BMO Wealth Insights

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Introduction

Business owners invest so much into their businesses – emotionally, physically, and financially. With so much at stake, it is important that the business is set up to succeed – to address any unforeseen or expected issues efficiently, so that the business can thrive and prosper through all the stages of the business life cycle.

This two-part series focuses on the life cycle of a business and its owner. There are four major stages of the business life cycle: start-up, growth, maturity and exit. The first issue focused primarily on key considerations that can help you to achieve your personal and business goals. This issue will explore considerations specifically relating to the business itself, to ensure it is able to adapt to change and can continue building toward sustainable success.

In this issue, we explore topics unique to the functionality of the business, from the value of a business plan to the raising of business capital. We also consider ways to ensure the business is able to adapt to change and continue its sustainability, focusing on the benefits of a shareholders' agreement. Following that, we focus on some common mistakes to avoid when selling a business, and how implementing a succession planning process can help navigate a complicated and most often challenging process of transitioning away from the business. We conclude by looking at ways to prepare the family or next generation to take over, while also exploring what to do when the kids don't want to take on the family business.

At BMO we believe that professional planning and advice go hand in hand. By working with BMO financial professionals who understand the importance of addressing the needs of the business and the entrepreneur as a coordinated unit, the entrepreneur can receive advice that is tailored to their individual and business needs and can plan for a financially stronger future.

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The value of a **business plan**

Whether you're a new start-up business or a mature company looking to meet annual growth targets, a business plan can be an effective tool to meet your goals and achieve success. A key benefit of business planning is the ability to create a united team, focused on a specific roadmap for the company.

A business plan is a written description of your business and how it operates, along with its vision, goals and objectives. Business plans are most commonly associated with start-up companies; however, all companies can benefit from having a plan which is continually updated for rapidly altering industry dynamics and internal company changes, as well as economic developments whether local or global in nature.

The most effective business plan will evolve as your business grows and changes. It is a dynamic document that will guide decision making and operations at any stage of your business life cycle:

- If you're intending to start a business, a business plan can help you turn your vision and capital into a viable business. It will provide support and direction when securing financing from lenders and investors.
- If you're operating an existing business, a business plan enables you to communicate your vision to employees and those who interact with your business.
- If you're growing your business, a business plan empowers you to raise capital to expand, manage growth and mitigate risks.
- Finally, when you plan on exiting the business, a business plan can help facilitate the development of a plan to transfer ownership, sell your business or wind it down.

Purpose of a business plan

A well-designed business plan can help keep you and your team focused on annual and longer-term goals, assess resource needs, and help you identify and critically assess opportunities and risks within the business. Writing out or updating your business plan forces you to think about your entire company, dissecting and planning within all of the moving parts: sales, marketing, production, customers, employees at all levels, and financial needs. When you consider all of the moving parts as a whole, you are less likely to miss any key factors and can identify key issues before they become a problem.

A business plan can be used for general internal purposes or a very specific need, such as raising capital for growth. The purpose of your business plan dictates the scope and level of detail required and may need to be updated as your business evolves and your goals change. An external party may require more detail to understand your business and industry than internal partners or colleagues.

Key components of the business plan

The overall structure and contents of a business plan may vary. However, there are a number of core components that should be considered for inclusion in a business plan:

Executive summary

- One-page summary of key aspects of the entire plan.

Business overview

- Description of the business and its purpose, vision statement and values. What differentiates and makes your business great?

Products/services

- Description of products/services provided, highlighting their unique value propositions.

Sales and marketing plan

- How do you market your products and/or services to your customers? What is the sales strategy to get customers to purchase your offerings? Do you employ sales representatives or agents?

Employee organization chart

- Matrix of roles and reporting lines. Critically assess this chart to determine if you have the right individuals to accomplish your plan and vision for the company. Are there any vacancies that need to be filled or a new role that should be created? Are there any employees approaching retirement? What is the plan if a key employee leaves? What is the bench strength in the company at all levels?

Customers/suppliers

- Who are your customers and suppliers? Are agreements in place? Why do your customers buy from you now and how will you ensure this continues?
- Breakdown of sales by customer and purchases by supplier. Are there customer concentration risks or suppliers critical to your business? If so, how are you working to decrease these risks?

Industry/market

- Total overall market and projected growth rates in the industry and the business position within it (i.e., market share and market positioning).
- Description of local and larger economy impacting the business.
- Competition (both direct and indirect) and plan to win more business.
- Consideration of strengths, weaknesses, opportunities and threats. This allows for critical thinking about the business, often identifying areas for growth and providing an objective view of risks and potential improvements.

A well-designed business plan can help keep you and your team focused

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Growth identification

- In what areas could the business grow revenues and profitability (new markets or products, capital investment to improve margins, growth through acquisition, etc.)?
- What is the plan to accomplish the identified growth?

Financial information

- Historical financial performance and a forecast with key assumptions. Consider including income statement, balance sheet and cash flow information.
- You should forecast for the next 12 months, and for 3 to 5 years. The 12-month forecast should illustrate the key assumptions in the greatest detail, including revenues and costs.
- The qualitative aspects of the plan should tie into the financial forecasts.

Exit strategy

- An exit strategy lays the foundation for a successful transition of your business, and also supports retirement or accomplishing other goals. Planning for this will allow you to consider all of your options, including strategies that may take time to implement.
- If selling the business, effective business planning during the life of the business will contribute to getting the best price.
- If you plan on passing the business to children or transferring to a key employee or partner, it may take time to integrate or facilitate the business transition.

