



A GUIDE FOR BUSINESS OWNERS

Business succession planning checklist



Life's brighter under the sun

Contents

3

The family business

4

Business succession and
financial security planning

5

Business succession
planning defined

6

Indicators of
succession viability

7

Before you get started
– questions about
preparedness

8

Retirement exit strategy

9

Contingency plan in the
event of your death

10

Contingency plan in the
event of your disability

10

Family law considerations

11

Selecting a successor and
future management

12

The shareholders'
agreement – discussion
agenda

13

Tax driven planning

14

Why choose Sun Life?



The family business

At least four fifths of all businesses in Canada are family owned. While statistics can vary, it is commonly accepted that less than one third of family owned businesses survive the departure of the founder. One third of those that do survive do not survive the departure of the second-generation owner.

There are many reasons why family businesses fail in successor generations, in some cases, there are no family candidates for succession. However, in many cases the termination or sale of the business results only from a failure to appropriately plan and create the proper environment for family succession.

The checklist that follows is intended to provide business owners with a number of questions to consider that relate to their state of preparedness for desired family succession. Clearly, not all of the questions will apply equally to each particular business and business owner. Among the factors that will govern the applicability of the questions that follow are:

- **Age of the owner and family stage:** an owner with no family or a young family and who has no other potential family successors will not have the same sense of urgency about family succession and may require an alternate plan for his/her departure from the business.

- **Business Stage:** A very new business, in the early survival stage, will not be as likely to have well defined needs for succession. Business survival and growth will be the focus of a new business owner. Furthermore, it may be unrealistic to consider mechanisms such as succession task forces and family councils. Again, an alternate exit strategy will be needed.
- **Size of business:** Similarly, the owner of a very small concern is likely to require far fewer complex considerations or decisions making structures about business succession.

Nevertheless, some elements of this checklist will be of relevance to every business owner. A review of its contents, and applicability to each particular situation, is a worthwhile exercise for any business owner.



Business succession and financial security planning

A business owner is unique for many reasons. One particular reason is the need that a business owner has to successfully integrate the success of their business with the plans they have for their own financial security on an ongoing basis, at retirement, at death or in the event of their disability.

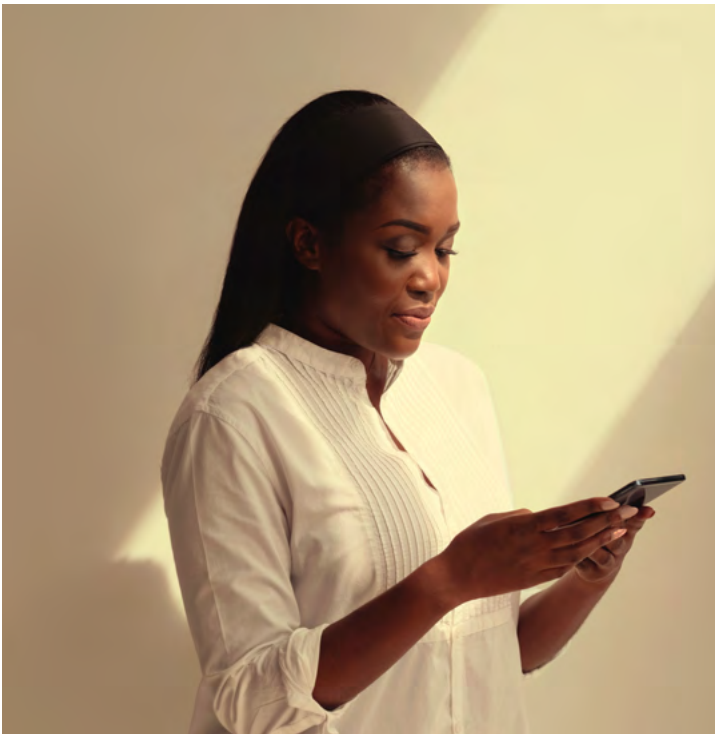
This checklist, while it does address some questions about financial needs at retirement, death or disability, is not intended to substitute for a thorough review of financial security plans for the business owner and his/her family. Financial security planning has a broader view, but must by necessity include the realizable value of the business interest and succession plan in order to be successfully implemented.

