect each other's vision of the future. This can be achieved by talking about. . .

- What they each want and don't want to do in their personal lives,
- What they each want and don't want to do in their professional lives,
- What they each want and don't want to do in their family lives,
- Their feelings toward the family members who will be working in the business, and those who will not be,
- Their expectations of their parents, and
- Their expectations of what the business can do for them.

### Repercussions for the family as a whole

It can be difficult to talk about what will become of the family's estate after the outgoing owner leaves.

In fact, the hesitancy around this topic is specific to North American culture. In our part of the world, it is extremely difficult to talk about inheritance, physical or mental incapacity, or—hardest of all—advance funeral arrangements. But families need to talk about these things, and one of the tools they can use to do so is the family council.

### Practical solution

#### The family council: the key to open communication

Made up of family members, whether they work for the business or not, the family council discusses the family's interests and concerns.

Its primary responsibilities are to. . .

- Ensure that the family's interests in the business are respected by the board of directors, and
- Provide members with support, mainly of the interpersonal and financial variety.

Its general tasks are to. . .

- Ensure the quality of communication between all members,

- Understand the values and family traditions embraced by the business and to make them known, especially to new members,
- Maintain the family's and business's good name,
- Identify the abilities of each member of the family and relate them to the business's goals,
- Encourage members to pursue business training, and
- Establish conflict resolution mechanisms.

And its specific tasks are to . . .

- Establish a succession plan that is transparent for everyone, and
- Take positions on problems relating to the transfer of ownership.

To operate successfully, the council must. . .

- Define rules of participation, e.g. the composition of the council based on the nuclear family (father, mother and their children) or based on the extended family (including sons- and daughters-in-law and grandchildren), or how to deal with cases of divorce, and discipline, and
- Establish rules of procedure for its meetings: invitation process, agenda, minutes, etc.

Warning. The presence of a family council in no way guarantees that the family transfer will proceed smoothly. It is not suitable for all situations. It is a recommended tool, not a mandatory step.

## CHAPTER 8

### PREPARING THE STAFF

Bringing the children into the family business in order to prepare them to eventually take over may upset certain loyal employees who have worked for the business for years.

A transfer of leadership within the family may seem to them like the end of their career ambitions or their possibilities for advancement. Out of frustration, they often act in ways that are harmful to the success of the process.

For business owners and their family successor, there are therefore some significant challenges to be dealt with. On the one hand, they should try to ensure that there is as little resistance as possible from all categories of staff. On the other hand, family successors will have to prove themselves, show dedication and integrity, acquire the skills needed for the position, and maintain good relationships with all members of the family and staff.

First practical solution: prepare and announce

To prepare for the efforts that will be required in the transition period, here are some important points that outgoing owners, on their own or with an experienced advisor like the ones at CTEQ (see Chapter 9, *Finding support*), should take into consideration, even before the official arrival of their family successor:

- Who among the staff is indispensable to the successful operation of the business?
- How should loyal employees be treated so that they continue to feel appreciated within the business?
- Is the staff aware of your plans aimed at ensuring the business's long-term success? Has someone already spoken to them about those plans?
- How is the staff likely to react to the arrival of the family successor?

- Considering that some of them may react negatively to the family successor's arrival, how can you ensure that they maintain their interest for and commitment to the business?
- Who among the staff can support the successor or the team of successors as they take on their new role within the business?
- Who among the staff can help you with your part of the process?
- To what extent can certain members of the staff get involved in the family's affairs?

To prepare the staff, owners will take proactive steps to . . .

- Officially announce their intention to step down from leading the company,
- Present a part of the succession plan, notably with regard to the date of the family successor's arrival and the date when the outgoing owner will disengage,
- Establish clear rules for the family successor, in order to minimize any perception by the staff that family members are receiving special treatment,
- Establish clear rules for managers in order to avoid any possible confusion about their role and position within the business, and
- Officially announce the arrival of the family successor.

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Another feeling will also have developed over the years, one at least as strong as loyalty: friendship.

Certain members of the staff, especially the top managers, will have formed bonds of friendship with the owner in their time working for the business. More than just valuable assets at work, they have also become friends. For them, the “changing of the guard” is likely to be more difficult than for other staff.

A second practical solution: call for participation

For managers and professional staff, the outgoing owner can help them to more easily accept the changes that await them:

By consulting with them. . .

- About the future of the organization, and
- About identifying the skills that the family successor should have.

And by inviting them to participate in. . .

- Developing the succession plan,
- Preparing the family successor and bringing him or her on board, and
- Strategic planning or other similar activities.

In general, people like working for family-owned SMEs, even if they may feel that they are treated unfairly in comparison to members of the family who work for the business. For example, they may feel that. . .

- They have quickly hit a ceiling in their career path (an impression that may be due to the size of the business, the presence of family members within the business, or the official arrival of the family successor), or that
- They have not been treated fairly, especially when they compare their salaries, benefits and working conditions with those of family members.



A third practical solution: Pass on a set of management techniques aimed at keeping staff motivated

The owner will be well-served by creating a favourable environment for non-related staff<sup>10</sup> by instituting the following management practices, if they are not already in place:

In general:

- Regularly inquire into staff members' impressions, and explain how they may be affected by the continuity of the business as a new member of the family takes over the leadership role.
- Hold periodic meetings to inform the staff about the progress of organizational measures.
- Encourage teamwork.
- Build the management team with members who have complementary skills and abilities, whether they are part of the family or not.