A business plan provides tremendous insight into your business and helps others such as investors, suppliers and banking professionals to understand and support your needs. It is important to review and update your business plan at least on an annual basis.

Conclusion

A business plan can be an effective tool for business owners to succeed over the long term. With a sound business plan, you'll have solid goals to aim for, a strategy for reaching them and a useful understanding of the environment in which your business is operating. A business plan doesn't have to be complicated or time consuming. It simply requires you to consider the factors that will affect your business and allows you to plan for dealing with them.

In developing a business plan, consider working with your trusted advisors, key employees, peer groups and local small business center to seek different perspectives and ensure that your plan meets your objectives. Knowing that you have well-thought-out plans and sound financial information will help you when making key decisions. And remember, your business plan isn't written in stone – expect the unexpected and update your plan when necessary.

How a financial proposal and debt can support your business

Banks can provide valuable financial services to help your business develop and succeed. The most accessible of these are debt financing and business credit cards. When a company requires a significant infusion of cash or a quick and convenient way to fulfill short-term financial needs, a loan or business credit card can provide useful financial support.

How credit is used depends on where your company is in the business life cycle.

1. **At the start-up stage**
   New businesses often do not have established credit, so qualifying for a loan is more challenging. Credit is a great resource that can be leveraged for additional financing.
2. **During the growth stage**
   Credit is an important part of the growth stage. Spontaneous opportunities and barriers often come up and require short-term financing. As a business grows, banks can more clearly see its strengths and short-term loans and business lines of credit may become easier to access.
3. **In the maturity stage**
   Established businesses are more likely to qualify for long-term loans, lines of credit, commercial mortgages and other financial services. Credit continues to play a big part in this stage as more employees join the business and financial responsibilities expand
4. **At the exit stage**
   Businesses often rely on term loans, lines of credit and business credit cards during the transition period to fulfill capital requirements for the sale or transfer of the business.

Most financial institutions will issue a business credit card based on a routine credit check and application. To access a significant amount of debt financing, a written financial proposal is usually required. A financial proposal contains details of how you intend to achieve your business plan:

- The amount of money you need?
- How that money will be used?
- The returns that can be expected?
- What security will be provided?

The preparation of a financial proposal can also be beneficial to the operation of your business. As a fundamental management tool, your proposal provides additional benefits:

- Forces you to write down facts clearly and objectively.
- Helps you to identify and clearly define products, markets and suppliers.
- Provides you with a guideline against which to measure results.
- Conveys a lasting impression of you and your company, and allows others to assess your chances of success.

Your financial proposal should be based on your business plan. It should be written clearly and to the point. While it should emphasize your strengths and the upside, it's important to acknowledge the risks and the downside. This allows you to demonstrate that you understand risk and know how to cope with it.

Speak to your BMO financial professional to learn more about maximizing the potential of your business when credit or debt financing is needed to develop and grow your business.

Raising business capital and funding innovation

Raising capital is one of the most important aspects of starting and building a successful business. While there are a variety of sources that may supply your business with the essential funds to develop and grow, it is critical to understand the expectations and requirements of investors.

Before approaching anyone for funding for your business, you should determine how much money is needed to support a range of business functions, from ongoing operations to growth objectives. This requires a comprehensive understanding of the capital requirements of the business, such as purchasing new equipment, hiring new employees and expanding office space, and how capital will help the company follow its business plan and achieve short and long-term goals.

There are a number of different sources of business capital, such as private investors, financial institutions, venture capitalists and government grants. Which source you choose can depend on where your company is in the business life cycle. Some are more popular for businesses that are in the start-up phase or progressing into the growth phase.

Private sources

Business owners often approach individuals for money – from friends, relatives, a spouse or partner, business contacts, employees and private or "angel" investors. When approaching any of these private sources, there are certain considerations that one should keep in mind.

Crowdfunding has become an additional source of funding for certain businesses. Each crowdfunding platform is different, so it is important to read the fine print. Crowd-funding raises funds for a business from many people, called crowd funders. Crowd funders aren't technically investors as they don't receive ownership in the business and don't expect a financial return on their money. Instead, crowd funders expect to get a "gift"from your company as an acknowledgement of their contribution. This is typically in the form of product or services offered by the business.

Individuals who are willing to invest in your business are rarely "silent" and may offer management or policy assistance, to provide contacts or to help with special assignments. Private investors tend to value equity – the right to participate in the future of your business. It is worth noting that the financial gain may be balanced by a certain loss of ownership. Individual investments often come with a highly personal relationship with the investor. If you are setting up a partnership, consider supplementing areas of weakness in the business with individual investors that have strong and complementary experiences.

A written shareholder or partnership (operating) agreement is essential when raising capital from financial backers or partners. This agreement will stipulate the rights and obligations of the shareholders or partners of the private company and will also include "buy-sell" provisions. It is important to review all agreements with your legal counsel.

Financial institutions

Although U.S. banks are primarily concerned with short and long-term lending, they also often provide other financing options such as leasing, mortgages, factoring and support services such as payroll, letters of credit, credit references, and more.

To secure funding from financial institutions, a financial proposal and business plan are most often required. The bank will review facts and figures from statements, records and projections. They need to be sure of the stability of your company and the commitment of the owners.

