PRIVATE COMPANY SUCCESSION PLANNING: WHERE DO YOU STAND?

ONLY **40%** OF PRIVATE COMPANIES HAVE A CLEAR PLAN OF SUCCESSION

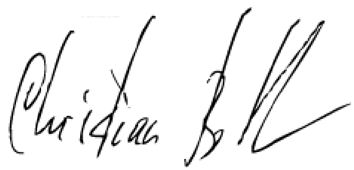
fei
financial executives international
canada

cferf
canadian financial executives research foundation
fondation de recherche des dirigeants financiers du canad

Grant Thornton

ACKNOWLEDGEMENTS

We gratefully acknowledge the efforts of our survey respondents and our forum participants who took valuable time away from their day jobs to participate in this work. We are particularly grateful to our research partner, Grant Thornton LLP, without whom this study would not have been possible.



Christian Bellavance
Vice President, Research and Communications
Financial Executives International Canada

First published 2011 by CFERF.
1201-170 University Ave.
Toronto, ON
M5H 3B3

ISBN# 978-0-9866833-5-0

CONTENTS

EXECUTIVE SUMMARY

Canada is preparing for a significant shift as baby boomers retire and a new generation takes the reins of private company ownership. But according to financial executives participating in a Canadian Financial Executives Research Foundation (CFERF) study, the process is unlikely to be smooth sailing. The research findings indicate that succession plans at most companies are murky at best: only 40% of Canadian private companies have a clear business ownership succession plan in place.

The lack of widespread succession planning may be partly due to a lack of overall business planning: 30% of financial executives respondents said business owners did not have a five-year vision for their business, while 20% did not have a clear overall strategy at all.

The survey of more than 100 financial executives was conducted in July, 2011, by CFERF, and insights were gathered via an executive research forum held by video conference in Toronto and Vancouver. The research study is sponsored by Grant Thornton LLP.

As company owners age along with the rest of the population, many entrepreneurs are finding they are ill-prepared for the inevitable ownership transition that lies on the horizon. The risks of this lack of foresight are enormous: by not having a plan in place, owners may fail to realize the full value of their business during the exit process or may take a significant tax hit – or both. For instance, 60% of respondents, all financial executives employed at private enterprises, said that no formal valuation of the business had taken place. With regards to estate planning, fewer than half of respondents said the owners of the company were satisfied that their succession planning objectives would be achieved through their estate plan. Only half said their company owners had an up-to-date will in place and had adequate pension or retirement arrangements. Less than half of owners knew how much personal income tax would be triggered upon his or her death.

Other risks identified in the study include alienating potential successors – be they outsiders, senior members of staff, or family members – and putting the business as a going concern at risk. Families may be torn apart when there is a lack of clarity on succession. It may even be difficult to obtain long-term financing if lenders perceive there has been inadequate business planning. These findings should trigger a call for action in a country which relies on small and medium-sized businesses to generate as much as half of Canada's gross domestic product.

Survey participants who indicated their businesses do not have plans in place gave a variety of explanations: small staff; tight resources; other priorities; struggling to manage high growth; and struggling to survive. Even logistics were seen as an obstacle. One executive complained about the difficulty of organizing a discreet meeting to do hypothetical succession planning without creating a ripple effect of employee rumours. Others told stories of passionate owners or founders unwilling to let go of the reins to another executive, or even to delegate management of operations. For instance, one study participant observed his company's owner, while paying lip-service to the notion, may ultimately be unable to relinquish control.

> "I think that every company needs to have a succession plan that is based upon multiple scenarios, be it exit through sale, buyout, death or lack of interest. The plan has to go beyond the president or the C-suite – it has to go right down to anybody who has any ground value to your company at all, and you integrate that in."
>
> **Don Miller – CFO, Blast Radius Inc.**

The study also pointed to challenges specific to family run businesses, which employed half of the survey respondents. While the majority of family businesses had appointed designated successors, the survey indicates that some of those successors did not go through any training or relevant education to prepare for their future responsibilities. Only half of the financial executives respondents employed at a family business where a successor had been identified believed the successor was ready to take on the challenge of running the business. This red flag is a huge concern for businesses relying on a successor who lacks the personal drive and commitment, let alone the skills, training and education, to take it over.

The research looked at situations in which some family members choose to retain an ownership stake while remaining uninvolved. The findings show that slightly more than half (55%) of survey respondents employed at family businesses said there were clear plans as to how family members not employed by the business would share in the profits, compared to family members working in the business. In addition, nearly 60% of respondents said there were no formal processes or mechanisms in place to address and minimize potential family conflicts.

For family members not interested in the business, an exit strategy that would allow potential successors to take over via a buyout requires a meticulously thorough, accurate and fair company valuation. Study participants indicated that CFOs were uniquely positioned to play a role in stick-handling the process; helping the owners in understanding the valuation process, and in keeping owners grounded and their expectations reasonable. It was noted that the CFO can also play a critical role post transition as a primary point of contact for new owners.

The role of CFO is well-suited to turn the company leadership's attention to long-term planning. Succession planning is one way of forcing owners to cast their sights on the horizon and to look at the steps which are needed to get there. Since business cycles, conditions, customers, competitors, markets, and people are all in a constant state of flux, a business succession plan should ideally be regularly revisited and revised annually to assess whether it is still fresh, relevant and applicable.

INTRODUCTION

Succession is just like any other change: Many find it difficult to accept. Yet it is the challenge facing CFOs or senior financial executives managing a transition. For the financial executive who plays a support role for the owner facing such a transition, there are obvious technical and financial issues related to "succession planning" – estate planning, tax minimization strategies and wealth preservation are but a few. But some of the greatest challenges are human or emotional issues, areas which the financial executive may not be trained or equipped to deal with.

Some of the issues on the "softer side" of succession include:

- Lack of common vision between interested parties,
- Lack of a communication framework for all parties involved,
- Difficulty dealing with conflict, particularly around sensitive issues,
- Unwillingness for all involved parties to support the succession planning process, including owners ambivalent about planning for transition and/or reluctant successors, and
- Managing the business profitably through change.

These issues, although not directly financial in nature, can have a very real impact on the numbers-side of the business if left unresolved. This can create a ripple effect throughout the organization, and ultimately boomerangs to the CFO and the finance team.

There may be problems with decision making and other conflicts. This could lead to a loss of focus by owners and management, ultimately leading to inefficiencies and profit loss. Similarly, the lack of a communication framework can leave everyone involved confused and perhaps without clear direction, including employees, clients, suppliers and other stakeholders – generating even more inefficiencies that will hit the bottom line sooner or later.

Many businesses haven't even started thinking about succession, or may have decided the topic is too difficult to deal with or couldn't figure out where to begin: all reasons why succession planning has the reputation of being overwhelming. What may appear to be a linear step-by-step process may be better viewed through a holistic approach. Each organization is unique, and is best viewed differently on a spectrum of succession planning readiness, compared to any other organization.

The unique aspects of every organization, together with the constant change and flux in the business environment, will have an impact on decisions made regarding succession planning and the eventual transfer of ownership of a business.

RESEARCH METHODOLOGY

The research results were based on an online survey which took place from June 20 to July 18, 2011. A total of 106 respondents from private companies completed the survey, of which half were employed in a family business. Most respondents worked for a company with multiple owners, while more than one-quarter were employed by a company with a sole owner. Six percent of companies were owned by private equity and three percent by a partnership. (Further details of survey demographics can be found in Appendix A.)

Half the companies had revenues of $50 million or less; the largest industry group represented was manufacturing (25%), followed by wholesale trade and construction.

Half of respondents held the title of CFO; 13% VP finance; 10% controller and 9% were owner/founders. The rest held other titles (see Appendix A).

The research report includes insights and comments gathered during an executive research forum which took place in Toronto and Vancouver, connected via video conference, on August 22, 2011.

