

RBC Business Succession Planning: Your Essential Road Map

Planning Your Business Succession



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This guide has each of the sections on the [RBC Succession Planning](#) web site, allowing space for you to enter in your own information and notes. Upon completion, you'll have a document that can help you plan your business succession.

Planning Your Business Succession

This workbook will get your succession plan started. We'll support you through your planning process with advice and solutions that match your business and personal needs. From business transition advice to wealth management, personal retirement and estate planning, we can help guide you through this process that will spur growth for both you and your business.

1. Creating your Team of Advisors

Working with professionals who have had the experience of supporting other businesses through succession planning and business transition will provide you with relevant insights and proper advice. You may decide to coordinate most of the transition yourself, or you might feel more comfortable appointing a trusted advisor to spearhead the planning and represent your best interests. Whatever you decide, your team members can work with you – and with each other – to enable the successful transition of your business.

The following is a list of potential advisory team members. You may not need all of them at the same time, but you will probably require the services of most of them at some point during the process.

| Who they are | Their role on your advisory team |
|------------------------|--|
| ACCOUNTANT | <ul style="list-style-type: none"> ▶ Develops financial statements ▶ Provides taxation advice ▶ Assists in estate planning ▶ Provides advice for business restructuring ▶ Assesses business value |
| LAWYER | <ul style="list-style-type: none"> ▶ Negotiates and drafts any necessary agreements, such as a shareholders agreement and purchase and sale agreements ▶ Provides tax planning advice ▶ Prepares wills and powers of attorney ▶ Advises on existing and proposed business structures and implements any needed corporate restructuring |
| FAMILY MEMBERS | <ul style="list-style-type: none"> ▶ Support family interests ▶ Provide an opportunity to understand each member's perspective about the business and their future roles in it |
| MANAGEMENT TEAM | <ul style="list-style-type: none"> ▶ Manages ongoing operation of the business ▶ Needs to "buy-in" to successfully execute business plans ▶ Provides operational advice and expertise for new owners ▶ Enables business continuity |

| Who they are | Their role on your advisory team |
|--|---|
| BUSINESS VALUATOR | <ul style="list-style-type: none"> › Estimates fair market value of the business › Provides credibility to asking price › Provides advice and suggestions on how to maximize business value |
| BUSINESS BROKER | <ul style="list-style-type: none"> › Finds a buyer › Provides market insights › Provides insights on enhancing business value |
| MENTOR | <ul style="list-style-type: none"> › Provides guidance on the development of the succession plan |
| FAMILY BUSINESS FACILITATOR | <ul style="list-style-type: none"> › Facilitates family councils › Clarifies boundaries and goals › Examines family values › Mediator for family resolutions |
| RBC® COMMERCIAL ACCOUNT MANAGER | <ul style="list-style-type: none"> › Offers business financial advice to support the business transition, before, during and after the event › Provides access to a network of RBC experts › Gives you access to market and industry insights, as well as economic outlook information › Advises on financing options for the acquisition |
| RBC PERSONAL FINANCIAL ADVISOR | <ul style="list-style-type: none"> › Offers personal financial advice and solutions › Advises on retirement planning, personal wealth management and estate planning › Helps define future goals, considering the larger picture |

2. Your Exit Options

Consider Your Exit Options

There are three main exit options for business succession:

- › [Transfer the business to a family member](#)
- › [Sell to partners or your employees](#)
- › [Sell to a third party](#)

Your advisory team can help you assess your options and decide which exit strategy is right for you, your family and your business.

Option A: Transfer the business to a family member

Start holding family meetings early

Family meetings are an ideal opportunity to start discussing business succession. These sessions can help create trust and understanding around estate planning, retirement and wealth management issues.

A family meeting is an opportunity to discuss:

- › retirement options with your family, even if you don't have a successor in line or in mind
- › whether you should keep the business in the family
- › what is needed to grow the business
- › what is needed from new leaders, inside and outside the family business
- › alternative exit strategies for your family-owned business

Some Questions To Consider

- › Are there one or more family members who want to take over the business?

- › Does the family successor have the skills to operate the business and guarantee your retirement income and return on investment?