Financial security planning, rather than merely concerning itself with risk management and succession planning for the business, will consider the following larger issues:

- What income does the owner and his/her family need in the event of his/her retirement, death or disability?
- What other needs for capital does the owner have (e.g. the need for capital to pay debts, capital gains tax or to provide an equitable estate to all family members)
- How much of these needs for capital will the business interest provide and how will the value of this business interest effectively be unlocked for this purpose? This is where business succession planning comes into play.

- How will potential financial security risks to the viability of the business be addressed? This question addresses business continuation concerns such as the loss of key people.
- What other assets, savings and insurance programs are in place today to provide this needed income and capital?
- If there is a shortfall in capital realizable from the business and other assets or insurance programs, how will this shortfall be addressed?

Business succession cannot be done in a vacuum. It must be done in the context of overall financial security planning for the owner. This is the context. This, along with the legitimate desire to leave a legacy to the next generation, must be the framework on which succession planning is carried out.



Business succession planning defined

Business Succession Planning can be defined as the process of determining both the method of transfer of ownership of a business interest as well as the transition of its management control. The subject of succession itself must be addressed in the event of retirement, death or disability of the owner or as the result of other foreseeable events.

This checklist was designed to challenge the business owner to consider some of the fundamental issues associated with succession planning. It has been organized into a series of sections, each one being an important component of a good succession plan. Specifically, the checklist addresses each of the following issues:

- **Indicators of Succession Viability** – Determining if the business is in a position where management and/or ownership can be successfully passed on to family, management or another buyer.
- **Questions about Preparedness** – Determining if it is feasible to retain the business in the family. This assessment has as much to do with family relationships as it does with the operating of the business.
- **Retirement Exit Strategy** – The plan should take into account the needs of the retiring owner. The owner should be prepared psychologically as well as financially for the transition. It should be demonstrated that there will be sufficient income to fund retirement and that

the owner will be able to maintain the desired standard of living. In order to preserve family harmony, heirs of the owner who do not receive part of the business should share equitably (not necessarily equally) in other assets or indirectly through the business.

- **Transition Strategy in the Event of Your Death** – Contingency plans should be in place in the event of the owner's death to ensure a smooth transition. The plan should protect and maintain the value of the business during the transition. To do this, it will be necessary to address the needs of employees, creditors, customers, and vendors. Employees and customers can become especially vulnerable when the business leader exits the scene.
- **Transition Strategy in the Event of Your Disability** – Contingency plans should be in place in the event of the owner's disability to ensure a smooth transition and to minimize business risk during transition.
- **Tax Driven Planning** – The plan should keep capital gains and other taxes to a minimum and invoke strategies that optimize tax consequences without jeopardizing other elements of the plan.
- **Family Law Considerations** – The plan should take family law and other division of asset legislation into account with respect to the owner, partners and potential successor owners.
- **Selecting a Successor and Future Management** – The plan should address the best way to select successors. Family members are a good choice, but only if they have the desire, expertise and experience to be effective managers. Usually, the next choices are trusted employees. The checklist provides some factors to consider.
- **Shareholders' Agreement** – Where purchase of the business interest is part of the succession plan, a buy-sell agreement should be in place. Where there are multiple owners today, a shareholders' agreement covering important operating matters should be in place. The checklist attached provides some high level questions to be answered.



Indicators of succession viability

- At what stage of development is your business? (The answer will help determine the most likely succession strategy.)
 - Survival: Is the business in the early stages and not yet profitable?
 - Growing: Is the business successful but growing rapidly with profits reinvested in the business?
 - Mature: Has the business reached a point of stability in terms of cash flow, profit and market position?
- What is the business culture? (Again, the answer will help determine the decision making process and the likelihood of success of a succession strategy)
 - Do you make most of the decisions?
 - Do family interests supersede the interests of other employees?
 - Do you involve key employees in the vision for the business and delegate some decisionmaking?
 - Are management appointments made based on merit and decisions made without reference to family influences?
- To what degree do business success and value rely on your skills and relationships? (Greater dependence on the personal goodwill created by the skills of the owner increases the likelihood of liquidation as a succession strategy.)
 - Can the business survive your departure?
 - Yes, a succession plan for ownership, management and equalization is required.
 - Maybe, a succession plan and an alternate liquidation plan are required.
 - No, a liquidation plan is required.
- Does the business have appropriate management and operational systems? (Without these systems in place, the likelihood of successful transition and succession is decreased.)
 - Do you have short and long-term business plans (in writing)?
 - Do you have appropriate budgeting and cash flow management?
 - Do you have appropriate financial reporting?
- Do you know what your business is worth?
 - What is the net asset value of your business?
 - Is goodwill based solely on your personal skills?
 - What is the condition of your industry and market, and recent sale prices of similar businesses?
 - How valuable are your key executives and work force to success?

