



# Business Transition

## A Literature Review

Derek Picard, Research Analyst  
May 2004

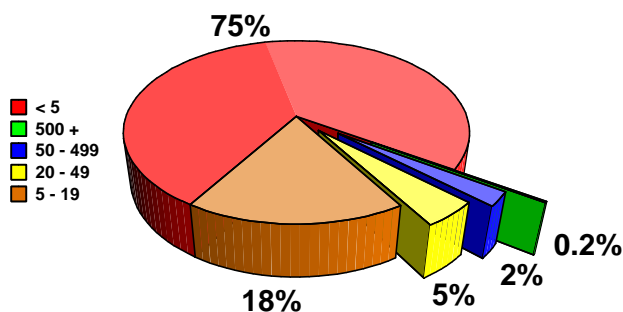
### Contents:

Introduction	1
General Succession Facts	1
The Succession Plan	2
Key to Successful Succession	4
Key Issues	5
Research Gaps	6
Conclusions	7
References and Notes	8

### Introduction

Significant research in recent years highlights the influence of Canada's aging demographic composition. The largest cohort in the population, the baby-boomers, will continue to exert influence on the economy as well as the direction of public policy. Next to health care issues, the decline in labour force participation, mainly due to retirements, is of growing concern. Governments, employers and educational institutions have studied the implications of the pending "exodus" from the labour force and the implications for public policy. Clearly, the concern of an aging population extends far beyond health care.

**Figure 1:**  
Size of Canadian Businesses by  
Employment (%)



Source: Statistics Canada, 1999 Employment Dynamics (2002)

Despite efforts to examine the aging workforce in recent years, there is a lack of research with respect to the aging of small and medium-sized enterprise (SME) owners in Canada. Recent data suggest that most SME owners are between the ages of 45 and 70, creating considerable concern over the effects of their retirement on the economy, the survival of their businesses and the people they employ.<sup>1</sup> Minimizing uncertainties, however, can be achieved through adequate business transition planning.

Focus on SMEs is pivotal in assessing the effects of succession planning. Seventy-five per cent of all businesses in Canada employ fewer than 5 employees (see Figure 1) and almost 60 per cent of employed Canadians work in for a small or medium-sized business. Moreover, of the self-employed in Canada, 40 percent are businesses with employees.<sup>2</sup> In addition, the SME sector contributes approximately 45 per cent of Canada's economic output and is the catalyst of innovative products and services.

Among large corporations, planning for the succession of senior officers is an integral component of their overall strategy. However, the very nature of small business and entrepreneurship is often a constraint to adequate succession planning. Moreover, the additional dimension of operating a family business often exacerbates these obstacles.

### General Succession Facts

Currently, general facts on transition planning are primarily obtained from two sources: A 1999 family business survey conducted by the Deloitte & Touche Centre for Tax Education and Research, at the University of Waterloo; and a 2002 Mass Mutual/Raymond Institute survey in the U.S. Although both target family businesses, they provide valuable insight on transition planning for all firms.

**Deloitte & Touche Study, 1999**

The primary benefit of the survey is its focus on Canadian businesses across the country on various issues related to business succession.<sup>3</sup> The most highlighted findings are the following:

- In 1999, over three-quarters of family business owners expected to retire within 15 years (see Figure 2);
- Two-thirds of family businesses indicated that they did not have an established succession plan;
- Only one-third of Canadian family businesses believe it is important to keep the business in the family; and
- The largest barrier to selecting a successor is the owner’s intent to sell the business (see Figure 3).

**Mass Mutual/Raymond Institute, 2002**

Although the Mass Mutual/Raymond Institute survey focuses broadly on various issues pertaining to family businesses, it supplements the findings of the Deloitte & Touche study. In particular, the survey finds that:

- Nearly 40 percent of family-owned businesses expected a change in leadership within 5 years;
- Over 84 per cent of respondents who had chosen a successor selected a family member to continue the business; and
- Of those who anticipate a change in leadership over the following five years, 42 per cent had yet to choose a successor.