Business Succession Strategies - The Breakdown¹

| | |
|---------------------------------|-----|
| Pass business to family members | 42% |
| Sell to 3 rd party | 19% |
| Sell to management/employees | 17% |
| Sell to partner | 10% |
| Don't know | 8% |
| Wind down business | 3% |

¹ Quantitative Study of the Business Succession Market in Canada (March 20)

› What qualifications, skill-sets and training would they need in order to succeed?

Qualifications: _____

Skills: _____

Training: _____

› How would employees, suppliers and customers react to a family-based succession?

› What is the most tax-efficient way to pass ownership to family members?

› What will be your continued role in the business, if any?

› How will this succession option impact the rest of the family?

Option B: Sell to partners or your employees

Selling your business to your partners or a group of employees can be an attractive option to consider. Current employees know the business and have a vested interest in seeing it prosper. As well, customers, suppliers and investors may be reassured by the stability this option offers.

Some Questions To Consider

› Which employees or business partners would be best suited to purchasing your interests?

› Do the purchasers have access to sufficient funds to buy you out entirely or will you have to finance part of the purchase price?

› Do employees have the vision and management capability to assume an ownership role through the transition period and run the business profitably in the long term?

› Is your management team prepared to assume the risk of ownership?

› Can the business take on additional debt to support the management in financing the acquisition?

› If you have to finance part or the entire purchase price, can the purchaser profitably run the business to ensure your repayment?

› Will the purchase price be paid from future profits or employees' own capital?

› Are employees able to provide personal indemnities and assume successor obligations?

Option C: Sell to a third party

For some business owners, selling to a third party may be the best option. Once your business is on the market, it is not unusual to take more than a year to find a buyer and finalize the sale. Your advisory team will be invaluable in providing the support and impartial advice during the process to keep your best interests in mind.

Some Questions To Consider

› Where can you find an interested buyer? Who might be likely candidates within your industry, or amongst related industries (i.e. upstream or downstream)?

Potential Buyers: _____

› Considerations to maintain confidentiality, before and during

› Do you want to sell the whole business or parts of it?

› Is it important that a potential buyer have the entire financial resources necessary to purchase the business, or would you be prepared to partially fund their acquisition?

› What is the most tax-efficient way to structure the sale?

Finding A Buyer

A buyer can come from anywhere – your customers, suppliers, business community or even the competition. A professional business broker is often useful in finding a buyer. Tap into your network -- your RBC account manager can help you extend your network.

It could take a year or more to find a buyer and execute the sale of your business.

3. Determining the Value of Your Business

Undergoing a business valuation is an important step for your succession plan; it can be used for a number of purposes that can range from determining a selling price to supporting the “fair market value” for taxation purposes.

Key Factors

| | Notes |
|---|-------|
| › Historical earnings performance | |
| › Future earnings potential | |
| › Accounts receivables | |
| › Contracts | |
| › Assets (inventory, equipment and real estate) | |
| › Patents & trademarks | |
| › Capital restructure | |
| › Reliability of supply chain | |
| › Supplier relationships | |
| › Company reputation | |
| › Customer concentration | |
| › Strength of management team | |
| › Market factors | |
| › Industry outlook | |

Approaches to determining business value

1. **Cost or asset-based approach** totals all costs and investments dedicated to the business. This method is simple and straightforward; however, it doesn't take into account things such as the business' competitive reputation, market share, expertise or future earnings.
2. **Market Value approach** compares your business to those recently sold. While reasonably accurate, it may be difficult to find comparable businesses.
3. **Earnings-based approach** is most commonly used. A price is calculated based on historical and future earnings. This approach relies heavily on management predictions of performance and normalized events.

It's important to get a professional valuation, since some owners may grossly overestimate or underestimate their business' value.

Use professionals qualified to assess the value of your business. They can review your financial performance, provide an industry outlook and propose strategies to enhance the market value of your business.