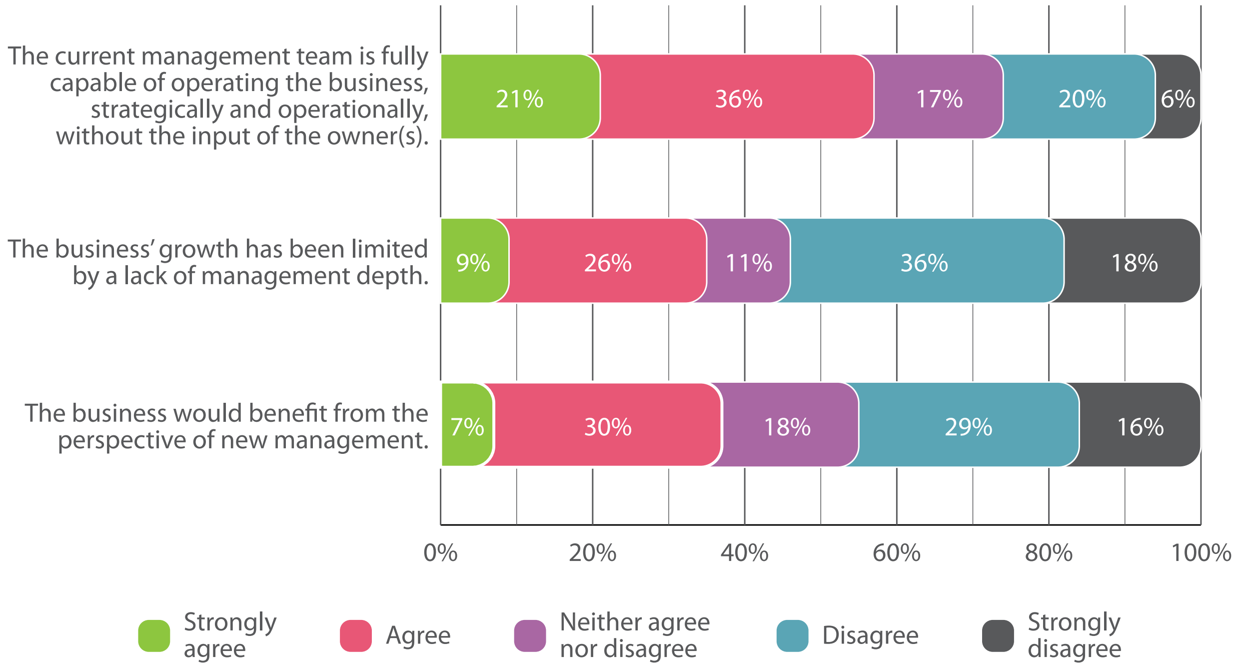
VISION AND LEADERSHIP

It was surprising to learn that, according to respondents, 30% of business owners appear not to have a clear vision of the next five years for their organization. Leadership was also not well articulated at a significant minority of businesses, as 30% of respondents indicated that there were no formal structures and processes in place for decision making in the organization. These results suggest that, while most organizations have a vision in place, some leaders are more reactive in nature, and are driven primarily by the events of the day rather than by their perception of what the future may bring.

A significant minority of respondents (37%) saw the need for new management, and 35% said the business' growth had been limited by a lack of management depth. Most agreed that the current management team was fully capable of taking care of the business, strategically and operationally, without the input of the owner (57%) (Chart 1).

> "We look for new offerings that make us unique from our competitors in the market, a strategy which has proven to be one of our competitive advantages. With a long-term plan of building a business which is relevant and which resonates with consumers, we end up creating and maintaining a value that other larger companies appear to find very lucrative."
>
> **Sheena Chandaria – Director, Conros Corporation**

CHART 1: EFFECTIVE LEADERSHIP



LONG-TERM STRATEGY

Although most survey respondents agreed that the company they work for had a clear, defined strategy (78%), one in five said that their companies did not. While these companies are in the minority, it's still significant enough to be of concern. Companies that do not set goals cannot meet them. And without planning strategies for a range of possible market scenarios, they may be exposing themselves to risk.

> "We're on the ground floor of succession. It's been talked about. The owners are setting the pillars of the company up first before they want to exit. So they want to make sure that the company is managed well and has the finance pillar, the sales pillar, the engineering pillar – we want to improve the operations area of management. Once all those pillars are in place then it's going to go to the next level of succession planning."
>
> **Forum participant**

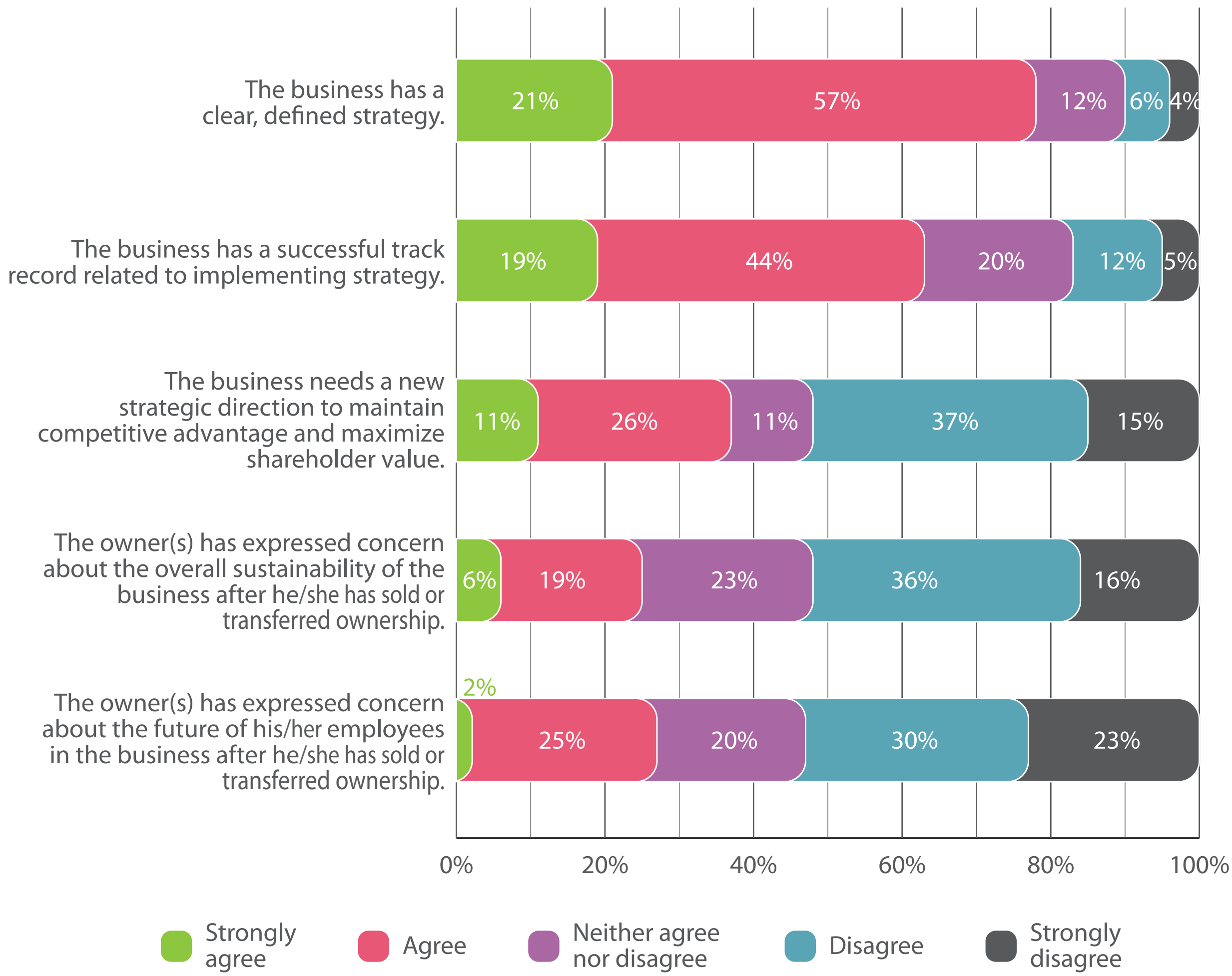
Even those companies surveyed that do have a plan may need to revisit it. According to the survey, a significant percentage of respondents – more than one in three – suggested the company needs a new strategic direction to maintain a competitive advantage (Chart 2).

When it comes to succession planning, one veteran financial executive suggested succession plans should look past the point of sale or ownership transition. For instance, keeping employees happy and motivated is key to maintaining the value of the company and this should be taken into account. Yet, in terms of strategy post-succession, only one in four survey respondents said owners had expressed concern about the sustainability of the business after a transition of ownership. More than half of respondents said the company owner had not expressed concern about the future of company employees after he/she had sold or transferred ownership (Chart 2).

> "The succession planning that I have witnessed has always been focused on getting things to the point of sale, but not getting beyond that, which is retention, growth, enhancement and brand. Something that I feel very strongly about personally is that the company we're planning for has an extremely large moral responsibility to the employment and the livelihoods of many employees and their families. I think we give lip service but I don't think we actually think strongly enough about how they manage that in the transition as well."
>
> **Don Miller – CFO, Blast Radius Inc.**

LONG-TERM STRATEGY

CHART 2: STRATEGY

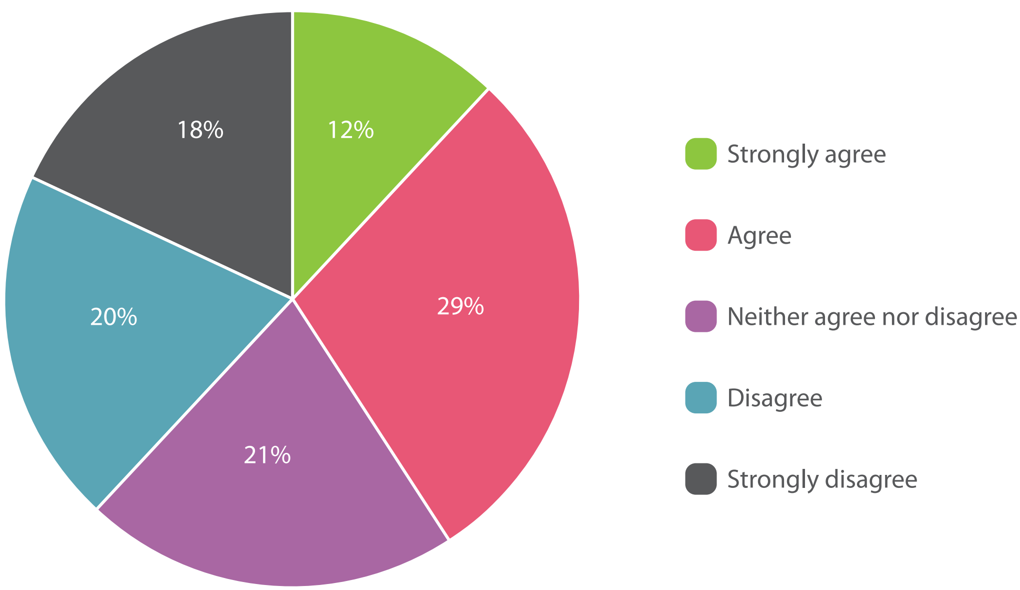


PASSING THE REINS

While the majority of company owners had blueprints in place for current operations and the management teams in place to carry out the plans, survey results indicate their plans for handing over the reins appear to be murky. Only two in five survey respondents said there was a clear exit or transition plan in place for the owner, while about the same number said there was not (Chart 3).