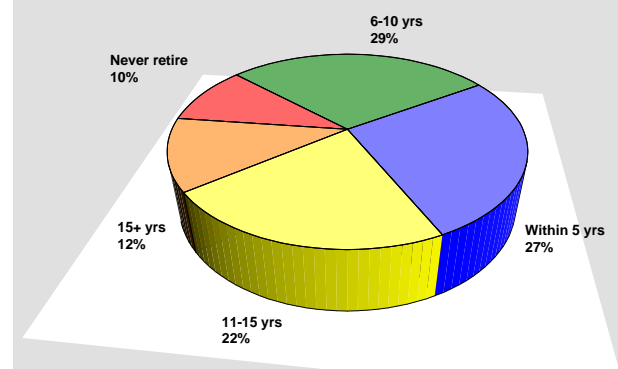
**Additional Facts**

- One third (33 percent) of family businesses survive from the first generation into the second, while only 15% survive into the third generation.<sup>4</sup>
- Most family business owners remain involved with the business after succession (see Figure 4)
- The family business represents the majority of business owners’ estate value.

**The Succession Plan**

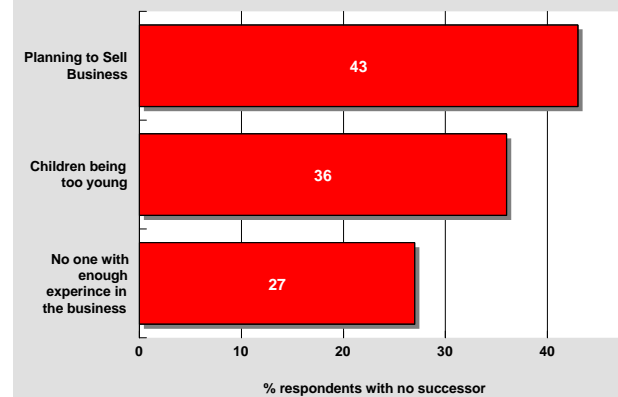
Succession is not a single event, but rather a process in which leadership and, eventually, ownership is transferred to the successor. The succession plan formally outlines this process.

**Figure 2:**  
When Business Owners Plan to Retire



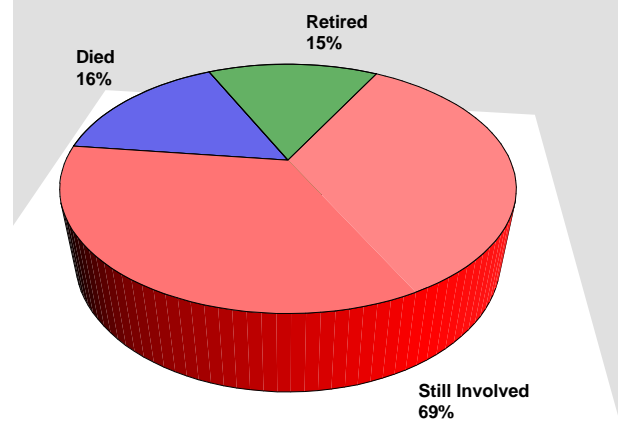
Source: Deloitte & Touche Survey, 1999

**Figure 3:**  
Barriers to Selecting a Successor



Source: Deloitte & Touche Survey, 1999

**Figure 4:**  
Involvement after Transfer of Ownership



Source: Morris et al. (1996)

More importantly, it selects and puts in place the tools required to attain the goals and objectives of all parties involved.

The plan involves several steps that require time, often years, for it to be effective, which is why one must start planning well in advance. Moreover, the legal, tax, and financial aspects of the plan come to play at different stages of the transition and are the tools by which the business owner's goals and objectives are attained. Identifying these objectives, however, is a pre-requisite to prescribing the appropriate tools.

According to Landsberg (1988), the failure to address business succession can be termed the "Succession Conspiracy". He cites four barriers to succession planning: the business founder, the family, the employees, and the business environment (see Box 1). Barriers to choosing a successor, according to a survey of business owners, include the intention to sell the business outright, the owner's children being too young, and the lack of trained candidates (see Figure 3).

