Maximizing Value and Achieving Family Harmony in Business Transitions

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Transitioning a business is a complex process. It's much more than a financial transaction and can have rippling effects, both personally and on the family. Without careful consideration, proper planning and active involvement from family and external advisors it could be a disruptive, demanding and overwhelming process.

This article outlines considerations for all business owners who may one day transition their business, whether planned or involuntarily.

Start early

The transition of a business is a process, not an event. Too often business owners decide they would like to transition the business through a sale or generational transfer, without giving it much thought or proper planning. There is plenty of work to be done prior to the ultimate transition date, so start planning early. Clearly define your goals, priorities, objectives and timeframes. These will change over time, but it is important to define them well in advance.

You may not always be in a position where you have time to transition your business on your terms (i.e., due to a sudden and unexpected death, disability or other health issue), and you'll be better served getting your affairs in order now to de-risk the business – ensuring business continuity and keeping your exit options open.

Personal and business planning

Start by considering your personal goals and objectives in conjunction with the business. Next, take an objective look at your business and be open to expert feedback. In what stage of the lifecycle is the business (i.e., start-up, growth, mature, decline/rebirth, etc.)? Your business lifecycle and your personal lifecycle may not be synchronized when you look to retire.

Ideally at this stage, your spouse (if applicable) should be involved in this discussion, and the following considerations when planning:

- What goals do you have in life, outside of the business? (both financial and non-financial)?
- What will you do "post-transition?" Many business owners do not put enough thought into this question and; therefore, are not prepared when the transition date occurs. Ask yourself:
  - Do you want to stay involved with the business in some capacity or transition out?
  - What does your retirement look like and how does this make you feel?
  - What is important to you in retirement?
  - If a traditional retirement is not a fit, what else could you do that doesn't demand the same amount of time or include the same amount of stress or risk?
- Will you have enough wealth to retire given your current savings and the value of your company? More details on this in the *Wealth Planning* section below.
- What does your ideal transition plan from the business look like? What gaps exist today with regard to this ideal transition plan?
- If something were to happen to you tomorrow, what are your wishes for the business? Are your wishes captured accurately in your Will, shareholders' agreement (if applicable) and other legal documents? For more information, ask your BMO financial professional for a copy of our publication, *Shareholders' Agreement – An Important Business Succession Planning Tool*.

- Take these factors into consideration:
  - Are there any other contractual obligations that affect your rights, obligations and your ideal plan? All of these must work together.
  - Does your Will have adequate provisions for the oversight of your business; from day-to-day management to strategic direction and decision-making?
  - Who will have legal or voting control of your company? How will other stakeholders react to this (employees, family, lenders, etc.)?
  - Have you communicated your wishes to your successor(s)/inheritor(s)? How about other family members who may be affected directly or indirectly?
  - If you want your successor(s)/inheritor(s) to continue running the company, give thought to the following:
    - Which advisors and employees should they rely on and trust in order to help run the business?
    - What steps should be taken immediately (first month) and near term (six months) to ensure continuity of the business?
    - How will your successor(s) and business leaders co-exist, and is there an alignment of vision?
  - If you want your successor(s)/inheritor(s) to sell the business, consider:
    - Has this been communicated in detail?
    - Who do you want them to work with in order to help sell the business?
    - Describe what that process would look like and arrange a meeting with these key people to have a discussion together as a group. This is good contingency planning.
- Consider creating a business plan, and amending it as needed.
  - What growth prospects exist for the business, and what actionable steps can be taken to start executing on these growth opportunities? For more information, ask your BMO financial professional for a copy of our publication, *The Value of a Business Plan*.
- Confidentiality is a key consideration overall. You want to disclose your plans at the right time, but only to people you trust and those that need to know.

Owning a business becomes part of your identity over the long term and; as a result, transitioning the business can be a significant personal loss filled with deep emotion. Do not underestimate the emotion and give it careful consideration and planning.

Undertake personal wealth planning

Every individual, couple and/or family should engage in the wealth planning process to understand their long-term financial health and how decisions made today can impact their future. Often during the process, business owners ask questions like: Will I have enough to retire? Will the proceeds of a transaction allow me to continue my current lifestyle throughout my retirement?

Wealth planning is vitally important for deciding when and how to transition your business. The plan should include as much information as possible to achieve a realistic plan, and it should be revisited every three to five years, or with any material changes to assumptions or life events. Items to consider in your wealth plan may include:

- Personal and business assets and liabilities;
- Retirement needs from the business;
  - What do you "need" from the business to support your lifestyle requirements?
  - How will you access funds on a tax-efficient basis?
  - If the business transition will happen over time, can the business support transition payments and the needs of the new owner? (There may be conflicting interests that surface or exist during a transition.)
- Estate tax considerations and tax mitigation strategies; and
- Philanthropic goals.

When complete, does the wealth plan achieve the goals you want for you and your family? If not, do your goals and expectations need to be adjusted, or are there steps you may take to grow the business and bridge the gap? This should be considered and weighed against all business risks.

Obtain a business valuation

It is important to understand the value of your business, valuation drivers and risks inherent in your business, so you can adjust accordingly. The value of a business is directly correlated with business risk. Therefore, a valuation will outline both positive and negative factors that exist at the valuation date that would affect the degree of risk associated with a business' ability to continue to achieve its estimated level of maintainable earnings before interest expense, income taxes, depreciation and amortization ("EBITDA"). For more information, ask your BMO financial professional for a copy of our publications, *EBITDA and Normalized EBITDA* and *Business Valuation Overview*.

