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FAMILY BUSINESS

Creating a climate where intergenerational transitions are supported

"Shirtsleeves to shirtsleeves in three generations," they call it when family-owned enterprises fail by the time the founder's grandchildren take over. It is a well-documented cycle: three out of 10 family businesses survive into the second generation, but only one out of 10 is handed down to the third.

A significant number of family enterprises are changing hands as Canada's boomers retire, says Bill Brushett, president and CEO at Family Enterprise Xchange (FEX), and their successful transitions to next-generation leaders will determine the degree to which they're able to continue their impressive legacy of acting as a primary economic driver in Canada, generating job growth and making sizable philanthropic contributions.

Estimates put the number of family businesses in Canada around 880,000, with five or six million employees. "Some family enterprises are small, others are household names that we all recognize," he says. "We also have a high number of mid-sized family businesses that operate in every community and city across the country."

Since family businesses are such an important cornerstone of the Canadian economy, Mr. Brushett believes their long-term success should be supported through policy and strategic decision-making at the leadership level. "Unfortunately, today in Canada, it is more lucrative to sell a business to a third party than to pass it to your children from a tax perspective," he explains. "We'd like to see changes that – at a minimum – level the playing field. But ideally, we'd like to see a climate where intergenerational succession is encouraged and really supported."

While a supportive business climate and tax structure can create better external conditions, Allen Taylor, chair of FEX, also calls on business families to lay the groundwork for successful transitions. "Family businesses that are interested in sustaining the business for longer than one generation need to make this objective part of the ongoing planning process," he says. "They need to be clear on what they want to achieve and work towards it rather than just reacting when there is a crisis."

In Mr. Taylor's view, long-term planning is as important as looking after day-to-day business metrics. "Families often resist discussions [about succession] because they can be uncomfortable, but if they are forced into crisis management versus strategic planning, their number of options is usually much more limited," he says.

Exploring questions of whether the next generation is ready to step into leadership positions, whether there is harmony in the family and alignment on key goals can facilitate a more holistic approach to transition planning, says Mr. Brushett. "Family businesses with successful successions from generation to generation typically put a lot of time and effort into planning."

Due to the interplay of family and business dynamics, many family enterprises assume their situation is unique, when in fact their challenges are often similar, says Mr. Brushett. "At FEX, we encourage them to share their knowledge and experiences, either through our programs or peer advisory and mentoring groups, and learn from each other and employ that knowledge and wisdom for creating successful transitions."

FEX is building a family enterprise community, which Mr. Brushett calls a "safe harbour environment," where members are encouraged and comfortable to share their personal experiences in a peer advisory group, for example. "This is working extremely well," he adds. "By studying what successful business families have done, we learn about things that can support intergenerational transitions versus the things that can be problematic."

Mr. Taylor agrees that with the right planning and advice, the outcomes for business families can be substantially better. "Over the coming decade, a very high number of family enterprises face the situation where the controlling generation will be looking for exit strategies," he says. "Many want to see a continuation of what they've built, and members of younger generations bring their own values, hopes and dreams."

This renewal carries a potential for revitalization, says Mr. Taylor. "Today's economy is very different from when the boomers started their businesses. The changes, which affect how resources are gathered and how services and products are distributed, for example, will only accelerate. Involving next-generation leaders can provide answers to the question of how to grow family enterprises in ways that fit this new economy."

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Bill Brushett
is president and CEO at Family Enterprise Xchange

Family businesses with successful transitions from generation to generation typically put a lot of time and effort into planning. ISTOCKPHOTO.COM

ABOUT

FAMILY ENTERPRISE XCHANGE

The Family Enterprise Xchange (FEX) is a national organization with the goal to empower family enterprises and their advisers so they can succeed and flourish. To achieve this, FEX provides business families and their advisers with a unique blend of shared wisdom and experience, and the world's best, leading-edge thinking and knowledge.

For more information, visit family-enterprise-xchange.com.

STRATEGY

A plan appropriate for the unique elements of business dynamics and the next generation

Death and taxes might be certainties, but for family business owners, advance planning can soften the financial blow when companies pass from one generation to the next.

Paul Tompkins, president of Tompkins Insurance Services Ltd., a Toronto company that helps business families meet their estate-planning needs, says that owners can sometimes procrastinate when it comes to undertaking their planning related to succession.

While Mr. Tompkins works mostly with larger business families, he notes that issues related to estate planning "are prevalent for family businesses no matter what size." These especially include how to fund the significant tax liabilities from capital gains as well as other costs that can arise from the intergenerational transfer of the business.

Life insurance can provide, in a tax-effective manner, the necessary funds in these situations. "Having a properly structured and managed life insurance liquidity estate plan is critical to meet the tax liabilities of the business," he explains, as part of a solid plan that provides certainty and direction, as well as avoiding future problems.

"It's a complex topic," says Mr. Tompkins, noting that it's important to establish an advisory team, including qualified accounting, legal and insurance experts and, if required, an internal key confidante. This core group can help to simplify and coordinate the plan, so that it fits the unique elements of the business dynamics and the next generation who will take over the business.

The goal is to find tax-effective solutions that minimize risk to the business family, for example, considering an estate freeze to cap the tax liability, which is a good strategy but should not be undertaken too early, Mr. Tompkins says. In all such decisions, "you want to make sure you're not going to cause friction in the next generation."

Flexibility in the plan and maximum liquidity are critical because tax rules and tax rates can change, as was evident this summer when the federal government announced tax changes that might have significantly increased estate tax liabilities. "Family businesses are the most important part of the Canadian economy, and it's good public policy for these businesses to be allowed to transition from one generation to the next."

One issue to be aware of is the role of family members in the business, for example, whether they work directly or own shares in it, Mr. Tompkins says. "A good team of advisers understands the technical side of things and the real-life issues that can arise when transitioning a business from one generation to the next."

