

Taking control of the present is the best way to plan for the future.*

Insights Into Building Value for Succession

Planning your own succession is one of the toughest challenges you can face as a business leader. The decisions surrounding your exit determine what will become of the organization you have devoted your life to building, and what the return will be on what is likely your most valuable financial asset. So why is it that many businesses and their owners are failing to plan for this inevitable event?

In the latest PwC Business Insights™ Pulse survey 54% of respondents don't have a plan outlining the future ownership of their business. One of the reasons seems to be that, while you may have decades of experience managing a business, planning your exit is something that for most of us is a once in a lifetime event. Should your business be sold? Should there be an outright sale? Sale of a minority interest? IPO? What is the right time to sell? How is the business valued? No doubt your blood pressure is rising!

Add to this the myriad of options available; the often divergent goals of seller and buyer; the tax, funding and legal implications of the transaction; and the nature and structure of the deal itself. The number and complexity of choices can quickly become overwhelming, and most people simply put off starting the process. Every situation is unique as every owner has different objectives. The best solution for you may be undesirable for your peers and colleagues. Optimizing the outcome depends on a carefully thought-out and well-planned exit strategy.

Ownership transfers are initiated for many reasons, but the top two are:

1. Retirement, death or illness of the primary shareholder

Because they are emotionally as well as financially connected to their business, many owners seem unwilling to seriously look into options to transition ownership before they are forced, by age or illness, to give up the business. This is borne out in our study, where we found the majority of owners are not planning for their exit even though over two thirds are over 50 years old and one in three is 61 or more.

2. Competitive pressures

Competitive pressures have increased because of consolidation. Many industries that in the past have experienced only local or regional competition have become global. Recent rises in the Canadian dollar are also squeezing margins for many companies selling into the US.

The common link here is that they are reactive situations, so they can only yield suboptimal results. Yet in our Pulse survey the biggest single concern around transition was maximizing value, with 45% of respondents citing this objective. Maximizing value means you need to be in control of the process from start to finish, and control needs detailed thought and planning. The earlier you start the succession planning process, the better your chances of getting more out.

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Define your objective: the mission-critical step

Getting the best value for your company starts with a clear statement of your goals. Objectives will be both financial (return, sale price, taxation/estate planning) and non-financial (succession, legacy and reputation, employee and stakeholder concerns, family dynamics, and so on).

First off you need to answer some tough questions.

- What is really important to me?
- Why would I want to keep the business in the family?
- What are my financial needs?
- How important is it to maximize the value I receive, relative to other considerations?
- What kind of ongoing management role, if any, would I like to have in the business? For how long?
- How do I decide whether to retain a financial stake in the business?
- Who do I want to sell or transfer the business to? How do I choose among family members, employees, financial investors, competitors, or others? Why would I care?
- What managerial expertise is required for my business to continue to be successful? Who is willing and able to run the business? What preparation will they need to take on that role?
- What can I do to protect or reward my employees, or others with a stake in the business?
- What other motivating factors might affect my decision? How do I feel about the business keeping its name and identity following my exit? How important is it that my business retains its independence?
- How should the business be structured and financed to be able to take advantage of future opportunities?

Family considerations

Apart from the financial considerations, one of the first things you need to decide is whether to keep the business in the family. Our Pulse survey shows 35% of owners want to pass their business on to the next generation. Frequently, the emotional or personal

issues around family business succession are more difficult to resolve than business or financial issues. You should address these sensitive issues before looking at the business challenges.

Many owners start out with the intention of transferring their business to their immediate family but ultimately that may not be a viable, realistic or optimal solution. Many factors come into play with such a decision. You need to think about the age of your family, their wishes and skill sets, management experience, potential sibling rivalries, and reactions of key non-family employees. To increase the odds of a successful transition you need the input and buy-in of everyone who will be directly affected by your decision.

Whatever you decide, it is only through a clear understanding of your personal and business priorities that you can choose the exit options that best meet your needs, as well of those of family members and key staff. In our experience, the passion and emotional involvement you need to run your business can get in the way of the choices you make to exit from it. Sometimes the perspective of an external advisor can help you stay on track.

Once your goals are set, planning for your exit will be much simpler. If you decide that maximizing value is still your main objective, the next step is to find out what drives that value.

What are your value drivers?

Value drivers are the real and perceived aspects that enhance your company's value from a buyer's perspective. Typical value drivers include:

- Synergies expected from a merger/acquisition
- Quality and reputation of the business
- Cash flow and profitability
- Customer relationships
- Growth trends for key products and services
- Intellectual property, such as patents, trademarks and brand name
- Quality of management team
- People and intellectual capital

Once you've identified these drivers, you need to assess their strengths and take actions to enhance them. For example, your systems may need to be upgraded to support growth; or the business may need to move to offshore manufacturing to increase margins. Your balance sheet and cash flow may need to be improved, perhaps through cost cutting or debt restructuring. Or your management team may need to be upgraded, and so on.

Employees and the decision to sell

Your exit strategy should consider the impact of a sale on current employees. Concerns may range from the need to keep key management personnel to providing security for valued long-term employees. An effective strategy also identifies and implements needed management changes long before any actual transaction is on the horizon.