They will look at your past and present performance, future potential, the amount you have invested, the amount you have left (equity and retained earnings) and the way you run the company. The bank will want proof of your ability to service the debt – that is, to pay the interest and retire

the loan on time. They may require security or collateral that can involve the pledging of accounts receivable or inventory, and a personal guarantee of principal. Term loans often require fixed or tangible assets as security.

It is important to keep lines of communication open. Tell your business banking professional in advance if there's bad news coming – the bank's confidence in you will remain strong if you're straightforward. Prepare and share a cash flow budget, and keep your banker in the loop each month, even when you're not borrowing. To establish a credit record, borrow from your bank early in your business cycle.

Use your banking professional as a valuable contact. Your banking professional can be a key partner to your business' success. They could offer support to your business beyond financing, such as cash management solutions that improve or create cash flow as an alternative to an operating line.

Your banking professional may also be aware of local economic conditions and suggest potential opportunities in other areas. They can introduce you to prospective customers and suppliers and help you with credit checks. Your banking professional can be your best business friend. Discuss future financing needs with your banking professional and take the time to nurture a good business relationship.

Venture capital

Venture capital firms will invest directly in a company if they believe that a business will be profitable and show substantial growth. Almost all deals are based on equity or some form of subordinated debt with conversion or option rights. (This means that in case of bankruptcy, their loans rank behind all other secured creditors but ahead of other shareholder loans.)

Venture capital companies expect high returns and usually want substantial minority positions – 20% to 40% of shares, or even full control of start-ups. They expect management shareholders to be fully committed financially, providing an efficient, balanced management team.

Venture capital companies can help in several ways, including planning and policy, finance and control, and arranging mergers and acquisitions or an IPO (initial public offering). They will likely require a seat on the board, to attend regular board meetings, monthly statements, life insurance for the owner, involvement in the budgeting process, and a buy-sell agreement covering your shares and their shares. Most venture investments usually require more funds to be invested later as the company progresses. Ensure the venture capital company has a good reputation and is well financed.

Incubators and accelerators

Incubators are programs that are offered to start-up companies. These programs offer business support (i.e., operating space) and the opportunity to work alongside other start-up companies with the potential for growth. There is also usually some measure of mentoring from retired business leaders. Connecting with an incubator is a very competitive market, but successful participation can be very advantageous. Incubators are usually composed of successful entrepreneurs who will offer advice and access to advisors of other successful start-ups.

A business accelerator, on the other hand, is a program that gives developing companies access to mentorship, investors and other support that help them become stable, self-sufficient businesses. Companies that use business accelerators are typically start-ups that have moved beyond the earliest stages of getting established.

Governments

Federal and state governments have loan, guarantee or grant programs for creating jobs, increasing capacity, and creating or upgrading technology.

When seeking government financing, you may need to show you can't get the funds elsewhere. Try to tailor your needs to the program and ask for help from the program officers.

Improving and growing your business with innovation

Many business owners raise capital to foster innovation in their company. Innovation may help to gain market share, introduce new products and to become more profitable.

Seek out and take advantage of all that is out there **to help you build your business**

To drive your business forward profitably, additional capital may be required to implement innovation.

Business owners can fund innovation from a variety of sources:

- Ongoing cash flow
- Business loans from commercial or private sources
- Government grants
- The business owner's own resources, or financial support from family and friends

There is a network of accelerators, incubators and hubs that allows entrepreneurs to work with experienced mentors in supportive environments and can also assist in attracting funding. For example, Y Combinator, a community of over 4,000 founders, supports many businesses each year with a small amount of money ($150,000). Combinator and alumni continue to help founders for the life of their company. SCORE is the largest U.S. network of volunteer, expert business mentors and is dedicated to helping small businesses get off the ground, grow, and achieve their goals. It is a resource partner for the Small Business Administration and assistance in finding that support coaching, mentoring and training across the country can be found on SCORE's website.

Conclusion

Seek out and take advantage of all that is out there to help you build your business. Not only sources of funding, but also the invaluable knowledge and learning from experienced business owners that have been there before. Speak with your BMO financial professional to learn more about your options for raising capital and how it can work for you and your business.

Women and innovation

Innovation is a widely used term that is often misunderstood. It does not necessarily mean inventing new items and does not always have to depend on technology. Peter Drucker, author of *Innovation and Entrepreneurship: Practice and Principles*, says that "innovation is the act that endows resources with a new capacity to create wealth." In other words, innovation should be a never-ending process of challenging how resources and methods are used to create new opportunities.

Innovation requires business leadership, motivation, a desire to improve and a supportive family including associates and employees. According to a survey commissioned by BMO Wealth Management, the top three reasons why small business owners implement innovation are to meet client needs (69%), maintain growth and sustainability of the business (61%) and create a better product or service (60%). The survey findings showed that women tended to be more client-centric, while men were more likely to focus on creating better products or services.[1]

In addition, the survey identified gender-specific trends and barriers within innovation that affect entrepreneurs. More women were unaware of the support available to foster business growth and innovation. Gaps in financial knowledge often limit women from reaching their entrepreneurial potential. Mentorship programs and incubators, often praised as an important component of entrepreneurial success, tend to be tech-oriented and less prevalent in service sectors where female entrepreneurs dominate. Women are under-represented among mentors and advisors, limiting the ability of female entrepreneurs to find a supportive environment or raise capital. Lastly, women continue to face double standards and other social barriers in their work and personal lives, such as household and caregiving duties.

