SELLER'S GUIDE 2

INTERNAL AND EXTERNAL SUCCESSION

Centre de transfert d'entreprise du Québec

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In this document, the use of the masculine gender is intended to simplify the text.

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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.

Centre de transfert d'entreprise du Québec
440 René-Lévesque Blvd. West, Suite 1501
Montreal, Quebec H2Z 1V7

Tel.: 1 844 200-2837
info@ctequebec.com
www.ctequebec.com

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Project lead: Gaston Drolet, Direction du développement des entreprises (business development branch)

Collaboration: Sophie de Courval, CPA, *Direction du développement des entreprises*
Denis Hébert, CA, M.Fisc., *Direction du développement des entreprises*

Subject-matter experts: Louise Cadieux, DBA, department of management science at Université du Québec à Trois-Rivières
Alain Samson, Société-conseil Alain Samson
François Brouard, DBA, CPA
Éric Sprott, School of Business, Carleton University

Project managers: Marie Roy and Pierre Lachance
Editing: François Grenier

For information about the content of this publication, please contact the *Centre de transfert d'entreprise du Québec*.

On behalf of the *Centre de transfert d’entreprise du Québec*, I am pleased to present our guide developed especially for managing owners in Quebec 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 considering an internal (co-op or family), external or or mixed type of ownership transfer, preparing properly and surrounding yourself with experts in the field 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.

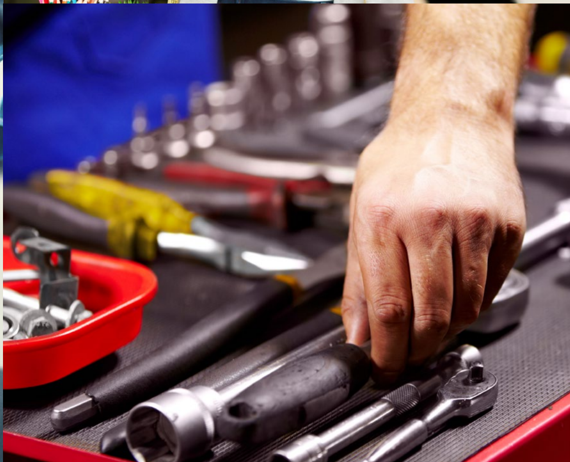
Martin Gagnon
Co-President and Co-CEO, National Bank Financial
Executive Vice-President, Wealth Management

BANQUE
NATIONALE

INTRODUCTION

BUSINESS SUCCESSION ISSUES

Centre de transfert d'entreprise du Québec



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

	T	F
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.	☐	☐

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

	T	F
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.	☐	☐

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
	☐	☐

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
	☐	☐

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
	☐	☐

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 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 main challenges of succession outside the family*, for more on this topic.

8. 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 6 of Section A, *Preparing the staff* or *Chapter 3* of Section B of this guide, depending on whether the successor is a family member; or Chapter 8 of Section A in Seller's Guide 1.

	T	F
9. 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.	☐	☐

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 repeat mistakes made by other business owners? Instead, look for assistance relevant to your needs by consulting Chapter 7 of Section A, *Finding support*, in the case of a transfer to a non-family member; Chapter 4 of Section B, *Finding Support*, if there is no successor; or see Chapter 9 of Section A, *Finding support*, in Seller's Guide 1 if there is a successor within the family. Don't face this challenge on your own.

	T	F
10. 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.	☐	☐

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

	T	F
11. 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.	☐	☐

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*.

—

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.

- This guide is the introduction to the collection of guides on the business transfer process for SMEs.

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 oversight 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. Thousands of businesses could close their doors in Quebec within the next 10 years.[1]

Most Quebec SMEs are family-owned businesses. 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. In recent years, businesses have also tended to focus 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.

1 *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 are 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.

   All the aspects of family succession are covered in Seller's Guide 1.

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 will increasingly see in the coming 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, no matter what 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 or even more interesting.

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).[2] 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.

   All the aspects of family succession are covered in Seller's Guide 1.

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 staff members? The business would then be in the hands of people who care about its success and who are familiar with how it works. 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, and may be the only way to go if all their wealth is tied up in it.

However, this type of sale 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 solid balance sheet, is the best way to ensure you get top dollar for your business if you sell.

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 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. An example would be a small retail store that has been in business for generations and is currently producing only a minimal annual profit, but that is 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 its *leadership* is entrusted to a 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 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.[3] Here are the major advantages and disadvantages. According to the

3 Cooperatives Act (R.S.Q., c. C-67.2), section 3.

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.[4]

Learn more about our cooperative buyout support program: www.ctequebec.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 in order to take over;
- Preservation of jobs, participation in the business's profits, reinforcement of a sense of belonging (motivation) and the right to have a say in 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.

<u>Selling to one or more minority shareholders</u>

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.

And this option. . .

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

4 Definition used by the *Ministère de l'Économie et de l'Innovation*.

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.

The foregoing 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 aspects of succession outside the family are covered in this guide.

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 aspects of an external sale are covered in this guide.

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, or
- 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.

Decisions about the transfer are the family's and outgoing owner's responsibility. We will 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.

Before we begin, we should note that there 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 that 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 can 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. Just like a human being, a business goes through different stages of life: creation, development, consolidation, levelling off and decline. These steps are not linear and the raison d'être of the management team is precisely to prevent the decline. 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.

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,[5] 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

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.

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.

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 <u>role</u> they can play within that system. . . if any!

Only under these conditions can the organized systems help the business to run efficiently and ensure its growth.

Which brings us back to our original matter of succession: <u>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.</u> 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.

I) <u>Family interference in the business</u>

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 looking 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.

For more information, read Seller's Guide 1 on family ownership transfers.

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 leader 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 while embroiled in a long legal battle. So it's better to professionalize your organization.

SECTION A

LEADERSHIP TRANSFER FOR SUCCESSION OUTSIDE THE FAMILY

Centre de transfert d'entreprise du Québec

INTRODUCTION TO SECTION A

- All SME owners will have to relinquish their leadership role some day. The goal is to keep the business running after they leave. There are two aspects to replacing an outgoing owner: the transfer of ownership and the transfer of leadership. This important step poses certain risks for the SME. Deep reflection is needed to prepare for the transfer. This collection examines the associated issues and prepares you to take the necessary actions.
- Section A deals with the leadership transfer in SMEs where the successor is not a family member. In other words, the leadership and ownership change hands.
- We use the term "successor" and "buyer" to refer to the person who will replace the current CEO (the seller), who is often the sole proprietor or co-owner of the business.