And in particular, establish the following systems for managing your staff:

- Treat related staff members the same as any other employee.
- Assign positions on the basis of ability.
- Establish a consistent salary and benefit structure that reflects common practices in the region.
- Recognize the importance of the staff's contribution, inform all members of the family, and establish a fair system of rewards.
- Recognize the potential of every member of the staff, institute a promotion system that clearly indicates the possibilities for advancement and the necessary steps to achieve it, and establish a system of ongoing education so that all staff members can constantly strive to improve.

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<sup>10</sup> Adapted from Poza (2004) by Louise Cadieux, UQTR, 2005. "Related staff" means members of the staff who are related to the family by blood or marriage.

CHAPTER 9

FINDING SUPPORT

Finding support before, during and after the transfer

Transferring a business requires external expertise.

Out of a concern for the continuity of their business, outgoing owners will seek advice and agree to be supported by skilled advisors, like those from the CTEQ, before making any final decisions. Table 1 presents each of the professions with their specific fields of expertise.

Table 1 Experts trained to support the business transfer process

Type of advice	Expert
Guidance and advice on the business transfer process for outgoing owners and successors, project coordination (plan and schedule) and collaboration with other advisors (below).	CTEQ business transfer advisor
Compares the performance of your business with that of other businesses in the industry, and identifies possible improvements.	Management advisor
Calculates the maximum amount of money to send to the governments.	Accounting advisor
Calculates the income tax that your heirs will have to pay.	Tax advisor
Knowledge of your rights and how to assert them; precise analysis of contracts of all kinds; preparation of a shareholder agreement, will, power of attorney, protection mandate, etc.	Lawyer, notary

Type of advice	Expert
Financing of the new business.	Accountant and financial management advisor
Provides advice on retirement and family estate matters, as well as investment advice.	Financial planner
Finds life insurance coverage that will be used to pay the owner's taxes upon death, and which can be used to buy out a business partner's shares in the event of his or her death; prepares a product portfolio for various assets of any kind.	Insurance broker
Evaluates the successor's skills and abilities; prepares a training plan and a career plan for the successor.	Workplace and organizational psychologist
Provides human behaviour counselling to a family member or to the entire family (choose the psychologist based on the nature of the problem).	Psychologist
Evaluates and assigns a value to the business to facilitate negotiations.	Chartered Business Valuator (CBV)
Develops strategic plans that can be used to make HR management decisions that will support the organization's future orientation.	HR advisor

It's a good idea to find an advisor who can act as a guide. The guide will develop an overall process and monitor its application. He or she must have the ability to take effective action in situations marked by conflict and strong emotions.

CTEQ's business transfer advisors are available to help you. Your CTEQ advisor will explain that this is an integrated process that requires various types of expertise, and that they will be working in concert with other experts (see Table 1). CTEQ advisors play roles as intermediaries and facilitators between owners, successors and experts. Throughout Quebec, they work to ensure efficiency, optimization and successful outcomes while staying completely neutral and maintaining confidentiality.

This list may seem very long, and you may be thinking: "My small business has never worked with this many outside advisors, and it's done just fine!" That's probably very true. But in the case of a business transfer, the goal is to plan the business's future for the next several years all at once. And your business has surely never had to put together a plan this big before!

This time, every aspect of your business has to be dealt with, and all at the same time. Not only that, but the interests that the family may have to give up also have to be taken into consideration. You can now see why the business transfer requires such a wide range of high-level expertise.

You may feel a bit ill at ease recruiting experts for this process. And that's not surprising, as this is a very delicate task. Remember that your CTEQ business transfer advisor can refer you to a network of experts who are familiar with the business transfer process and have already handled many different transfers in your region.

There are also ways to confirm their qualifications for yourself. We encourage you to do so, based on the following suggestions.

## Confirming qualifications

1. Training and experience. Here's a sample of the questions you can ask at your first meeting with any experts offering you services:
  - What training and experience do you have with business transfers?
  - How long have you been offering this service? Are you the only one who offers this service? If not, what distinguishes you from the others?
  - Are you a member of a professional order? If so, which one?
  - What specific training have you received with regard to family businesses? When? What is your experience with family businesses?
  - Can you give us an idea of the problems associated with family business transfers, and explain how you deal with them?
  - How long do you work with each client?
  - What other professionals do you work with? How do you work with them?
  - What can you do for us?
  - What can't you do for us?

You won't be able to evaluate the full content of every response. But you can judge the consistency and coherence of the expert's responses as a whole. Do they fit together logically with one another?

In particular, take note of the expert's reactions. Are the spontaneity, clarity and conciseness of his or her responses (while allowing for occasional pauses to think) more or less the same from the first to the last response? This is a good indicator to start with.

2. Qualities and attitudes. Pay attention to the experts' behaviour in relation to the following qualities and attitudes:
  - Patient, good listeners, don't interrupt when you're speaking. Periodically echo back their summary of things you've said.
  - Discreet, don't identify the other businesses they've worked with, and don't brag. In particular, they don't claim that they'll do the same things for you that they've done for their other clients, since each SME is a unique case.

Along the way, you'll be able to confirm whether such experts. . .

