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Succession Planning for Small Businesses

In his book "*Straight From the Gut*", former GE CEO Jack Welch states that he started the process of finding his successor seven years before he was scheduled to retire. He figured it would take that long to make the right choice. Although GE is one of the world's largest companies, the same can be said for companies of any size. Developing a succession plan and finding a successor to a small business is easier said than done.

In a 2006 survey, the Canadian Federation of Independent Business asked its members about their succession plans. It found that even though two thirds of business owners plan to exit their business in the next 10 years, only 10% have a formal plan in place to sell, transfer or wind down their operations; 38% have an informal plan; 52% have no plan at all. The risks to business owners and the Canadian economy as a whole are significant. Without a plan in place, owners may be forced to wind down or sell their companies in less than ideal conditions, resulting in a discounted sales price. The risk is compounded for small business owners who have a disproportionate amount of their assets tied up in their company.

With scores of baby boomers set to retire over the next few years, the need for proper succession planning has never been more prevalent than it is now. The following are some of the things owners should consider while formulating their succession plans and retirement strategies:

1. Determine When You Want to Retire or Sell and Work Backwards.

A minimum lead time of seven to 10 years is considered ideal. An owner may consider selling early but staying on for a period of time during a transition phase. This all needs to be considered as part of putting a plan together.

2. Determine How Much Money You Need and When.

All owners will want to maximize the proceeds on the sale of their companies. However requiring funds immediately on the sale may limit who the company may be sold to. Selling to management or a family member may be the preferred alternative but if these parties have liquidity issues, this may not be a viable option if funds are required immediately by the owner. The more flexible an owner is with respect to receiving funds on a sale, the greater the options available to him in selling his company.

3. Name a Successor and/or Determine Who the Company Will Be Sold To.

If there is no intention to sell to management or family, then selling the company to a

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third party is a simple alternative. To maximize proceeds, an owner should consider retaining an advisor to market the company and attract potential purchasers. If the successor is part of the management or a family member, this person should be named as soon as possible in order to generate support for the decision. Other key managers should be on side with the decision. If possible, these managers should be "locked up" under long term contracts in order to ensure as smooth a transition as possible. Part of the process of naming a successor would include how the sale will be structured (e.g. sale of shares or assets) and over what period of time the proceeds will be received (e.g. immediately, over a number of years, or a combination of both with some upside if the owner stays on and certain performance targets are met).

4. Train the Successor.

70% of intergenerational transfers for family owned businesses do not survive into the second generation and 90% do not survive into the third.[1] The main reason for this high failure rate is due to inadequate training of the successor by the owner. It follows that the earlier an owner names a successor, the more time he has to assess the successor's traits and can design a training or mentorship program to enhance the successor's strengths and eliminate or manage his weaknesses. This would hold true whether the successor is a family member or not.

5. Get Some Professional Help.

There are a number of professionals that should be retained in order to ensure an owner is making the best decisions when it comes to succession planning. A lawyer is required to ensure the owner's will is up to date and sets out what happens to the ownership of the company in the case of his death. The owner's accountant should be involved to minimize the tax liability upon the sale of the company. A business valuator should be consulted to ensure the owner is getting fair value when the company is sold. And an advisor should be retained to assist the owner in "flushing out" his requirements upon retirement and the drafting of the succession plan. The advisor can also liaise with the other professionals to ensure that someone other than the owner is looking at the big picture and his overall interests are being served.

Aries Advisory Group Ltd. is uniquely suited to offer succession planning services for you and your company. With our significant experience, we can provide objective, third party advice on what you should consider in formulating your succession plan. And if necessary, we can assist managers or family members in obtaining financing through a management buyout process. Please contact us at info@ariesag.com or at (416) 467-7878 to get started and to see how we can streamline the process for you.

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[1] Rene Lewandowski, "Planning for Success," CA Magazine,Vol 140, No 5, June/July 2007, p. 24.