

# BUSINESS VANCOUVER

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**Kim Inglis, BCom, CIM, PFP, FCSI, AIFP**

## **Successful business succession planning starts early** Locking in the value of your “sweat equity”

A Quantitative Study of the Business Succession Market in Canada published by RBC Royal Bank found only 3% of business owners plan to wind down their operations at retirement. A whopping 88% intend to have the enterprises taken over by family members, by employees or partners, or by third party entities. The rest simply don't know.

Although a large percentage of small business owners are considering succession of some sort, most haven't planned for it. A TD Waterhouse poll found that 76% do not have a succession plan. It's a large percentage but much can be attributed to emotion.

Most small business owners have invested years of "sweat equity" building their companies. They are proud of their accomplishments and the companies have become a big part of their identity and self-esteem, so it's not surprising they find succession planning difficult to contemplate. Fortunately, the process can be less daunting than it seems and there are many options, particularly for those who want to keep it in the family.

BDO Dunwoody LLP Chartered Accountants and Advisors say that shareholder agreements require careful consideration and should cover share ownership rules, buy/sell rules, and the death or disability of a shareholder. The conduct of shareholders and any areas of potential conflict also need to be spelled out.

Share ownership rules stating who can own the shares of the business are of utmost importance when marital breakdowns occur. BDO points out that shareholder agreements may prohibit in-laws from becoming owners but provincial family property equalization rules can result in shares becoming property of the ex in-law. Properly structured agreements can address this by requiring family members to have specific conditions in marriage contracts, in order to be eligible for share ownership.

Buy/sell rules are another important consideration. The Family Firm Institute says that 70% of family businesses will not survive into the second generation and 90% won't make it to the third. When family members want (or need) to sell their shares, buy/sell rules help by outlining where and to whom shares can be transferred and how they will be valued.

There is much to consider when drafting buy/sell rules. Some families want restrictions that only allow share transfers to other family members, or that offers must be presented to the family before selling to non-family members. Some want conditions governing any sale to non-family members and, of course, there is the question of what happens if the business is sold. Buy/sell rules should dictate the approval procedures for any share sales.

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Finally, shareholder agreements should cover the more sensitive areas such as disability or death of a shareholder. If a shareholder is an employee and they become disabled, shareholder agreements need to clarify what benefits are paid and whether any share sales are required. In the event of death, the agreement should cover the inevitable transfer of shares to the heirs and the use of proceeds from any corporate-owned life insurance.

There are many more aspects to this topic but the important point to take away is: Get advice and get started. Succession planning is an evolutionary process that should begin early. Don't let an unexpected event, such as illness or injury, force you to make key decisions without the benefit of time to consult and reflect.

*Kim Inglis, CIM, PFP, FCSI, AIFP is an Investment Advisor & Portfolio Manager. The views in this column are solely those of the author.*  
[www.kiminglis.ca](http://www.kiminglis.ca)