- Show tact and respect your pace. To do so, they constantly check that you understand the issues being discussed. If you don't understand what they say the first time, they repeat their explanations without making you feel inadequate or acting like a know-it-all.
- Know their limits — and if one ends up acknowledging them during the discussion, you're probably dealing with a trustworthy advisor.
- Establish a trusting relationship with each member of the family participating in the activity, whether they work in the business or not. Never take sides with one member of the family or staff.
- Never try to dazzle you with ready-made solutions; instead, they focus on identifying your real needs.

3. Considerations. You can continue your assessment based on the following points, which the expert should quickly address. Check whether they. . .

- Ask for information about the history of the business since it was founded.
- Establish a diagnostic of the business based on financial statements, records and other documents like strategic orientations and general operational objectives, and taking the size of the business into account.
- Ask about your will, your power of attorney or your intentions.

With regard to the family, watch whether the experts. . .

- Use tools like the genogram, allowing them to construct a family tree along with a portrait of the interactions within the family and their type.
- Are clearly interested in the family's values and able to identify them and help you to understand them, and explain the connections to the business's values.
- Take the personal and professional life goals of all family members into account, whether or not they work for the business. The goal is to better understand the transfer's impact on each of them, and to establish the family dynamic, which is generally different from the business's dynamic but has a strong influence on it.
- Ask to meet with each of the family members who work for the business.
- Show concern for the other members of the family who don't work for the business.

4. Risk assessment. To manage risk, you need to know what risks you face. Check whether the expert is familiar with this aspect of business transfers, and is actually able to perform a risk assessment. The goal is to perform both a diagnosis of the business's operations and a prognosis for future operations.
  
5. The evaluation will be complete when. . .
  - The expert notifies you relatively early in the process that the time has come to call on other skills;
  - He or she recommends other competent experts.

Throughout this process, rely on your own judgement.





## SECTION B

# LEADERSHIP TRANSFER TO A PROFESSIONAL MANAGER



### INTRODUCTION TO SECTION B

- SME owners all have to leave their position as the CEO some day. The goal is to keep the business running after they leave. There are two key aspects to replacing the outgoing owner with a new owner: ownership and leadership. This important step poses certain risks for the SME. An extensive process of reflection is needed to prepare for the transfer.
- Section B focuses on the case of a family business that will be led by a professional manager:
  - Majority ownership of the business remains in the family's hands.
  - The leadership role is no longer held by a family member.
- We will use the term "successor" to refer to the person who takes on the overall leadership of the business in place of the current head (the "outgoing CEO"), who is often the sole proprietor or co-owner of the business.

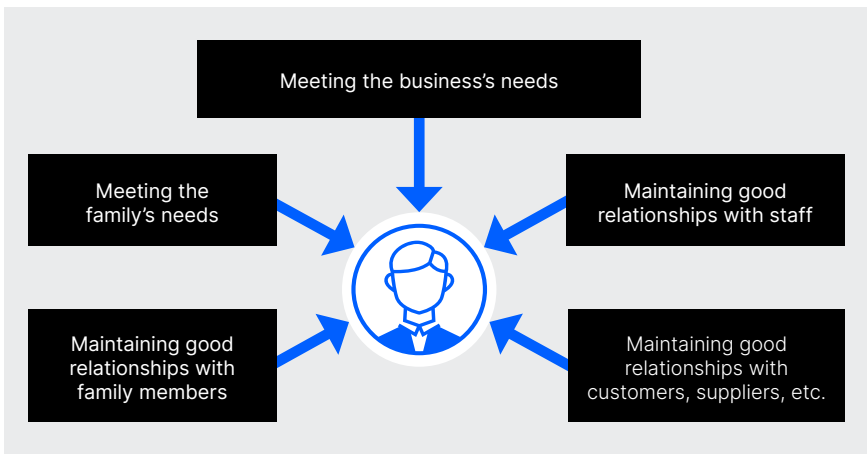
### **The family business will be led by a professional manager from outside of the family**

The circumstances are that either. . .

- No member of the family is willing or able to take over leadership of the business, or
- The designated family successor isn't ready.

In either of these cases, an outgoing CEO may decide to bring in a professional manager, whose mandate will be to take care of the business until a permanent successor is found.

Figure 1 Primary concerns of a professional manager at the head of a family SME  
from Louise Cadieux, UQTR, 2005



As seen in Figure 1, professional managers need to take a variety of different dynamics into account, the first of which is of course to manage the business. They also need to build relationships with the leadership team, staff, customers and suppliers, and with the family as well (both the family members who work for the business and those who do not).

This is a complex situation. But it's possible to make the most of it and harmonize these different human aspects of the process. Here are some initial thoughts.

First practical solution: finding a skilled successor

Before bringing in a professional manager, the outgoing CEO will want to examine the candidates closely:

In terms of their training

- The managers' education, training and experience as they relate to the unique aspects of the industry,
- Their career and business goals.

### In terms of their ability to manage the business

- Their knowledge of the industry in which the business operates,
- Their commitment to the business's mission and their ability to mobilize the troops,
- Their willingness to surround themselves with an effective team whose members complement each other well,
- Their openness to staff members with whom the outgoing CEO or the family have a special connection,
- Their openness to customers, suppliers or any other outside actor with whom the outgoing CEO and the family have a special connection.