**Box 1:**  
**The Succession Conspiracy -- Main reasons why owners fail to plan for succession**

**Founder**

- Fear of death
- Reluctance to let go of power and control
- Personal loss of identity
- Fear of losing work activity
- Feelings of jealousy and rivalry toward successor

**Family**

- Founder's spouse's reluctance to let go of role in firm
- Norms against discussing family's future beyond lifetime of parents
- Norms against "favoring" siblings
- Fear of parental death

**Employees**

- Reluctance to let go of personal relationship with founder
- Fears of differentiating among key managers
- Reluctance to establish formal controls
- Fear of change

**Environmental**

- Founder's colleagues and friends continue to work
- Dependence of clients on founder
- Cultural values that discourage succession planning

Source: Ivan Landsberg (1988)

## Strategic Plan

The strategic plan involves a long-term assessment and identification of the goals and objectives of the business owner and, in the case of a family business, the family's goals. In addition, it charts out a clear, and shared, vision for the business and may include a formal mission statement.

The process involves asking questions such as: Where do I/we want the business be in the future? Who will run the business? Should the business remain in the family? What is the role of the family in the business?

***"Developing a common vision for the future is vital to the long-term success of any plan. Otherwise there is not one plan but many plans that are probably in competition with each other – a sure recipe for failure".*** (Barnett, 2000)

Often, business owners do not have clearly defined goals and objectives. Barnett (2000) finds it effective to provide business owners with generic objectives that can be customized. Such objectives include, but are not limited to the following:

1. Provide for the family
2. Maintain the value of the business over the transition
3. Prepare for the future
4. Maintain family harmony
5. Minimize tax liability

The formal discussion and setting of goals and objectives is a prerequisite to succession planning. As will be illustrated below, a succession plan encompasses the tools to attain these goals and objectives.

The strategic plan allows the family, the business owner, and the successor(s) an opportunity to chart out the future course for the firm. Collectively setting the business goals will ensure that everyone has a clear picture within the business. The plan may consist of written policies that determine the entry and exit criteria of family members, or outsiders, into the business; or the necessary criteria required to manage the business. A strategic plan will also assist in dealing with and avoiding conflicts regarding compensation, ownership, and management control.<sup>5</sup>

### *Elements of a Succession Plan*

According to the European Federation of Accountants (FEE), a succession plan should contain the following ten elements:<sup>6</sup>

1. A statement of the distribution of ownership
2. The identity of the new leader or leaders
3. How the new leaders are to be trained for their roles
4. A definition of the roles of other key members of the business during the transition
5. Mechanics for the purchase or sale of stakes in business
6. Taxation and legal considerations
7. Financial considerations
8. Retirement considerations
9. A procedure for monitoring the process and dealing with disputes and problems
10. A timetable.

In addition to the above ten elements, Upton-Bowman (1999) and Barnett (2000) recommend a formal process of finding a successor, as well as a formal financial valuation of the business.

Several steps are required in order to satisfy the above ten (or twelve in this case) elements. Listing out common steps for the average business, however, is a futile exercise. Every business has a unique structure; a unique relationship with family, suppliers, and customers; a unique history with the community; and, above all, unique goals and objectives of the current owners. Simply put, there are too many uncommon factors involved in succession planning to formulate a common set of specific steps.

As a result, not surprisingly, the efforts of consultants, accountants, and researchers have focussed on a common framework to succession planning; emphasizing the need to discuss and formalize the goals and objectives of all stakeholders involved. Once accomplished, the common elements of a succession plan, as listed above, can be satisfied with the use of specific steps involving financial and legal tools. These steps are ultimately guided by the unique circumstances of each business as well as the established goals and objective.

### **Key to Successful Succession**

According to Morris (1996) there are three general categories of factors that play a vital role in effective business transitions (see Box 2).