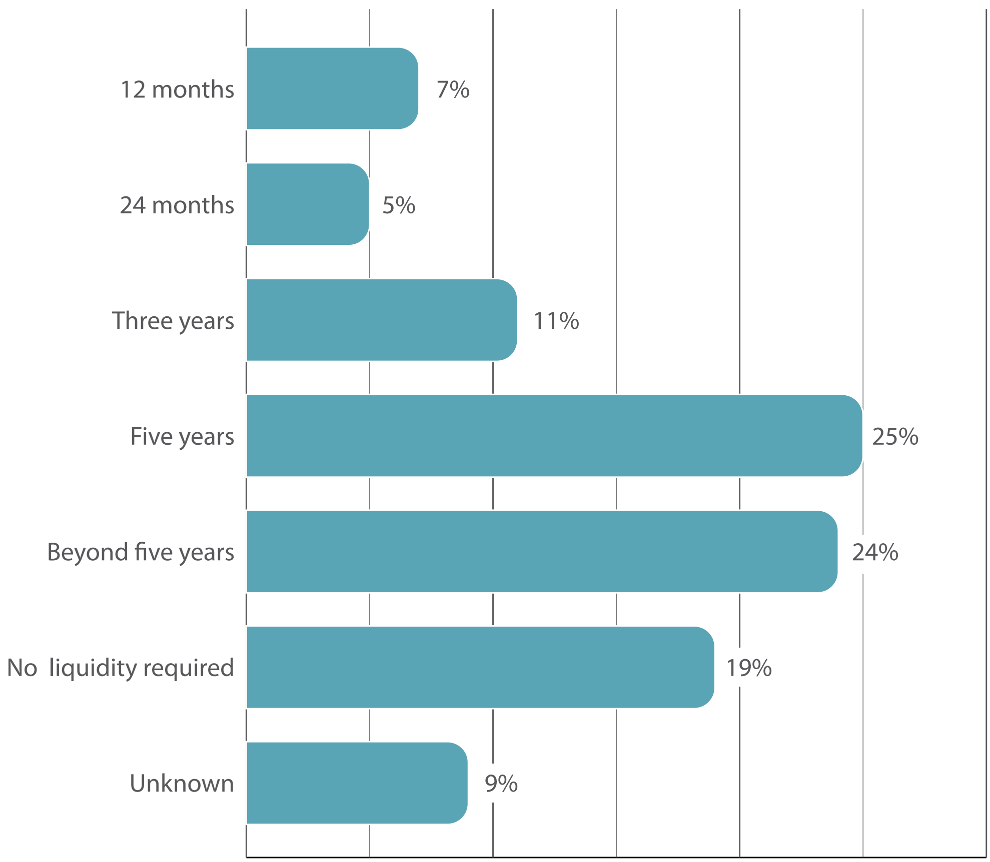
The majority of those companies who have a plan in place appear to have given consideration to issues beyond financial concerns. Of the respondents who confirmed the existence of a succession plan at their companies, three quarters said it included non-financial considerations, such as the readiness or suitability of successors and/or future governance, as well as tax and financing considerations.

CHART 3: IS A CLEAR EXIT/TRANSITION PLAN IN PLACE FOR EXITING OWNER(S)?



Nearly half of survey respondents indicated that the owner of their business was unlikely to require liquidity until five years from now, or beyond, which could explain why some owners did not have clear succession plans in place (Chart 4). It also appeared that many owners lack a pressing financial reason to start planning for retirement, since 63% of respondents agreed that the owner could afford to retire without selling his/her shares in the business.

CHART 4: WHEN OWNER WILL REQUIRE LIQUIDITY



For young, growing companies like Dr. Battery, which is experiencing triple-digit growth, succession planning seems to be at the bottom of the priority list compared with managing booming sales. “There are more issues that we need to deal with than we have bandwidth for,” says Fan Chun, CFO of Dr. Battery.

Other owners may actually want to retire, but may be unable to do so. For instance, certain owners have certain skills or abilities or client connections that make it difficult for them to transition out of the business itself, and the business in many cases becomes unsalable without them. They may be referred to as “stuckholders” – unable to get out.

Financial executives offered a wide range of reasons explaining why it’s hard to get started on succession planning:

“I was actually in the software industry for over 15 years in senior financial positions, such as VP Finance. As for succession planning, it’s interesting, because for a lot of those smaller companies, my experience was that we were more focused on survival than considering succession.”

Susan Clayton – Director, Financial Reporting, Powell Dorian

“I guess one thing I have on my side is time. There’s nothing urgent ... I’m not 80 yet, so I’ve got lots of time to think about it.”

Paul Chan – President and Owner, Storageflex Inc.

“A major obstacle would be the preparedness of the existing ownership group to turn their minds towards succession. I'm sure that there are many companies out there where the patriarch is just enjoying what he's doing, or maybe doesn't have confidence in the next generation or in key management to take the enterprise over. Unless that person has some sort of a triggering event, whether it's health or financial, he will just persist in terms of trying to retain control of management. We often times see individuals well into their seventies who will not pass the business on, whatever that translates into. And I'm not just talking about the ownership. I'm talking about the day-to-day management.”

Paul Coleman – Partner, Grant Thornton

“I think one of the big obstacles that I have noticed in creating a good succession plan is that there are very few safe places for leadership to meet and discuss the 'what if' questions. The 'what do you think about this,' without the fear of the ripple effect of it going through the organization in the guise of bad communication. And I think that's the place where owners really need a lot of help – finding a safe venue to explore how a succession plan might be crafted.”

Don Miller – CFO, Blast Radius Inc.

“Succession is very difficult when you've got a very small staff. So that's our challenge.”

Glen Benway – Director, Audit, Equity Financial Trust Company

For those financial executives who reported a successor had been identified at their company, the majority said that they were indicating behaviour consistent with the defined core values of the business. Responses were mixed on whether key employees who were not likely to be the successors understood why: two in five said the employees had a clear understanding, while the rest said they did not, or were neutral on the topic.

Most respondents suggested their company was not planning to transfer ownership to a third party. Those businesses which were planning to transfer ownership to a non-family member (roughly 25%) appeared to be most likely considering a private equity deal (one in three of survey respondents). One in five said the sale could also be made to a trade competitor, but would far less likely to be sold to an employee, or through an IPO.

While companies with young owners may state they are not ready to begin succession planning, Vicki Nishimura, a veteran financial executive, says it's never too early to start. "Prior to my current job, I spent several years working with very small or closely-held private companies dealing with succession planning that included a number of younger gentlemen, so 35 is definitely not too young."

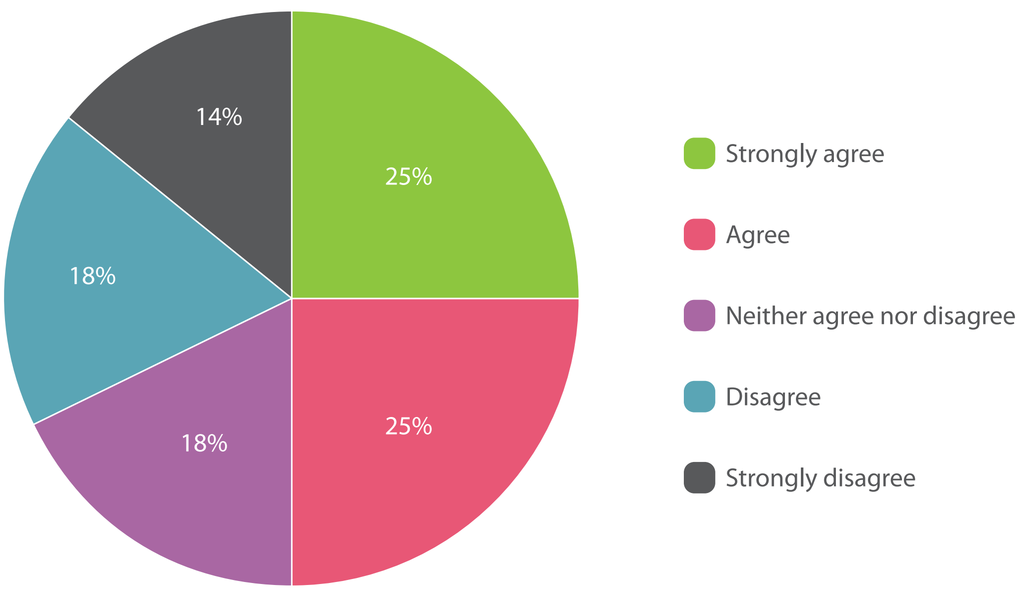
> "One of the things we're faced with is an aging ownership. We have a number of partners and they're to a point where retirement is imminent. And we know they're going to be looking for a way to have the company move along and so a succession plan is really at its infancy stage, but it certainly is something that has to be dealt with in the next year to two years."
>
> **Forum participant**

FAMILY BUSINESSES

Exactly half of respondents worked for family-owned businesses. Of this group, most (55%) said the current owner of the business planned to transfer ownership to the next generation of family.