### In terms of the relationship with the family

- Their ability to understand and sincerely respect the values that the family considers important,
- Their ability to establish relationships with the family,
- Their ability to manage the business in accordance with the family's interests.

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There will be reactions from the family.

You won't be able to plan every detail before the new manager arrives. But one thing is certain: once the new manager has stepped into his or her role, some family members will take a different view of the situation. Some of them will want to work in the business, while others will no longer be interested in staying. In either case, the professional manager must respect the choices they express.

To make things easier, the outgoing CEO will want to check in with family members about their openness to the new manager. We recommend that outgoing CEOs draw on their relationship with family members to sound out their opinions—whether in spontaneous meetings, planned interviews or in a family council meeting.

### A second practical solution: self-knowledge

For the professional manager, it's a good idea to meet each member of the family early on. Later, the manager and the family members can each get to know each other better so that their respective goals and aspirations are clear.

To do this, the manager may wish to call on expert advisors in workplace and organizational psychology. Among other things, such experts have tools to provide the different parties with structured knowledge of themselves. The ideal would be for outgoing CEOs to start preparing a profile of each family member themselves. But only as a start, for the time being. That should be enough to encourage the professional manager to continue — after all, it's important to give the successor some space to make his or her own way forward!

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To ensure that every member of the family understands the transfer process, you'll need to talk about it. Then, you'll have to make sure everyone understands that it's essential to consider the needs of the business — which are not the same as the family's needs. One of the available tools here is to set up a family council.

### A third practical solution: the family council

Made up of family members, whether they work for the business or not, the family council discusses the family's interests and concerns.

Its primary responsibilities are to. . .

- Ensure that the family's interests in the business are respected by the board of directors, and
- Provide members with support, mainly of the interpersonal and financial variety.

Its general tasks are to . . .

- Ensure the quality of communication between all members,
- Develop a clear understanding of the family values and traditions embraced by the business and make them known, especially to new members,
- Maintain the family's and the business's good name,
- Identify each family member's abilities and relate them to the business's goals,
- Encourage members to pursue business training, and
- Institute conflict resolution mechanisms.

And its specific tasks are to . . .

- Set up a succession plan that is transparent for everyone,
- Take positions on problems relating to the transfer of ownership, and
- Determine who will be responsible for the family's activities after the CEO leaves.

To operate successfully, the council must . . .

- Establish rules of participation, e.g. the composition of the council based on the nuclear family (father, mother and their children) or based on the extended family (including sons- and daughters-in-law and grandchildren), and how to deal with cases of divorce or discipline, and
- Define rules of procedure for its meetings: invitation process, agenda, minutes, etc.

Warning. The presence of a family council in no way guarantees that this process will go smoothly. It is not suitable for all situations. It is a recommended tool, not a mandatory step.

## SECTION C

# TAX ASPECTS OF OWNERSHIP TRANSFER



## INTRODUCTION TO SECTION C

- SME owners will have to leave their position as the CEO some day. The goal is to keep the business running after they leave. There are two key aspects to replacing the outgoing owner with a new owner: ownership and leadership. This important step poses certain risks for the SME. An extensive process of reflection is needed to prepare for the transfer.
- Section C focuses on tax aspects of the ownership transfer.



## CHAPTER 1

# TAX ASPECTS WHEN OWNERSHIP STAYS WITHIN THE FAMILY

This chapter is for a business seeking to continue its activities as a family business. The family retains ownership.<sup>11</sup>

We will examine the primary options available to outgoing owners and their successor. The tax implications of these different options must be carefully evaluated by their advisors (see Chapter 9, *Finding support*, in Section A). Note that the outgoing owner's decisions must take into account the factors mentioned in Section A, which covers family succession.

We will use the term successor to refer to the (natural or legal) person who will replace the current head of the business, namely the outgoing owner, who is often the sole proprietor or co-owner of the business and does not intend to liquidate it.

Some key points to clear up before we begin:

- Ownership of a business resides in its assets or its shares, depending on the legal form of the business (sole proprietorship, partnership, business corporation, etc.).
- This chapter covers ownership transfers between business corporations only.
- The transfer can be total or partial, and be completed gradually or in a single step. For example, the outgoing owner may wish to spread the transfer out over time, retain a certain number of shares, or retain certain assets like a building or an investment.

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<sup>11</sup> In most cases, leadership of the company will be entrusted to a member of the family. In some cases, it is transferred to a professional manager instead. This chapter applies to both of these options (which are described in Section 1.3, "Detailed options," in the "Introduction" guide. See options A and B).

We will look at the following points in order:

- 1.1 Types of family ownership transfer
- 1.2 General tax conditions
- 1.3 Other relevant issues

### 1.1. Types of family ownership transfer

In a family context, ownership of a business can be transferred in three ways:

1. Assignment (straight transfer)
2. Estate freeze
3. Creation of a trust

#### 1. Assignment

The business is handed over to a related person, i.e. a family member or relative. The transfer can then take one of two forms:

- Gift (or donation)
- Sale

A gift transfer is free. In a sale, the outgoing owner is paid in liquid assets. A gift has a major disadvantage: it does not produce any cash for the outgoing owner.

#### TAX IMPLICATIONS

Despite its simplicity, an assignment via gift or sale has significant tax implications: the outgoing owner must declare a capital gain, because it is taxed. In compliance with tax laws, you'll have to determine the business's fair market value (FMV).

