



# Getting the transition right

Survey results on small business succession planning

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# **GETTING THE TRANSITION RIGHT**

## **Survey results on small business succession planning**

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## Executive summary

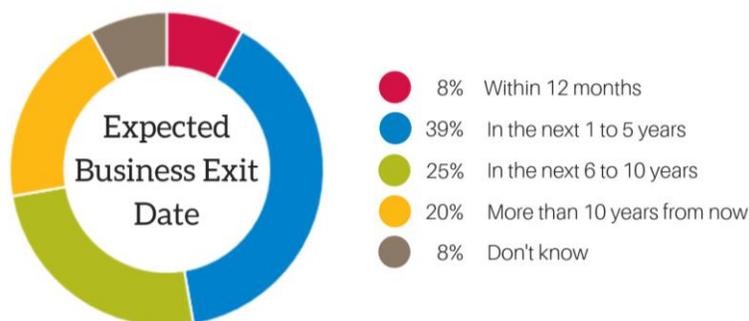
The approaching retirement of the baby boomer generation means that the business landscape is poised for a dramatic shift. Some 72% of business owners intend to exit their business within the next decade, with over \$1.5 trillion worth of business assets to be transferred to a new generation of business owners. Ensuring a smooth transition of ownership requires an effective succession plan, yet less than half (49%) of business owners have a succession plan and of these only about one in ten (8%) have a formal written plan. While it is encouraging that many owners have a succession plan, more owners need to undertake formal planning. Ultimately, succession planning is not only critical for the continued success of the business, but also for Canada's competitiveness and economic prosperity. The research presented herein is part of CFIB's continuing effort to provide information on business succession including the risks, opportunities, and recommendations to ensure that owners of small and medium-sized businesses (SMEs) can better plan their exit strategy. This study focuses on the key findings of CFIB's latest survey<sup>1</sup> on succession planning.

## Business Exit Strategy

### KEY FINDING #1 Exit Timelines

Just when do business owners plan to exit their business? CFIB research finds that 47% of business owners intend to exit their business within the next five years — 8% within 12 months, and 39% in the next 1 to 5 years (see Figure 1). Looking further ahead, 72% of owners plan to exit their businesses within the next ten years. To put this into perspective, over \$1.5 trillion of business assets could be transferred to a new generation of business owners over the next decade, up 50% from our last estimate in 2012.<sup>2,3,4</sup> If not managed well, this could have a significant impact on jobs in many local communities and the economy overall.

**Figure 1**



<sup>1</sup> The CFIB Business Succession Planning survey was conducted online May 4 - May 24, 2018 and is based on a sample of 2,507 small business owners from Canada. For comparison purposes, a probability sample with the same number of respondents would have a margin of error of +/-1.96%, 19 times out of 20.

<sup>2</sup> CFIB calculation based on Statistics Canada data: the share of owners exiting their business in the next 10 years (72%) multiplied by the total assets for incorporated SMEs (\$2.3 trillion). To simplify, "over \$1.5 trillion" is used as a ballpark estimate.

Source: Statistics Canada, Industrial Organisation and Finance Division, 2016. Special tabulation includes assets for incorporated SMEs with assets up to \$25 million.

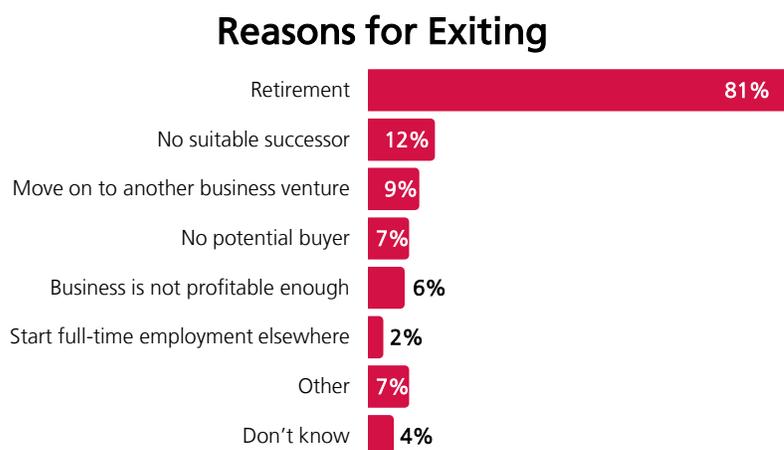
<sup>3</sup> The change in the estimate of total business assets from 2012 to 2018 may be due to a number of reasons including economic growth/decline, inflation, mergers and acquisitions activity, industry reclassifications and revisions to the data.

