

Family Business Succession Considerations

What is a Family Business?

A family business is commonly thought of as a private company where more than one member of a family either works in, or is an owner of the business. This can be extended further to include businesses in which there is potential for a second family member to work in the business or become an owner at a future time. The vast majority of businesses in Canada can be described as family businesses. As family businesses are often the most valuable family asset, the succession of a family business can be complex and sensitive due to the different points of view of family members.

Every business has at least two distinct oversight systems, being the ownership (i.e. owners) and the people who operate the business (i.e. management). In most private companies, these systems overlap – i.e. the owner-manager. It is when a third system, “the family system”, intersects with the owning and operating of the business that makes the company a “family business”.

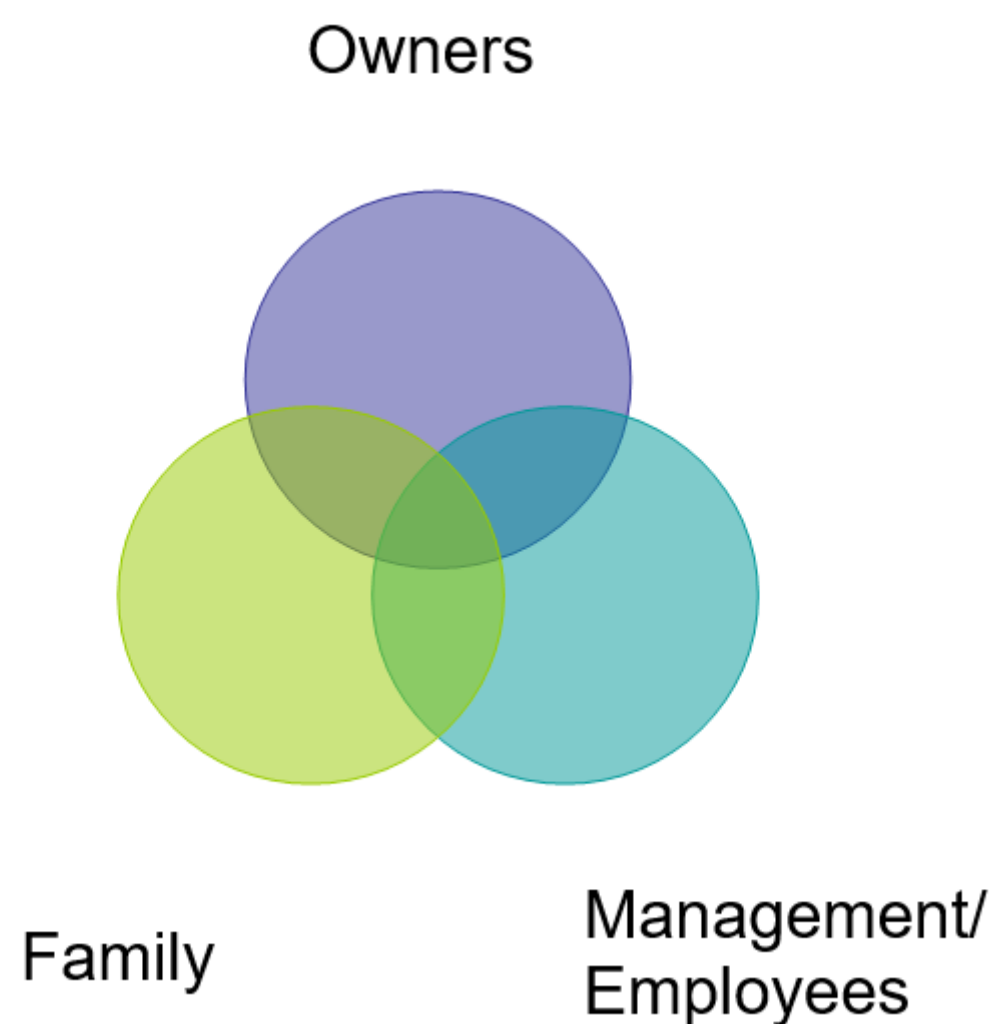
As many family businesses will be transitioning both management and ownership in the near future due to our aging population, it is important to have an understanding of how these overlapping systems affect their business succession planning, to optimize the outcome.

The Three Circle Model

In a family business, there are three distinct but highly interrelated systems at play that have a bearing on any decision involving the business¹.

These three systems are:

- Family System – owners and their siblings, spouses, children, children’s spouses, nephews, nieces;
- Ownership System – anyone who owns shares in the company; and
- Management System – anyone who is an employee or manager of the company.