The impact of ownership succession on an organization can be positive or negative, depending on how carefully the transition is managed. Sometimes employee performance deteriorates as a result of uncertainty and fear of change. However, business succession can also improve employee performance if the planned changes are quickly and effectively communicated to staff. Employees often work harder to prove themselves to new management. In addition, new internal or external managers are sometimes more willing to address certain personnel issues (e.g., dealing with "dead wood") than the previous management, resulting in improved efficiency and morale.

The business succession process gives you an unprecedented opportunity to take a fresh look at where your company is going, establish new goals, identify any missing talent, and take steps to secure appropriately skilled outside talent or train existing staff. Having a strong managerial track record gives confidence to potential buyers and increases the overall value of the business.

Exit strategy options: structuring the transaction

Effective deal structuring often adds significant value to a business. The sooner you can begin to understand the implications and importance of effectively structuring

transactions, the better positioned you are to lay the groundwork for future success. Although there are many ways to transfer ownership, the most common are sales/transfers of ownership within the current family (36% of the Pulse survey respondents), to an employee group (12%) and sale to a third party (25%).

Selling or passing control to the family

It's not surprising that many owners would like to see family members or other heirs enjoy the fruits of their labour. But, non-family managers and employees can be suspicious of plans to transfer management control to a family member, and often family members who own shares but are not actively involved in the business will voice objections as well. Key employees and family members alike may have concerns about who controls the business. The earlier and more openly you consider these issues, the greater the likelihood of a satisfactory resolution.

Selling to an employee

Sometimes the logical successor is an existing employee. Plans to transfer ownership and/or management responsibilities to employees may help ensure their continued loyalty to the business. Where certain employees are key to the business or closely involved in day-to-day operations, you must take steps to ensure that the employees will want to remain in the business after the current owner is gone. If those employees depart, possibly to a competitor, the value of your business could be significantly affected.

Sale to a third party

The simplest way to transfer ownership is through a sale to an outside party. Sales to larger companies are a common form of transfer as is a sale to private equity buyers. However, the outside sale of assets or stock can have complications and unintended consequences. In the context of a family business, the family may lose its identity or be unable to find a career path for family members associated with the business. A sale to an outsider may also change relationships with key employees, vendors and customers.

Whatever you decide, early planning is essential

In our experience, owners delay planning because they are caught up in day-to-day operational demands, or because they find it difficult to acknowledge that the time has come to start thinking about letting go of the business. As a result, most companies are reactive when it comes to planning succession. This lack of proactivity will, at best, mean failure to maximize value and, at worst, will see many businesses fail in transition.

Effective succession begins long before an actual exit. You need to give yourself time to:

- Demonstrate you have long-term relationships with customers and vendors.
- Develop an effective management team which alleviates concerns that the business value is dependent on the entrepreneur.
- Review your strategy (e.g., choice of clients, markets) to focus on creating a more attractive asset for sale down the road.
- Get your finances in order. Any potential buyer will pay a great deal of attention to your financial results from the past few years. They will scrutinize historical performance to get a better understanding of the risks and rewards associated with their potential investment. Historical performance will give a benchmark for future performance.
- Create and organize regular management reports to help buyers understand the key metrics and performance indicators being used to manage the business.
- Develop a message around quality of earnings and performance, and anticipate the questions and concerns of potential buyers.
- Start considering who might be the ideal buyer and the concept of subjective value. By understanding a potential buyer's view about what drives value, you can position your business to highlight those points.
- Realistically understand the strengths and weaknesses of your business. The better understanding you have the better prepared you are to talk to a potential buyer. This understanding can be used to shore up relevant weaknesses and highlight key value drivers and investment considerations.

- Formulate and implement a comprehensive sell-side due diligence process that will make you better prepared for buyer skepticism, rigorous analysis and negotiations.
- Identify, quantify and amplify upside sale value opportunities such as real estate and other surplus assets.

Regardless of a particular investment or economic climate, early and thorough planning will optimize value. You need time to invest in developing a strategy, building your team, and managing the process.

At PwC we know that the best way to plan for the future is to start by taking control of the present. Let's talk.



I'm Carla Eisnor and as a transactions partner with PwC I help business owners and their financial advisors get the most out of selling their companies. In my experience, people know exactly what they want to get out of the sale but are unfamiliar with the process and

the opportunities that exist to maximize or preserve value. By looking at your business through the eyes of a potential buyer, my team and I can help you identify and highlight your value drivers, shore up weaknesses, and make sure your information and management team stand up to a buyer's scrutiny when the time comes to start negotiating. We can also help you structure your taxes to make sure you pay what's fair but not a cent more. The earlier you start the succession planning process, the better your chances of getting more out at the end so why not give me or one of the contacts on the back page here a call — there's a lot to be gained.

Carla Eisnor
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Coming in the Fall:

We will be talking about the next step of the process in a forthcoming Insights article. Once you've taken the decision to sell and built up value your next move will be to find the right buyer and negotiate the deal.