Assuming that the process of selecting the successor has occurred, the study cites the preparation level of the business heirs, the relationships among family and business members, and planning and control activities as the primary factors to successful business transitions.

The key finding of Morris' study is that successful heirs to businesses were reasonably well prepared, in both educational attainment and general work experience – the latter including the undertaking of various positions within the business. Moreover, successful transitions were apparent in those situations where there were shared vision and values among stakeholders involved and minimal rivalry. Finally, despite the extensive tax planning involved, the planning and control activities surrounding succession planning were informal.

#### **Box 2:**

#### **Underlying determinants of successful transitions**

##### **Preparation level of heirs:**

- Formal education, training, and work experience (outside firm);
- Entry-level position
- Year(s) working within firm (and/or industry);
- Motivation to joining firm;
- Self-perception of preparation.

##### **Relationships among family and business members:**

- Communication;
- Trust, commitment, and loyalty;
- Family turmoil and sibling rivalry;
- Jealousy/resentment;
- Conflict;
- Shared values and traditions.

##### **Planning and control activities:**

- Succession planning;
- Tax planning;
- Use of outside board;
- Use of family business consultants/advisors;
- Creation of a family council.

Source: Morris et al. (1996)

At a higher level, however, the findings by Morris et al. (1996) demonstrate the importance of the steps preceding the actual succession plan. That is, appropriate strategic planning (family and/or business) well in advance of succession will enhance the success of any transition plan whether they are informal or not.

## Key Issues

**Professional Consultants:** Given the complexity of proper succession planning, guidance and advice from professionals is often required. Several professionals can assist during different stages of the succession plan. Among the most common are accountants, lawyers, financial and estate planners, and succession managers.

The succession manager is often beneficial as he or she serves as the business owner's succession coordinator, facilitating communication with the other professionals involved and minimizing the time required from the business owner. More importantly, the coordinator, as a succession specialist, can facilitate communication of the goals and objectives of all parties involved. In addition, the coordinator can act as an impartial third-party in resolving disputes between stakeholders in the succession process.

Nevertheless, the "soft-issues" involved in succession planning are complex and time consuming. They pose a significant challenge not only to the successor, but also the succession coordinator and other professionals involved.

The challenge is locating a succession coordinator: A specialized succession manager or another professional with a successful practice in succession planning. Although the investment is justified, there are cost considerations for smaller businesses.

**Family/non-family business:** Although many of the succession issues faced by business owners are common, whether family-owned or not, there has been some examination in the differences in the approach taken. Fiegenger et al (1996) found that owners of non-family businesses favour the "outsourcing" of successor preparation (e.g., university course enrolment, seminars, and experience outside the business). Owners of family-owned businesses, however, favour the development of relationships among stakeholders within the business.

As indicated above, strategic planning is a pivotal component to reconciling differences among stakeholders and setting common goals and objectives for the future of the business. However, relative to non-family owned businesses leaders, the leaders of family-owned businesses, according to the study, rate strategic planning among the least

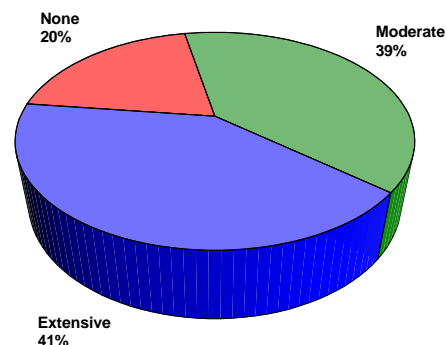
important in preparing for succession. Moreover, the authors found that, where a strategic plan exists in family-owned businesses, the leaders have a tendency not to share the plan with successors.

Despite the above-noted differences and approaches to succession planning by family and non-family owned businesses, Fiegenger et al. (1996) find that business owners, in general, exert tight personal control over the preparation and training of successors – a characteristic common to how many entrepreneurs manage their businesses.