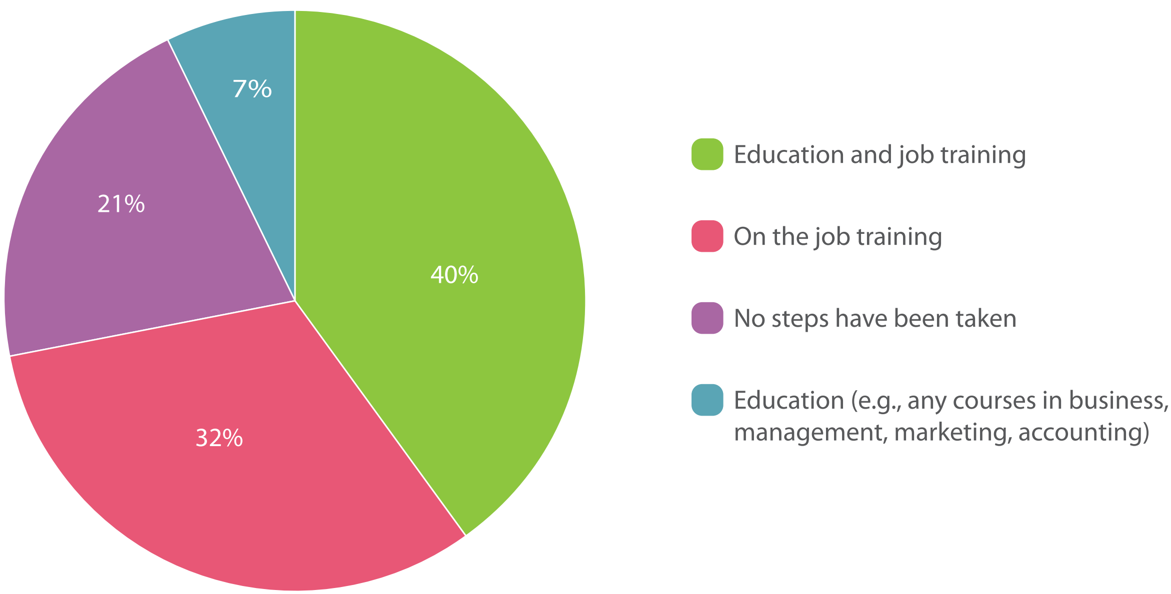
Of this "next generation" subgroup, 60% said a specific family member has been identified. But only half of the subgroup said they believed the identified successor was ready to take on the challenge of running the business (Chart 5). This could be a concern for businesses that may have appointed a successor, only to discover that the person lacks the personal drive and commitment, let alone the skills, training and education, to run the operation.

CHART 5: IS THE IDENTIFIED SUCCESSOR(S) READY TO TAKE ON THE CHALLENGE OF RUNNING THE BUSINESS?



Most of the successors are preparing through on the job training (40% were doing both on the job training and doing relevant educational programs, 32% were doing on the job training only, while 7% were doing education only). One in five potential successors had taken no such steps as part of succession readiness planning (Chart 6).

CHART 6: READINESS STEPS TAKEN BY POTENTIAL SUCCESSOR(S)

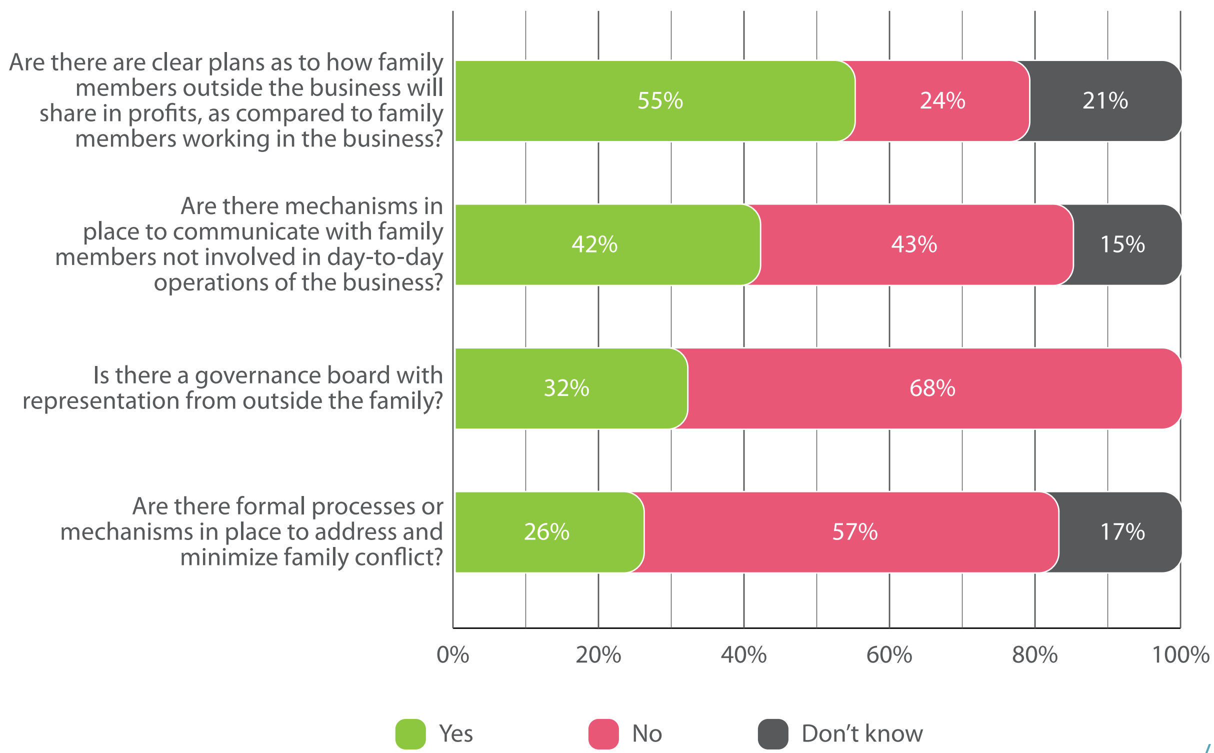


> “I guess I'm lucky I don't have brothers, sisters or other family members in the business to complicate things. I can flip the switch tomorrow and be done.”
>
> **Paul Chan – President and Owner, Storageflex Inc.**

The study indicates that most potential successors who had engaged in "readiness steps" were being trained in various aspects of the business, according to 67% of survey respondents.

Only half (55%) of survey respondents at family businesses said there were clear plans as to how family members outside the business would share in the profits, compared to family members working in the business. Less than half said there were mechanisms in place to address and minimize family conflict between those involved and those not involved in the business. Nearly six out of ten said there were no formal processes or mechanisms in place to address and minimize family conflicts (Chart 7).

CHART 7: FAMILY RELATIONSHIPS



Sometimes families are able to be more open about their plans for the future, without fear of reprisals, according to Nancy Lala, CFO of About Communications, a private national telecommunications company she owns with her husband and a number of other private investors. "I wonder if it's actually easier in a family business because we're more open and honest – brutally honest with each other," Lala said. "It seems that we're all on the same page. We know where we're going to go and we're not afraid to say what we want to do, as opposed to when it's a group of owners where there may be some fear saying, 'I want to get out' or 'I'm getting a bit tired here and would like to phase out.' It may be easier with family to do that."

The Chandaria family, which owns and run Conros Corporation in Toronto, saw a smooth transfer of responsibilities about five years ago from founder Navin Chandaria to his three children, according to Navin's daughter, Sheena Chandaria. Conros, which currently manufactures mailing and packing supplies, has a history of developing a market for a product and then being provided an opportunity to exit at a valuation that cannot be refused. For instance, the company popularized the glue stick in North America as an alternative to liquid glue in the 1980s, then sold Ross Adhesives to Elmer's Products Inc. According to Sheena, the family plans to continue that business approach of developing and divesting, a business strategy which inherently involves succession planning.

