

## Succession on the Front Burner



For many business owners succession planning ranks right up there with malaria and root canal in the list of things they most prefer to avoid. This reaction is understandable given all the confusion surrounding this subject. But what is this thing called succession planning, anyway? Ask an accountant, a lawyer, a human resource professional or a financial planner to define succession planning and each will have a different answer. It all depends where you sit.

As a business owner, how do you define succession? You may see it in terms of an outcome such as leaving the business to the kids so that they have careers and financial security. That seems fair and equitable but are the kids on the same page when it comes to leadership, control and their role in the business? Further, how will they pay for the business if the retiring generation needs the capital to fund retirement? What about the option of selling to a key employee, or someone else altogether?

One thing is certain; succession planning is a big deal. Over the next ten years about two-thirds of the current generation of private business owners in Canada will retire or exit their business. Given that businesses with fewer than 100 employees account for 30% of GDP and 48% of total employment,

it is clear that getting succession right will preserve wealth, provide continuity of employment, and fuel economic growth.

So how do I define succession planning? Well, since you already have too many definitions dancing around in your head I will avoid further confusion by telling a little story. That way you can start to work on your own definition.

In other words, you have homework.

### **The Case of Arnold & Bonnie**

Arnold & Bonnie Kettle (A&B) own a successful retail housewares business called Ma & Pa's Kettles. Arnie is 62 and Bonnie is 57. They love the business but after 25 years they are tired of the daily grind and thinking about retirement.

The business has been doing well, particularly since they opened their second store and started an online business in 2005. These changes gave Ma & Pa's the purchasing power and staff economies to increase profit nicely.

The business has funded a good lifestyle and allowed them to put their son, Charlie, and daughter Diane, through college. Diane recently graduated from a retail management program and will pursue a career at Ma & Pa's. Charlie is pursuing a career as a music

producer. He hopes to open his own studio with the money he will get from the business once his parents retire. After all, mum and dad have been talking about how nice it would be to pass ownership along to him and his sister.

About eight years ago A&B hired a general manager, Erica, to free them up so they could take more time off. Erica has proven capable in all aspects of store operations and management. The opening of the second store and in particular the online business would not have been possible without her skill and vision. It has occurred to A&B that if Erica were to leave the business, it would leave them in a lurch. They would have to jump back in with both feet until they brought Diane up to speed, and they knew that would take quite some time. In reality, Erica was integral to their plans for stepping back from the business.

It is Friday. A&B are looking forward to a relaxed weekend. As is tradition, they gather for their monthly lunch with Erica to discuss business. It is usually a relaxed affair but today Erica is nervous and awkward. After a few minutes of forced banter, Erica announces that she feels the time is right for her to become a partner in the business, and states her case. It is hard to argue because she really has been an engine for growth.

Erica issues her ultimatum: "I have seen the future, and the future is either owning a piece of Ma & Pa or starting up my own kettle empire!" Erica pounded the table for effect, causing the flatware to clatter and Arnold's knife to fall to the ground. Being of Irish heritage, Bonnie knew this wasn't a good sign, and immediately tossed some salt

over her shoulder. Meanwhile Arnie hailed the waitress and ordered double scotch.

Their heads were swimming. They knew that they had to take Erica's request seriously or risk her leaving and becoming a competitor. And if they did make her an owner then how on earth were they ever going to get to the point where they could realize enough money from the business to retire?

A&B are worried about their financial future because outside of their house and a modest RRSP all of their wealth was tied up in the business. Maybe selling some of the business to Erica was one avenue to liquidity? But if they did, where would that leave the kids in terms of their hope to pass ownership over to them? Was it an option to have both family and someone outside the family sharing ownership?

A&B knew that bringing in another shareholder meant they would be accountable to someone other than themselves. It also seemed clear that being able to retire in some degree of comfort was going to prove a challenge because neither Erica nor the children had the money to buy into the business. How could they remove themselves from the business if most of their wealth was tied up inside it?

The thought of a relaxed retirement suddenly seemed like a distant fantasy. Still, Arnie recalled hearing someone at a cocktail party talking about a big U.S. retailer coming into Canada buying up businesses just like theirs. Apparently the U.S. retailer was valuing their acquisitions using a multiple of something called "EBITDA", whatever that was. All he knew was that

some store owners had allegedly cashed out ‘big time’ according to unnamed sources. Was selling to some big U.S. company really a viable alternative? Or would selling to a 3<sup>rd</sup> party buyer be akin to selling the family and Erica ‘down the river’?

A new reality was beginning to dawn. Arnold & Bonnie needed to do some hard thinking in order to make an informed decision about the future. How were they going to accommodate their future financial needs, answer to the demands of Erica and maintain the viability of the business for future generations?

One thing was clear: Arnold and Bonnie need to get to work because like it or not succession was now on the front burner.

### **Where to From Here?**

Arnold and Bonnie face a common dilemma. Erica’s ultimatum is forcing their hand on the succession question. In a perfect world A&B would have already conditioned Charlie and Diane on the rules of ownership, employment and the family estate. And they would have had conversations with Erica about her long term role. The time had arrived to have these past due conversations.

Arnold and Bonnie also have a choice to make about how the frame Erica’s ultimatum. So, rather than viewing her demand as a personal betrayal they can choose to consider it as a potentially viable exit option. Perhaps Erica’s entrepreneurial spirit is the ticket to retirement they need!

A&B had only ever thought in terms of keeping Ma & Pa’s in the family. One thing is now clear: their sacred cow concept of family business needs to be reconsidered in light of Erica’s demand.

### **In the Next Installment**

Family dynamics add a dimension of complexity to the succession equation. In the next article we will consider how these dynamics are managed as Arnie, Bonnie and the children work to establish rules about ownership, employment and financial entitlement. For example, how will Diane and Charlie co-exist as equal owners, with Charlie pursuing a career outside the business? After all, if Diane is going to run the show, she will want to invest in the business, whereas Charlie will be looking for big dividends to make good on his plans to start a music studio.

As for Erica, should she be invited into the ownership circle? Or are there other alternatives like profit sharing that could provide her with the incentive to stay at Ma & Pa’s for the long term?

#### **About the Author**

Andrew Pigott is the Principal of The Succession Bridge. He works with business families and business owners to develop and implement succession plans and processes in concert with other trusted advisors.

T: 905.582.8270

E: [apigott@thesuccessionbridge.com](mailto:apigott@thesuccessionbridge.com)