**Taxes:** Although Barnett (2000) indicates that tax issues should not dominate succession planning; it remains a major focus for business owners, as forty-one percent of surveyed businesses said that the amount of tax planning in their succession plan was extensive (see Figure 5). Such taxes arise from the sale of the business to the successor – primarily in the form of capital gains.

Currently, the \$500,000 capital gains exemption has been available to Canadian business owners since 1985. The concept, according to Ball (2003) is simple—the first \$500,000 in capital gains, on a lifetime basis, resulting from the sale of qualifying business shares can be received on a tax-free basis. However, to qualify for the exemption, specific requirements must be met.

**Figure 5:**  
Amount of Tax Planning for Succession



Source: Morris et al. (1996)

According to Downer (2001), these requirements, and their accompanying legislation, are complicated and many small businesses are unable to take advantage of the exemptions. However, Ball (2003) states that very simple steps well in advance can often make the difference between qualifying

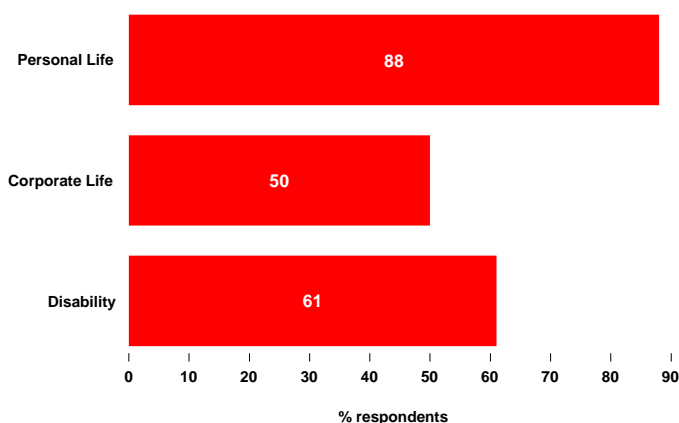
and not qualifying for the exemption when a business is disposed.<sup>7</sup>

Given the complexities in dealing with the exemption, many businesses continue to face taxes on their capital gains. As such the cost associated with transferring a business and moving to another, more profitable, venture is increased.

**Estate and Insurance:** Estate planning, according to most authors, is an integral component of succession planning. For the most part, one knows that business owners balk at the prospect of forfeiting their business to the state. Unfortunately, many are voluntarily, and unknowingly, doing so. Despite the significance of the business to the owner's estate, 63 percent of business owners do not know the tax liability of their estate. Moreover, to further complicate the family angle to planning for the future, 73 percent of business owners do not discuss the division of their estate with their children.<sup>8</sup>

As for insurance coverage, it too plays a significant role in succession planning. Business owners, however, seldom address planning in the event of death or disability. A substantial number of them, according to the Deloitte & Touche survey, do not possess insurance coverage required to maintain the business in the event of death or disability (see Figure 6).

**Figure 6:**  
**Insurance Coverage**



Source: Deloitte & Touche survey, 1999

If the goals and objectives of the business owner (strategic planning) are to operate the business as a going-concern, then adequate insurance coverage should be included in the succession plan.

**Financing:** Successfully finding a successor, training them, and integrating them in to the business and/or family is one step in the overall transition. In the end, however, the business owner will want compensation for the sale of the business. There is some research into the different methods to dispose of the business and, according to the European Federation of Accountants (FEE), management buy-outs are becoming more common.<sup>9</sup>

For those seeking an outright purchase of the business, however, finding the required financing for the successor may be difficult. Recent research by the Canadian Federation of Independent Business (CFIB) indicates that small businesses tend to have difficulty obtaining traditional forms of financing from financial institutions.<sup>10</sup> Moreover, according to the FEE, the special capital requirements in acquiring an SME are 60 percent higher than the average business start-up.<sup>11</sup>

However, some European countries offer special funding programs to assist in the transfer of small businesses. The Belgium government, for example, offers a program that funds the transfer of businesses at subsidized interest rates. The loan is guaranteed, by the government, for 7 to 20 years and no personal guarantee is required to secure the loan.<sup>12</sup>

## Research Gaps

There are four major research gaps in the current literature pertaining to succession planning. The first is a mapping of what motivates business owners to plan ahead of time for succession. The second is an analysis of the net overall impact of failed business succession in the Canadian economy. The third research gap is the role of government and the financial community in promoting and facilitating business succession in Canada. Lastly, there is remarkably little research on the perspective of future successors of businesses.