> "In our business, my father stepped out of the day-to-day running of the business over five years ago. Like any entrepreneur, he still enjoys being involved, but luckily has left the daily activities for us to handle, allowing my siblings and I to divvy up the responsibilities. My brother stepped into the CEO role at our company, and he has an incredible passion and drive to lead Conros forward, which worked out well for us. In terms of responsibility, all three of us are equally responsible for the company, so there's no competition amongst us, as we all have the same goals in mind."
>
> **Sheena Chandaria – Director, Conros Corporation**

Case study: Multiple related owner-shareholders, no family successor

A private company with a handful of shareholders, who are related, is now grappling with how to facilitate the impending retirement of one or perhaps two of the senior-most players, according to a senior executive. Since none of the shareholders' adult children is a potential successor, company owners are discussing the possibility of grooming a senior executive who is currently not a shareholder. "The larger question is: how do they give a bigger piece out to someone," the executive said. Another challenge to consider is whether and how the business should consider approaching a possible major acquisition, given that one or two major shareholders may be bowing down soon.

Other companies find themselves with unclear succession plans. For instance, SciAn Services Inc., a contract research organization which supports the clinical development of the pharmaceutical and biotech industries, has not yet developed a long-term succession plan, according the Mark Donaghy, the firm's vice-president of finance and general manager. "We have not hammered that out," Donaghy said, referring to who will lead the company in the long-term'. Towards this end, Donaghy has encouraged the creation of a board of directors committee at the company to clarify the issues in succession planning and to help do this kind of planning.

Family succession becomes particularly problematic when some children express an interest in taking over the family business while others do not. "Inevitably, the individuals within the company feel that the non-active family members are getting a free ride, while those outside of the company feel they're getting shafted by the insiders," says Howard Johnson, of Veracap Corporate Finance Ltd. "The key is to have a mechanism for shareholder liquidity so that those family members who don't want to participate in the family business are allowed to exit on a basis that is fair, while not burdening the company."

"I was involved with two very different succession planning projects. One was a very successful transition, one was not. It can be very tricky where families or founders don't get along or are conflicted. You need an independent party. So in the successful situation, a personal succession coach was engaged to help navigate through the process, take a holistic approach and be a facilitator of the various dynamics at play. The focus was not just on tax and estate planning. Instead, the succession coach was a generalist who was independent and impartial; helping to facilitate a broad range of areas and quarterbacking the overall planning from both the dynamics of the demographics – the emotional, passionate – as well as the financial aspects. I think that worked out extremely well, as it kept everyone focused, calm and enabled the process to keep moving forward and come to a well-balanced solution quickly."

Vicki Nishimura – Vice President and Corporate Controller, Prism Medical Ltd.

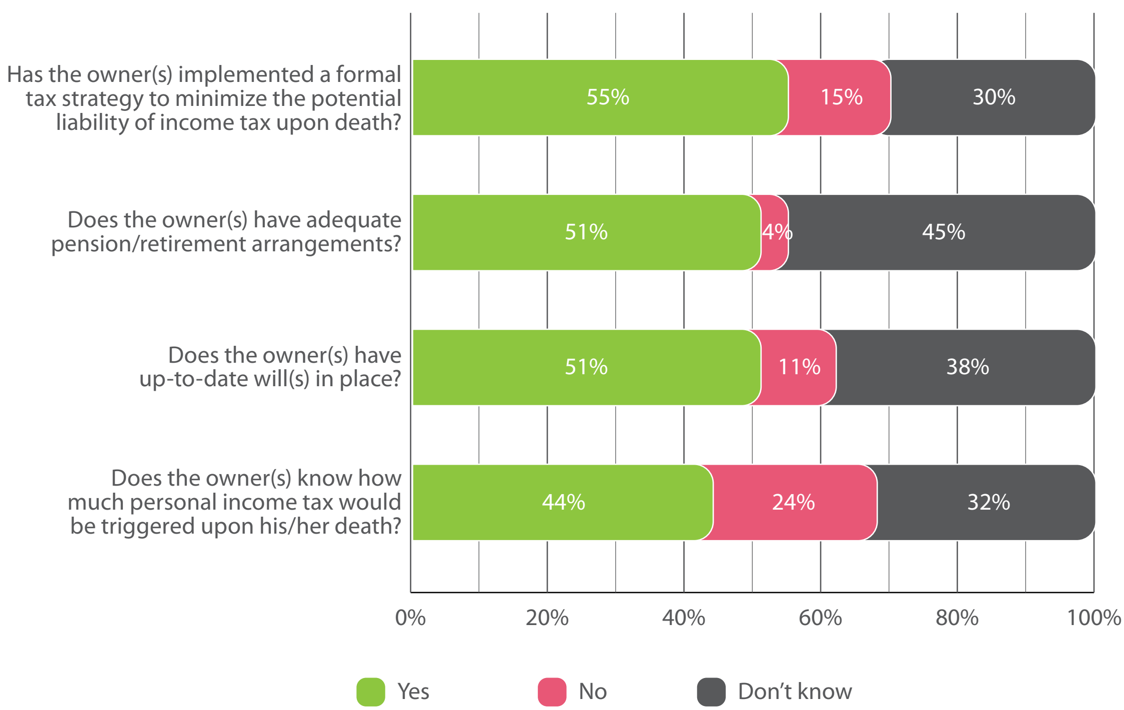
TAX AND ESTATE PLANNING

The importance of tax planning is well known: as one participant aptly put it, every deal has three parties: the buyer, the seller and the government. "The latter's involvement tends to lead to one of the more typical pitfalls of succession planning, which is allowing tax issues to take centre stage too early on in the process," says Paul Coleman, a partner with Grant Thornton in Toronto. "If a tax-planning perspective dominates, the tendency is to keep the valuation of the business as low as possible. But other factors have to be considered in estate planning, and the lower valuation may not benefit all the parties in a succession. There may be other ways to pass the company on to the successor(s) in a tax-efficient manner (through the use of a trust, for instance). I'm a firm believer that you put the tax piece at the end once you have fashioned all the other key decisions out," Coleman said. "Make sure that the tax people have their role, but they don't drive the process."

Three-quarters of the respondents had sought professional tax advice with regards to the tax implications of a future transfer of ownership, and most said the owner had implemented a formal tax strategy to minimize the potential liability of income tax upon death. However, less than half knew how much personal income tax would be triggered upon his or her death (Chart 8). Most respondents said their companies had operations in more than one jurisdiction in Canada, and most were also operating outside Canada – two factors alone that can add to any tax burden upon death.

With regards to estate planning, fewer than half of respondents said their company owners were satisfied that their succession planning objectives would be achieved through their estate plan. Half said their company owners had an up-to-date will in place and had adequate pension/retirement arrangements (Chart 8).

CHART 8: ESTATE EFFICIENCY



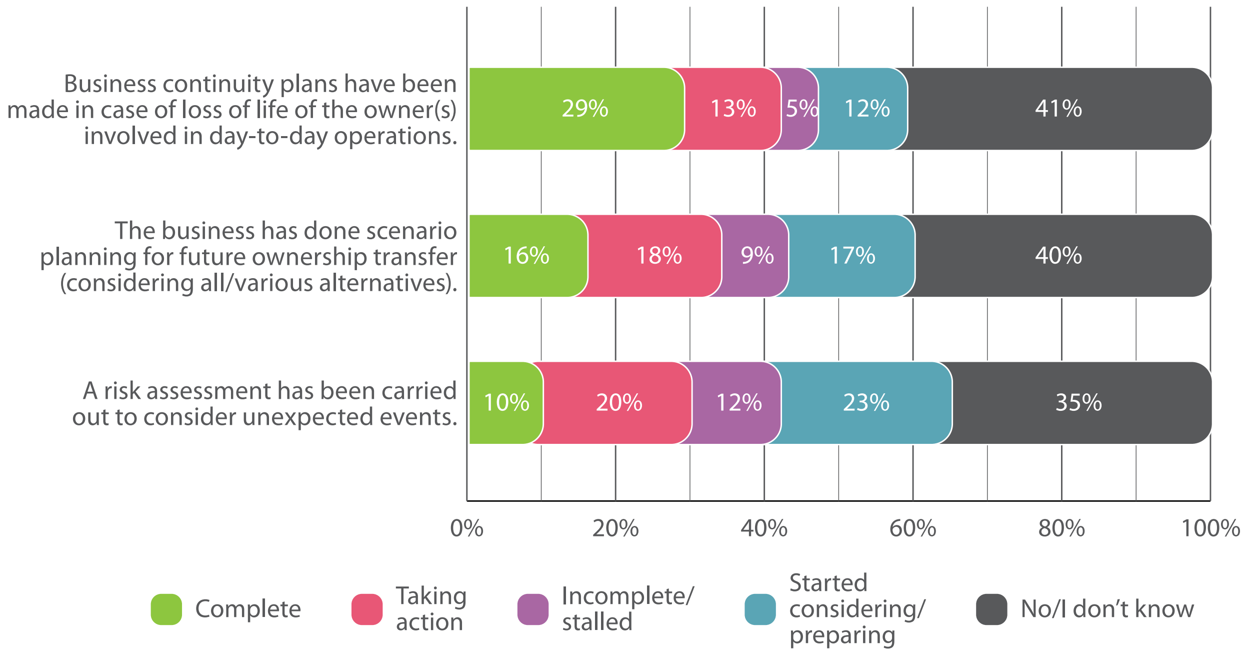
CONTINGENCY PLANNING

Fewer than 10% of survey participants had completed risk assessments to consider unexpected events. Slightly more had done scenario planning for a future transition (16%) of ownership, with consideration given to all alternatives. The most common scenario was the potential death of the company owner(s) involved in day to day operations; as 29% had considered this possibility (Chart 9).

