BUSINESS: THE NEXT GENERATION

by Craig Zawada

One issue which every small and medium sized business faces at some point is succession. It is extremely difficult to ensure that a business continues after the founder leaves. For the founder, this means problems in recovering the value wrapped up in the business.

Many business owners think that succession planning is simply a matter of letting the kids take over. Sometimes this works. More often, it does not. Less than one third of family businesses survive into the second generation. Only 12% make it into the third. Even family businesses that become giant corporations are not immune to this problem. Ask the Eaton family, or the Bronfmans.

Succession planning is like compound interest – it works best when time is plentiful. While it is difficult to forecast far into the future, there are steps owners can, and should, take now to increase the chances of a continued success after the owner is gone.

There are two broad questions that accompany succession planning. First, who can the business be sold/transferred to? Secondly, what steps should be taken to provide the most flexibility, and to ensure that the present owner gets the best results?

The second question will be covered in the next issue. For the remainder of this article, we'll discuss who can take over a business, and some of the features of each.

For a family business, the preference is usually to keep it within the family. This is particularly so in businesses such as farming, where there may be a strong emotional attachment to the land that supports the farm. In almost all cases, keeping it in the family means that the spouse or one or more children will take over. The spouse is often only a short term alternative; if one passes away, the other may be too old, or not have the desire, to continue the business for a long period.

Passing a business to a child or children involves as much psychology and mediation as legal skills. If there is only one child who desires to continue the business, fine. Other than equalizing the value with other children on the owner's death, which admittedly is not always easy, the child can be trained and groomed to assume operations.

In some cases the child will only take control upon the death of the parent, but in other cases, the parent will want to gradually wind down his or her time commitment and retire. Depending on the level of control that the parent wishes to maintain, there are different ways of structuring the takeover, from an outright gift, to more stringent controls over voting power.

If there are multiple children who want to take over the business, different considerations apply. One cannot guarantee that they will continue to get along, but if there is already friction among family members when the owner still controls the rudder, don't expect the divisions to just disappear. Steps may have to be taken now to heal rifts.

After family, the most common alternative is to sell the business to existing employees. There are a number of advantages to this. For one, the employees will be the best acquainted with customers, business methods and other aspects that will make the transition smoother. The employees are often highly motivated as well, since they may be out of jobs if they cannot swing a deal.

Not all employees are able to afford the substantial capital investment to take out an owner, however, and this may mean the owner has to be paid over time. The risk to the vendor thus increases. Also, if there are significant divisions among employees, finding a suitable bloc willing to buy, while ensuring that other employees still feel part of the business, can be a challenge.

Absent family or employees, an owner has to go to third parties. Some of these may be known to the owner, such as friends (although be aware of the risks, legally and personally, of entering into business deals with friends) or they may be complete strangers. The biggest hurdle is often finding these buyers. Personal and business contacts are the usual method, but there are a growing number of businesses that specialize in matching buyers and sellers of businesses. Professional advisors, such as the business's accountant or lawyer can also be a good source of contacts.

If a transfer is not on the immediate horizon, there is a tendency to do nothing, thinking that the plans might change. There are actually several things that can be done at any point which will help decrease the hassle of business succession. In the next issue, we will talk about common steps that businesses take to maximize their flexibility when transferring to new owners.

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