<sup>4</sup> Wong, Queenie, et.al. Passing on the Business to the Next Generation. CFIB, 2012.

## KEY FINDING #2 Reasons for Exiting

Retirement is the main reason cited by about four in five business owners (81%) for exiting their business (see Figure 2). Another 12% will exit since they have not found a suitable successor and 9%, mostly those under the age of 50, plan on moving to another business venture. Since most business owners (62%) rely on the sale of their business as a source of retirement income, any obstacles encountered by business owners looking to sell a business may not only be problematic to the business itself but to the wellbeing of the business owner and their family.<sup>5</sup>

Figure 2



Note: Multiple answer question; therefore data does not add to 100%.

## KEY FINDING #3 Exit Approach

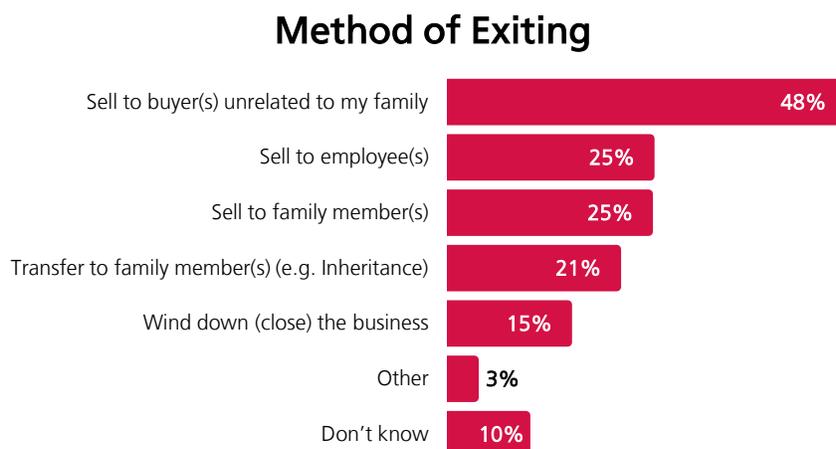
The most common method business owners plan to use to exit their business is to sell to buyer(s) unrelated to their family — cited by close to half of business owners (48%) (see Figure 3). About one quarter (25%) of business owners intend on selling their business to their employee(s), and the same proportion (25%) plan to sell to their family member(s). About one in five (21%) business owners intend to transfer the business to family member(s) through inheritance, and another 15% will wind down their business.

To ensure business owners successfully accomplish their transition, it is essential that they have the necessary tools and resources at their disposal. For example, those selling to an outside buyer will need help finding potential buyers. With regards to family transfers, it is essential to remove impediments within the tax system. Under the current tax rules, when owners sell their business to a family member, the

<sup>5</sup> CFIB Survey: *Retirement Savings*. June 26-July 6, 2015. Total responses: 7,889.

difference between the sale price and the price originally paid is considered a dividend. However, if they sell to an unrelated person, it is considered a capital gain. In effect, these rules can discourage the transfer of a business to a family member because the transaction does not include the right to a lifetime capital gains exemption and is, therefore, more heavily taxed.

**Figure 3**



Note: Multiple answer question; therefore data does not add to 100%.