In a sale scenario, you may want to consider hiring a transaction advisor who is experienced in selling privately held businesses and has a proven track record for sales of businesses in your industry. For more information, ask your BMO financial professional for a copy of our publication, *Considerations for Exiting Your Business*. Ask prospective advisors to critically look at your business through the lens of a buyer and assess the risks that exist within the business that would prevent a sale or reduce your selling price. Finally, a business valuation or pricing analysis should be completed in conjunction with wealth planning so that an accurate business value is included within the wealth plan.

Effective tax planning

The after-tax proceeds are more important than the total transaction price. It is important to ensure you have the optimal corporate structure to transition your business on a tax-efficient basis before the transition. The general guideline is to start looking at your structure at least two years in advance of any sale or transition. When selling, consider interviewing transaction tax specialists to do the transaction work on your sale. Different specialists may uncover different structuring opportunities to lower the overall tax rate on your sale.

Estate planning and corporate governance

Estate plans and corporate governance are often overlooked in transition planning. Review your Will(s), shareholders' agreement and other legal documentation well in advance of a transition. Consider the following:

- What happens if you die before or during the transition? Who will have authority to continue to operate the business during estate administration. How will the business transition to the beneficiary or potential buyer?
- What is your corporate and share structure, and can it be easily transferred to a purchaser or beneficiary? Do the articles, bylaws, or shareholders' agreement affect you or your estate's rights and obligations to operate or transfer ownership of the business?

For more information, ask your BMO financial professional for copies of the publications, *Wills that Work* and *Shareholders Agreement – An Important Business Succession Planning Tool*.

Hold family meetings

For those considering a business transition, especially a transition to the next generation, consider investing capital into hiring a professional facilitator to facilitate family meetings and educate the family, with the goal of increasing family cohesion and harmony.

Consider the following:

- Involve family members in planning: your spouse and/or children whether they are working in the business or not, and other family members, if appropriate. Tell them about your transition plan and where you see yourself at the end of the journey. Outline the steps needed to be taken now and in the future.
    - Open the topic up for discussion and input. Do your goals, vision and plans align with those of the family?
    - For most families, harmony is the goal and; therefore, views, interests or expectations of the family are important considerations. Assumptions should not be made about what is important to each family member and how they feel about certain topics or issues.
    - Consider the concept of "voice versus vote." Take the time to understand everyone's perspective; but know, and be clear that the shareholder(s) have the ultimate decision-making authority. Giving people a chance to be heard and understood will go a long way to achieving family harmony, regardless of what decision is made.
- The goal is to align the family on the future direction of the family and the business:
    - What values do you want preserved for the family and the business?
    - Does your business define your family, or is your business a vehicle to expand family wealth?
    - What is the purpose of the business and family wealth? What is the reason the business exists beyond making money? What do you want your wealth to achieve for you and future generations?
    - Formalize a "Mission Statement" that sets the tone for how the business operates, in order to create value.
    - Establish a "Family Vision" and "Business Vision" to create a shared and united picture of family values and wealth in order to foster business success.
    - In what circumstances would the business be sold? How does the family ensure that the business remains relevant and stays on top of disruptive shifts? How frequent will the family reassess these issues (i.e., quarterly, annually, etc.)?
    - What are the family's short-term goals and how does these support the mission and vision of the business?

Conflict and opposing views are healthy in families and business, but there needs to be mechanisms in place to facilitate productive discussions and resolve conflicts. Avoiding these conversations can lead to misunderstandings and miscommunication; preventing issues from coming to the surface to be heard, discussed and resolved. Disruption or lack of communication in the family can also create problems for the business and prevent companies from evolving or adapting to industry shifts or disruptors.

Establish a written transition plan

At this point, you have a plan, and key family members and other stakeholders are aware of your plan and are onside. It is important to develop a tailored, written transition plan in draft form. Remember, the details and goals can change over time. Best practices include:

- Get everything out of your head and onto paper;
- Incorporate items agreed upon with family into one document;
- Detail key milestones and associated timeframes;
- Distribute a draft plan to your family members involved in planning and your trusted advisors who will be key to helping you execute. Seek input and/or changes; and
- Ensure that they respect the confidentially of the document and keep it safe (password protected if electronic, or in a safe place in hard copy form).

Improve financial information

Having timely and robust financial information is critical for business owners and stakeholders. It is especially important if you are selling your business, as buyers are assessing the business acquisition opportunity against current and future risks. Presenting your company to buyers in the best light, through information disclosure and due diligence, is vitally important. Consider the following best practices:

- What are the key metrics in your business to understand its financial and business health? The most astute business owners claim to have one page of information they review in order to assess the health of the business. What are your key business metrics?;
- Consider preparing an annual budget and updating forecasts. For more information, ask your BMO financial professional for a copy our publication, *Monitoring the Financial Health of Your Business*;
- Make sure the information is readily accessible;
- As previously stated, consider creating a business plan and amending as needed; and
- If you are selling your business, consider switching to a review or audit level of assurance for your corporation's annual financial statements at least two years prior to the sale to provide potential buyers additional comfort that an independent accountant has completed analysis and work on the financial statements.

Ensure family preparedness and wealth stewardship

A business sale will bring a significant change to your family's net worth. Consequently, its impact should be considered and properly prepared for to ensure that your family are good stewards of wealth for future generations.

Are your children adequately prepared to handle the financial and psychological aspects of receiving significant wealth? It doesn't matter how far away the estate inheritance is (if that is part of your plan), knowing about the money and the expectation of receiving this wealth in the future can affect your children's lives and the decisions they make today.

Just as you have invested in the business for years, understanding the wealth transition process and investing time, energy and, potentially, capital towards family planning is critical.

Seek professional advice

A BMO Business Advisory and Transition Planning Specialist can be a trusted resource in helping to navigate the complex business transition process.

For more information, speak with your BMO financial professional.

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