There are seven potential positions that an individual can occupy in the overall family business picture (comprised of the three overlapping systems). They are as follows:

1. **Family Member only** – A person in this position will be mainly interested in family harmony and the fair and equal treatment of all family members.
2. **Owner only** – A person in this position will be mainly interested in return on investment – both in income the business can provide and also the overall growth in value of their share in the company.
3. **Manager/Employee only** – A person in this position will mainly be interested in expanding their compensation and career opportunities within the business.

4. **Family Member and Owner** – A person in this position will have dual interests in family harmony and fairness to family members, especially with respect to return on investment from the business.

5. **Owner and Manager/Employee** – A person in this position will have dual interests of business growth to create more career opportunity and compensation along with dividends and increased value of shares.

6. **Family Member and Manager/Employee** – A person in this position will have dual interests of family harmony and enhancing their own career opportunities and compensation.

7. **Family Member, Owner and Manager/Employee** – A person in this position is the quintessential “Owner Manager”. Although this person will have the best overall perspective and should understand all parties’ interests, they face the most pull from all parties and may have trouble reconciling the appropriate direction on important decisions. It may be difficult to satisfy all three of their potential interests.

This is how each party may view the business succession planning process:

- Family members with no ownership will obviously want a process that will be best for the family. For example, the spouse of a business owner may want a plan that will maximize financial security for the couple, allow them to live their desired lifestyle outside the business, ensure that none of the children feel unfairly treated and that no relationships within the family are strained.
- Owners that are neither employees nor family members will want a process that maximizes value to them in the form of return on their investment. For example, an inactive investor in the business will want to see the most qualified person take over the business regardless of how it personally affects the members of the owner-manager’s family. Such a person may favour selling to a competitor even if it means employees (both family and non-family) may lose their jobs.
- Management and employees that are not family members and do not have any ownership interest will



want to see a competent successor taking over the business and continue its growth and success for reasons of job security and career advancement opportunities. For example, a vice-president that has been with the company for 20 years will want to have continued opportunities to increase his/her compensation and perhaps control the operations of the company.

- Family members with shares in the company but who do not participate in the business will want to ensure their future dividends from the business or may also be in favour of being bought out. For example, the business owner's daughter who lives in another city and has her

own career may look at the investment and be attracted to an option that gives her the best financial return but may be in favour of her father retiring earlier because of his health and her mother's loneliness.

- Employees that are also shareholders but are not members of the controlling owner's family will obviously want business growth and expansion/protection of their own career opportunities within the business. For example, the employees may be in favour of bypassing the business owner's family member as a successor and want an experienced outside manager to take over the operations of the company if the business owner is ready to retire.

- Family members who are employees but have no ownership interest may want a succession plan that involves passing both management and ownership to them rather than to third parties or other family members. For example, two brothers in their mid 40s may manage a business which is still owned by their father, who is in his late 60s and still acting as President. The brothers will likely feel accountable for the current and future success of the company and will therefore want a succession plan that calls for the father to retire soon and provide a way for both management and ownership to pass to them as opposed to other family members or a third party.
- The Owner-Manager has the broadest perspective and should have the greatest understanding of the interests of people who fall into any one of the above six categories. However, this does not mean they will make decisions that are most advantageous for the whole company. For example, the owner-manager may know that stepping aside in the next three to five years will be best for the business, the family and employees; however, he or she may not be emotionally ready to retire.

Process for Family Business Succession

As outlined above, family business succession can involve multiple parties with conflicting interests. The business owner(s) is still the key person in business succession planning but they need to be aware of and take into account all the different interests of various parties involved. Generally, taking the steps below may help a business owner cover all the bases.

1. Business owner explores his or her future aspirations before transfer of management and ownership.
2. Business owner explores the aspirations of the other members of his or her family.
3. Business owner formulates the strategy/plans for the business and the people who work in it.
4. Business owner aligns the business plan with the plan for the family.
5. Business owner prepares the successors for taking over management of the business.
6. Business owner prepares to pass on ownership in the business.
7. Business owner integrates his or her estate planning with the business succession planning.

Considerations

As every business succession is different and can be complex due to the different interest groups, it is prudent to consult with a business succession advisor or team of specialist advisors well in advance, to validate the most desirable outcome and execution strategy.



¹Tagiuri, R. and J.A. Davis. 1982, "Bivalent Attributes of the Family Firm." Working Paper, Harvard Business School, Cambridge, MA. Reprinted 1996, Family Business Review IX (2):199-208.

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