## Motivation to Planning

As noted by many surveys, business owners in general are not planning for the succession of their businesses. There are many reasons why this may be the case: the psychological issues surrounding the thought of "letting-go", the entrepreneurial characteristics of business owners as well as small

business, or family related issues and tensions just to name a few.

Nevertheless, business owners should plan well in advance. What factors motivate them to plan, however, is a topic that has not been addressed. Flooding business owners with succession related material, as has undoubtedly been done by professional service providers in the past, will yield little success if particular attention to the motivating factors is not addressed.

To promote effectively the issue to businesses and obtain the interest and the participation of other stakeholders, substantial research on the factors that motivate entrepreneurs to plan for succession is required.

### ***Economic Impact of Failed Succession***

The economy as whole is a major stakeholder with respect to the successful transfer of businesses. Given the current demographics of business owners, a high failure rate of their businesses, post-succession, will exert great impact on employment, economic output, and business formation in the future.

Nevertheless, there exists very little research on the total economic impact of succession failure. Those who have addressed the consequences do so in a simplistic and myopic fashion. One cannot simply observe the loss of employment and business income that is lost. Rather, at the expense of using technical jargon, a general equilibrium approach is required. That is, evaluating the “net economic effect” on employment and income, as failed businesses also yield employment and business opportunities elsewhere.

The difficulty of performing such an analysis, however, is likely the cause of the research gap. Nevertheless, an attempt to measure net economic effect of failed successions will greatly promote the significance and importance of the issue.

### ***Role of Governments and the Financial Community***

Given the complexities of succession planning, the large role of small businesses in the economy and the impacts of succession failure, there is a need to investigate what role governments can play in facilitating succession planning. A significant role, not just by governments, but also by all stakeholders alike, is to promote the issue of planning in advance.

In addition, access to timely, useful information, special funding programs and tools should be explored. Whether governments are involved or not, financial institutions have a critical interest in fostering smooth business transitions. Failure of transitions may result in loan losses as well as lost business customers. Alternatively, those institutions that have traditionally distanced themselves from financing business successions may profit from better planning on the part of owners and the greater success rates of the transitions. The Baby Boomer *Owner* is currently an un-tapped market.

How governments and financial institutions can effectively promote succession planning, provide information and efficiently assist in transfer funding remains a research gap in Canada. Such research on initiatives in other countries and their effectiveness would be a good start.

### ***Views of Successors and Potential Successors***

When referring to succession planning, there is a tendency to focus on the issues relevant to the business owner. However, given the structure of most business successions and the dependence of the current owner on the success of the business after succession, research on the issues faced by successors is pivotal. Nevertheless, little work has occurred in this domain apart from the study by Fiedgener (1996), who looked at the views of successors after the transition.

As noted above, a large issue faced by successors is the financing of the business acquisition. Sources of funding should be explored as well as the options available through private financial institutions.

### ***Conclusions***

---

The message, it would seem, is relatively clear. Business owners are not planning, for the most part, for the future—and this is of no real surprise. Small businesses and entrepreneurs are unique in that their very nature serves as the ultimate barrier to succession planning. Nonetheless, succession planning must occur well in advance.

The main finding of this literature review is that the key issues related to succession planning are not the technical ones, such as tax, insurance, estate, and specific legislation. These are complicated issues that are all involved in a complete and effective succession plan. However, they are merely the tools required to achieve the goals and objectives of the business owner, his or her family, and successor(s).

These goals and objectives are sorted, discussed, and shared in the steps preceding the actual succession plan. For the most part, business owners are not sharing a common vision for the business with all stakeholders. They are not sorting through the many “soft-issues” which are laid out in a complete strategic plan. As result, even those businesses with a succession plan seldom succeed because the soft issues were not addressed in advance.

