



CFIB

Research



SME Succession: Update

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Introduction

Time is rapidly catching up with more and more Canadians. As the population ages, it creates greater stresses and challenges for our health care system, pension policy, and labour markets to name a few. A significant level of resources, private and public, have been devoted to better understanding the demographic nature of these topics and how Canada as a nation can continue to provide its work force and retirees with strong, sustainable social programs. However, one aspect of public policy that is in need of further study is the impact of an aging small and medium-sized enterprise (SME) sector.

Succession planning is critical to the business owner and the SME sector. It also has major implications for the future of Canada's overall economy and job creation potential. Seventy-five per cent of all businesses in Canada employ fewer than five employees and almost 60 per cent of employed Canadians work for a small or medium-sized business. In addition, the SME sector contributes approximately 45 per cent of Canada's economic output and is the catalyst for innovative products and services.

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This report is part of the continuing effort by CFIB to provide additional information on SME succession. In June 2005, CFIB released major findings on SME succession planning based on a web-based survey of independent business owners. The information outlined in this report is based on several questions contained in a nationwide survey on financing that was conducted by mail and through the Web during February to April 2006. It provides an update on some of the main elements of SME succession, such as the timeline for when business

owners plan to exit their business and the incidence of a business owner having a succession plan. In addition, this report sheds some light on where business owners are seeking information and advice for their succession planning.

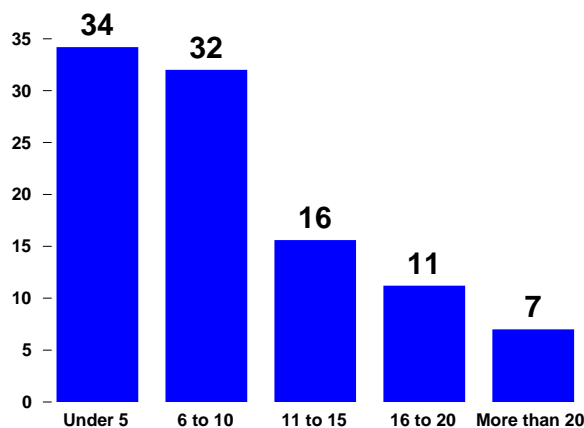
Highlights

- Survey results from 2006 indicate that slightly more than one third of independent business owners plan to exit their business within the next 5 years.
- The majority of SME owners are not adequately prepared for their business succession: only 10 per cent of SME owners have a formal, written succession plan; 38 per cent have an informal, unwritten plan and the remaining 52 per cent do not have any succession plan at all.
- Accountants and legal advisors are the most common types of professionals used by SME owners to prepare a succession plan.
- Business owners have highlighted the need to improve the information and advice on succession planning, particularly from the banking sector.

Exit Timeline

The latest findings from a CFIB survey shows that 34 per cent of independent business owners intend to exit ownership or transfer control of their businesses within five years (see Figure 1). Within the next ten years, two-thirds of owners plan to exit their business.

Figure 1:
Exit Timeline for SME Owners
(% response, years)



Retirement is the main reason for business owners to exit their business, as shown in previous CFIB research. However, previous CFIB research found that one in ten owners planning to exit their business have their sites set on starting another business venture.¹ This represents part of the natural churning of businesses whereby resources are shifted to more productive purposes. This has important implications for the growth of the SME sector and the overall economy given that exiting a business does not always entail retirement for the owner, but that a succession plan is the link between old and new ventures.