4. Maximizing the Business Value

If you find that the value of your business isn't what you were expecting, you can look at enhancing company value by:

| | Notes |
|---|-------|
| › Exploring new markets for growth | |
| › Investigating strategic acquisitions | |
| › Investing in sales and marketing efforts | |
| › Reviewing product lines for efficiencies or new opportunities | |
| › Diversifying your customer and supplier base | |
| › Enhancing management infrastructure | |
| › Reducing discretionary spending | |
| › Disposing of non-operating assets | |
| › Minimizing contingent liabilities | |

Work with your advisory team to explore and identify options that can help maximize the value of your business and recognize that it may take some time for the value to increase.

We, at RBC Royal Bank®, have industry specialists who understand your business and your market. We can provide advice and solutions to help you get the most value from your business.

Contact us today: [Click here](#) or call 1-800-769-2520.

Many businesses can stagnate during a selling period because the owner may not want to make major strategic decisions that could affect the price.

5. Financing the Business Transition

A key part of the succession plan is the financing of the change of ownership. The ability of the prospective buyer to obtain the right financing is a key success factor in the execution of the succession plan, the future success of the business and in structuring the right deal for both the buyer and the seller.

Your RBC account manager can advise on the financing options to support the business acquisition and enable a smooth transition.

Some Questions To Consider

- › How much will the buyer invest?

› Will you be a source of financing for the buyer?

› What is your ideal method of payment?

› What are the tax considerations and advantages for the different methods of payments?

Acquisition Financing Options

There are a variety of financing options available, including:

| Finance Method | Description |
|--|---|
| BANK FINANCING | <ul style="list-style-type: none"> › Most affordable and easiest to acquire › Available through operating loans secured against accounts receivable and inventories › Also available through term loans, leasing and commercial mortgages to finance capital assets (real estate, machinery) |
| MEZZANINE DEBT | <ul style="list-style-type: none"> › Also known as subordinated debt › May be appropriate for businesses that are highly leveraged or those that lack the business assets to finance through bank financing alone › Carry higher fees and rates and may require giving up some ownership interest |
| EQUITY INVESTMENT | <ul style="list-style-type: none"> › Suited to companies that operate with limited tangible assets or those that have maximized their borrowing potential › Investors become partners in the business with decision-making rights › Future business' profits repay the investor |
| VENDOR TAKE-BACK LOAN (VTB) | <ul style="list-style-type: none"> › Seller supports the financing of the acquisition in the form of a loan or becomes an investor in the business › Ideal for business owner who does not need immediate access to funds and wants to retain some control over the transition of the business › Seller will continue to bear some of the risk of the business |
| SHAREHOLDER (BUYER) EQUITY OR LOANS | <ul style="list-style-type: none"> › Buyer uses personal funds to finance the acquisition , either in whole or in part › Buyer may have to borrow – the resulting loans may be secured against personal assets › The amount of the buyer's equity will also be a factor in determining other financing options |

6. Tax Strategies

A layer of complexity is created as the value of your business assets transitions into your personal investments. Tax laws and regulations may be complex, requiring advice from a qualified tax advisor or consultant. Some of the tax strategies to discuss with your tax advisor when transitioning your business are:

| Tax Strategy | Description | Key Benefits |
|--------------------------------|---|--|
| CAPITAL GAINS EXEMPTION | <ul style="list-style-type: none"> ➤ The seller may be able to claim a lifetime capital gains exemption of \$750,000 on the sale of shares | <ul style="list-style-type: none"> ➤ Potential tax savings on sale of shares |
| ESTATE FREEZE | <ul style="list-style-type: none"> ➤ Original common shares exchanged for new fixed value preferred voting shares ➤ Family members (or trust) issued new common shares with nominal value ➤ New common shares have potential to grow in value in the future ➤ Tax liability of original shareholder is capped at value of newly received preferred shares | <ul style="list-style-type: none"> ➤ May reduce tax liability of original owner on death ➤ Owner and/or family members may each be able to use the \$750,000 capital gains exemption ➤ Allows for greater span of ownership ➤ Facilitates income splitting |
| HOLDING COMPANY | <ul style="list-style-type: none"> ➤ Places a layer between individual owner(s) and the operating company ➤ Often a key component of an Estate Freeze ➤ Often used to hold non-operating assets such as excess cash / investments outside the operating company ➤ Often used to distribute the ownership interest more broadly among family members | <ul style="list-style-type: none"> ➤ Potential for income splitting with adult family members ➤ May qualify for the \$750,000 capital gains exemption ➤ May be helpful in asset protection from creditor claims against the operating company |
| FAMILY TRUST | <ul style="list-style-type: none"> ➤ Often used in conjunction with an Estate Freeze to allow family members to have an indirect ownership of a business ➤ Provides trustee with control over business and distributions to beneficiaries | <ul style="list-style-type: none"> ➤ Maintenance of control ➤ Potential for income splitting with named beneficiaries or defined classes of beneficiaries ➤ Useful for eventual family succession planning ➤ May reduce probate fees |