Now the question remains: Where do we go from here? As expressed in the previous section there are four major research gaps. First, what factors motivate business owners to plan ahead? The key, it would seem, rests with the entrepreneurial characteristics of business owners. Second, what is the true economic impact of business succession failure? Such a study would greatly influence efforts by governments and financial institutions in addressing the issue. Third, what is the role of governments and financial institutions? Finally, what is the perspective of the successors of businesses?

Based on the literature, surveys, and anecdotal evidence by professionals found in business periodicals, the key to improving the success rate of business transition consists of the following steps:

- First, spark interest and motivation by business owners;
- Second, promote the issue to stakeholders such as governments, financial institutions, and professional bodies;
- Third, ensure that, when interest is present, the demand for information and guidance is met; and
- Fourth, that the complexity of the tools involved is minimized.

## References

C. Newton, “Succession Planning and the Small-Business Owner: A Transition ‘Tug-of-War’,” *Journal of Financial Planning*, (September 1999): 58 – 66.

N. Bowman-Upton, “Transferring Management in the Family-Owned Business”, U.S. Small Business Administration, 1999.

“How to Prepare the Successful Sale of an Established Family Business,” Fédération des Experts Comptables Européens, April 2002.

“Keeping it in the Family: SME Family Business Succession,” Fédération des Experts Comptables Européens, 2002.

“American Family Business Survey,” MassMutual Financial Group/Raymond Institute, January 2003.

“Are Canadian Family Businesses an Endangered Species?”, Deloitte & Touche Centre for Tax Education and Research, University of Waterloo, 1999.

I. Landsberg, 1988, “The Succession Conspiracy: Mapping resistance to succession planning in first generation family firms,” Working Paper A70, Yale School of Organization and Management.

M. Fiegner, B. Brown, R. Prince and K. File, “Passing on Strategic Vision: Favored Modes of Successor Preparations by CEO’s of Family and Nonfamily firms”, *Journal of Small Business Management*, (July 1996): 15 – 26.

P. Downer, “International Appraisal of Effect of Capital Gains Tax on Investment on Small Business,” *Journal of Financial Management and Analysis* 14, no. 2 (2001) : 32 – 42.

J. Barnett, “Transition Planning: An Advisor’s Approach to Planning for the Business Owner” CCH Toronto, 2000.

M. H. Morris, R. W. Williams, and D. Nel, “Factors influencing family business succession” *International Journal of Entrepreneurial Behaviour and Research* 2, no. 3 (1996): 68 – 81.

<sup>1</sup> Statistics Canada, *Labour Force Survey*, November 2000

<sup>2</sup> Statistics Canada, *Labour Force Survey*, November 2000

<sup>3</sup> Questionnaires were sent to Canadian businesses that fit a restrictive definition, which excluded businesses with annual revenues under \$1 million, sole proprietorships, etc. According to Dun & Bradstreet, less than 124 thousand Canadian businesses were eligible to receive the survey. 7500 surveys were sent and researchers obtained a 10 per cent response rate.

<sup>4</sup> Wharton School of Business, University of Pennsylvania

<sup>5</sup> See Bowman-Upton (1999)

<sup>6</sup> “Keeping it in the Family: SME Family Business Succession,” European Federation of Accountants, 2002a.

---

<sup>7</sup> See [www.cfib.ca](http://www.cfib.ca) for Bruce Ball's handout on the lifetime capital gains tax exemption.

<sup>8</sup> The 1998 Deloitte & Touche survey found that 52% of owners indicated that the business accounted for more than 50% of their estate.

<sup>9</sup> European Federation of Accountants (2002a)

<sup>10</sup> CFIB, Banking on Competition (2003)

<sup>11</sup> European Federation of Accountants (2002b), quoting Deutsche Ausgleichsbank

<sup>12</sup> European Federation of Accountants (2002b)