With these barriers come a potential for change. Policy changes, including the provision of equitable grant funding and better maternity benefits, should be considered by the government. Financial institutions should work harder to address and eliminate unconscious bias and improve support for female entrepreneurs. Additionally, better educational resources should be provided to grow the awareness of financing options.

BMO is making great strides as an innovator in empowering women to reach their potential as a business owner. We're committed to providing women with access to services, tools and resources to help them manage their money and grow their businesses. How we help? We continue to provide personal wealth and entrepreneurship education workshops. Our networking events have connected women of different backgrounds and industries to help them grow professionally. Also, **BMO Celebrating Women** has raised the profile of 91 women in communities across North America by honoring them for their achievements in a variety of community building and entrepreneurial ventures.

BMO is dedicated to breaking down the financial barriers that female entrepreneurs face and we want to support them in as many ways as we can. We offer banking services, tools, case studies, and resources, both online and in branch, to support business owners at every step of their entrepreneurial journey.

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[1] Innovation – Creating wealth through business improvements. BMO Wealth Insight, BMO Wealth Management, May 2018, U.S. Edition

Protecting your business with a shareholders' agreement

A shareholders' agreement sets out the rights and obligations of the shareholders of a private business.

When two or more people go into business together, they usually have a common understanding of the way the business will operate and what decisions will be made as circumstances change. The purpose of a shareholders' agreement is to record these understandings so there is a documented reference that can be used if a dispute arises.

There are also partnership agreements; the difference between shareholder and partnership agreements relates to the legal structure as partnerships share business ownership based on the interests of each partner, while shareholders hold ownership based on the number of shares held by each person and the percentage of the company's value represented by those shares. While this article is general in nature and focuses particularly on shareholders' agreements, there are similarities to partnership agreements.

Without a shareholders' agreement, the relationship between the shareholders could deteriorate if they disagree about the response to events that affect the business. Some scenarios are likely to cause disputes between shareholders:

- A shareholder wants to sell some of their shares of the business to a family member
- A shareholder wants to hire their spouse
- A shareholder suffers a long-term disability or premature death and their interest in the business needs to be liquidated

In each of these scenarios, shareholders could be on opposite sides of the issue based on their own personal perspectives and biases. A shareholders' agreement should address how each of these scenarios would be handled, thereby avoiding future disagreements over such events.

> A shareholders' agreement sets out the rights and obligations of the shareholders of a private business

Having a say, sharing the profits and transferring ownership

Typically, each shareholder will have voting rights that allow them to make decisions that are important to the business. These decisions are most often made by a majority vote, but there may be instances when a critical decision should demand a certain percentage of the vote. Most often, the shareholders' agreement will list the types of corporate actions that require a vote and specify when a significant majority is required for the most crucial of decisions. Examples of such crucial decisions include the sale of assets or shares of the company, changes to shareholder rights, or large capital expenditures.

The shareholders' agreement should also include a distribution policy that specifies when and how corporate profits will be distributed to the shareholders. The agreement should allow for some flexibility to allow the company to scale back on distributions when the company needs additional cash flow or to increase cash distributions when there are excess funds that do not need to be reinvested in the business.

The shareholders' agreement should also stipulate who can become a shareholder of the company. Frequently, provisions are set in the agreement that prohibit shareholders from transferring their shares to anyone without the other shareholders' consent.

Common provisions in shareholders' agreements

Shareholders' agreements usually cover a wide variety of issues in respect of the business, such as the way it is managed, decision making, financing, share transfers/subscriptions and the buying and selling of shares. Addressing how shares are bought and sold is very important because it ensures that the parties agree who could be future shareholders and under what circumstances the shareholders will buy or sell shares among themselves.

There are a number of provisions with respect to share transfers that are commonly included in shareholders' agreements.

Restriction on transfer

This provision prohibits shareholders from transferring their shares to any other person without the unanimous consent of all the shareholders. This ensures that one shareholder cannot admit a new shareholder without the consent of the other shareholders.

Right of first refusal

If one shareholder wants to sell their shares to a third party, this provision requires that they are first offered to the current group of shareholders. This controls the way new shareholders can enter the business while also allowing a shareholder the opportunity to sell their shares.

Buy-sell events

Certain events can be defined as triggers that determine when shareholders should have the right to buy shares from another shareholder to protect the financial viability of the business. These events normally represent a change in a shareholder's circumstances such that they want to be able to sell their shares to liquidate their investment in the business:

- Premature death
- Permanent disability
- Divorce
- Retirement
- Bankruptcy/insolvency

The provisions with respect to the buy-sell events should clearly define a closing date and the terms of the buy-sell arrangement. The terms would include the amount of payment due at the closing date, the period over which the outstanding balance is paid, the security for the outstanding balance and whether the outstanding balance attracts interest.

Using insurance to fund a buy-sell arrangement

Insurance is one of the most efficient funding vehicles for completing a buy-sell arrangement between shareholders triggered by a premature death or a long-term disability. The event that triggers a buy-sell event between the shareholders would also trigger the insurance payout.

The life insurance policy covering each other can be held personally by the shareholders, or it could be held by the company. Since the exact structure of the insurance ownership and beneficiary designation will depend on the facts of the situation and objectives of the shareholders, professional advice is required.