Under certain specific conditions that your tax advisor can explain to you, the outgoing owner may be able to . . .

- Claim the capital gains exemption,<sup>12</sup>
- Defer part of the capital gain to later tax years (capital gains reserve), or
- Reduce the capital gain by using earlier capital losses.

These latter points are explained in Section 1.2.

## 2. Estate freeze

A. An estate freeze consists of exchanging assets that will increase in value (participating shares) for assets whose value will remain fixed (frozen, non-participating, preferred shares). The participating shares belong to the new owner.

### Circumstances

You may want to consider an estate freeze if . . .

- The successor has been identified, and
  - The business has acquired enough value for the outgoing owner's needs.
- The circumstances are discussed in detail in Section 3.1.

### Procedure

The value of the business is “frozen” as at a given date. The future growth in value will accrue to the participating shares. The objective is to attribute the increase in the value of the shares to the new owner, starting from the date of the freeze.

### TAX IMPLICATIONS

This type of transfer makes it possible to avoid the tax implications that would normally apply to the transfer, and to defer those tax implications to a later date, for example when the frozen, non-participating, preferred shares are redeemed.

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<sup>12</sup> It was \$824,176 in 2016 and is indexed annually.

### Advantages

An estate freeze has a simple structure and is easy to implement. In addition, it allows you to . . .

- Get an idea of how much income tax will have to be paid upon the outgoing owner's death,
- Split the income among family members, while complying with anti-avoidance measures,<sup>13</sup>
- Teach your successor about the inner workings of the business and financial concepts,
- Engage the successor by putting him or her in a situation that creates responsibilities and requires choices, and
- Integrate the successor in an orderly and gradual way.

### Beneficiaries

In general, the beneficiaries of an estate freeze will be members of the next generation, i.e. the outgoing owner's children, grandchildren, nieces or nephews. This type of transfer has no tax implications for them.

### B Forms of estate freeze

An estate freeze can be done in one of three ways:

- Reorganization of capital (exchange of shares, traditional freeze)
- Sale to a holding company (traditional freeze)
- Sale of assets (reverse freeze)

A reorganization of capital can be carried out under the same business identity. The other two forms require the creation of a new legal entity.

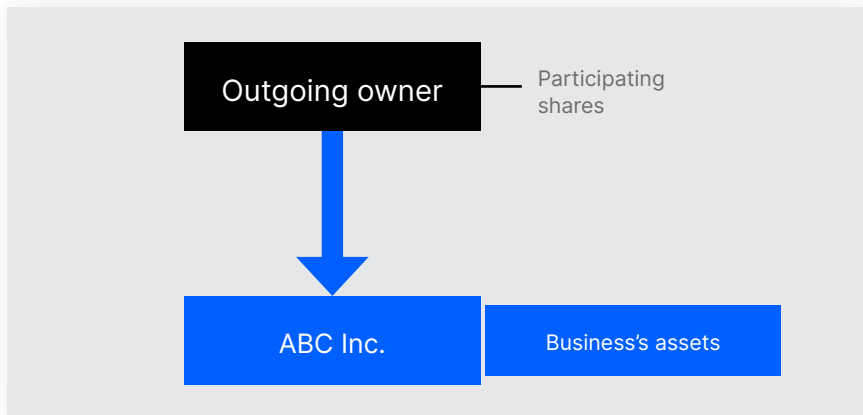
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<sup>13</sup> Tax rules that prohibit the use of certain tax reduction strategies.

## C Illustration of the different forms of estate freeze

Let's start by characterizing the situation before the ownership transfer, as illustrated in Figure 1. The outgoing owner owns all the participating (common) shares of a business corporation (ABC Inc.).

Figure 1 Initial situation



Participating shares are shares that give the shareholder the right to fully participate in the company's profits and in the growth of the company's value. Common shares are a good example of this type of shares.

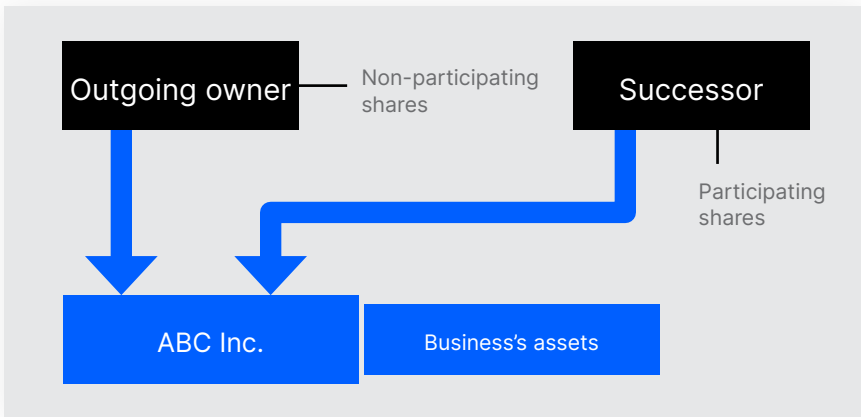
In contrast, non-participating shares (in a freeze) only receive the dividend amount specified in the articles of incorporation.

### Estate freeze via reorganization of capital

A reorganization of capital consists of reconfiguring the share capital, or simply carrying out an exchange of shares.