Before you get started – questions about preparedness

- Do you want ownership of the business to remain in the family?
- At what stage is your family? (The answer will help determine current viability of family succession.)
 - Owner in 30s or early 40s with no children or young children
 - Owner in late 40s or early 50s with children in teens or early 20s, some in the business
 - Owner in late 50s or 60s with some children integral to the business
- What is the degree of family involvement in decision making? (The answer will help assess who the key decision-makers are and the likelihood of success of a succession strategy.)
 - Do you make most of the decisions?
 - Do you involve your spouse and children in decision making?
 - Are there differing goals amongst family members?
- Can the family survive the stress of succession planning?
- Have you prepared yourself for succession planning through consultation with peers and professionals and done the necessary reading?
- Are you committed to actively managing the implementation plan?
- Will other key stakeholders (family members, shareholders, and senior management) be involved? Are you willing to involve these people and communicate your views to them?
- Have the appropriate forums for reaching consensus on key issues been established?
 - Family council
 - Board of directors (preferably with outside members)
 - A core team of skilled individuals, including outside professionals where appropriate, to assist in planning and managing the succession
- Have you developed a clear and accepted vision for the future of the business? Have you created a written transition plan?
- Have a successor and candidates for other key management positions been selected and a training program developed for each? Have you (with or without the advice of others) objectively assessed the capabilities of your children or other active family members?
- Where a successor has been identified, are you helping your successor build a profile and credibility within the family and the business community?
- Have you developed an estate plan that clearly indicates how ownership of the business will be distributed among members of the next generation?
- Have you informed important business partners about the succession plan? (customers, suppliers, and creditors)
- Have you ensured that each family member understands the rights and responsibilities that come with the various roles they will assume?
- Do you have a contingency plan for events such as death, disability or failure to identify an appropriate successor?



Retirement exit strategy

- What are your income needs in retirement?
- Have you determined to what degree the business interest will meet this need for capital?
 - By providing a continuing income?
 - From redemption of frozen shares or dividends thereon?
 - From proceeds of sale?
- If there is a shortfall, do you have a supplemental retirement savings program?
- Regardless of the answers above, is most of your net worth tied up in the business? Do you have plans to diversify your pool of retirement capital?
- Does your retirement exit plan include:
 - A clear statement of your personal objectives and those of potential successors?
 - A proposed method of structuring the planned succession including tax consequences?
 - Formal timing for transfer of ownership?
 - Defined management roles for each family member?
 - Defined transitional roles in the business for each family member and non-family management people?
 - A communication plan to third parties (suppliers, customers, and creditors) and employees?
 - Shareholders' agreement, will revisions, corporate restructuring, share transfers, and insurance program, etc.?
 - A contingency plan for unexpected events (e.g. death or disability of owner or successor)?
 - see below
- Do you have backup succession methods, taking into account tax implications, if the main plan does not come to fruition?
- Are there family members who will not be involved in the business? How will you deal with their expectations of equitable treatment?
 - Are there assets targeted for this purpose at retirement and at death?
 - Will this be accomplished by leaving the business to everyone and have you considered the implications of doing so?
 - If you are planning to leave the business to everyone, have you considered putting in place a buy-sell agreement allowing active family members to buy out non-active family members?
 - Is there a need to financially assist those who will assume ownership of the business in carrying out this purchase?