Insurance policies are also available that pay a lump sum amount, after a waiting period, following the permanent disability of a shareholder. These policies can provide the funding necessary for a buy-sell arrangement. Since the insurance company will already have an adjudication process in place, these policies can be used to confirm the permanent disability as well as provide the funding necessary for the buy-sell arrangement.

Conclusion

The best time to complete a shareholders' agreement is when all the shareholders are in agreement. The document will lay out the ground rules for issues that are important to the shareholders and the company to limit any disruptions to the ongoing operation of the business.

It is important to consult with professional advisors when drafting a shareholders' agreement. If you are considering a shareholders' agreement for your company, your BMO financial professional can refer you to the appropriate professionals.

Immediate **financing solution**

You own a successful private corporation that generates a significant annual surplus. You want to protect the value of your corporation, but you also want to have assets available to grow your business, if and when new opportunities arise. An insurance policy can help you grow assets within your business, but you aren't sure if you want to tie your money up in an insurance policy.

How does it work?

Your business purchases a permanent life insurance policy that covers you, the key person, for a substantial death benefit and premiums are paid in excess of the annual cost of the insurance (but below the amount that would cause it to be treated as a modified endowment contract). The insurance policy can then be used as collateral to secure a loan or line of credit, or you can borrow against the cash surrender value (CSV) of the policy internally. Any CSV not borrowed should grow on a tax-advantaged basis. The loan proceeds are typically reinvested in the corporation's business and you use your company's cash flow and/or retained earnings to pay the insurance premiums and any minimum loan repayment necessary. Since you're using the insurance policy for key persons purposes, the interest on the loan may be tax-deductible. You must ensure the loan and/or the collateral assignment of the life insurance policy meets the requirements for deductibility under the Internal Revenue Code.

The CSV can grow over time due to excess premium funding and may be used to pay off any loan. Any remaining death benefit is payable to the beneficiary – usually the business. The full amount of the death benefit, less the policy's adjusted cost basis, creates a credit to the business's equity account, which can be used to pay out potentially tax-free distributions to the inheritors or your estate (depending on your type of entity).

A succession planning roadmap can help avoid **five common mistakes when selling a business**

Every business owner's succession plan will be unique to their own situation. For those who are selling the business, it is usually the largest and most challenging financial transaction of their life. Most owners will only sell a business once, so unfamiliarity with the process could lead to critical mistakes during the sale. Selling a business is emotionally and technically challenging and the business owner must follow a defined process – a succession planning roadmap.

When the selling process works well, everybody walks away happy. The seller knows that they achieved the best available price and terms under the circumstances, while the buyer feels like the deal was fair. But when the selling process breaks down, the results can be disastrous.

There are five common mistakes to avoid to help you achieve your goals and reach the best possible outcome:

1 Unrealistic value expectations

It is shocking how many private company owners do not know how much their business is worth. Often, business owners overvalue their company, and in a sale situation they will be reluctant to accept a fair offer if they believe it is too low. Ultimately, the business is worth what the buyer is willing to pay, and the seller is willing to accept. It's critical that you understand what your business is worth before you start the sales process. If the value is lower than you expect, there may be time to do certain things to help increase the value before selling the company.

2 Lack of advanced preparation

They say that failing to plan is planning to fail, and this holds true in many areas related to the sale of a business. Most business owners want to extract the maximum value from their company, however many may not be fully aware of how buyers will assess their business, or how to improve certain value drivers well in advance of sale to ensure the company is well positioned. The impact of income taxes must also be taken into account. Selling the shares of a business can result in a very different income tax bill than a sale of business assets, so it's important to understand the differences. Planning in advance may mitigate the tax burden. Also, the sale process typically takes 6 to 12 months, and some business owners are surprised that the process is so intense and time-consuming.

3 Waiting until you have to sell

No one knows the future, so this one can be challenging. However, it is unfortunate that many business owners are confronted with selling their business prematurely when an unfortunate life event arises (such as poor health, divorce or death), and a succession plan is not in place. Waiting until you must sell to implement a succession plan can be troublesome and is less likely to maximize the value of the business and ensure its continuity.

Lack of a selling strategy

Timing is important: your company's performance, the economic environment and your industry's outlook all make a difference because it's harder to sell during challenging times. Understanding the differences between potential buyers is important. Strategic buyers will be right for some businesses, while financial buyers will be better for others. Know the difference. Finally, consider price, confidentiality and time; you may not be able to achieve all three of these goals, so it's critical that you decide what's most important to you.

