WEALTH GENERATIONS: THE IMPORTANCE OF SUCCESSION PLANNING FOR FAMILY BUSINESSES

WHEN JOHN SIMPSON'S FATHER, JACK Simpson, died at 64, he left a perfect tax plan for his estate, but no plan for who should lead CANA Construction Ltd. Initially a chief engineer, the elder Simpson had successfully bought out the Calgary-based company's founders, but hadn't designated his own successor. His son John had been employed at the company for most of his life, starting out with a shovel and working his way up to vice-president. But there were other contenders and no obvious plan for selecting one.

"It ended up being me," says the younger Simpson, who had a dispute with his sister over the fate of the business. Simpson decided he wanted to protect his own two children, who are now in their 30s, from such uncertainty. Twelve years ago, Simpson started working on a contingency plan in case of his untimely death, a management strategy that's updated annually to reflect who's in senior management, where his children are in their skills and ambitions, and the status of his own eventual retirement. "I thought that rather than giving this dirty job to someone by surprise, it would be best planned out," he laughs. His daughter, who had previously pursued a career in landscaping and worked as a ski instructor, now runs the development side of the business, while his son, who studied communications, would

"love to run the company, but he needs more time."

Simpson is exceptional. Surprisingly few Canadian family businesses have formally planned how the next generation will take over. The 2014 Deloitte Family Business Survey of 120 family-owned Canadian companies found that just 17% of those surveyed have a formal leadership succession plan in place. While half have an informal plan, that doesn't leave them in much better shape than the 33% with no plan at all, says John Hughes, managing partner for Growth Enterprises at Deloitte Canada. "They may have a sense of who's coming up through the ranks, but that isn't really a plan," says Hughes, who also leads the Canada's Best Managed Companies program. There is no designated successor for the CEO or president at 54% of the companies surveyed, and of those that do have one, it is formally recognized in just 13% of cases. "It's really about controlling the process as opposed to having it thrust upon you," says Hughes. "Do you want to run the process or do you want to be run by the process?"

> **"THE RESULTS POINT TO A GAP BETWEEN KNOWING WHAT'S NEEDED AND ACTUALLY INVESTING IN WHAT'S NEEDED"**

While family businesses have a reputation for being more nimble and better at long-term thinking than their publicly owned competition, the familial dynamic has its own pitfalls. Rivalries, feelings of entitlement, poor performance by underqualified relatives, and blurred boundaries between home and business interests have brought many of these companies to ruin. The survey results suggest that Canadian family-run companies do recognize the dangers. Respondents strongly agree that ability should trump family connections when hiring for senior roles and that family members shouldn't be guaranteed jobs. A majority also say their family members are paid equal to other non-family members in the same roles. "Attitudinally and directionally, this shows a general acceptance and understanding of good governance practices and the need for proper planning, which is great to see," says Michelle Osry, Deloitte partner responsible for leading the firm's Canadian Family Business Advisory practice. "However, the results suggest many family businesses have gaps in governance, board operations and planning—there's a difference between knowing what's needed and actually investing in what's needed. There are operational and competitive advantages that come with good governance."

Companies seem hesitant to take active measures to prevent problems from arising. There may be a perceived lack of urgency for succession plans, which only come into play when a leader steps down or dies. But many companies also neglect to spell out the family's day-to-day role in the business. Twenty-eight per cent of those surveyed say they have a formal family shareholder agreement spelling out how family interests in the company will be managed. Among the larger companies surveyed—those with 100 or more employees and/or more than $50 million in revenue—just 30% have a formal family shareholder agreement.