CHAPTER 1

THE MAIN CHALLENGES OF SUCCESSION OUTSIDE THE FAMILY

Sooner or later, owners of family-owned businesses who have been at the helm for many years sense that the family will not be as involved, if at all, in the business. The company will probably pass into other hands, and there is a growing likelihood that it will not be run by a family member.

At the same time, they wonder about how the company will perform when they're no longer in charge. They want the business to thrive.

This is the time to prepare for the company's future and to define a new role for themselves.

Issue #1: What form of business continuity should you choose?

In this case, you have a few options to choose from. Let's review them:

- Sell to one or more staff members, with or without the formation of a cooperative;
- Sell to one or more minority shareholders;
- Sell to one or more business partners.

You can read about the pros and cons of each option in sections 1.2 *Business continuity options* and 1.3 *Detailed options* in the Introduction. Take the time to reflect on these options.

Issue #2: Some factors have a crucial impact on the transfer.

Regardless of which option you choose, the transfer period is a risky time for any business. Keep the following important factors in mind.

Human factors play a strategic role in the success or failure of the business transfer.	Although a business transfer entails a financial risk, there is also the human factor. The number one human risk is that the outgoing owner will refuse to step away from his business and therefore will not prepare for succession. Another example: the owner's unexpected departure due to death or illness considerably increases the risk that the transfer will fail.
Other factors reduce the risk.	Conversely: • The chances of a successful transfer are definitely greater if the buyer is familiar with the company's industry. • There is almost no risk in the case of a family transfer. • A manager who takes over the business is twice as likely to succeed as an outside buyer.[6] • The risk of failure is 150% higher for a buyer who is not familiar with the company's industry.[7]
The seller's presence during the transfer has an impact.	• The seller's presence when handing over the reins avoids complicated situations. • The risk of failure is 50% lower when the seller stays on during the transition. • There is, however, a caveat: see box 1 on the next page.
An experienced buyer increases the chances of a successful transfer.	• The buyer's experience in the company's industry is important. • The buyer's knowledge of the industry can be more important than his management experience. • A former manager from the same industry is twice as likely to succeed as a manager from another industry.

While it is highly recommended that the outgoing owner be present when handing over the reins, he must also be comfortable with the decision to gradually step away. This is essential for the successor to take on his responsibilities.

Box 1 Guidance* from the outgoing owner: it makes good business sense

Keeping the outgoing owner in the organization during the handover period is not easy. Although his presence can reassure employees, it can also make it difficult for the new owner to establish his legitimacy and credibility.

* Guidance comes into play in stages 3 and 4 of the transfer process.

Practical solution

The following tips will help you regardless of which option you choose, and should be considered along with the success factors discussed above:

- Clearly announce your intention to step down from leading the company.
- Find new interests well before you exit the company.
- Agree to gradually reduce your role before completely stepping aside.
- Agree to pass on your knowledge.
- Accept the need to prepare for a transfer and to guide the new owner during the transition.

On a personal level:

- Set new goals that are both realistic and motivating; or
- Take on new challenges at the family, social and individual levels; or
- Channel your energy into recreational, business or other activities that you've always loved; or
- Accept your new financial situation. Consulting a financial planner can help with this.

The buyer's chances of success increase when:

- The business is sold to an insider as opposed to an outsider.
- The buyer has experience in the company's industry.
- The buyer is well prepared.
- The seller helps the buyer to assume his leadership role.
- The business is sold to two buyers with complementary skills.

CHAPTER 2

IDENTIFYING YOUR SUCCESSOR

Owners who care about the future of their business need to think about certain things if they want to make sure their life's work is left in good hands. First, how do you go about finding a successor with the right skill set and who is prepared to get involved in the business? And if you're going to guide the new owner, how do you make sure that your visions are aligned?

When it comes to choosing a successor, ask yourself:

- Will I be able to guide the new owner? If so, how?
- What type of relationship do I currently have with this person?
- Am I prepared to share all my knowledge with him?
- Does the successor have a good relationship with the staff?
- Does the person have what it takes to take charge of the business?
- What are his personal goals?
- What are his business objectives?
- Are key employees receptive to the new leader?
- What about relationships with vendors, customers and other external stakeholders?
- What is the timetable?

These questions are best addressed now and not during the process, which could slow it down and discourage you. Here are some tips for a smooth transfer process.

Tip #1

Start by looking at the various transfer options:

- Selling to one or more staff members, with or without the formation of a cooperative;
- Selling to one or more minority shareholders;
- Selling to one or more business partners.

These options are viable if the new owner has the necessary skills and a real interest in seeing the business succeed.

Take the time to think about these options. You can read about them in sections 1.2 *Business continuity options* and 1.3 *Detailed options* in the introduction.

The next tip can help you choose an option and get started on the selection process.

Tip #2

To choose a successor:

1. Take 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 define a realistic vision for the company based on its strengths, weaknesses, opportunities and threats.
2. Next, keeping in mind the criteria presented later in this chapter, prepare a detailed list of the skills that the successor will need to have to take on these challenges.
3. Now use your list to evaluate each potential candidate or group of candidates.
4. Discuss your evaluations with your advisors or family members. This will provide you with additional input that you might not have considered and that will inform your comparison.

5. Look carefully at the candidates’ progress and performance at work. This will of course be easier if they are working in the business, and the chances of success will be higher.
6. Make the most informed choice possible!

As mentioned earlier, the chances of success are greater if the new owner is genuinely interested in the business and has the necessary skills. At this point, you might be asking yourself, “But how can I be sure my successor has the necessary skills and wants to get involved in the business?”

Tip #3

Skills

To make an informed choice, you must ensure that the candidate has four different types of skills. First, consider essential basic human qualities; then look at technical and management skills; and finally, complete your evaluation by considering the candidate's business acumen. Let’s take a closer look at each of these qualities.