In simple terms, it involves the outgoing owner exchanging participating shares for frozen, non-participating shares.

Figure 2 Situation after a freeze via reorganization of capital

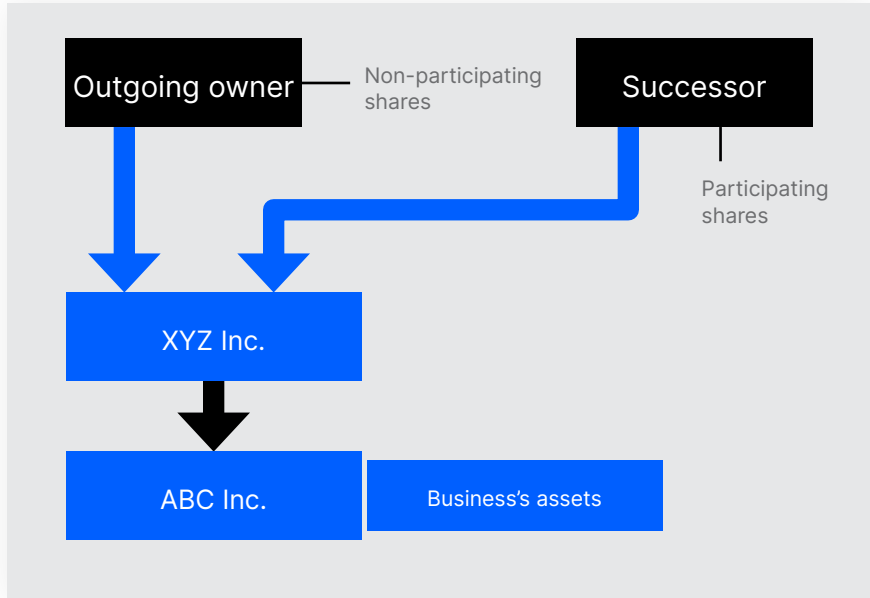


- The business's capital has been reorganized: the participating shares are now held by the successor. For outgoing owners, this step consists of exchanging their shares for shares of another category. The new shares have the same tax characteristics as the old shares.
- The same company "ABC Inc." continues to operate the business.

### Estate freeze via sale to a holding company (also known as a "traditional freeze")

The outgoing owner transfers the participating shares in his or her business corporation to a new company, a holding company.

Figure 3 Situation after a freeze via holding company



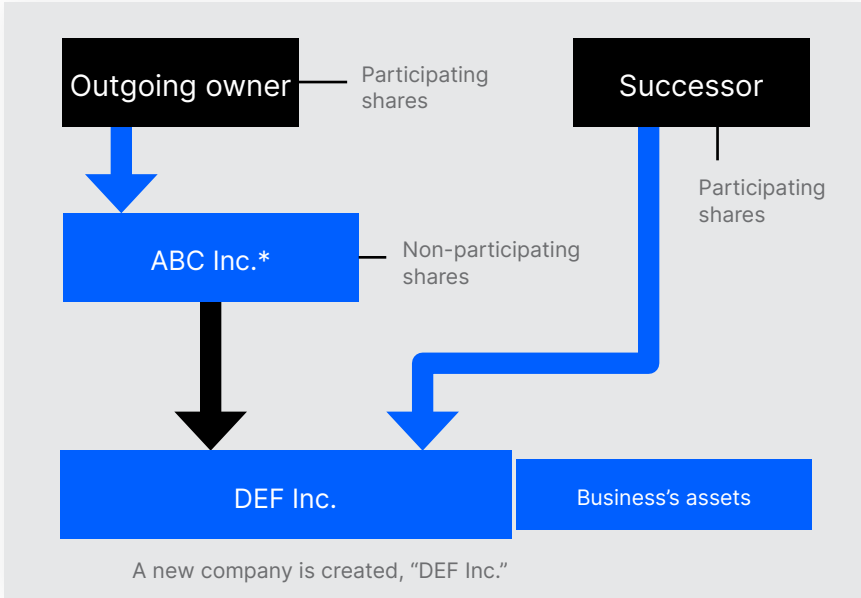
- The holding company, “XYZ Inc.,” has been created and has issued non-participating shares for the outgoing owner and participating shares for the successor.
- The same company “ABC Inc.” continues to operate the business. But it is controlled by the holding company.

Estate freeze via sale of assets (also known as a “reverse freeze”)

The original company, which holds all of the business’s assets, transfers some assets to a new business corporation and receives non-participating shares in return.

The new company issues participating shares for the successor.

Figure 4 Situation after a reverse freeze



\* Non-transferred portion of the original ABC Inc.'s assets

- “ABC Inc.,” the original business corporation that held all of the business’s assets, has transferred some of its assets to “DEF Inc.”
- “DEF Inc.,” the new business corporation which has been created. . .
  - Has issued non-participating frozen shares to “ABC Inc.” in exchange for the assets it received,
  - Has issued participating shares for the successor,
  - Will now operate the business.
- The former owner retains participating shares in “ABC Inc.,” which may have kept certain surplus assets, such as a building or investments.



### 3. Creating a trust

#### Circumstances

Creating a trust is an option to consider in the following circumstances:

- The successor has not been identified.
- The business is of little value or its future is uncertain.