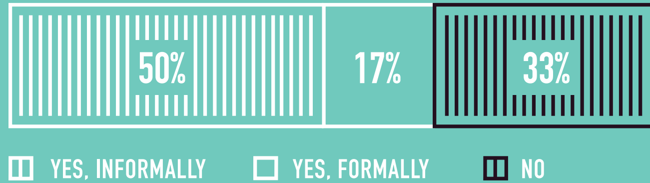
"In our view, family-owned businesses frequently leave themselves exposed to unnecessary risk because of a reluctance to commit to formal planning processes and good governance protocols," says Osry. "In the absence of formal agreements, a succession event tends to become a crisis event. We encourage families to consider a number of key questions ahead of such events: How can family members exit the business or ownership group? To whom can they sell? How do you ensure a fair valuation or shareholder interests? How do you deal with disabilities? How does the family deal with spousal ownership? Who gets to vote, and who has a voice in key ownership decisions?"

✳ RESULTS BASED ON RESPONSES FROM 120 FAMILY BUSINESSES WITH 50 EMPLOYEES AND/OR $25M+ IN REVENUE

—THE 2014 DELOITTE FAMILY BUSINESS SURVEY

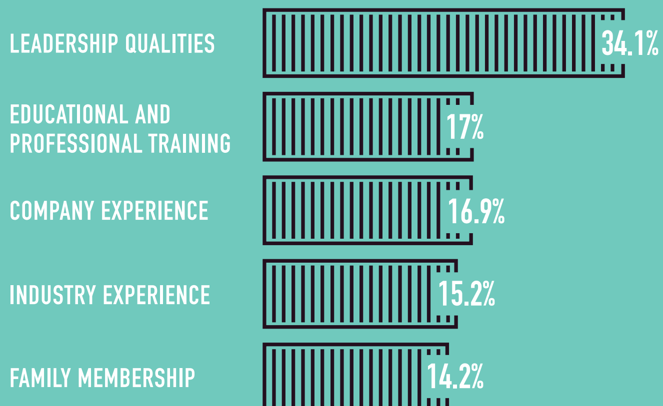
01

Does the company have a leadership succession plan in place?



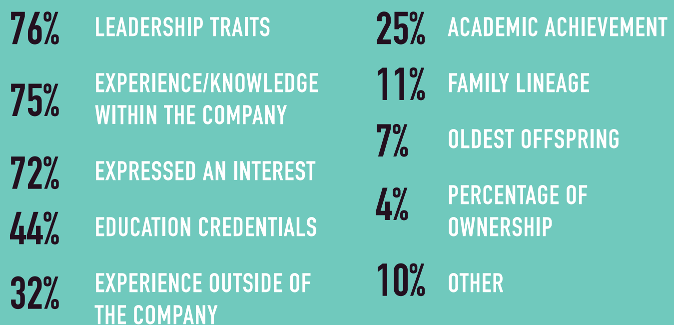
02

In making the decision on who will succeed the current leadership, which of the following will be taken into consideration?



03

What factors are used in deciding which family member(s) are groomed for leadership?



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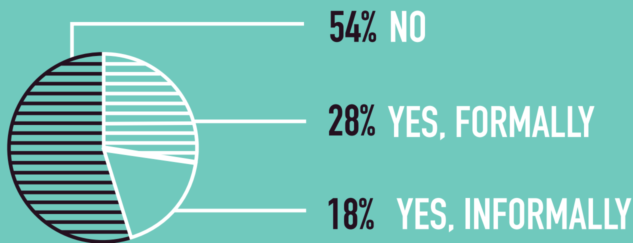
04

Is there a family shareholder agreement to decide on how family interests in the company will be managed?

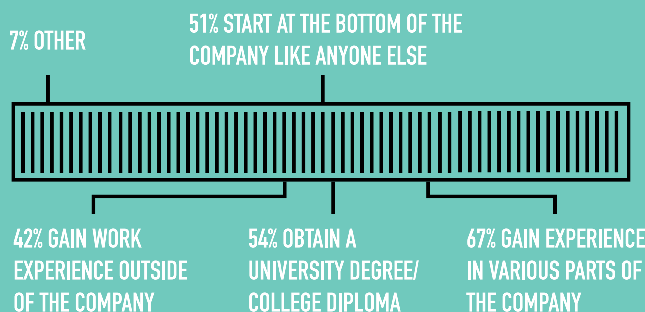


05

Which of the following governance/management structures is in place at your company?

