

Succession challenges family businesses

As baby boomers age, help will be needed

By JAN DEAN

The peaceful transfer of power is one of the hallmarks of stable government.

It's just as important for businesses – especially family businesses.

Dave Schnarr, executive director of the Waterloo-based Centre for Family Business says only 20 per cent of family businesses make it to the third generation and the biggest issue is communication.

Families working together are a strength but when the time comes to pass the crown and sceptre to the next generation of leadership the emotions and passions that once united the family and business can disintegrate and tear the both apart.

That's why it's important to start working on a succession plan when business is good, the founder is healthy, and it's clear sailing.

Issues like succession were the reason local business people started the Centre which is now in its 12th year. Sixty-five family businesses are members of the Centre which regularly presents breakfast meetings that draw up to 100 and peer to peer round tables.

Schnarr says communication is the biggest issue for family businesses whether the business employs 10 or 500. The Centre holds gala banquets to honour those who have completed succession plans.

Schnarr says it's all about the process and that has to be led by the senior person. He says the "leading generation can mentor and guide the new leadership because after all, they know the business, but at some point they have to let go control," explains Schnarr.

Schnarr says that dealing with succession usually requires a change in business mentality because very often the second generation has been to university and has a different perspective. "They're keen and want to succeed," says Schnarr.

At the Centre he says, "we recommend that kids work someplace else before they come into the family business – you want them to have a variety of experiences so they can decide what they want to do."

Ken Hanbidge, managing partner of Borden Ladner Gervais LLP in Waterloo says putting together a succession plan for a family business should be a team effort because getting input from an accountant, lawyer, insurance broker, banker and advisor who understands the family dynamic makes sense.

"The founder is like the quarterback or driver of the process," says Hanbidge. "This isn't something you put together overnight, there are a lot of questions that need to be addressed: who is the potential successor? Family or an employee? Should the business be sold?"

He agrees wholeheartedly with Schnarr that the time to get this process underway is before the founder is thinking of retiring because there is always the risk that a divorce or a sudden death could make succession and the future of the business an immediate issue.

Then there's the whole family dynamic. "My sense is that personal issues are as important as legal and tax issues for succession, and sometimes parents hang on too long," says Hanbidge.

It's not just deciding who will head up the company – it's about how to recognize the sweat equity put in by different members of the family.

And sometimes a successor can recharge a business, making it more successful than it was under the founder.

For most people, the family business represents a big part of their portfolio, and it takes time to put together a plan that allows them to get the cash they need without putting the business at risk. Then there's the whole issue of how long-time employees are treated during a power transfer.

Those are the kinds of issues that Hanbidge says the Centre for Family Business handles well. "At the Centre they facilitate discussion, and can help with inter-generational transfers of business," says Hanbidge.

And during succession discussions Hanbidge says each family member involved should be using his or her own lawyer and advisors, "because the hard questions need to be asked and there's no way one lawyer could represent the interests of everyone," notes Hanbidge. "Sometimes a trusted advisor can smooth out problems – and that's a lot better than ending up in court for months – that's a no-win situation. The owner/manager/parent has a responsibility to be fair and not drive a wedge in the family."

Jim Harper, managing partner BDO Dunwoody for Waterloo Region says succession plans are tough to put together for family businesses but it's exciting to work with passionate people and in his experience families are passionate about their businesses.

He says most founders want to pass the business on to their kids but a small number of founders realize that their children just aren't interested in the business, and sometimes the family dynamic overrides that ambition.

There are cases, Harper says where, "the next generation might not have the same values and passion as the founder – and times change so sometimes economic circumstances make it impossible."

There are a lot of resources available about governance for family businesses through organizations like the Canadian Association of Family Enterprise (CAFE) or locally the Centre for Family Business – which is why BDO Dunwoody is a major sponsor of the organization.

The good news, says Harper, is that a lot more family businesses are taking advantage

of the educational resources out there because, "they understand the need to run their business professionally."

Talking about succession is inevitable because of basic demographics, says Larry Klar, managing partner of Argosy Partners Ltd.'s The Succession Fund. The simple fact is that the boomer generation is aging.

But putting together a succession plan shouldn't be an event, says Klar, "it should be a process. And now is the time to consider it, when the founder is in his or her 50s, healthy and the business is doing well because it allows them to consider all the incredible emotional factors involved and prepare the business for sale."

"It's really about the business leaders preparing 'to obsolete themselves,'" explained Klar. "Say Mr. Smith of Smith Ltd. – who is the business, has never added depth to his management team.

The business relies on Mr. Smith's goodwill and that really can't be sold. It's important that Mr. Smith put together a management team so his business has value."

For some companies, the best option is the Succession Fund which Klar leads. The Fund is a private company of investors who 'buy in' to a company – allowing the founder/owner to realize some cash value while bringing on board investors who want the business to continue and to be profitable.

"We're very proud of Westmount Storefront Systems," says Klar, the Succession Fund bought into that, to the satisfaction of both parties."

Klar's business also includes the Shotgun Fund which can step in to alleviate family business strain when one side is determined to buy out the other.

Klar says the Shotgun clause in business is a buy/sell clause in the shareholder agreement that is invoked when a partner dispute turns ugly – he likens it to a corporate pre-nup. that allows one partner to bid for another partner's share but the other partner can then

turn around and buy the instigator's share for the same price – so low-balling is dangerous. These clauses typically have a time constraint as well.

The Shotgun Fund steps in when the business operator is having problems and gives him or her the cash to buy out the other partner, taking on the Shotgun Fund as the new partner.

Klar says there's no doubt there are businesses where the sole objective of the founder is to hand it off to the next generation without considering whether the kids are interested, or capable. In that situation you see rampant nepotism.

"When we get involved," says Klar, "is when the family business owners are ready to deal with the issue of ownership transition. Should they add management depth, focus on only one product? It's difficult stuff and increasingly people are challenged by it. But it's a subject that should be helpfully debated whether you're talking a mom-and-pop operation or a multi-billion dollar company. Historically tensions are heightened where there is no formal board or directors."

Then there's the issue of how likely it is that someone else in the family has the vision and drive of the founder. Think Eaton's and Seagrams. Where are they today?

Companies often falter when the key is just handed to the next generation.

He says that bringing in the Succession Fund allows the founder to realize some of the cash value of the business and also brings in outside perspective to the board level. That adds a layer of governance that might be missing.

"We partner with people where managers are ready to have those questions answered," says Klar. "But it means the business can't be a private piggy bank anymore – it has to be ready for new dynamics and a layer of professionalism that might have been missing."

He says the whole process speeds up during a recession because owners get nervous about their net worth.

"Inevitably this is a dance – we have to get to know one another. And the dance can move as quickly or as slowly as necessary."



Dave Schnarr



Jim Harper

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CENTRE FOR FAMILY BUSINESS AGM

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