Contingency planning is often presented in negative terms, and family businesses must be prepared for tragedy with succession plans, wills and insurance policies in the event of death or natural disaster. But interestingly, positive events may also affect a succession plan. For instance, one forum participant said that booming revenues have put a damper on succession plans.

A contingency plan could also include alternate scenarios to an outright sale. For instance, Paul Chan, President and Owner Storageflex Inc., said he could see himself one day possibly delegating the operations of his company while still retaining ownership.

CHART 9: CONTINGENCY PLANNING



GOVERNANCE

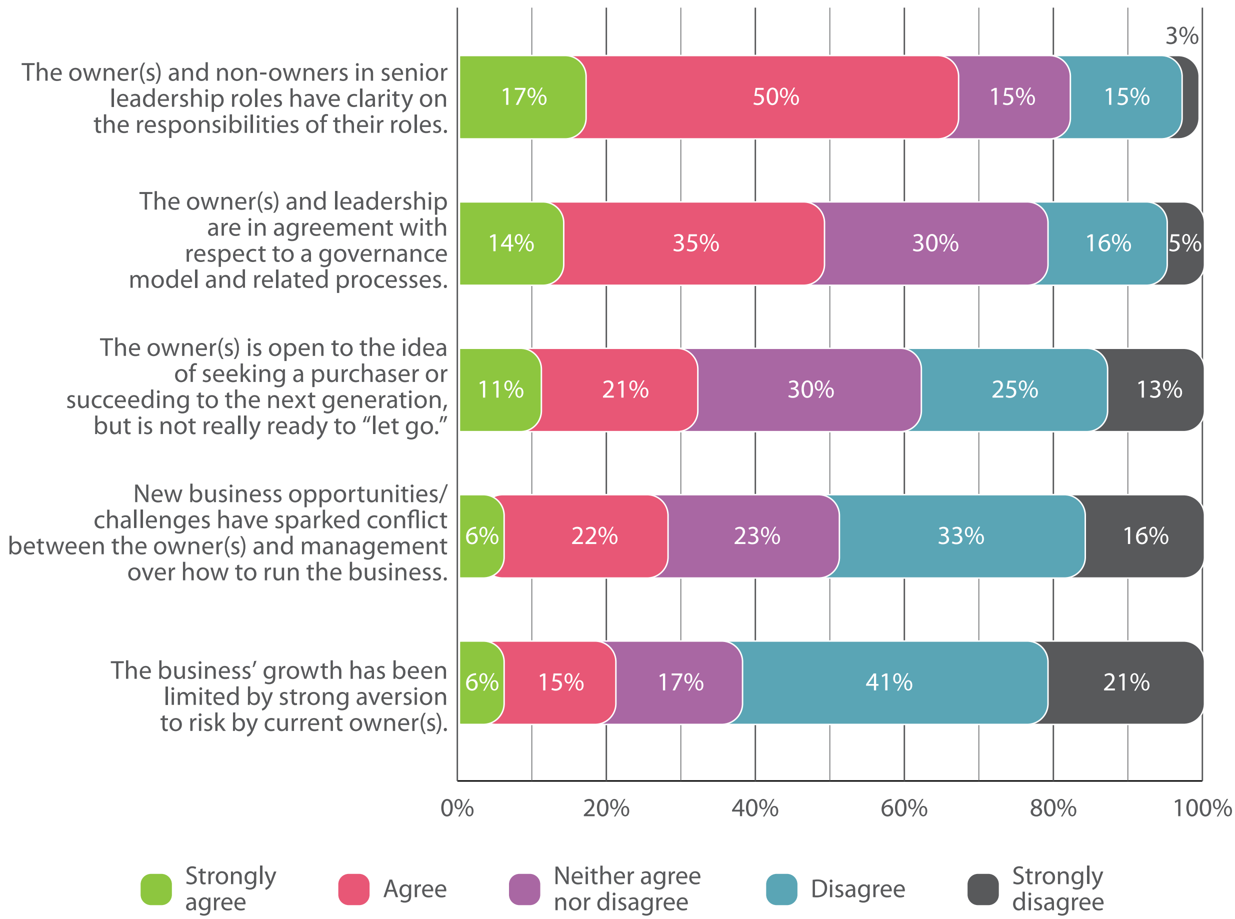
Most private companies surveyed had not yet established a formal governance model, according the majority of respondents. Only two in five said their companies had done so. Private companies can benefit from a board, or board committee with some oversight, to function as a driver of well-informed business decisions. Some perspectives could include views on setting strategy, mapping out growth and assessing performance, targets and goals.

A formal governance model with outside input may also assist in helping a company make tough decisions, particularly, around succession, retirement and transfer of ownership. This may be necessary in instances where the owner is open to the idea of ceding ownership but is not really ready to let go, as in companies employing three out of ten respondents (Chart 10).

Examples may include dealing with underperforming family members; dropping products; evaluating executive perks; evaluating vendor and customer relationships (such as timeliness of payment and/or creditworthiness); and approving major transactions, including acquisitions and spinoffs. The need for transparency and accountability is equally important in the case of multiple private company shareholders, whether they are related or not.

Despite the benefits, some small companies may resist any move toward formalized governance structures, arguing the bureaucracy involved in such a process would be cumbersome, and restrict flexibility and the company's ability to respond quickly to business opportunities.

CHART 10: GOVERNANCE



Owner can't let go: A case study

One very successful private company with established clients and contracts – and a very passionate, creative owner-founder – has been struggling with implementing a succession plan for at least two reasons, according to a veteran financial executive employed there. For starters, the energetic, dynamic founder has been unwilling to delegate duties, and if he does, it's only for short periods. For this reason, a board of directors was established in order to help ease the transition process of delegating duties.

"It's a real conflict between the desire to hand things off and his passion for the business," the executive said of the owner. Meanwhile, the designated successor is also a reluctant one, which adds an additional layer of complexity to the planning, according to the executive. "It is a very big concern. We have people who are more routine-oriented and we have people who are creative and passionate. The company requires those routine people to be highly efficient. We need the passionate people to deal with the one-off problems that are frequently showing up in our line of work. The problem is, of course, that the designated successor is more routine than passionate ... whereas the CEO is more passionate than routine. We are having a problem bridging this."

VALUATION

While formal business valuations had been conducted at 42% of the businesses employing survey respondents; most (58%) said no formal valuation had been conducted. Of those companies that had undergone a valuation process, about half were within the last two to five years (47%), while 36% were done within the last 12 months. 17% had been done within the last six months. The vast majority of respondents whose companies had done a valuation said they believed it was accurate given current market conditions, while one in five said it was not. Reasons included growth; market expansion; bad assumptions; goodwill not reflected and lower earnings. The majority of companies have not undertaken measures to enhance the value of the business in anticipation of a future sale.

While some companies may view the expansion of a successful business as an effective method of enhancing value, this may not be the case. Investing more money to expand the business does not mean the business is worth more even if it is sold for more – the real value resulting in profit from the sale is intangible, also known as goodwill. Another intangible asset is people, who are at risk in any succession plan. For instance, any valuation process which may be made public could create a ripple effect of uncertainty through a business. A sudden wave of departures of high-level people could have an impact on value, necessitating a plan to pre-empt that.

“I think when you're looking at your business and you're looking to succession planning, you have to step back as a financial person and look at it a little bit more holistically as a brand ... very little on your financial statements actually drive the value of business. It's the people, it's the talent, it's the unique set of skills and it's the reputation – those are the pieces that make up the value of your business. Once you realize that, it helps you to better understand what it is you have to do to retain them or where you need to focus your attention. Retaining people is more about feeding the need for what drives them to do well. Money is important, but it's number seven on our list. Focus your succession plan on ensuring those things actually get enhanced.

In one of the ad agencies, one of the key pieces of value we could bring back to the team to retain them was that they otherwise would have the access to clients they would never get access to, real top 500 brands of the world. That they could actually work on the creative and work on a strategy, that to them was as important as anything. Focusing on the networking opportunities that came from a large acquirer helped to build and retain loyalty in a very fragile group of creative people .”

Don Miller – CFO, Blast Radius Inc.

True shareholder value comes through creating intangibles, such as a recognized brand name, strong reputation, or a diverse base of repeat customers, according to Howard Johnson, Managing Director of Veracap Corporate Finance Ltd. “Ultimately the determining factor of intangible value is whether or not a business can generate a return on its capital greater than its cost of capital,” he said. “And that’s where I think the CFO can really be helpful. They can act as a sounding board for the business owner who’s anxious to grow their company at any cost. The CFO needs to assess whether that growth will translate into higher shareholder value.”