1. Essential basic human qualities

- Open-mindedness, which includes confidence, determination, perseverance and, especially, 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 of this is the 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-day business. This training must be matched by decision-making abilities, which are acquired with experience.
- Management also includes the ability to motivate others, in other words, leadership. Leaders can show their leadership qualities in different ways. They:
  - 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);
  - Know how to 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;
  - Act as an inexhaustible source of positive energy to establish relationships, build their social and business networks, and become an asset to the community.

4. Business skills

Broadly speaking, the entrepreneurial personality is characterized by originality and a non-conformist mindset. A 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;
- 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.

CHAPTER 3

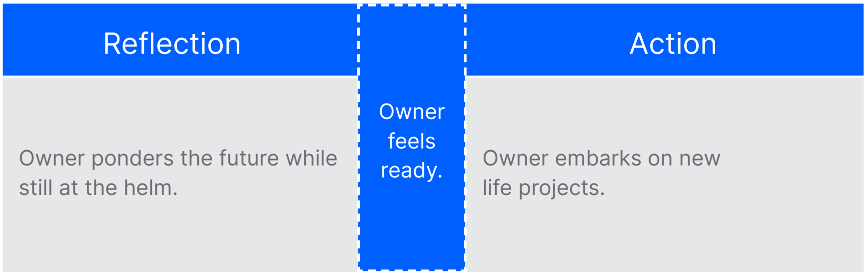
PREPARING THE OUTGOING OWNER

We can prepare for a stage of life when we know what it involves. We can navigate through it successfully if we replace our fears with acceptance and view it as a project.

For the outgoing owner, stepping down as CEO does not happen overnight. It's a long process.

As shown in Figure 1, this process begins when a business owner realizes that he will not be around forever, and ends on the day when he leaves his business for good.

Figure 1 Owner's disengagement process



Reflection period. As the business owner starts to think about other life projects, forming ideas of what he would like to do, he discovers that he doesn't know how to make them happen. And the more new projects he comes up with, the more uncertain he feels, leading him to seek reassurance about his plans from those closest to him.

This is the stage when he is most likely to resist change in both his personal and professional life. The sooner you define and believe in a new life project or a group of projects, the sooner you'll feel ready to move on to the next critical phase of the process: making them a reality.

<u>Owner feels ready.</u> While they will surely have arisen much earlier, the following points will become especially impactful once you feel ready to pass the torch:

- Is this the right time to sell? For you? For the company? For the prospective successor(s)?
- Is there a potentially interesting market for the company?
- How far are you prepared to go?
- Are you prepared to guide the new owner? If so, for how long and under what conditions?

<u>Project implementation period.</u> The fact that an outgoing owner has officially stepped down doesn't mean that the disengagement process is over. Quite the contrary. Rather, it is the beginning of a new path, along which he will encounter a number of surprising obstacles.

First, although he learned to gradually distance himself from the company during the reflection period, once he is no longer in charge, a former business owner typically goes through a slump that can last anywhere from three to six months, during which he feels helpless—and above all, disoriented. This is because, although he has new life plans, he doesn't quite know where to begin. There is also the matter of how to deal with the company's new leadership. How can he provide guidance and advice while giving the new owner the independence that is rightfully his?

The owner will eventually become comfortable in his new way of life, in which he will learn to find meaning and comfort.

These moments are normal steps in the process. To reorganize your life once you have exited the business, you will need to:

- Choose to take charge as you have always done;
- Let go of the past and live in the present;
- Focus on the new (and realistic) goals you set for yourself involving things you love to do (recreation or business) as well as new areas of interest, while taking up new challenges if you so desire;
- Build rewarding relationships on new foundations with family members, friends, your community or members of your social or business network, sharing the knowledge you have worked so hard to acquire over the years;
- Above all, keep an open mind.

How can you make this happen with minimal stress?

Practical solution

First, pay attention to signs that it’s time to move on to the next stage of your life.

For example:

- A defining event such as an illness or death of a relative or close friend;
- The realization that your 60th birthday is around the corner;
- Signs of physical or mental fatigue;
- Satisfaction that you’ve achieved what you set out to do and the need to take up new challenges;
- A sense of dissatisfaction at work.

The next step is to ask yourself the following questions.

Right now:

- How much do I enjoy my work?
- Do I still feel the need to take on challenges? If so, what type?
- Do I still have the same need for recognition?
- Do I still think that the company can’t run smoothly without me?

- Is my status as a business owner still important to me? In the eyes of my family? My peers? The community?
- Have I discussed this with my spouse? With my children? With relatives?

Down the road:
- What are my life goals?
- What kind of life do I envision in the next five years? Ten years?

You will get the most out of this exercise by staying in touch with your feelings and acknowledging your concerns.

You can mentally prepare to exit your company, and the better you prepare, the easier the transition will be.

To that end:
- Find new interests well before you exit the company;
- Share your concerns, hesitation and worries with people you trust.

CHAPTER 4

PREPARING THE INTERNAL SUCCESSOR

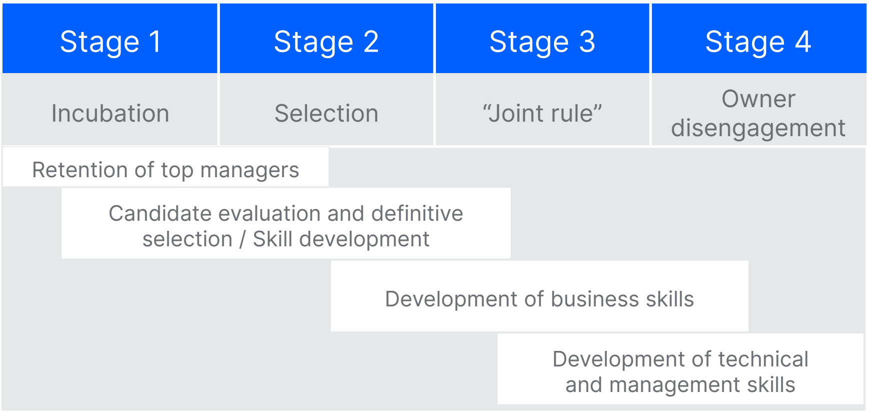
It's essential to prepare the successor to take the helm, even if he is familiar with some aspects of the company's internal or external environment.