Table 1
Exit Timeline, by province
(% response, years)

	Under 5	6-10	11-15	16-20	20+
BC	42	31	14	9	4
Alta	37	34	13	12	4
Sask	40	31	13	10	6
Man	37	30	19	8	6
Ont	34	32	15	12	7
Que	29	32	19	11	9
NB	28	33	16	13	10
NS	33	31	17	12	7
PEI	34	28	18	12	8
N&L	35	28	19	11	7

¹ For further information, see Bruce, Doug and Derek Picard. *Succession Can Breed Success: SME Succession and Canada's Economic Prosperity*. Toronto: CFIB Research. (June 2005), 13 p. <http://www.cfib.ca/research/reports/rr3007.pdf>

Business owners in Western Canada are the most likely to be planning to exit their business in the next five years, while the least likely are based in Quebec and New Brunswick (see Table 1). The exit timeline is slightly more pronounced for businesses in the primary, wholesale and personal services sector, and slightly less for those in agriculture, community services, and construction (see Table 2).

Table 2
Exit Timeline, by sector
(% response, years)

	Under 5	6-10	11-15	16-20	20+
Agriculture	27	29	20	14	10
Primary	37	36	12	10	5
Manufacturing	34	32	17	12	5
Construction	30	33	17	12	8
Trans/Comm	36	34	14	11	5
Wholesale	39	32	15	9	5
Retail	37	32	14	10	7
FIRE	36	36	16	7	5
Business services	33	34	13	12	8
Community services	28	27	16	16	13
Personal services	37	32	13	12	6

The Plan

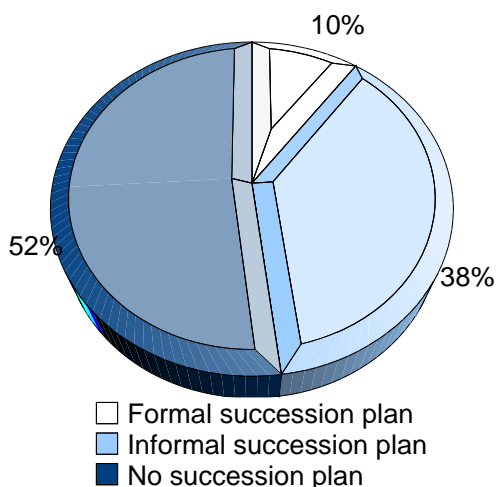
With the aging of business owners come many inherent risks. These risks, however, can be mitigated with succession planning. Compared to other types of business planning, succession planning requires a much more structured and formal approach. This is not only due to the many different aspects required for succession planning, but the longer time horizon needed to prepare the next new generation of business owners to ensure ongoing success.

Succession planning is a long-term process; it is not a one-time event.

Only 10 per cent of SME owners have a formal plan to sell, transfer or wind down their business in the future, while 38 per cent of owners have an informal, unwritten plan (see Figure 2). More than half (52 per cent) of SMEs do not have any succession plan. These latest results differ slightly from the previous CFIB survey that showed a higher

proportion of business owners did not have any type of succession plan at (65 per cent). This is likely due to the recent efforts of CFIB and other organizations to help increase awareness to business owners about succession planning.

Figure 2:
Existence of Succession Plan



The sooner one expects to exit their business, the more likely it is that the owner will have a succession plan (see Table 3). For example, among those who plan to exit within the next five years, 61 per cent have a succession plan. Among those planning to exit in the next six to ten years, only 50 per cent have a plan. The issue remains that the majority of these plans are informal regardless of the exit timeline. Given a succession plan can take up to ten years to result in a properly executed transition, much more needs to be done at an earlier stage.

Table 3:
Existence of Succession Plan, by exit timeline
(% response)

	Under 5 years	6-10 yrs	11-15 yrs	16-20 yrs	20+ yrs
Formal plan	15	9	6	6	5
Informal plan	46	41	33	25	22
No plan	39	50	61	69	73

Exit Timeline, by financial institution

CFIB has consistently shown that access to financing is an area of concern for many SME owners. More specifically, the 2005 CFIB succession study highlighted access to financing as the most significant challenge in the succession planning process from both the perspective of the current owner (seller) and the successor (buyer).