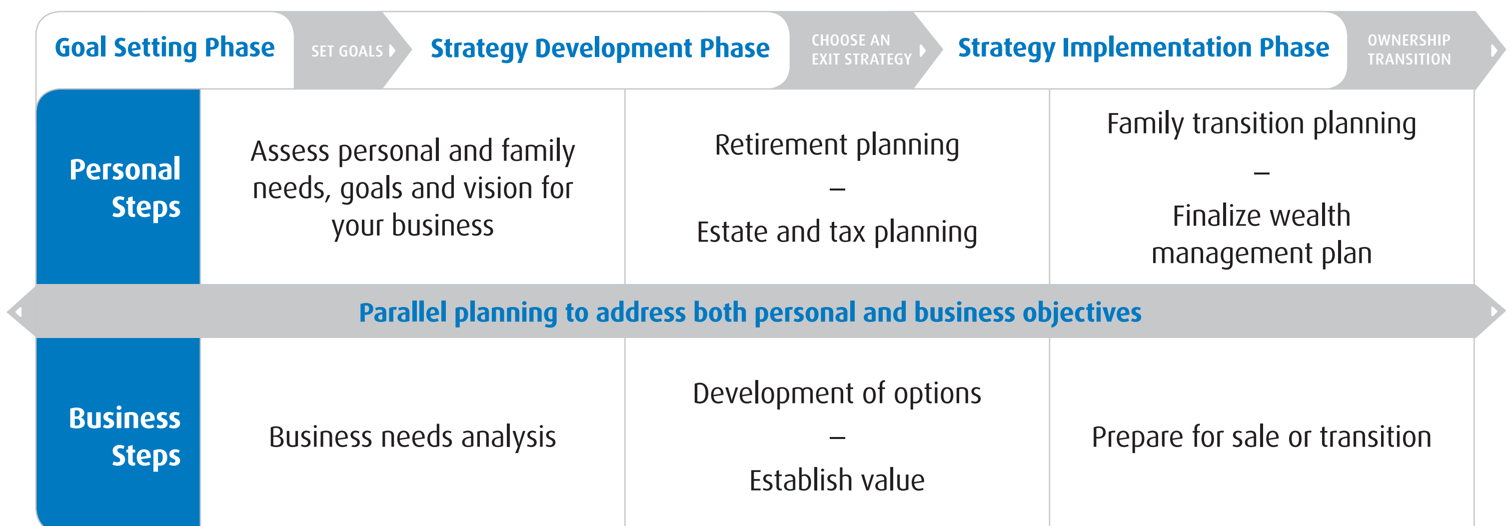
Confidentiality

Selling a business is unlike selling real estate, because people are a big part of every business. Some of the employees may leave if they know the business is for sale, and staff turnover is usually bad for business. Similarly, if customers and suppliers know that a change in ownership is coming, this sometimes opens the door for them to reconsider their relationship with your business. Confidentiality is key, knowing when and how to communicate to various internal and external stakeholders will impact on the transition.

Implementing a succession planning roadmap

Developing a succession plan and following a roadmap that covers all the details of the transfer of the business can help avoid common mistakes when selling a business. A succession plan details your vision for the management of the business and the disposition of your shares in the business. You have devoted a significant amount of time, energy and money to building your business. If you're contemplating a sale to a third party or a transition to family or employees, setting goals, having a vision and developing a formalized business succession plan are critical for success.

Succession Planning Roadmap



There are a number of steps to consider from a personal and business point of view when **developing a succession plan:**

1 Assess your personal and family financial needs, goals and vision

It is important that each family member contributes their own goals and objectives. The business owner and their family should establish or review all of their objectives in terms of retirement, working, business ownership, wealth transfer, and so on. Establishing clear objectives for each family member will help the decision-making process become more transparent and inclusive.

2 Business needs analysis

The business will have goals, objectives and a vision independent of the family. What is the five- or ten-year plan for the business? How will the business plan be achieved? What are the obstacles confronting the business? What are the leadership needs of the business? A clear business needs analysis will simplify decision making for a family succession or third-party sale.

3 Development of options

This step reviews the current resources and assets available and the goals of the owner, family and the business. Options or strategies can be developed to achieve objectives with the resources available. This step requires a team of professionals to be assembled to address the goals of the owner, their family and the business and work together to analyze the situation and develop appropriate strategies.

4 Establish business value

Completing a business valuation is an important step in succession planning. The value will drive the asking price, the income tax plan, any corporate reorganization and the estate plan. Knowing the value and what drives value will help with the development of options and choosing the right alternative.

5 Retirement planning

The retirement plan will ensure that the appropriate level of assets is segmented, or that sources of income are available for retirement to free up business assets for succession or estate planning.

6 Estate and tax planning

Tax minimization and asset conversion are common objectives of estate planning, but the plan should be dictated by the family's goals and objectives for their intergenerational wealth plan.

7 Prepare for sale or transition

Once the family has decided whether to take on the business or sell, preparation is necessary to move forward. Either decision will require a review of information systems, review of management structure, review of financial statements, general corporate housekeeping and operational analysis.

8 Family transition planning

The family will need plans and arrangements to pass on your attitudes and visions for the business to the next generation. This starts with the development of a mission statement, formation of a family council and other governance elements.

9 Finalize intergenerational wealth plan

This plan pulls all the pieces together in terms of family and business succession. By carefully reviewing the wealth plan, the family can see the financial results of their decisions and will be able to gain confidence that they are on the right track.

Conclusion

Selling a business is a complicated process and it's important to avoid the common pitfalls that are often encountered. If you are a business owner contemplating the sale or transition of your business, setting your goals and envisioning your exit plan early is critical for success. It is important to consult with professional advisors well in advance of selling or transitioning your business. A BMO business advisory and succession planning professional can help you steer through these and many other challenges that are likely to arise.

Preparing for the transition

As business owners plan their exit, they should ensure that all of their constituents are informed and prepared for the transition of the business.

The constituents typically include members of their family, the management team, current employees, customers and suppliers. The foundation of a smooth transition is open communication. Bringing up the idea early helps prepare everyone for change and allows them to address concerns, risks or identify issues that may arise later. In addition to open communication, there are some other strategies worth considering.