06

Prior to or when joining the company, are family members expected to do any of the following?



✳ RESULTS BASED ON RESPONSES FROM 120 FAMILY BUSINESSES WITH 50 EMPLOYEES AND/OR $25M+ IN REVENUE

—THE 2014 DELOITTE FAMILY BUSINESS SURVEY

Family-run companies that fail to define and nurture their future generations endanger not only their ongoing prosperity but also the company's very existence. Businesses that have survived a family dispute learn a simple but hard lesson: Delaying succession planning is not an option.

THE FIRST GENERATION MAY HAVE A FALSE SENSE OF OPTIMISM. INDEED, THE transition from first to second generation, when the founder's vision and entrepreneurial passion is still strongly felt, may be less fraught. But businesses that are successfully passed on to grandchildren and great-grandchildren are special creatures. Just 14% of the surveyed companies have made it to the third generation or beyond; for larger companies, 20% have survived past the second generation. As businesses outgrow their startup origins, a different kind of management approach is often required.

"I'm a second-generation guy," says Larry Rosen, who in 2000 became president of Harry Rosen, the men's clothing company founded by his father and uncle in 1954. "I've got three university degrees, including an MBA. I practised law. When I was younger, I sold for a long time in the stores, so I understand that part of it. I grew up in the business." In the 15 years Rosen spent managing various departments of Harry Rosen before taking the top job, the succession details were never written down, but "we had advisers who knew the end game was that I was ultimately to run it," says Rosen, who is now 60 himself.

When it came to his own children's roles in the business, Rosen decided to be more formal. He sought outside advice. "It's very hard to be objective with your kids. Parents in business tend to either be too hard on them or too easy on them," he says. From the time his three sons were in their teens, they each knew they'd be required to have an MBA from a top university and three years of high-quality outside experience in order to be considered for a senior position. So far, one son has followed that path and will be joining his father at Harry Rosen soon. "There are no surprises. They understand what their role can be down the road, when they inherit or there's trust," he says. "They can be a shareholder or they can be a shareholder in management, if they meet the right criteria."

Grooming strategies—like having potential successors work in various departments, fast-tracking them for promotions, or having them participate in the board of directors or advisers—take place at 76% of surveyed companies, but just 53% of those companies formalize the process. Many successors find their way back to the company after pursuing their own educational and career objectives. Paul Genier was between jobs one day when he had lunch with his father, who, at the time, owned the Ottawa-based IT consulting firm Veritaaq.

> **"IT'S ALMOST LIKE YOU'RE PLAYING CHESS. YOU HAVE TO THINK SEVERAL STEPS AHEAD"**

"My father broached the topic that he needed a sales person, and would I be interested. To be honest, I didn't really know what he did," says Genier, now president of Veritaaq. Genier eventually joined with his older brother and half-sister for a management buyout from their father, with the three of them taking on appropriate senior management roles. A sibling who hadn't pursued a management position did not participate in the buyout. Though Genier says there was little serious fallout from leaving a sibling behind, Veritaaq's second generation created a family code of conduct that will apply when and if their seven offspring, currently all preteens, become involved with the company. "We want to ensure they're competent and capable, and know what it's like to work in a professional busi-

ness environment," says Paul Genier.

It's almost like playing chess. You have to think several steps ahead," says Doug Munro, CEO of the Brampton, Ont., trucking company M-O, which his father established with partners in 1962. Munro would like his three children, presently in their teens, to be involved in the company. But he's nervous about creating feelings of entitlement among them and perceptions of nepotism among staff.

"Unless the children work their way up and are capable, it's hard to retain good outside management. Nobody likes to be stepped over," says Munro.