Banks have much at stake when it comes to SME succession. Variations in the exit timeline for business owners differ by the main banking institution. ATB Financial has the most at risk, with close to half (46 per cent) of its existing small business clients exiting their firms within the next five years (see Table 4). Among the big banks, RBC and Bank of Montreal will each face 37 per cent of owners exiting their business in the next five years—69 per cent in the next decade. The exit timeline is also very high for the other chartered banks and credit unions. Results are slightly lower for Desjardins, which likely reflects the lower average age of Quebec business owners.

Table 4
Exit Timeline, by banking institution*
(% response, years)

	Under 5	6-10	11-15	16-20	20+
Royal Bank	37	32	14	11	6
CIBC	34	35	14	10	7
Bank of Montreal	37	32	15	10	6
Scotiabank	33	32	15	13	7
TD-Canada Trust	34	31	17	11	7
National	30	34	19	11	6
Credit union	36	29	15	12	8
Desjardins	29	32	19	11	9
ATB Financial	46	31	14	6	3
HSBC	34	36	16	9	5

*Based on the survey question: "Which financial institution does your firm use for its day-to-day banking needs?"

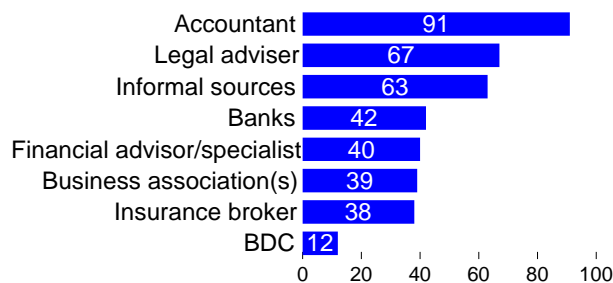
The banks will likely find it very challenging to maintain, or even increase, the number of small business clients in the next decade. One factor that will help define the level of success is the banks' ability to offer guidance on how owners can successfully transition their business to the next generation of owners. Another factor is the need for the banks to be challenged to provide financing to

the successor and the current owner to ensure a smooth business transition.

Information and Advice

Accountants and legal advisors are the main sources of information and advice in succession planning. The majority of business owners who have a succession plan, formal or informal, are most likely to rely on their accountant or lawyer (see Figure 3). This type of professional assistance is required for the many technical aspects of a succession plan such as: the legal transfer of business ownership; the tax implications of disposing of the business; the financing of a successor; and the division of future profits after the transition. Previous CFIB research has shown that the non-technical or soft issues receive significantly less attention. For example, including a process for resolving disputes or for the selection process for the successor plays a relatively minor role in most SME succession plans.

Figure 3:
Succession information sources for SMEs
(% response)

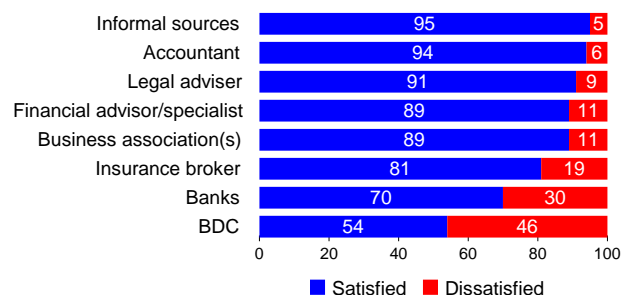


Note: Results for those respondents who have either a formal or informal succession plan.

Given that the development of a succession plan often requires the input and services of other parties outside of tax and legal experts, SME owners also receive succession information from other sources such as banks, financial advisors, business associations, insurance brokers or the Business Development Bank of Canada (BDC). Informal sources such as business associates, friends or family are also a common information resource. This likely reflects the need for owners to discuss and share their intentions with family, friends or key employees who may be under consideration as a future successor.

Overall, business owners appear satisfied with most of the different sources of succession information and advice (see Figure 4). Informal sources, accountants, legal and financial advisors, business associations and insurance brokers all received a high level of satisfaction from SME owners about the information they provide related to succession planning. The banking sector, including the BDC, came in at the low end in terms of satisfaction level. It is important to note that these survey results are from February to April 2006 and that some of the banks have subsequently made attempts to better assist their SME clients on succession planning.

