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How to make a success of succession when passing on the family business

BRENDA BOUW
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Growing up, Roland Chan never expected to take over his father's insurance business.

"My father and I always discussed business, but never really talked about a transfer of leadership or ownership of his," Mr. Chan says.

After all, Mr. Chan's education and background are in technology. He worked at a tech startup and later ran his own tech-consulting company.

About 10 years ago, his father (who is also named Roland) asked him to "join forces" in the family business. Mr. Chan thought long and hard about the move, including how it would affect his personal life, as a married father of two young children, as well as satisfy his professional goals.

"Although I wasn't involved in the company, I had a tremendous amount of respect for my father and the good he was doing in the community and for the employees and agents associated with the company," the 42-year-old Mr. Chan said. "I had a sense it was something bigger than the business I was involved in."

He says his father also wanted to make sure his son was the right fit. "We knew I was a good candidate, but just because I was a family member didn't mean I would be the correct choice," Mr. Chan says. "My father and I have a great relationship, but when we talk about the business it's about performance."

Mr. Chan took over as director of operations of Toronto-based LiLand Insurance Inc. in early 2009, following a lengthy succession period and a lot of family discussions and planning.

"We knew it was going to be complex," Mr. Chan says of the process. "It's not just about tax and estate planning."

Mr. Chan says the plan allows his parents to continue to benefit from the business they built, while also taking into consideration other family members involved in the business as part of the overall estate plan.

An increasing number of business owners, especially retiring baby boomers, are wading through the complex process of transferring their companies to the next generation. Of course, not all business owners are choosing their children to run their companies, but experts say those who are should carefully plan the transition well in advance, taking into consideration interests of the company, the family and other stakeholders such as employees and shareholders.

Only about half of business owners have a succession plan, according to the Canadian Federation of Business. Not having a plan can create turmoil among family members, especially if the business owner was to suddenly pass away. Who will own and run it then?

“Too often, business owners leave the succession planning until just weeks before they retire, or don’t plan at all,” says Jennifer Reid, vice-president of tax and estate planning at Richardson GMP in Calgary. “It can be done the right way,” she says, with a lot of preplanning.

Ms. Reid suggests owners start to gauge their children’s interest and competency in the business when they’re teenagers or young adults by having them work at entry-level jobs in the business. From there, the kids will need to develop the right skills and training to advance, including some leadership chops if they want them to eventually take over.

Parents are often reluctant to talk about the family business with their kids, which can be a mistake.

“You don’t need to start with numbers,” Ms. Reid says. “Have some discussion about what the vision is for the business and the family … and what the interests are of the children.”

As time passes, parents need to figure out which of their offspring, if any, want to take over the company and in what capacity. Some may want to own the business and not run it, while others may want to do both. Parents also need to ensure the kids who are interested are capable not just of running it, but helping it grow – and not running it into the ground.

“Unless the kids are charged up about the opportunity to take on the business, they’re better off to do everyone a favour and sell the business – that’s what I hear, a lot,” says Sean Foran, managing director of business transition planning at CIBC Private Wealth Management.

In many family businesses, there are some kids who want to be involved and others who don’t. That leaves parents trying to figure out how to arrange their estate in a way that’s fair to all of their children.

“It can be a delicate balancing act,” Mr. Foran says.

A common strategy is to use an estate freeze with a discretionary family trust. It’s a reorganization of the company’s share structure that locks in the current value of the business.

An estate freeze can be a tax-efficient way for parents to transfer future growth of the business to the next generation, while still retaining flexibility with how the assets will eventually be divided among the children. Parents can also be beneficiaries of the trust to control what portion of the growth they eventually transfer. The trust can also provide tax benefits on income distribution and on a future sale of the business using the lifetime capital gains of the trust beneficiaries, which in 2017 is about $835,700.

Mr. Foran says the structure also gives parents time to consider which of their kids will run the company.

“If there’s a sibling that really wants to drive the business forward, it might make sense to freeze the value of the business and put shares in a trust to allow you to wait and see who emerges as the leader,” Mr. Foran says.

“An estate freeze can be a way to balance the interests of kids who feel entitled to their share of the wealth that their parents built up to a point in time, and then allow somebody to take it forward and be working for themselves and their own family without subsidizing their siblings who might be making less of a contribution.”

Parents should also formalize their succession plan not just for their offspring, but to address any concerns employees and suppliers may have about the future of the operations.

“You don’t want to give your employees or customers any uncertain feelings about having the business transfer generations,” Ms. Reid says. “You see that a lot in movies – the son takes over and doesn’t know what he’s doing. You don’t want that in real life.”

Business owners also need to keep legal and financial professionals in the loop about their plans – and get them working together. “If you’re not speaking to your accountant, lawyer, financial planner and investment adviser, you’re probably missing something,” Ms. Reid says. “Your business might be running great, but you might be missing something on the personal, retirement side.”