> Preparing the successor is an integral part of the process.

Ensuring the company's future takes time. In fact, it's a process that begins as soon as the outgoing owner starts to think about succession and that can go on until the moment he steps away from his leadership role.

The figure below summarizes the process involved in adequately preparing a successor.

Figure 1 Preparing the successor for the handover, from Louise Cadieux, 2005



In the following, we consider the details of this process.

Pass on a management framework

In stage 1, owners will be well-served by creating a favourable environment to retain key employees by instituting the following management practices, if they are not already in place:

In general:
- Regularly ask staff members about their impressions and explain how they may be affected by the continuity of the business as a new person takes over the leadership role.
- Hold periodic meetings to let staff know how organizational projects are progressing.
- Encourage teamwork.

And in particular, establish the following systems for managing your staff:
- 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 and establish a fair reward system.
- Recognize the potential of every staff member, institute a promotion system that clearly indicates the possibilities for advancement and the necessary steps to achieve it so that all employees can constantly strive to improve.

The successor is chosen

As regards the successor, by the end of stage 2, the outgoing owner must:
- Openly accept his differences;
- Consider the pace at which he learns;
- Strongly encourage him to read about the industry in which the business operates, and to attend conventions or trade shows;

- Encourage him to participate in training and development programs relating to his work;
- Publicly acknowledge him as the future CEO;
- Allow him to assume his rightful place in the company as he takes on his responsibilities;
- Introduce him to the company's vendors, bankers, lawyers, accountants and any other external partners, and to its business networks as well;
- Gradually delegate the decision-making to him;
- Allow him to take on new challenges.

The successor prepares for the handover

Once chosen, the new owner must make sure to develop the skills required in both the short and and long term for the position that awaits him.

One of his first responsibilities will be to build a management team. This is best done by identifying personal strengths, after which he, possibly in collaboration with the successor, can work to identify the complementary strengths the position will require. In this way, the new owner will be able to surround himself with people who can complement his strengths.

Buyer and seller working together

Keeping the seller in the organization while the buyer is learning the ropes is not easy. For example, although the outgoing owner's presence in the company while the new owner assumes his position may be reassuring for some employees, it can also affect the new owner's ability to establish his credibility and legitimacy. To avoid such a climate of ambiguity, the buyer and the seller should:

- Clearly delineate each one's responsibilities during the time they will be working together, referred to as the "joint rule" period;
- Set a timetable that will end on the official transfer date;
- Agree on the seller's role once the buyer officially assumes his position, i.e. during the disengagement period.

Essential votes of confidence

While building trust in general is important, a new owner must also receive votes of confidence from important, credible people.

This could be the seller, a senior manager, a friend, an external advisor or a combination of these. Some can guide the buyer by providing mentoring, while others can act as advisors. Regardless of the type of support provided, the relationship between the buyer and the mentor (or advisor) must be based on mutual respect, openness, trust and commitment.

Should you be a mentor or an advisor?

	Main Tasks
Mentor	• Supports the new owner in developing management skills by: – Providing advice – Providing visibility – Providing opportunities to take up challenges • Encourages the new owner to develop psychosocial skills by: – Building his confidence – Acting as a role model – Providing support throughout the process
Advisor	• Identifies the new owner's strengths • Proposes a skills development plan for the new owner • Shows the new owner how to acquire certain specific skills • Shows the new owner how to improve managerial behaviour and make decisions • Guides the new owner during critical moments • Provides the new owner with feedback on his performance

A few more pointers

Finally, here are a few other points that buyers and sellers will have to take into account 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 5

PREPARING THE FAMILY

A 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, it is important to understand the different stages of a person's life, which vary immensely.

- In their twenties, people are at the start of their careers. At the same time, they're leaving the family home and starting to form their own family.
- In their forties, they are advancing in their careers. They have children and start to question various aspects of their lives.
- 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: the couple 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
- Their expectations regarding their children

<u>Example of diverging interests at different stages of life</u>. A husband and wife are 20 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 company's long-term success by acting as:

- A mediator in situations of potential conflict, especially when they involve members of the family;
- A facilitator between the business owner and other members of the family;
- 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 <u>role</u> to play in the process.

Repercussions for the owner’s children, and practical solutions

How are the owner's children 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
- Their expectations of what the business can do for them

CHAPTER 6

PREPARING THE STAFF

The transfer is not only a matter between buyer and seller; it affects the entire organization. The arrival of the buyer, wherever they may come from, may displease some loyal longtime employees. Out of concern for the possibility of losing their jobs or acquired rights after the new owner takes the reins, they often behave in ways that prevent the transfer process from proceeding smoothly.

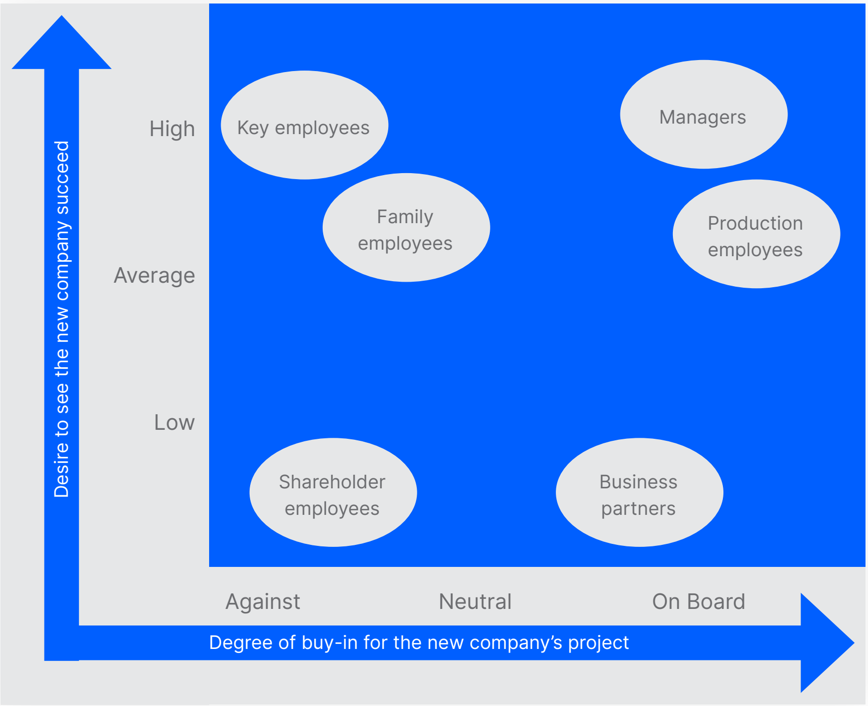
This poses a formidable challenge for both seller and buyer. On the one hand, the seller must ensure that employees resist the change as little as possible. On the other, the buyer must demonstrate commitment and integrity, acquire the necessary skills and have good relations with employees—in short, he must establish his credibility.