#### Procedure

- The outgoing owner receives non-participating shares in the same way as in an estate freeze via reorganization of capital (see Figure 2).
- The trust company, not the successor, will hold the participating shares in the original company. It will hold them for a certain period of time.
- The outgoing owner will then act as the administrator, or will appoint trusted administrators. The decisions will be made by the trust company.
- The trust company will administer the successor's shares and will report to the outgoing owner.

#### TAX IMPLICATIONS

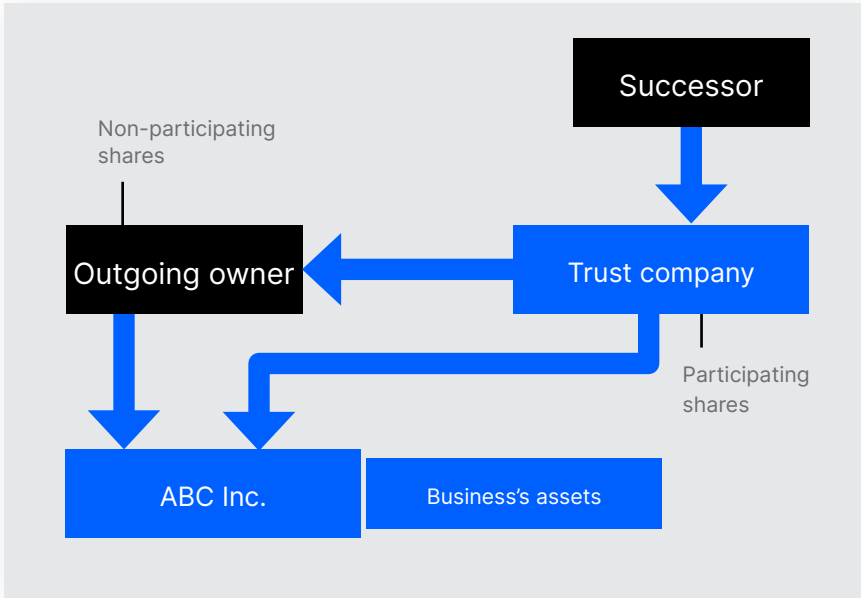
This type of transfer makes it possible to avoid the tax implications that would otherwise apply to the transfer, and to defer those tax implications to a later date, for example when the non-participating shares are redeemed.

#### Advantages

Creating a trust allows for . . .

- Greater flexibility in how the future growth in the business's value is apportioned,
- Income splitting.

Figure 5 Reorganization of capital using a trust company



A trust company has been created as part of a reorganization of capital:

- The trust company (not the successor) will. . .
  - Receive the participating shares in the original company,
  - Hold them for a certain period of time, and
  - Administer the successor's shares and report to the former owner, as indicated by the arrow.
- The former owner. . .
  - Has received non-participating shares in the same way as in an estate freeze via reorganization of capital (see Figure 2),
  - Acts as the administrator, or appoints administrators whom they trust. The decisions will be made by the trust company.
- The same company "ABC Inc." continues to operate the business, but it is controlled by the trust company.

## 1.2. General tax conditions

- Exemption. To reduce the tax implications of the business transfer, the outgoing owner can take advantage of provisions like the capital gains exemption<sup>14</sup> for “qualifying small business shares” and “farm property.”
- Deferral. It is possible to defer the capital gain over a period of five years (capital gains reserve). In this case, any sellers (outgoing owners) do not receive the full profits from the sale at the time of the transaction, but only a fraction of it. This allows them to pay less in taxes than if they had received the whole payment at once.
- Previous losses. To reduce the capital gain, it can also be beneficial to take advantage of any previous capital losses that have occurred.

Throughout this process, remember that professional assistance from your tax advisor is a must!

## 1.3. Other relevant issues

### General issues

- A business transfer must include estate planning and the preparation of a will.
- Outgoing owners need to come to terms with the need to separate themselves from their business. Losing the control that they were accustomed to having over the business is probably the most serious drawback the owner will have to deal with.

### Issues specific to an estate freeze

- The right time to proceed with an estate freeze will depend on . . .
  - The outgoing owner’s age and need for financial security,
  - The size and composition of the estate (value of the business and other assets), and
  - The successor’s age and degree of preparation. So it may be wise to wait until a certain age before doing an estate freeze.

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<sup>14</sup> It was \$824,176 in 2016 and is indexed annually.

- In order for an estate freeze to be a reasonable option, the business should have good growth potential.
- A freeze is not an irreversible operation. It is possible to “unfreeze” an estate under certain conditions.

Certain precautions are called for before proceeding with a freeze.

- To avoid giving family members who do not work for the business the impression that they're not being treated fairly in comparison to those who do work for the business, it's a good idea to issue distinct compensation for work (salaries) and for capital (dividends).
- Potential successors may be looking to get rich quick, which may have an impact on their diligence at work or in their studies as they anticipate stepping in as the successor. The choice of when to carry out the transfer should therefore be made with care.

## SECTION D

# FINANCING ASPECTS OF OWNERSHIP TRANSFER



## CHAPTER 1

### FINANCING WHEN OWNERSHIP REMAINS WITHIN THE FAMILY

- SME owners all have to leave their position as the CEO some day. The goal is to keep the business running after they leave. There are two key aspects to replacing the outgoing owner with a new owner: ownership and leadership. This important step poses certain risks for the SME.
- Section D focuses on financing aspects of the ownership transfer.