## Succession Planning

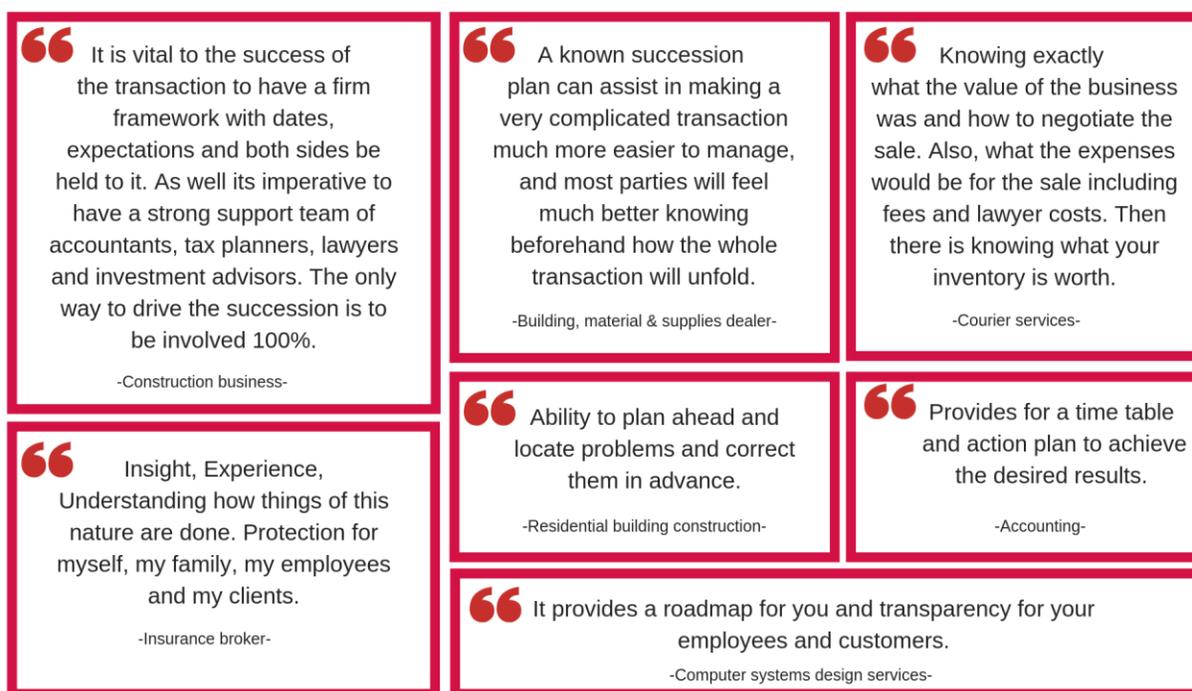
Whether business owners decide to exit or transfer ownership of their business, having a succession plan is critical for a smooth transition. Succession planning is the process by which a business owner chooses the best exit strategy for them to successfully transition into the next stage of their life. Succession plans can be informal or formal in nature. A formal succession plan sets out the process and schedule for a business owners' withdrawal, including legal and supporting documents needed to put the plan into effect. An informal plan is more ad-hoc in nature.

### **KEY FINDING #4** Benefits of Being Involved in a Formal Succession Plan

Formal succession plans have many benefits which cannot be replaced by informal plans. For example, formal written succession plans are developed with the input of various advisors, including accountants and legal professionals who help to address the technical aspects of transferring a business — e.g. financial, tax and legal considerations including the mechanics for the transfer, a process for resolving disputes, and a timetable. Figure 4 contains a few examples of the benefits of being involved with a business succession plan as described by business owners.

Figure 4

The Benefits of a Succession Plan – Business Owners’ Comments



 **KEY FINDING #5** Existence of a Succession Plan

Given the importance of having a succession plan, just how prepared are business owners for exiting their business? About half (51%) of business owners do not have a succession plan and of the other half (49%) of business owners that do have a succession plan, 41% have an informal plan and only 8% have a formal written plan (see Figure 5). The level of preparedness (i.e. having a succession plan) varies based on the business owners exit timeline. A closer look at those business owners with either a formal or informal plan reveals that the nearer an owner is to the intended exit date, the more focus is placed on having a succession plan (see Figure 6). In terms of having a formal plan, 21% of business owners intending to exit within 12 months have such a plan, compared to only 6% for those exiting in the next 6 to 10 years.

While it is encouraging that a good proportion of business owners intend to pass their business on to a new generation, the lack of formal planning gives rise to significant risks for Canada’s competitiveness and prosperity. With potentially over \$1.5 trillion in assets changing hands during the next ten years, Canada cannot afford to have so many SME owners unprepared to make that transition. Finding ways to assist SMEs in overcoming obstacles they may face when planning the succession of their business will be critical to help them succeed. This will not only benefit the business owner and

their successor, but may very well help to save and even create new jobs, keep local communities prosperous and continue to grow Canada’s economy.