Figure 4:
Satisfaction level with succession information sources
(% response)

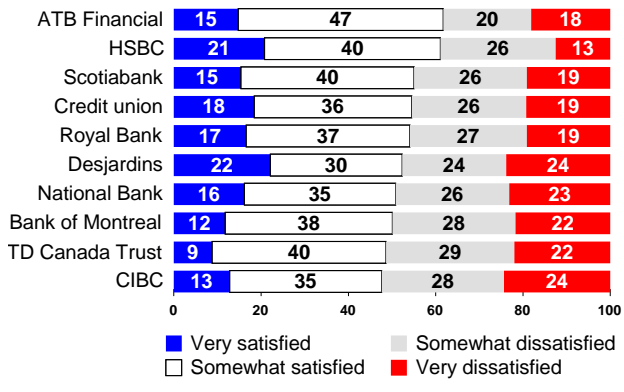


Note: Results for those respondents who have either a formal or informal succession plan; and use the succession-related services for each source.

To obtain a higher level of understanding of individual bank’s performances, CFIB asked respondents to indicate how good or bad a job their bank is doing in providing information and advice on succession planning. This approach results in a more precise assessment of the banks performances on the provision of succession planning information to their SME clients, as well as the ability to have bank-to-bank comparisons.

The SME clients at ATB Financial and HSBC appear to have a slightly higher level of satisfaction on succession planning information (see Figure 5). Results for the remaining banking institutions are quite similar, with approximately one in two respondents citing they are either “very satisfied” or “somewhat satisfied” with their bank’s information on succession planning. These findings demonstrate that much more can be done by the banking sector to provide guidance to their SME clientele on how to approach the planning for their business succession.

Figure 5:
Bank* ratings on succession planning advice/information (% response)



Note: Excludes "not applicable" responses.

*Based on the survey question: "Which financial institution does your firm use for its day-to-day banking needs?"

Meeting the Challenge

Having a succession plan will help ensure business transition goes as smoothly as possible. A well-designed succession plan will help:

- Ensure the future financial stability and value of the business
- Reduce the potential tax liabilities of transferring the ownership
- Set a timetable for transfer of ownership to the successor, whether a family member, employee or an outside purchaser
- Contribute to the growth of the business in terms of market share, profitability and size
- Provide stability for employees

SMEs are the heart of Canada's economy and social structure: they are a catalyst of innovative products and services, and the engines of employment growth. The downside of not planning is undeniable: jobs are at risk. Without preparation, many business owners will be forced to sell at a discount to competitors or outside interests, with the associated risk of business closure and a loss of jobs.

The challenge is to turn these risks into opportunities – for small business owners, their employees and the economy at large.

This report is based on the results of a survey conducted from February 15 to April 4, 2006 in which a total of 9,347 responses were received. The responses reflect the views of small and medium-sized independently owned businesses located in all regions and sectors throughout Canada. The responses are accurate within ± 1 percentage points, 19 times out of 20. The margin of error is larger within regions and sectors.

For further details on CFIB publications on SME succession, please refer to the following:

CFIB, "Investing In Your Future: Building A Succession Plan", (October 2006)

Bruce, Doug and Derek Picard (2006), "Making Succession A Success: Perspectives from Canadian Small and Medium-Sized Enterprises," in the *Journal of Small Business Management* 44 (April 2006): 306-309.

Bruce, Doug and Derek Picard. *Succession Can Breed Success: SME Succession and Canada's Economic Prosperity*. Toronto: CFIB Research. (June 2005), 13 p.
<http://www.cfib.ca/research/reports/rr3007.pdf>

Picard, Derek. *Business Transition: A Literature Review*. Toronto: CFIB Research. (May 2004), 9p.
http://www.cfib.ca/research/reports/succession_0405_e.pdf