7. Planning Your Retirement

It's helpful to think of your personal retirement plan as part of your overall business succession plan.

Some Questions To Consider

› How will you achieve your goals and dreams and feel fulfilled?

› Is your spouse or partner also changing their work plans to coincide with your changes?

› Do you think you might live in different locations during the different phases of your retirement?

› Have you considered personal and family health in your retirement decisions?

Leaving a Business: Myths & Misconceptions

| Statement | True | False |
|---|------|-------|
| 1. There is very little beyond business ownership that will challenge me emotionally or intellectually. | | |
| 2. Business owners are highly skilled in managing their business finances and they readily apply this skill to their personal finances. | | |
| 3. In about a decade, Canada's population will have more people at an age where they can leave the labour force than at an age when they can begin working. | | |
| 4. Business owners wait too long to retire and enjoy this next stage of life. | | |

(Answers: see next page)

Leaving a business: Myths & Misconceptions - answers

1. False. It's important to consider what you'll do with your time after you leave your business before you retire. Approach friends and family for their opinions. Take a look at the goals you put on hold to build your business.

2. False. Business owners often do too little personal financial planning and leave it too late. It isn't as exciting as running a business and it can be difficult to ask for help when the owner is so competent at many other things. Many owners also overlook communicating with their spouses about these key life transitions.

3. True. Declining birthrates and advances in longevity are increasing the average age of Canadians. This means that business owners will be choosing their successors from a shrinking pool of talent.²

4. False. More and more often, business owners are considering their health and families. They have expressed their desires to share a healthy retirement with family.

45% of business owners planning their succession intend to have a continuing role in the business.¹

¹ Quantitative Study of the Business Succession Market in Canada (March 20)

² Statistics Canada, The Daily, July 17, 2007, 2006 Census, Age & Sex

8. Scheduling Your Succession Plan Work

Assign a time frame to each of your succession plan steps to help you stay on track.

| Succession plan step | Required time | Start date | End date | Done |
|---|---------------|------------|----------|------|
| Your Personal and Family Goals | ___ Weeks | _____ | _____ | |
| Your Business Goals and Needs | ___ Weeks | _____ | _____ | |
| Set Timelines | ___ Weeks | _____ | _____ | |
| <u>Create Your Team of Advisors</u> | ___ Weeks | _____ | _____ | |
| <u>Contact RBC account manager</u> | 1 Day | _____ | _____ | |
| <u>Select Your Exit Option</u> | ___ Weeks | _____ | _____ | |
| <u>Determine Business Value</u> | ___ Weeks | _____ | _____ | |
| <u>Your Retirement Planning</u> | ___ Weeks | _____ | _____ | |
| <u>Tax and Estate Planning</u> | ___ Weeks | _____ | _____ | |
| <u>Financing the Acquisition</u> | ___ Weeks | _____ | _____ | |
| Preparing Your Business for Transition | ___ Weeks | _____ | _____ | |
| Plans for enhancing the business value | ___ Weeks | _____ | _____ | |
| Grooming the successor | ___ Weeks | _____ | _____ | |
| Creating a communication plan | ___ Weeks | _____ | _____ | |
| Legal considerations | ___ Weeks | _____ | _____ | |

Working together, we can start your business transition now:

- › Talk to your RBC® account manager today
- › Call 1-800-769-2511 to schedule a meeting with an RBC industry expert
- › Visit www.rbcroyalbank.com/succession or click any of the links in this workbook