Company owner-founders need to hear the truth from CFOs about what their business is truly worth, to keep their expectations realistic when going into a sale, said a forum participant. “A lot of owners have pretty big egos and the value they believe their business is worth to what it really is worth are fairly different. And I think the CFO’s role is to try to ground them and to explain either mathematically, or through benchmarking, the business isn’t worth that, and this is what it is worth. I’ve been involved in a lot of sales that have gone sideways just because the ownership was way up here but the true market value of that company was way down there. They lost good opportunities to sell the company at a reasonable number, then the market had changed down the road and what they could have got was missed. So opportunity lost due to over-valuation.”

ROLE OF THE CFO

Succession planning begins by encouraging business owners to cast their sights on the horizon and to look at the measures which are needed to get there. While some companies have taken steps to plan for the future, and most of those have prepared for both financial and non-financial issues, it is clear that many have not, and require help to start on the path. The CFO is well-suited to turn the company leadership's attention to long-term planning. The role is perhaps best viewed as a quarterback, coach or sounding board in the succession planning process. Financial executives may stick-handle a valuation strategy, helping the owners understanding the valuation process, and in keeping owners grounded and their expectations reasonable.

> "The CFO really needs to be engaged and aware of the owner's succession plans: what their intent is, whether they want to go public or sell, and what the timeframe they're looking at is, because there is so much work that has to be done by the CFO and they need to get working on it right away, especially for a smaller business. There's so much that has to be done in order to prepare for due diligence. So it's really critical that the CFO is engaged early."
>
> **Nancy Lala – CFO, About Communications**

While financial executives have a role in steering the owner towards succession planning, they must also be prepared to help with any transition following a transfer of ownership: "In each case I've been involved with, the succession process has actually gone on for several years after the actual transition," recalls Don Miller, who has worked for years as a financial executive in the advertising industry. He recalled that the acquirer designated him as the main post-merger liaison after the company he worked for was sold. "In my experience, I spent more time actually post acquisition, working through the succession issues than I did pre-acquisition – and the challenges were huge. They're demanding, they're tiring, they're frustrating, and as a CFO you're the primary point of contact. I once had the (acquirer's) CFO tell me: 'You're the only person I want to talk to. You are the principal point of contact for everything we learn about your company.' So you had better understand the other issues outside of the financials."

CONCLUSION

Private company succession planning: Where do you stand? clearly demonstrates that private businesses face an uphill battle regarding ownership transition, even though many have either started the process or are considering it. But time is running out quickly as a whole generation of baby boomer entrepreneurs has reached or is quickly approaching retirement age. That translates into a large number of businesses that may be negatively impacted by an unplanned change in ownership. Some of this potential for turmoil might be avoided or at least minimized through a well thought out succession plan involving the entire organization. There are many steps to take on this route, but perhaps the first is for current ownership to work with its management team to create a long-term vision for the company.

Best practices:

- Don't delay or simply wait until there is a "trigger" event such as illness, divorce or death. Succession planning should be an ongoing process that is started early and revisited regularly.

- When it comes to planning the transfer of responsibilities, draft a clear list of the key responsibilities and tasks required to run the company. Are there internal candidates with appropriate characteristics, traits and skills? Write job descriptions which can be matched against prospective successors.

- When dealing in a family business, ensure there is transparency and clarity regarding the roles and responsibilities of active and inactive family members, as well as agreement between all parties on the succession plan and direction of the business.

- Offer opportunities to train and develop internal candidates now. Look for gaps in skills and seek ways to address these. Examples include job shadowing, job sharing, rotations and lateral transfers.

- Ensure there are appropriate successors lower down to move up to fill the vacancies left when senior managers move up. If remaining staff are not able to handle more responsibility, find other duties for them, or make arrangements for training and education so they will be.

- Prepare for issues post-succession. If there are finance executives staying on after an ownership transition, it's best that they're familiar with all aspects of the business beyond the numbers.

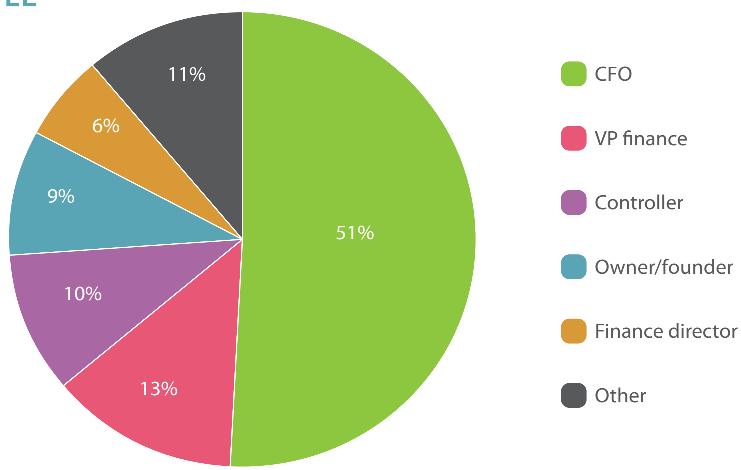
Since transfer of ownership comes with many challenges – some of which may not have been considered in a traditional "succession plan" – the study indicated that sometimes outside help is useful. One financial executive involved in a successful succession planning exercise reported that the presence of an independent facilitator was helpful in keeping the process on track and quarterbacking the overall planning, while balancing both financial and emotional concerns.

However, when professional advice is sought, it was felt that tax experts alone were not best suited to driving the process. Rather, a holistic approach which takes all concerns into account should be the key consideration when planning a succession. Advisors can include accountants, tax and estate experts, business valuators and other consultants, bankers, lawyers, mediators and a board of directors.

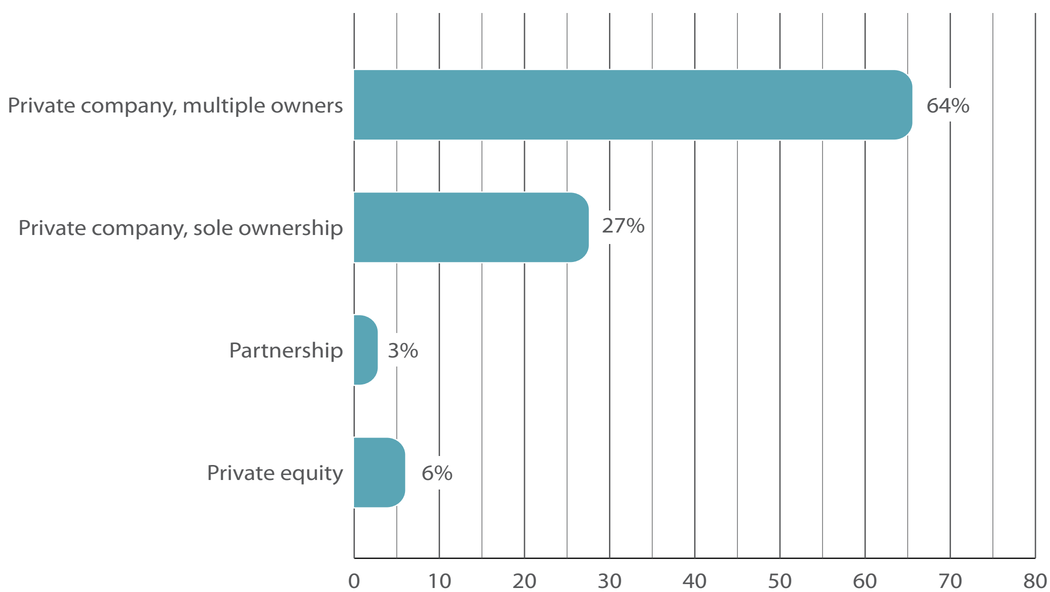
Since business cycles, conditions, customers, competitors, markets, and people are all in a constant state of flux, a business succession plan should ideally be revisited annually to assess whether it is still fresh, relevant and applicable. By consistently revising the plan five or even 10 years before a potential planned ownership transition, the business will still be on a stronger footing if and when unexpected events occur.