Whether family members are business operators or stewards of the company, they should "have a forward-thinking outlook," Mr. Tompkins says.

His long-term advice for family business owners: "Don't just write your plan and stick it in a drawer or file, only to be opened when you've passed away" – keep it up to date, ensuring that it covers any changes in the business, underlying values and whether the type and level of insurance involved in the plan are adequate.

"Then the family can go back to what they want to do – running their business," he adds.

"Having a properly structured and managed life insurance liquidity estate plan is critical to meet the tax liabilities of the business."

Paul Tompkins
is president of Tompkins Insurance Services Ltd.

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New rules: Aimed at big business, but likely to hit small and mid-sized operations

Every now and then something big happens when it comes to taxation affecting business in Canada, and that time is now, says one of Canada's leading tax experts. "The changes being proposed by the federal government are certainly the most substantive I've seen in 21 years of practice, and probably the most substantive since the entire tax system was overhauled in 1972," says Heath Moore, national tax leader at Grant Thornton LLP.

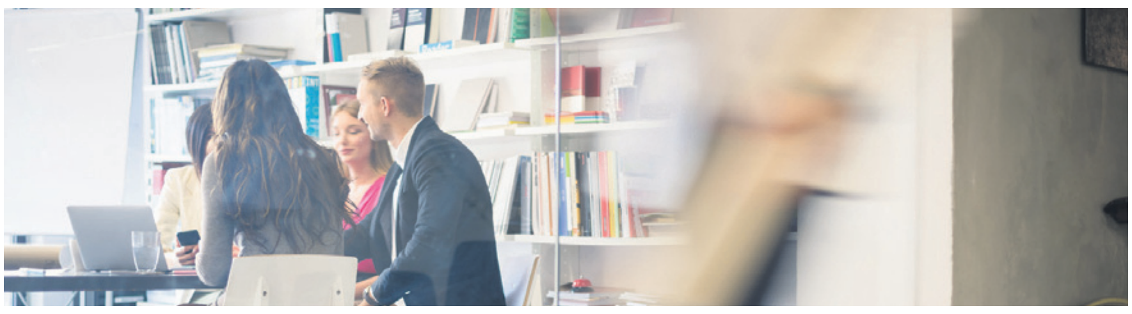
Although the government is proposing the changes with the laudable goal of "levelling the playing field" and forcing more wealthy Canadians to pay their fair share of taxes, they have the potential to sideswipe a wide range of private and family-owned businesses – small, medium and large – as well as professionals. As they are currently worded, says Mr. Moore, the new rules are going to have "a very negative impact" on the ability of a business to split income between family members. They will also limit the ability of an owner to save or build assets within a company that could be used for reinvestment, to manage business cycles, or even save for retirement. Additionally, their complexity and reliance in some cases on vague definitions will make them more difficult and expensive for business owners to navigate.

"The impact is not just going to be on the business owner and their family but also on the communities where they play an important role in terms of jobs, local investments and even charitable donations," says Mr. Moore. He adds that while much is made of how the new rules are aimed at big business, it's the small and medium-sized ones that are going to feel the pinch the most; a $20,000 or even $50,000 hit isn't likely to have much impact on a big corporation, but it could be catastrophic to a struggling professional or a small business owner just scraping by.

Mr. Moore advises business owners to familiarize themselves with the proposed changes sooner rather than later and ensure the corporate structure they have in place is appropriate to their business, ownership and family needs over both the short and longer term. Then they need to have their voices heard. "I don't think it's ever too late to let your government or your local MP know how you feel about the impact the proposed legislation is going to have, not just on your business and your family, but on your community and working Canadians," says Mr. Moore.

"The impact is not just going to be on the business owner and their family but also on the communities where they play an important role."

Heath Moore
is national tax leader at Grant Thornton LLP



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PHILANTHROPY

Financing real solutions, and deploying them quickly

Family businesses are some of the largest contributors to social and charitable causes, and they are heading into the "largest intergenerational wealth transfer in North American history," says Gena Rotstein, a family enterprise adviser specializing in philanthropy. "Not only will we have a younger demographic stepping up, we'll also see more women in leadership roles. We will definitely see a shift on how financial decisions are made."

Ms. Rotstein observed that incoming leaders "want to make sure their financial investments are aligned with their values, their social expectations and their business growth strategy."

In philanthropy, they are increasingly interested in maximizing their impact, says Ms. Rotstein, who founded Place2Give Foundation, a donor-advised fund that matches donors with charities, and is a principal of Karma and Cents, a social impact lab. "We want to enable family foundations to make their money work for good."

The next generation of family business leaders "saw their parents build a business, and they want to apply the same methods to their [charitable] work," she explains. "They want to be involved to ensure that they are not just putting money in on one end with nothing happening on the other."

In short, they are looking for tangible outcomes, says Ms. Rotstein, citing the example of a client who focuses her philanthropic efforts on prostitution. "The sex trade is a complicated issue with many layers, and addressing the root causes takes time, but our client learned from conversations with front-line agencies that sex trade workers needed to go to the bathroom with dignity," she explains. "They couldn't just go into a coffee shop and use the facilities. Our client bought them gift cards, so the women can get a coffee and use the bathroom. That's a simple measure that provided an immediate layer of comfort."

Combining front-line activities like this with other systemic change solutions can create a diversified giving portfolio that allows the donor to address the problem from multiple angles, says Ms. Rotstein. "Philanthropy 3.0 is about financing real solutions, not just funding problems. And this generation wants to deploy solutions quickly and see how they work."

"We want to enable family foundations to make their money work for good."

Gena Rotstein
is a family enterprise adviser specializing in philanthropy