Results of the Business Insights™ Pulse Survey on Succession.

In our latest Pulse survey over half of the 293 private company leaders who responded do not have a succession plan which outlines the future of their business (Figure 1). This is true of companies of all sizes right across Canada but for those businesses with revenues less than \$10m the number rises to over 70% of companies without a plan for the future.

The majority of respondents, 63%, reported that the current owner/CEO of their business is between the ages of 51 and 70 (Figure 2); a figure not surprising given the Canadian demographic of baby boomers approaching retirement. Considering these two facts together presents a worrying picture. One in three companies have CEOs retiring in five years or less but there is little evidence that adequate plans are in place to maximize the value of this transition. In our experience a robust succession plan often requires a five year timeframe so it's imperative that companies address this issue sooner not later.

On closer interrogation of the data there is evidence suggesting the picture is not quite as bleak as it first seems. For those companies without a plan the CEO is more likely to be younger than those who have but there are still thousands of companies across Canada who risk failing to maximize their value on transition to a new generation or owner.

Just over a third of all businesses reported they planned to pass their company to the next generation with more than a further third looking to sell to either an outside party or existing management or employees. More than one in ten report not knowing what will happen to their business when the CEO retires (Figure 3).

Both the options of sale and transition to a family member require substantial planning in order to ensure a successful transition.

The greatest concern for business leaders, accounting for almost half the respondents, is receiving the maximum value from their business during ownership transition (Figure 4). This is reported by leaders of all business sizes in all regions. The most significant of variations to the full group is that those respondents who are concerned with realizing the value are also the group most likely to have a succession plan. But there are still a third of respondents wishing to maximize value who have no succession plan. In our opinion these respondents run the greatest risk of, at best, disappointment and, at worst, disaster when the time comes to exit their company.

Looking at the timeline, four in ten companies will face transition in five years or less. This does leave time for a plan to be implemented but for a significant chunk of Canada's private companies time is running out to maximize the return on a lifetime of hard work.

Figure 1. The current owner/CEO has a succession plan in place.

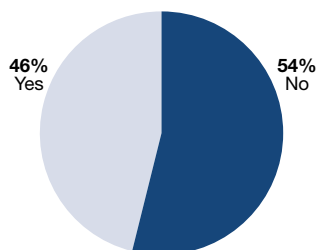


Figure 2. Age of the owner/CEO

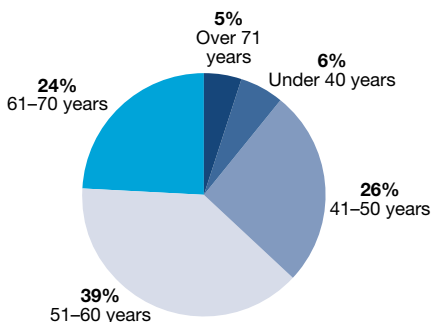


Figure 3. When the current owner/CEO retires, the business will be:

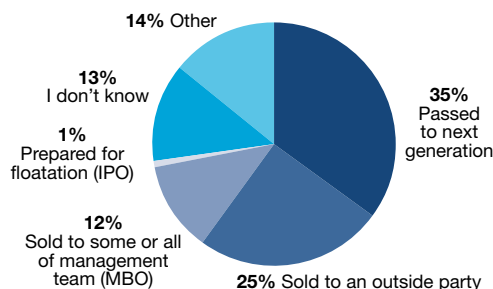


Figure 4. In the ownership transition, the owner/CEO's biggest concern is:

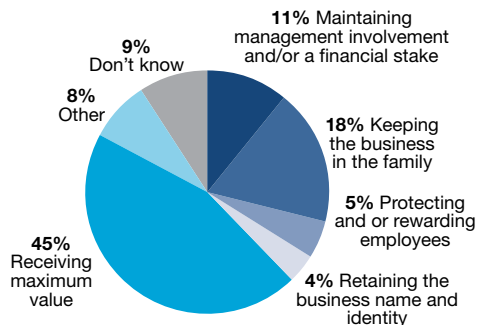


Figure 5. The timeline for this is:

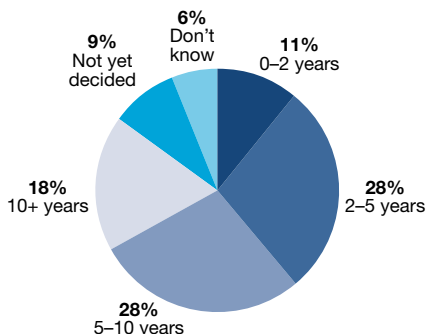
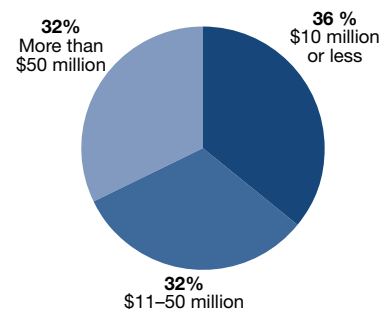


Figure 6. What are your company revenues per year?





Looking for more information? *Let's talk.*

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