Figure 5

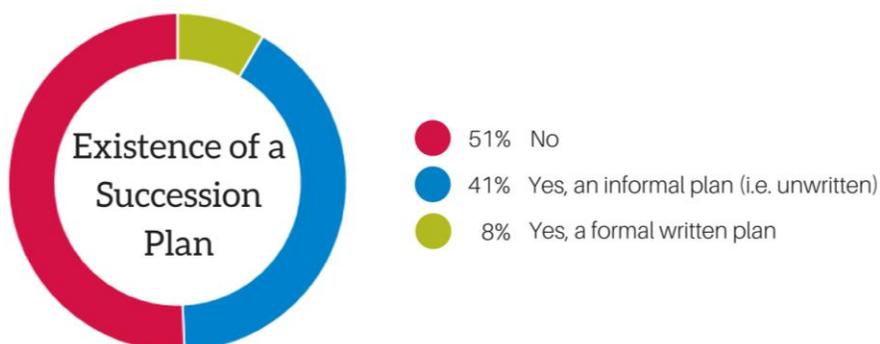
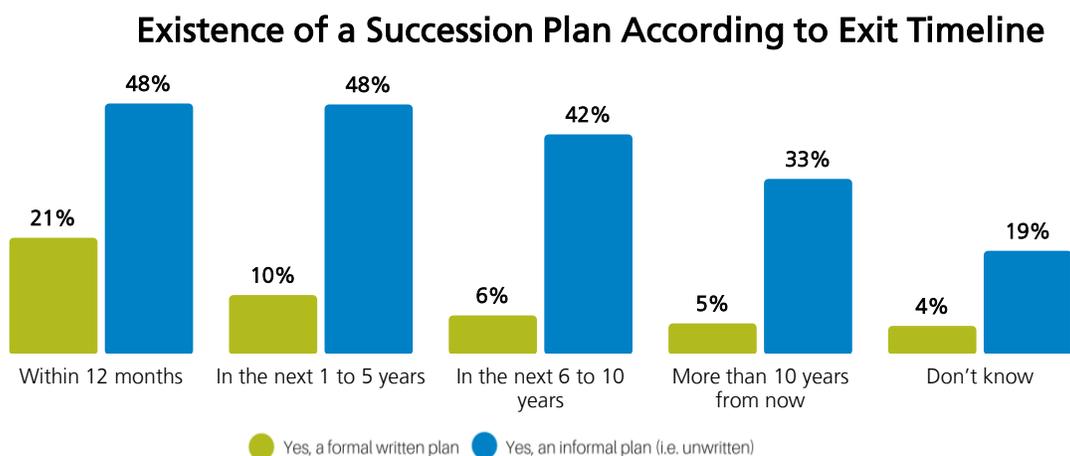