Box 1 Resistance to change
From Dessler et al. (2004) via Louise Cadieux, UQTR, 2005

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.

As Figure 1 shows, there are different degrees of receptiveness to a change in ownership.

Figure 1 Example of staff dynamics
Adapted from Lambert et al. (2003) by Louise Cadieux, UQTR, 2005



First practical solution: prepare and announce

To prepare for the staff efforts that will be required for the transfer, here are some important points that the outgoing owner, on his own or with an experienced advisor (see Chapter 7, *Finding support*), should take into consideration even before the official arrival of his successor:

- How will the staff react when they learn that a successor has been appointed or that a new owner is arriving?
- When is the best time to bring him in?

- Who among the staff is indispensable to the successful operation of the business?
- Who among the staff can help you with the process?
- Who among the staff can support the successor as he assumes his new role?
- Is the staff aware of your plans to ensure the business's long-term success? Has someone spoken to them about those plans? If not, when would be the right time to do so?
- When is the best time to tell the staff about the upcoming change? And who is the best person to do so?
- What information should be given to the staff? What information should not be revealed?
- Considering that some of them may react negatively to the successor's arrival, how can you ensure they remain engaged in the business?
- To what extent can you involve staff members in the successor's integration?

To prepare the staff, the outgoing owner will take proactive steps:
- Officially announce his intention to step down from leading the company;
- Present a part of the succession plan—in particular, the date the successor will arrive and the date the outgoing owner will disengage;
- Officially announce the successor's arrival;
- Present the new leader to the staff.

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

Certain staff members, 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

The outgoing owner can help managers and professional staff 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 successor should have.

By inviting them to participate in. . .

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

And by encouraging them. . .

- To help the other staff members see the positive side of the change by preserving their jobs and acquired rights.

A third practical solution: pass on a management framework

The outgoing owner will be well-served by creating a favourable environment for staff[6] by instituting the following management practices, if they are not already in place.

In general:

- Regularly ask staff members about their impressions and explain how they may be affected by the continuity of the business as a new person takes over the leadership role.
- Hold periodic meetings to let staff know how organizational projects are progressing.
- Encourage teamwork.

6 Adapted from Poza (2004) by Louise Cadieux, UQTR, 2005.

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 reward system.
- Recognize the potential of every staff member, 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 staff members can constantly strive to improve.

Other issues

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 their impact.

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

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
Provides 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
Knows your your rights and how to assert them; carefully reviews contracts of all kinds; drafts shareholder agreements, wills, powers of attorney, protection mandates, etc.	Lawyer, notary

Type of advice	Expert
Assists with matters involving 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 your taxes upon death and which can be used to buy out your business partner’s shares in the event of his death; prepares an investment portfolio for your assets.	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

Regarding the last field of expertise cited, 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 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 advisors 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.

You can also look into their qualifications 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 sets you apart from the others?
- Are you a member of a professional order? If so, which one?
- Can you give me an example of problems associated with business transfers and explain how you deal with them?
- How long do you work with each client?
- How many business transfers have you been involved in?
- 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 experts' reactions. Are the spontaneity, clarity and conciseness of his 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 reveal the names of former clients, and don't brag or claim they'll do the same things for you that they've done for them, 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.
- Never try to dazzle you with ready-made solutions; instead, they focus on identifying your real needs.

3. <u>Considerations.</u> You can continue your evaluation based on the following points, which the experts 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, power of attorney and intentions.

With regard to the family, watch whether the experts:

- Take the personal and professional life goals of all family members into account, whether or not they work for the business, so as to better understand how the transfer will impact each one of them and to gauge the family dynamic—which, although usually different from the business dynamic, greatly influences it.

4. <u>Risk assessment.</u> 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 in other experts.
- He recommends other competent experts.

Throughout this process, rely on your own judgement.

SECTION B

LEADERSHIP TRANSFER WHEN THERE IS NO SUCCESSOR

CTEQ Centre de transfert d'entreprise du Québec

INTRODUCTION TO SECTION B

- All SME owners will have to relinquish their leadership role some day. The goal is to keep the business running after they leave. There are two aspects to replacing an outgoing owner: ownership and leadership. This important step poses certain risks for the SME. Deep reflection is needed to prepare for the transfer.
- Section B deals with the leadership transfer in SMEs where there is no successor.
  - Both leadership and ownership are transferred to outsiders.
- We use the term "new owner," "successor" and "buyer" to refer to the (natural or legal) person who will replace the CEO, i.e. the seller, who is often the sole proprietor or co-owner of the business and does not intend to liquidate it.

CHAPTER 1

PREPARING THE OUTGOING OWNER

There are situations where neither the family, nor someone who is familiar with the business, nor a professional manager is able to step in as a successor.

The outgoing owner then has no choice but to sell his business to an outsider (who could be a competitor) or to merge with another company, assuming his goal is continuity rather than liquidation.

For the outgoing owner, stepping down as CEO does not happen overnight. It's a long process.

As shown in Figure 1, this process begins when a business owner realizes that he will not be around forever, and ends on the day when he leaves his business for good.

Figure 1 Owner's disengagement process
from Louise Cadieux, UQTR, 2006

Reflection	**Owner feels ready.**	Action	
Owner ponders the future while still at the helm.		Former owner embarks on new life projects.	
		Slump	Ownership of new life projects

Reflection period. As the business owner starts to think about other life projects, forming ideas of what he would like to do, he discovers that he doesn't know how to make them happen. And the more new projects he comes up with, the more uncertain he feels, leading him to seek reassurance about his plans from those closest to him.