Management succession plan

A management succession plan is the best way to prepare the management team and current employees for a transition. This plan ensures that there is a smooth transition of power and leadership within the business. It ensures business stability and continuity, builds confidence in suppliers and investors, boosts workforce morale, incentivizes the best employees to stay and increases the overall value of the business.

A few things should be considered when preparing a management succession plan.

- Document formal job descriptions for each of the key positions in the company
- Identify individuals within the company who have the skills and attributes to grow into leadership roles
- Note the gaps in knowledge of prospective leaders and plan for ways to bridge those gaps
- Communicate the plan to people within the business, lawyers, accountants and other professional advisors

With a plan in place, your business will experience a smoother transition as you exit from the business.

Business valuation

Many business owners do not know the value of their company at any given time. A business valuation can provide that important piece of information, which can be used as a fact check or benchmark. Additionally, it can be used for planning and negotiating the transfer strategy when exiting the business. However, be aware that a business valuation is a subjective process and the results can vary according to the approach taken.

Nondisclosure agreements and due diligence

During the sale of the company, some sensitive business information must be disclosed to potential buyers. Information disclosed in due diligence can include financial statements, trade secrets and details of employees, customers and suppliers. The best way to protect your business is to avoid disclosing too much, too soon and by entering into a non-disclosure agreement (NDA). NDAs are legal documents intended to prevent confidential information being disclosed to a third party or being used against the party disclosing the information.

As you start to think about the decision to exit your business, communicate openly with your constituents, devise a strategy to protect both you and your business and assemble a team that can assist you. Your BMO business advisor is available to support you as you look toward transitioning your business.

Preparing the family or next generation to take over the business

As a business owner, you've worked hard to build a successful business, and perhaps you envision your children taking ownership and control when you retire. Having a succession plan in place will help to ensure a smooth transition to the next generation, and the continued success of your business. This article explores several considerations to keep in mind when planning the transition of your business to the next generation.

Plan early

Business succession is a process, not a one-time event. Start discussions with your children (or other family members) early; ideally, at least three or more years in advance of the actual transition. Communication is key, it's important to understand different perspectives and expectations, and to be flexible. This will help facilitate a smooth transfer of responsibility and maintain the operational continuity of the business.

During the initial planning phase, you should ask yourself a few questions:

- Who will take over the business? Will it be one or more of your children, or another family member?
- Who will be responsible for making business decisions? It's important to think about who will be the key decision maker(s) upon your eventual full exit from the business.
- Will your children have part or full ownership of the business? Consider whether and for how long you want to continue to participate in the growth of the company or retain control through share ownership (if applicable). Be sure to speak with your tax and legal professionals to understand the full implications of these decisions.
- How will the transition impact any of your children who will not be involved in the business, and your estate planning?
- What is the proposed timing for transferring management responsibilities, ownership and control?

Assessing your successor's skill set

An assessment of the current business and operational skill levels of whoever takes charge of your company, compared to what will be required in the role post-transition, will help you identify areas for development in advance of the succession.

> Preparing the next generation to take over your business is not straightforward

Balancing management, ownership and family

While the management team of the business, its ownership structure and the family are closely intertwined, each must be considered within the context of the succession. For example, a succession plan for the business should include all relevant stakeholders, such as the current shareholders, the successor(s) and key employees who are crucial to the operation of the business, even if these employees will not become shareholders post-transition. You also need to garner the support of key employees to avoid any discontent during the transition process and ensure there is a strong support team in place, if needed. From an ownership

perspective, current and future shareholders should be included in this process. And, to alleviate potential family conflicts, your estate plan should include provisions for children who won't be shareholders or engaged in the business going forward, so they are treated fairly. Communicating in advance will help ensure that everyone's perspective is known and understood.

Transitioning control

During the transition process, you may experience a great deal of change. Addressing family dynamics will be easier to manage when you have a plan that clearly specifies key milestones, and the roles and responsibilities of you and your successor(s) throughout the transition period. Ideally, the transfer of labor will begin slowly, when your children are young adults, and evolve over time into the eventual transfer of management responsibilities. The transfer of business ownership is the final step, which could be viewed as a formality after the transfer of management responsibilities is complete.

Business owners should be aware that they may need some time to accept the idea of transitioning their responsibilities and ownership to the next generation. To avoid conflicts and ensure capacity of your successor(s), transitioning out of your responsibilities progressively is key to reduce risk and support business continuity. Think about planning for your retirement from the business by identifying new activities, hobbies or potential philanthropic endeavors that will provide you with a rewarding and enjoyable retirement, as well as helping you decide how much – if at all – you want to continue playing a role in the business.

Seek professional advice

As the current business owner, you must teach the next generation of owners and managers about your business, strategies, goals and family values. While this responsibility may seem straightforward, the process can be quite challenging in practice. Seeking the support of a professional who specializes in family enterprise transitions can help you through this process to ensure that you achieve your personal and business objectives.

Conclusion

Preparing the next generation to take over your business is not a straightforward or simple task and beginning the planning process as early as possible is the key to a smooth and successful transition. Speak with your BMO financial professional if you would like to be referred to a BMO business advisory and succession planning professional to discuss your transition plan.