Figure 6



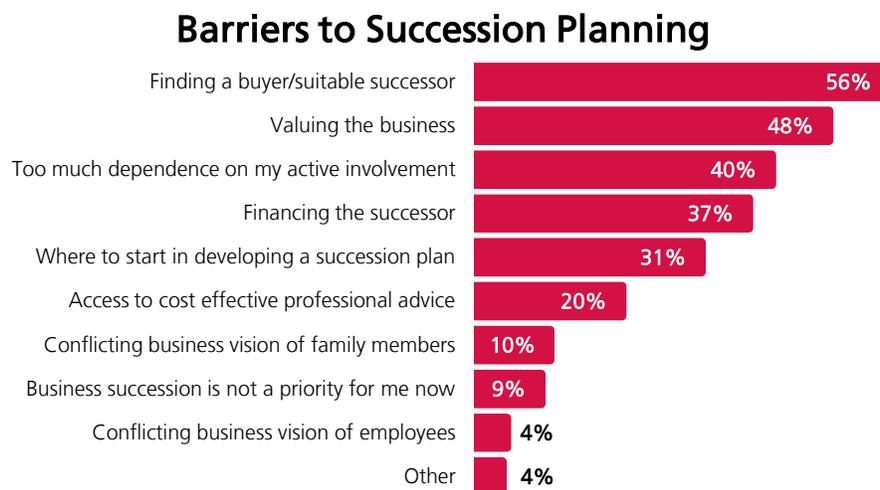
**KEY FINDING #6** Succession Barriers

When it comes to creating a succession plan, business owners tend to encounter several obstacles. More than half (56%) of business owners say that finding a buyer or suitable successor is a key barrier (see Figure 7). Indeed, family members may not have any interest in taking over the business, and many entrepreneurs are interested in starting their business from scratch rather than purchasing an existing one. Currently, there are very few options in Canada to connect those looking to exit their business with those who may be interested in purchasing a business and this may be an area for governments to explore.

Measuring the value of the business is also viewed as a key barrier by 48% of business owners. This can be a significant challenge as some business owners may overvalue their business, thinking only about what they invested over the years rather than what it is worth today, while others may undervalue their business neglecting to think about

certain intangibles such as the company’s reputation, trademarks or intellectual property. Other top obstacles include too much dependence on the owner’s active involvement (40%), securing financing for the successor (37%), and nearly one in three business owners do not know where to start when it comes to developing a plan (31%). Many of these obstacles can be addressed to some degree if there is a willingness by governments, advisors and organizations like CFIB to work together to try and assist small businesses through this important transition.

**Figure 7**



Note: Multiple answer question; therefore data does not add to 100%

## Conclusions and Recommendations

With over \$1.5 trillion in assets set to change hands within the next ten years, and only a fraction of business owners having a formal succession plan, the risks associated with improper planning are undeniable for the small business sector, its employees and the Canadian economy at large. Having a well-designed succession plan not only helps to improve the transition of a business from one generation to another, but also ensures the vitality of the SME sector. To ensure SMEs can better plan, CFIB offers the following recommendations:

### For Business owners:

- Plan early for business succession and include proper professional advice where possible.
- Include the future successor in the plan to help maintain stability within the business.
- Consider alternative exit strategies to account for uncertainties.
- Monitor and assess the business succession plan on a regular basis to ensure it remains relevant and adapts to changes in personal and business circumstances.

### For Professionals (e.g. financial advisors):

- ☑ Create a better service offering that is targeted towards the unique needs of SMEs and ensure value for money for services offered. Ensure that those service offerings are tailored to the size and complexity of the business.
- ☑ Develop and distribute “how to” templates for solving common issues related to succession planning.
- ☑ Help SMEs understand the valuation of their business.
- ☑ Move towards a consistent approach in valuating a business.

### For Financial Institutions:

- ☑ Adopt more flexible lending practices that take into consideration the financing needs related to business succession.
- ☑ Develop more affordable and comprehensible packages of guidelines for diverse types of business owners on how to start planning their business succession.

### For Governments:

- ☑ The Lifetime Capital Gains Exemption (LCGE) is a very important tax measure because for many business owners, the sale of their business is their retirement income. The LCGE threshold is \$848,252 in 2018 and \$1 million for farmers and fishers. CFIB recommends the following changes to the LCGE:
  - Simplify LCGE and expand it to include at least some assets.
  - Increase the LCGE amount to \$1 million for all SMEs (not just fishers and farmers).
- ☑ Change the Income Tax Act so that intergenerational transfers of small businesses to family members are treated in a similar manner as those to a third party.
- ☑ Allow small corporations to defer the tax on the capital gains from the transfer of a business to the owner’s children.
- ☑ There is already some very good information available on succession from a variety of sources, including the Canadian government through CanadaBusiness.ca.<sup>6</sup> However, no one knows about it and it can be difficult to find. Governments need to find ways to increase awareness of existing information they offer on proper business succession planning (e.g. through social media, education, and advertising campaigns).
- ☑ Increase awareness, particularly among young entrepreneurs, about the opportunities and advantages of purchasing an existing business.
- ☑ Consider creating a business succession immigration stream that allows potential immigrants to purchase and operate an existing business in Canada.

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<sup>6</sup> <https://canadabusiness.ca/business-planning/succession-planning/> accessed October 15, 2018.