This is the stage when he is most likely to resist change in both his personal and professional life. The sooner you define and believe in a new life project or a group of projects, the sooner you'll feel ready to move on to the next critical phase of the process: making them a reality.

Owner feels ready. While the following points will surely have arisen much earlier, they will become especially impactful once the owner feels ready to pass the torch:

- Is this the right time to sell? For you? For the company? For the prospective successor(s)?
- Is there a potentially interesting market for the company?
- How far are you prepared to go?
- Are you prepared to guide the new owner? If so, for how long and under what conditions?

Project implementation period. The fact that an outgoing owner has officially stepped down doesn't mean that the disengagement process is over. Quite the contrary. Rather, it is the beginning of a new path, along which he will encounter a number of surprising obstacles.

Although he learned to gradually distance himself from the company during the reflection period, once he is no longer in charge, a former business owner typically goes through a slump that can last anywhere from three to six months, during which he feels helpless—and above all, disoriented. This is because, although he has new life plans, he doesn't quite know where to begin. There is also the matter of how to deal with the company's new leadership. How can he provide guidance and advice while giving the new owner the independence that is rightfully his?

The outgoing owner will eventually become comfortable in his new way of life, in which he will learn to find meaning and comfort.

These moments are normal steps in the process. To reorganize your life once you have exited the business, you will need to:

- Choose to take charge as you have always done;
- Let go of the past and live in the present;
- Focus on the new (and realistic) goals you set for yourself involving things you love to do (recreation or business) as well as new areas of interest, while taking up new challenges if you so desire;
- Build rewarding relationships on new foundations with family members, friends, your community or members of your social or business network, sharing the knowledge you have worked so hard to acquire over the years;
- Above all, keep an open mind.

How can you make this happen with minimal stress?

Practical solution

First, pay attention to signs that it's time to move on to the next stage of your life. For example:

- A defining event such as an illness or death of a relative or close friend;
- The realization that your 60th birthday is around the corner;
- Signs of physical or mental fatigue;
- Satisfaction that you've achieved what you set out to do and the need to take up new challenges;
- A sense of dissatisfaction at work.

The next step is to ask yourself the following questions.

Right now:

- How much do I enjoy my work?
- Do I still feel the need to take on challenges? If so, what type?
- Do I still have the same need for recognition?
- Do I still think that the company can't run smoothly without me?
- Is my status as a business owner still important to me? In the eyes of my family? My peers? The community?
- Have I discussed this with my spouse? With my children? With relatives?

Down the road:

- What are my life goals?
- What kind of life do I envision in the next five years? Ten years?

You will get the most out of this exercise by staying in touch with your feelings and acknowledging your concerns.

You can mentally prepare to exit your company, and the better you prepare, the easier the transition will be. To this end, you should:

- Find new interests well before you exit the company;
- Share your concerns, hesitation and worries with people you trust.

CHAPTER 2

PREPARING THE EXTERNAL SUCCESSOR

There are situations where neither the family, nor someone who is familiar with the business, nor a professional manager is able to step in as a successor. The outgoing owner then has no choice but to sell his business to an outsider (who could be a competitor) or to merge with another company, assuming his goal is continuity rather than liquidation.

In these circumstances, to make sure the buyer is as prepared as possible, as soon as the transaction is confirmed, the outgoing owner must:

- Inform the staff of the expected change;
- Encourage the buyer to talk to the top managers;
- Introduce him to the company's vendors, bankers, lawyers, accountants and any other external partners, as well as your business networks;
- Publicly acknowledge him as the future CEO.

Buyer and seller working together

Keeping the seller in the organization during the transition period is not easy. For example, although the outgoing owner's presence in the company while the new owner assumes his position may be reassuring for some employees, it can also affect the new owner's ability to establish his credibility and legitimacy.

To avoid such a climate of ambiguity, the buyer and seller should:

- Clearly define each one's responsibilities during the time they will be working together in the company;
- Set an official transfer date;
- Agree on the seller's role once the buyer officially assumes his position.

Other issues

Finally, here are a few other points that buyers and sellers will have to take into account 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 their impact.

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 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 3

PREPARING THE STAFF

It is important to prepare the staff to ensure a successful transition to the new company. This represents a formidable challenge.

The sale is not only a matter between seller and buyer; it affects the entire organization. The arrival of the new owner, wherever he may come from, may displease some loyal longtime employees. Out of concern for the possibility of losing their jobs or other acquired rights, they often behave in an inappropriate manner.

Box 1 Resistance to change
From Dessler et al. (2004) by Louise Cadieux, UQTR, 2005

> "There is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage than a new system. For the initiator has the enmity of all who would profit by the preservation of the old institution and merely lukewarm defenders in those who gain by the new ones."
>
> Machiavelli

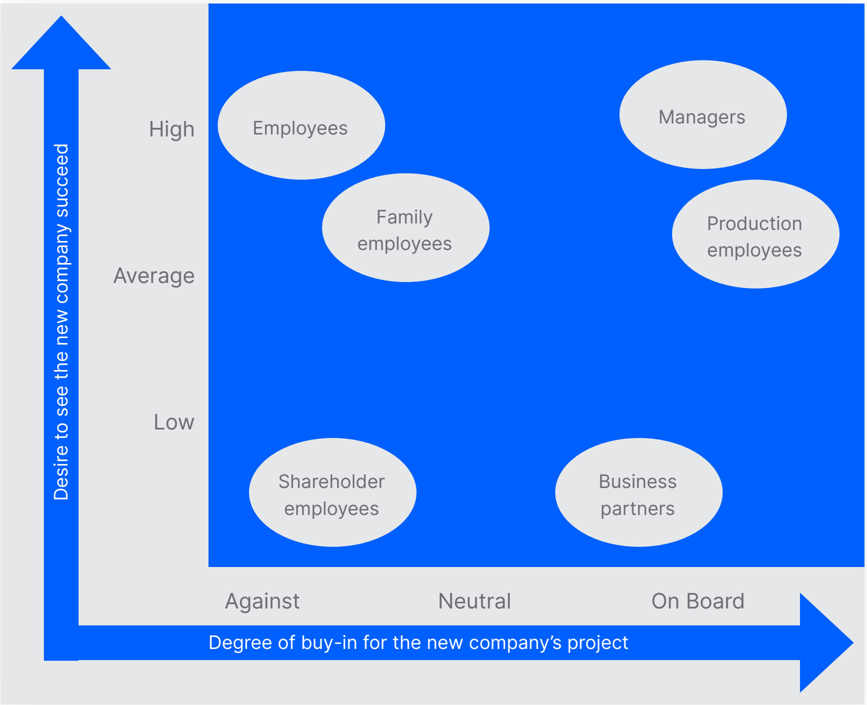
Seller. If the former owner-manager will remain in the organization during the transition period, a climate of ambiguity must be avoided by:

- Clearly defining each one's responsibilities (seller and new owner);
- Setting an official departure date for the outgoing owner.

The seller for his part must ensure that employees resist the change as little as possible.

Staff. As Figure 1 shows, there are varying degrees of employee receptiveness to a change in ownership.

Figure 1 Example of staff dynamics
Adapted from Lambert et al. (2003) by Louise Cadieux, UQTR, 2005



First practical solution: prepare and announce

To prepare for the staff efforts that will be required for the transfer, here are some important points that the outgoing owner, on his own or with an experienced advisor (see Chapter 4, *Finding support*), should take into consideration even before the official arrival of the new owner:

- How will the staff react when they learn of the sale and official arrival of the new owner?
- When is the best time to bring him in?
- Who among the staff is indispensable to the successful operation of the business?
- Who among the staff can support the new owner as he assumes his new role?
- Is the staff aware of your plans to ensure the business's long-term success? Has someone spoken to them about those plans? If not, when would be the right time to do so?
- When is the best time to tell the staff about the upcoming change? And who is the best person to do so?
- What information should be given to the staff? What information should not be revealed?
- Considering that some of them may react negatively to the new owner's arrival, how can you ensure they remain engaged in the business?

To prepare the staff, the owner should take proactive steps:
- Officially announce his intention to step down from leading the company;
- Present part of the business plan to implement after the transfer;
- Officially announce the new owner's arrival;
- Present the new leader to the staff.

—

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

Certain staff members, 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

The outgoing owner can help managers and professional staff to more easily accept the changes that await them by suggesting to the new owner that he:

- Consult with them about the organization's future;
- Help the other staff members see the positive side of the change by preserving their jobs and acquired rights.

A third practical solution: pass on a management framework

The outgoing owner will be well-served by creating a favourable environment for staff by instituting the following management practices, if they are not already in place.

In general:

- Regularly ask staff members about their impressions and explain how they may be affected by the continuity of the business as a new person takes over the leadership role.
- Hold periodic meetings to let staff know how organizational projects are progressing.
- Encourage teamwork.

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.
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Other issues

Finally, here are a few other points that the new owner and the seller will have to take into account to ensure a successful business transfer.

Before the transfer period:
- All staff must be informed and reassured about the changes that will be made to the company.

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.
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CHAPTER 4

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.

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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

Type of advice	Expert
Knows your rights and how to have them recognized. Carefully review contracts of all kinds. Drafts shareholders' agreements, wills, protection mandates, etc.	Lawyer, notary
Assists with matters involving 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 your taxes upon death and which can be used to buy out your business partner's shares in the event of his death. Prepares a product portfolio for your various assets.	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

Regarding the last field of expertise cited, 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 must have the ability to take effective action in situations marked by conflict and strong emotions.

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.

You can also look into their qualifications 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 expert 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 sets you apart from the others?
- Are you a member of a professional order? If so, which one?
- How long do you work with each client?
- How many business transfers have you been involved in?
- 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 experts' responses as a whole. Do they fit together logically with one another?

In particular, take note of the experts' reactions. Are the spontaneity, clarity and conciseness of their 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 reveal the names of former clients, and don't brag or claim they'll do the same things for you that they've done for them, 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.
- 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, power of attorney and intentions.

With regard to the family, watch whether the experts:

- Take the personal and professional life goals of all family members into account, whether or not they work for the business, so as to better understand how the transfer will impact each one of them and to gauge the family dynamic—which, although usually different from the business dynamic, greatly influences it.

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 in other experts.
- He recommends other competent experts.

Throughout this process, rely on your own judgement.

SECTION C

TAX ASPECTS OF OWNERSHIP TRANSFER

Centre de transfert d'entreprise du Québec

INTRODUCTION TO SECTION C

- All SME owners will have to relinquish their leadership role some day. The goal is to keep the business running after they leave. There are two aspects to replacing an outgoing owner: ownership and leadership. This important step poses certain risks for the SME. Deep reflection is needed to prepare for the transfer.
- Section C focuses on tax aspects of the ownership transfer.

CHAPTER 1

TAX CONSIDERATIONS FOR TRANSFERS OUTSIDE THE FAMILY

There are tax considerations that must be dealt with when the company is sold to new owners who are not family members.[9]

- The buyers may have ties to the company as staff members (who may have formed a cooperative), minority shareholders or business partners (option C).
- They may have no ties at all to the company, e.g. in the case of third parties like a competitor or the head of another company with which your business is merging (option D).

This chapter covers the tax implications of this type of transfer. It deals with ownership transfers between business corporations only. It is in the best interest of both the seller and the buyer to carefully evaluate these implications with their advisors. (See Chapter 7, *Finding support* in Section A, or Chapter 4 in Section B). The seller's decisions must take into account the factors discussed in sections A or B dealing with non-family succession.

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

9 The business is sold to new owners who will also take over its management. The sale can be either under option C or D, which are explained in Section 1.3, "Detailed options" in the "Introduction."

1.1 Tax implications of selling a business

Ownership of the business can be transferred in two ways:
- The outgoing owner sells his shares to the buyer;
- The outgoing owner sells the assets of the business.

1. The outgoing owner sells his shares.

<u>The outgoing owner must declare the capital gain.</u>

Under certain specific conditions that your tax advisor can explain to you, the outgoing owner may be able to:
- Claim the capital gains exemption;
- Defer part of the capital gain to later tax years (capital gains reserve);
- Offset the capital gain with previous capital losses.