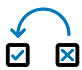
What if the kids don't want the **family business?**

When it comes to a family business, a common exit strategy for business owners is to pass the business on to the next generation. However, recent findings in the United States by professional services firm PwC suggest that passing the business on to family members is no longer the norm. According to a PwC survey of family business owners who want to exit their business within the next five years, only 41% want to keep it in the family, 30% want the business to be owned but not run by the next generation and 11% plan to look for buyers outside the family. In addition, adult kids often have career plans outside of the family business. All these factors contribute to the possibility that a business may not remain within the family.

Considering this shifting landscape, it is important for family business owners to have a clear transition strategy. There are a few things that should be kept in mind to make this process easier.

Communicate early

When it comes to planning a transition strategy, early communication is key. Communicate clearly with family members at an early stage to kick-start the conversation around the family business. For kids, this may mean beginning the conversation before they enter post-secondary school. In addition, make sure to check in with your children often for updates on their shifting interests.



Have a plan B

If the younger generation is not interested in taking over the business, consider asking if they are willing to own it if somebody else will run it. This option brings in outside leadership and keeps ownership within the family. If the answer to this option is no, it may be best to consider an external buyer; this often means a friendly competitor or a loyal employee.

Allow enough time

Ideally, allow a buffer of up to five years for the transition period. This will provide enough time to complete and implement a thorough transition plan. According to the PwC survey, less than a quarter (23%) of family business owners currently have a formal succession plan in place. Significantly, almost half (44%) of the owners surveyed believe succession planning will be a major challenge for them. Starting earlier can help mitigate this challenge.

Get a professional valuation

One of the first steps in creating a transition strategy is to get a professional valuation of the business, whether the business owner decides to sell or keep the business within the family. Knowing the fair market value of the business will allow business owners to plan and negotiate the exit decision, and to plan for retirement. When it comes to estate planning, the value of the business is also an important factor in the division of children's inheritances.

If you are beginning to think about the development of a plan for eventual exit from your family business, contact your BMO business advisor for advice on the transition of your business.

Passing down the business

Fred Olson is the third generation to own his manufacturing business. The privately-owned company specializes in injection moldings for the automobile industry and has grown substantially since it was founded by his grandfather. Having seen it passed down to his father, and then taking it on himself, Fred has always had business succession on his mind.

Fred began learning the ropes from his father at an early age. While Fred became very familiar with the way their company worked, he lacked confidence in the business environment. “I think I missed out on learning about people, experiences and decision-making on my own terms because my father wanted me to work alongside him.” Fred learned a lot from his father, but he is taking a different approach with his own children.

“My children will have the opportunity to work outside the business and develop core competencies that will enable them to become successful owners.” Having married later in life, Fred’s children are still young. His son has just finished his undergraduate studies, while his daughter is currently pursuing a law degree. “My son is too young and inexperienced to be involved in the business at this time, and my daughter is not currently interested in being involved on a day-to-day basis.” Fred is happy his children are getting the opportunities he missed, but still hopes they will eventually become actively involved in the family business.

Many business owners have children who are not yet ready to take on an ownership role. However, since he is not certain that either of his children will actually take over the family business, Fred’s exit strategy has to be flexible.

With no clear successor as he nears retirement, Fred has been developing an interim solution. Working closely with succession planning advisors, Fred is looking to fill temporary leadership positions to ensure his business is well managed at all levels. “That’s certainly one of the advantages of working with professionals – they can raise potential problems and present possible solutions that I might never have considered.”

During this stage, an interim CEO should be appointed, and Fred should consider creating a contingency plan in case of his sudden death or a critical illness.

Over the last five years, Fred has been having family meetings to educate his children about the business and openly discuss potential risks and mitigations. Through these meetings, the family came up with a shareholders’ agreement, an employment policy and a mission statement: “A big topic for us is developing conflict resolution mechanisms that everyone can agree to.”

When Fred is considering strategies for conflict resolution, creating a successor development plan in case one or both of his children eventually wish to be actively involved with the business would be a good option.

Fred is confident about the future of his business: “I think there’s a very good chance that one or both of [my children] will play some kind of significant role in the management of the company and – who knows – maybe one day pass it on to their children.”

Acknowledgement

This client story is abridged from Sarah Kruger and Sean Foran, Succession Stories from the Front Line (BMO Bank of Montreal, 2008), 3–12.

Closing remarks

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Who do we help?

We serve a broad spectrum of clients, including ultra-high-net-worth and institutional clients, from individuals and families to business owners and entrepreneurs, professionals and executives, and corporations and institutions. We operate in the United States, Canada and in select global markets, including Asia and Europe.

For a business owner, we can help untangle your personal and business wealth plans, allowing you to focus on growing your business. We can also provide guidance on business succession planning when you are ready to move on to the next chapter in your life.

We understand the unique challenges professionals and executives face, from concentrated stock positions, stock options and restricted stock to special borrowing needs. We aim to simplify the complexities that can come with wealth and help build a comprehensive wealth management strategy.

Our wealth management approach is based on helping our clients plan, grow, protect and transition their wealth. We work with you to help develop solutions that match your needs.

Plan

A sound wealth plan is a vital component in achieving your current wealth goals and securing the financial future for you and your family.

Grow

Although no one can fully predict the future, our wealth management professionals will work with you to help you grow your wealth; you can also use our self-directed services to develop your own solutions.

Protect

The careful balance of risk and reward is one of the primary benefits of professional wealth management, helping to protect your portfolio from market volatility.

Transition

We will work with you and your family to put strategies in place to prepare for life changes and help to make unexpected transitions as smooth as possible.

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