APPENDIX A: SURVEY DEMOGRAPHICS

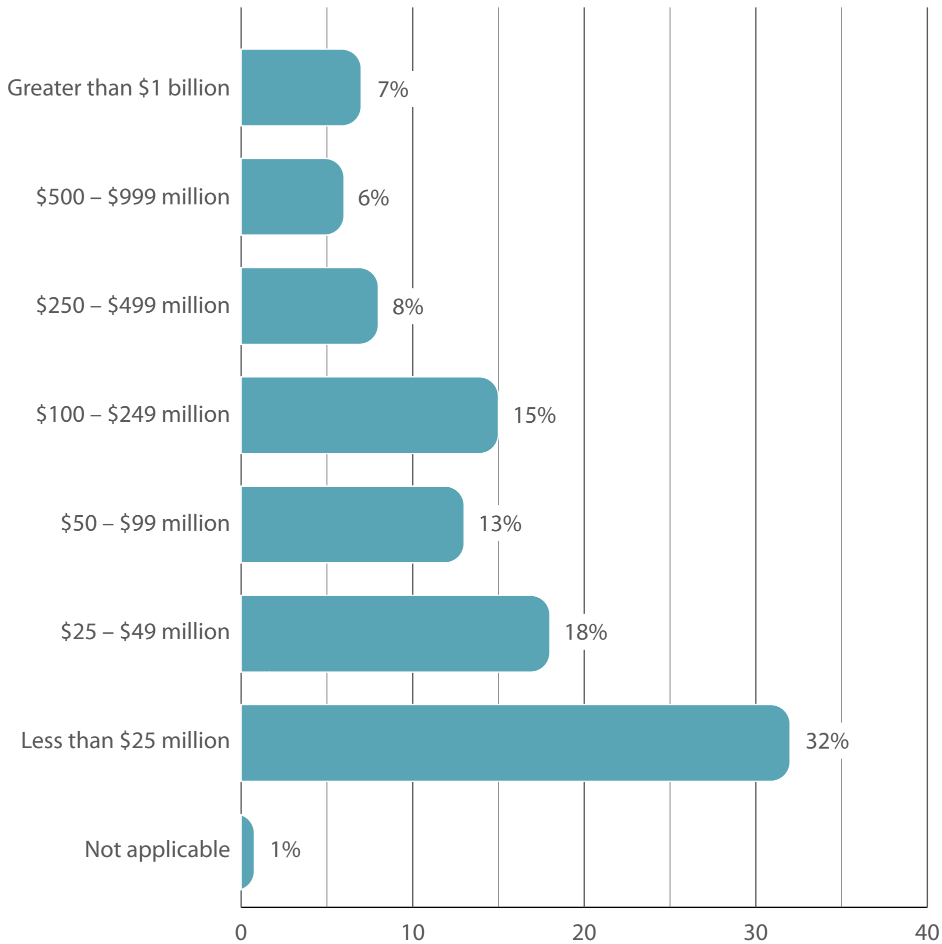
POSITION TITLE



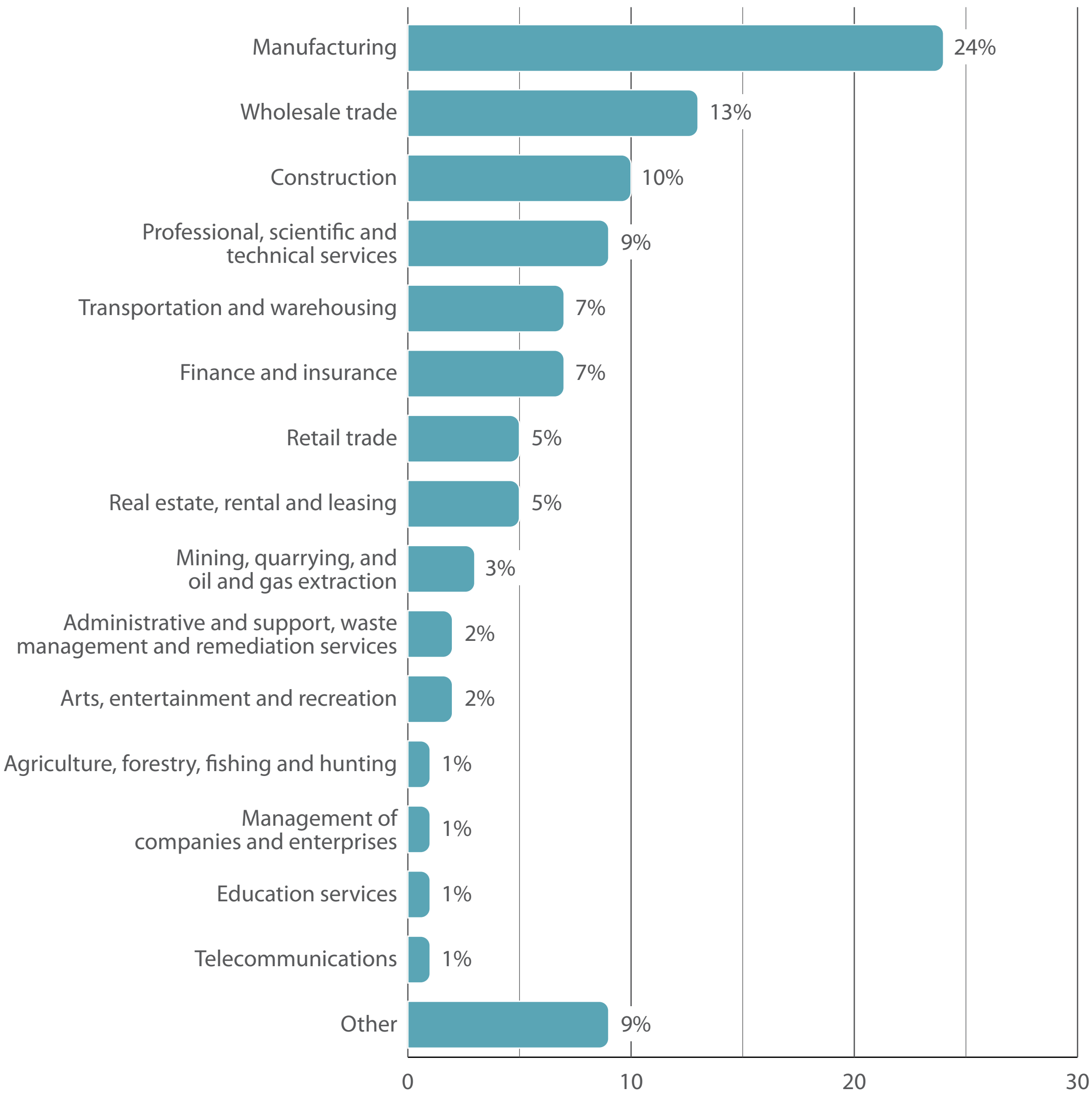
COMPANY STRUCTURE



ANNUAL REVENUE



INDUSTRY CLASSIFICATION



APPENDIX B: FORUM PARTICIPANTS

Chair

Michael Conway – Chief Executive and National President, FEI Canada

Moderators

Christian Bellavance – VP Research and Communications, FEI Canada
John Harris – Partner, Grant Thornton

Attendees in Toronto

Glen Benway – Director, Audit, Equity Financial Trust Company
Paul Chan – President and Owner, Storageflex Inc.
Sheena Chandaria – Director, Conros Corporation
Paul Coleman – Partner, Grant Thornton
Mark Donaghy – VP Finance & General Manager, SciAn Services Inc.
Howard Johnson – President, Veracap Corporate Finance Limited
Nancy Lala – CFO, About Communications
Marc Langlois – CFO, International Custom Products Inc.
Vicki Nishimura – VP and Corporate Controller, Prism Medical Ltd.

Appendix B: Forum Participants

Attendees in Vancouver

Fan Chun – Chief Financial Officer, Dr. Battery, Canada

Susan Clayton – Director, Financial Reporting, Powell Dorian

Ken Kirk – Chief Financial Officer, Sepro Mineral Systems Corp.

Don Miller – Chief Financial Officer, Blast Radius Inc.

Ron Sun – General Manager, Ampco Manufacturers Inc.

Dave Rickards – Managing Partner, Grant Thornton

Observers

Mishka Alarcon – Marketing Manager, Grant Thornton

Laura Bobak – Senior Writer, FEI Canada

Fabiola Garcia – Senior Manager, National Marketing, Grant Thornton

Melissa Gibson – Communications and Research Manager, FEI Canada

Krista Han – Senior Manager , Grant Thornton

Rachel Walton – Communications and Research Intern, FEI Canada

THE CANADIAN FINANCIAL EXECUTIVES RESEARCH FOUNDATION (CFERF) is the non-profit research institute of FEI Canada. The foundation's mandate is to advance the profession and practices of financial management through research. CFERF undertakes objective research projects relevant to the needs of FEI Canada's 2,000 members in working toward the advancement of corporate efficiency in Canada. Further information can be found at www.feicanada.org.

FINANCIAL EXECUTIVES INTERNATIONAL CANADA (FEI CANADA) is the all industry professional membership association for senior financial executives. With eleven chapters across Canada and 2,000 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada's leading and most influential corporations. Further information can be found at www.feicanada.org.

GRANT THORNTON LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. Together with the Quebec firm Raymond Chabot Grant Thornton LLP, Grant Thornton in Canada has approximately 4,000 people in offices across Canada. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member firms operate in close to 100 countries worldwide.
www.GrantThornton.ca

CORPORATE DONORS:

GOLD ($10,000 +):
Husky Energy Inc.
Manulife Financial Corp.

SILVER ($5,000-10,000):
Agrium Inc.
Imperial Oil Ltd.

BRONZE ($1,000-5,000):
Canadian Western Bank Group
FinEX Group
Nexen Inc.

OTHER DONORS:
Marsulex Inc.
General Electric

FEI CANADA'S RESEARCH TEAM:

Michael Conway – Chief Executive & National President
Christian Bellavance – Vice President, Research & Communications
Laura Bobak – Senior Writer
Melissa Gibson – Communications & Research Manager

170 University Avenue, Suite 1201
Toronto, ON M5H 3B3
T 416.366.3007
F 416.336.3008
www.feicanada.org

cferf
canadian financial executives
research foundation
fondation de recherche des dirigeants financiers du canada