These points are explained in Part II.

2. The outgoing owner sells the assets of the business to the buyer.

<u>The business will be taxed.</u>

1.2 General tax advantages

- The sale of assets is taxed at the small business rate, which is lower than the personal income tax rate.

- Exemption. There is no capital gains exemption for the sale of assets.

- Deferral. You can defer the capital gain on the sale of capital assets over a period of five years. The outgoing owner's business therefore only receives a portion of the proceeds of the sale at the time of the transaction.

- Previous losses. The business selling the assets may also be able to reduce the capital gain by offsetting it against previous capital losses.

1.3 Other relevant issues

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

- The transfer can be total, partial or gradual. For example, the outgoing owner may wish to spread the transfer over time, retain some shares, or retain certain real estate assets.
- When the transfer involves the sale of shares, the buyer will probably want to protect himself against the previous leadership's actions through a limitation of liability clause.
- In some cases, the buyer may decide to proceed with a general reorganization of his companies. This will allow him to group them in an appropriate legal structure.
- An estate freeze can be done in favour of the buyer.
- A business transfer must include estate planning and the preparation of a will.
- A business transfer is carried out in the more general context of estate planning, including the drafting of a will.
- If the circumstances allow, the former owner can remain associated with the business (in the case of an estate freeze in particular).

Taxation of cooperatives

The Cooperative Investment Plan (CIP)

The tax deduction granted under the CIP is included in the calculation of taxable income at the provincial level. The applicable deduction is 125% of the cost of the qualifying shares. For any given taxation year, the deduction cannot exceed 30% of the eligible investor's total income. It can be carried forward for the next five years.

The following cooperatives are eligible:

- Work cooperatives;
- Shareholding workers' cooperatives;
- Producers' cooperatives;
- Farm cooperatives;
- Solidarity cooperatives (with restrictions);
- Federations of cooperatives (three sectors).

Co-op RRSP

The cooperative Registered Retirement Savings Plan (co-op RRSP) is aimed at natural persons and companies who are members of cooperatives:

- The funds invested as preferred shares in the cooperative can be registered in a co-op RRSP;
- The co-op RRSP provides a deduction of 100% of eligible investments at both the federal and provincial levels.

Conditions

- All types of cooperatives are eligible;
- Minimum of 15 contributors;
- Application fee (approximately $500);
- Annual fee for each participant (approximately $60).

SECTION D

FINANCING ASPECTS OF OWNERSHIP TRANSFER

CTEQ Centre de transfert d'entreprise du Québec

CHAPTER 1

FINANCING FOR A SALE TO A NON-FAMILY MEMBER

Financing the "new" business when the successor is outside the family or when there is no successor.

This chapter covers financing of a business which was family-owned until now.

It covers the new business that will no longer be family-owned: it is sold to non-family members.[10]

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

These new owners (or successors) may:

- Have ties to the company as staff members (who may have formed a cooperative), minority shareholders or business partners;
- Have no ties at all to the company, in other words, third parties such as a competitor or the head of another company with which the business is merging.

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

- The sale is a cash transaction.

10 The business is sold to new **owners** who will also take over its **management**. The sale can be either under option C or D, which are explained in Section 1.3, "Detailed options" in the "Introduction."

Section 1.1 below discusses the key aspects of this type of transfer. However, more often, only a portion is paid, leaving a balance.

This balance can 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 seller's shares created by an estate freeze;[11]
- Financed. Section 1.2 discusses the main types of financing.

1.1. The sale is a cash transaction

Using their own funds, other financing that they have access to, or a combination of both, 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 owner, since he receives the full amount that was agreed to.

Personal financial resources
This is the buyer's own money or money obtained from family, partners or friends.

Bank loan
The new business takes out a secured or an unsecured loan.

A secured loan is guaranteed by the company's assets (inventory, accounts receivable and fixed assets). It is also limited by the value of these assets. An unsecured loan can take the form of an equity loan or subordinated debt.

Note:
These loans must not interfere with the new company's operation or growth.

11 Estate freezes are explained in Chapter 1 of Section C, "Tax aspects when ownership stays within the family."

1.2 Financing the balance of sale

The following options carry risk for the outgoing owner because he is helping to finance the sale.

Balance of sale

The balance of sale is the part of the price that the buyer does not pay at the time of the transaction. In other words, when you agree to a balance of sale, you are not immediately paid in full. The balance of sale will be paid in instalments. The seller thus generally agrees to be paid over time at an interest rate similar to that of a mortgage.

This is a simple, inexpensive and flexible type of financing. However, the seller absorbs the risk and it is difficult to obtain collateral. It's a good idea to consider taking out a life and disability insurance policy on the buyer to protect against these risks. On the plus side, you can benefit from a tax deferral.

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 are generally the net profit plus depreciation.

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

Financial partners

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

- The terms of the investment (equity interest, equity loan or subordinated debt) vary with the partners.
- Some take part in managing the business, while others do not.
- Those who do take part in managing the business have two things in common:
    1. The partner appoints a representative to the company's board of directors, who remains in office as long as the partner remains a shareholder;
    2. The former owner receives an initial payment of 20% to 30% of the company's value. His remaining shares and those of the partner will be purchased by the new company over a 5- to 10-year period.

1.3 Other relevant issues

- Different types of financing can be combined. In other words, the buyer can use multiple types of financing to become the new owner. This is the prevailing trend today.

- The buyer may be asked to personally guarantee the loans taken out by the business.

- We strongly recommend that a due diligence review be conducted before buying a business, as this will allow the buyer to evaluate the company's business, financial and legal information to determine whether the acquisition makes sense.

It is important to use an experienced advisor. Look for the support that's right for you in Chapter 7 of Section A, "Finding support," or in Chapter 4 of Section B.

For information purposes only, note the following:

- Buyers who have to take on personal debt will have to pay that debt back with after-tax dollars, meaning significant additional financing costs.
- Life insurance. Life insurance secures the company's survival in the event of the seller's death (while money is still owed to him) or that of a shareholder. The premium, which takes age and health into account, can be expensive if the insured person is older.

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