#### Financing the “new” business that continues to be owned by the family<sup>15</sup>

A key step in transferring a family business to a new generation involves financing the transaction. Outgoing owners must be given compensation for the business they are passing on to the successor. The successors, for their part, have to pay a substantial amount of money.

The financial issues for the new family business are the amount of financial resources available to pay the selling price, and the sum total of assets that can be used as collateral for a loan.

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<sup>15</sup> In most cases, leadership of the company will be entrusted to a member of the family. In some cases, it is transferred to a professional manager instead. This chapter applies to both of these options (which are described in Section 1.3, Detailed options, in the “Introduction” guide. See options A and B).

We will use the term “successor” to refer to the (natural or legal) person who will replace the current head of the business, namely the outgoing owner, who is often the sole proprietor or co-owner of the business and does not intend to liquidate it.

#### The transaction is completed in cash.

Section 1.1 discusses the key aspects of this type of transfer. But quite often, what happens is this:

#### Only part of the price is paid, leaving a balance.

This balance may be . . .

- Paid by the new business over a certain period of time agreed to by the parties, by means of a dividend, compensation (salary), or the outgoing owner's shares created by a financed estate freeze.<sup>16</sup> Section 1.2 discusses the main types of financing.

### 1.1 The transaction is completed in cash

Using their own funds, other financing that they have access to, or a combination of these options, successors can pay the full selling price to the outgoing owner and end up owing no remaining debt to them.

This approach carries no risk for the outgoing owners, since they receive the full amount that was agreed to.

#### Family resources

These are the successor's own financial resources and those of their spouse and/or their respective families.

#### Bank loan

The new business acquires a bank loan via secured debt or unsecured debt.

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<sup>16</sup> Estate freezes are explained in Chapter 1 of Section C, Tax aspects when ownership stays within the family.

Secured debt is secured by the business's assets (inventory, accounts receivable and fixed assets). At the same time, it is also limited by the value of these assets.

Unsecured debt can take the form of an equity loan or subordinated debt.

Note. These debts must not interfere with the new business's operations or growth.

### 1.2 Financing the remaining balance

The options below carry risk for the outgoing owner, because he or she is helping to finance the sale.

#### Balance of sale

The balance of sale is the part of the price that the successor does not pay at the time of the transaction. In other words, agreeing to a balance of sale means that the outgoing owner will not be immediately paid in full. The remaining balance will be paid back in periodic instalments. The outgoing owner generally agrees to be paid back at a specific interest rate over time, as with a mortgage.

This is a simple, low-cost and flexible form of financing. However, the outgoing owner assumes the risk, and has few options for securing the debt. It's a good idea to consider taking out a life and disability insurance policy on any successor(s) to protect against these risks. But the outgoing owner can also benefit from spreading out their tax payments over time.<sup>17</sup>

#### Funds generated by the business

The new business should be profitable and produce net earnings that can then be used to pay the former owner. The funds generated by the business generally correspond to the new business's net earnings, plus depreciation.

Payments to the former owner can take the form of dividends, remuneration (salary), or a purchase of the former owner's shares.

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<sup>17</sup> This benefit is explained in Chapter 1 of Section C, Tax aspects when ownership stays within the family.



### Financial partners

These are public or private investors that have no connection to the business. The best-known investment institutions in Quebec are the Caisse de dépôts et placements du Québec (CDPQ), the Business Development Bank of Canada (BDC), Fondation CSN, the Fonds de solidarité des travailleurs du Québec (FTQ), Capital Régional et Coopératif Desjardins (CRCD) and Investissement Québec (IQ), among others.

- The terms of the investment (equity interest, equity loan or subordinated debt) will vary depending on the financial partner.
- Some take part in managing the business, and some don't.
- Those who do take part in managing the business have two points in common:
  1. The partner appoints a representative to the business's board of directors, who remains in that position as long as the partner is a shareholder;
  2. An initial payment of around 20% to 30% of the business's value is made to the former owner. The former owner's remaining shares and the partner's shares will be bought by the new business over a period of 5 to 10 years.

### 1.3 Other relevant aspects

- These different types of financing can be combined. In other words, the successor can draw on multiple types of financing to become the new owner. In fact, this is becoming the most common pattern.
- In some cases, the family connection leads outgoing owners to provide their successor with a certain degree of flexibility, even if they have to extend their disengagement period as a result. However, this benefit increases the risks for the outgoing owner.
- The successor may be asked to personally co-sign the loans taken out by the business.
- Due diligence is a must before agreeing to a business transfer. This is an essential recommendation that will allow the successor to evaluate sales, financial and legal information about the desired business to determine whether to proceed with the acquisition.

Working with an experienced advisor is clearly a very smart option. Read Chapter 9 in Section A, Finding support, to start looking for appropriate support.

For information purposes only, let us close by mentioning one last point:

- Successors who have to take on personal debt will have to pay that debt back with after-tax dollars, which means they'll be faced with significant additional financing costs.
- Life insurance. Life insurance secures the business's survival in the event of the former owner's death (while money is still owed to him or her) or that of a shareholder. The premium, which takes the insured person's age and state of health into account, may become quite expensive as the person gets older.

# NTCO

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