IF FOUNDERS FACE THE DILEMMA OF CHOOSING WHICH OFFSPRING SHOULD take over, decisions for the next generation—with a growing array of cousins who may or may not have what it takes to lead—are even more complicated. Companies are equally as likely to have a single family member groomed for leadership as they are to have multiple family members groomed (each scenario applied to 30% of survey respondents). Another 39% say it "depends on talent," meaning other options, including non-family leadership, may be considered. The largest proportion of surveyed companies (26%) expect that the chief executive alone will make the ultimate decision on who will lead the company in the future. That's tricky. By the third generation, a founder may no longer be able to make the ultimate decision. "With subsequent generations, there's added degrees of complexity and risk, adding to the need for strong governance frameworks; particularly the experience and insights that come with having an independent and capable board of directors or advisors," says Osry.

Companies may delay succession plans or avoid formalizing them because the next generation may seem too young to commit to a life in the family business. Yet there are some ways to prepare children for being shareholders and possible successors, even when their roles in the company remain uncertain. Osry suggests that some children are ready take part in family meetings as soon as their early teens. Before they are answering the front-desk phones on their summer vacations, and before being considered for management positions, potential successors can participate in, for example, the family's philanthropic giving—an early taste of corporate governance that may help clarify their interests.

Marcia Mayhew was in her 20s when her parents asked her to take over Mayhew, a Richmond Hill, Ont., office design and furniture business that grew out of a company founded by her great-grandmother. They came up with a 15-year plan that, as well as spelling out how Mayhew would gain ownership of the company, had her work with coaches, advisers and a CEO network to develop her leadership skills. "When my parents asked me to step in, I was extremely green," says Mayhew. Now president and CEO, the fourth-generation leader makes quarterly reports to an advisory board. Appointing such a board of shareholders and outside experts is an increasingly popular tool for family companies that want to remain private while maintaining high standards. "I have parents that are very excited about the direction I'm taking the organization, but they will definitely fine-tune the strategy if they don't feel it fits into the overall direction of the family."

When Mayhew took charge, there were a few changes with the executive leadership team. Managing the expectations of non-family staff requires deft manoeuvring. While family companies are known for holding on to

employees for decades, ambitious managers may have to accept that they will never be president or CEO. Just 21% of the privately owned companies surveyed have any non-family ownership. Allowing senior staff to have a stake might compensate them for not having the opportunity to be a CEO. "The outside ownership seems to be a retention strategy for senior folks," says Hughes. "It's not sharing the risk of the enterprise, it's a retention of employees."

Clayton Bzdel joined Simpson Seeds in 2012, the first non-family member to hold an executive position with the Moose Jaw, Sask., seed producer and lentil exporter. "There's always the perception that family is being treated differently from everybody else, but we do a pretty good job of making sure everybody, including family members, are sitting in the right seats on the bus," says Bzdel, who serves as CFO.

Founded in 1979 by three brothers and their father, Simpson Seeds currently employs nine family members, including one founding brother, Greg Simpson (as CEO) and six members of the third generation, referred to as G3. The company has developed a succession plan that determines how the current shareholders group will transfer ownership to G3 and how the current CEO will make his exit. The plan will eventually spell out what will be required of Greg Simpson's replacement.

Good communication plays a part in keeping things running smoothly. Among surveyed companies that have a leadership succession plan in place, 70% say that all family shareholders have informal knowledge of the plan; 13% say all shareholders have written knowledge. "The people running the company may be very successful, and they don't necessarily put their minds to the fact that they're not going to be on the Earth forever and haven't started the conversation soon enough with the kids, which is a recipe for disaster," says Paula Higgleton, a Deloitte senior tax partner who leads the Family Office Team in the United Kingdom. She sees very similar trends between the U.K. and Canada. "Families typically recognize the need to put good governance structures in place. But the process of formalizing these plans can be quite challenging."

Perhaps it's not surprising that 88% of respondents say the interests of the business are more important than family interests when making strategic decisions. After all, a successful company can be the foundation for a happy and prosperous family life, while a divided company can damage familial bonds. For smart companies, passing the torch to the next generation is about giving them the means to build the company's future.

"I think my son or sons will take this business places where I'm not capable of taking it," says Rosen. "Not by themselves, but with other talented senior management beside them."

This report was produced by CB Insights in association with Deloitte LLP

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