Contingency plan in the event of your death

- What part of your succession plan will have to be altered in the event of your premature death?
 - Will ownership of the business be retained by your estate, liquidated, sold or given to family members or sold to third parties?
 - Have you determined the income needs of your spouse and dependent children in the event of your death?
 - Have you determined what other bequests you would like to make to your children, charities or others?
 - Have you determined the tax cost that will arise in the event of your death (e.g. capital gains tax)?
 - Are there family members who are or will not be involved in the business?
 - Is there a need to leave a bequest to non-active family members? Have you evaluated this need? Are there assets that have been identified for this purpose?
 - Does your will properly reflect all of these desired bequests and funding requirements?
 - Have you determined to what degree the business interest will meet the needs listed above?
 - By providing a continuing income?
 - By creating a pool of capital from the sale of the business?
- If there is a shortfall, do you have a life insurance and/or savings program in place to make up the shortfall?
 - If the business is to be left to family members, will this be accomplished by leaving the business to everyone?
 - Have you considered putting in place a buy-sell agreement allowing active family members to buy out non-active family members?
 - Is there a need to financially assist those who will assume ownership of the business in carrying out this purchase?
 - Do you have a properly structured buy-sell provision in your shareholders' agreement dealing with the timing, amount and financing of the purchase of your business interest?
 - Is your will consistent with the succession plan in the event of your death?
 - Is there a need to reduce or eliminate business debt in the event of your death?
 - Is there a need to inject capital into the business to finance interim management, consulting or executive search costs?
 - Is there a need to inject capital into the business to finance any operating losses created by your premature departure?
 - Is there a need to put executive benefit programs in place to maximize the likelihood that key employees will remain on board in the event of your premature death?



Contingency plan in the event of your disability

- What part of your succession plan will have to be altered in the event of your long-term disability?
 - Will ownership of the business be retained by you, liquidated, sold or given to family members or sold to third parties?
 - Have you determined the income needs for you, your spouse and dependent children in the event of your long-term disability?
 - Have you determined to what degree the business interest will meet your need for ongoing income?
 - By providing a continuing income?
 - By creating a pool of capital from the sale of the business?
 - If there is a shortfall in meeting your income needs, do you have a disability income insurance and/or savings program in place to make up the shortfall?
 - If you plan to retain ownership of the business interest or give this interest to family members, can the business support both you and those families in view of your absence from the business?
 - Do you have a properly structured buy-sell provision in your shareholders' agreement dealing with the timing, amount and financing of the purchase of your business interest?
- Do you have disability insurance or another source of financing in place to provide the capital for the purchase of your business interest?
 - Do you have an up-to-date Power of Attorney that is worded consistently with your succession plan?
 - Is there a need to reduce or eliminate business debt in the event of your disability?
 - Is there a need to inject capital into the business to finance interim management, consulting or executive search costs?
 - Is there a need to inject capital into the business to finance any operating losses created by your absence from the business?
 - Is there a need to put executive benefit programs in place to maximize the likelihood that key employees will remain on board in the event of your disability?

Family law considerations

- Have you considered the implications of the matrimonial property laws in your province to your estate distribution and to the transfer of ownership of the business interest?
- Do you have a marital contract? What are the terms regarding division of property and support?
- Do co-owners have a marital contract? What are the terms regarding division of property and support?
- Do children who own or will own part of the business have a marital contract? What are the terms regarding division of property and support?
- Does the buy-sell agreement have a mandatory or optional buy-out or other measures to appropriately protect against the marital breakdown of an owner?
- Does the buy-sell or other succession structure consider gifting and other measures to cause the business interest to fall outside the definition of divisible property of the recipient children?



Selecting a successor and future management

- Have you identified the situations that will call for business succession decisions (death, disability, retirement or unexpected departure of key people including the owner)?
- Have criteria been established for family member entrance into the business (e.g. education or business experience)?
- Have potential successors and other family members been made aware of the benefits of being an owner versus the responsibilities of management?
- Is there a process for selecting successors (family or non-family)? This process could include the following steps:

1. Identify the key positions

2. Create job descriptions and identify required skills for each key role. The business will generally require skills in the following areas:

- Overall business understanding (leadership)
- Operations (general management)
- Marketing
- Product and production
- Financial management
- Human resources management
- Computers and information management

3. Create a replacement plan for each position.

- Identify and contact candidates

4. Evaluate promotability

- Confirm or reject candidates
- Determine internal and external availability
- Finalize a list of immediately qualified and potentially qualified candidates
- Prepare action plans

5. Evaluate training and development needs

- Develop individual training templates
- Justify the training costs

6. Review the training programs, and develop a strategy for furthering the process



The shareholders' agreement – discussion agenda

- Describe the partners or shareholders and their investments
- Describe the firm's trade name and legal identity
- Describe the nature and scope of business activity
- Identify the official business office address and phone number
- Establish a date to review the agreement
- Detail each equity contribution and include the terms of each shareholder loan
- Establish all banking resolutions and signing authorities
- Establish the limits for personal guaranteed bonds and postponements before negotiating any bank financing
- Establish a dividend policy
- Establish a compensation for per diems, bonuses, salaries or drawings for the term of the agreement
Establish a policy for the inspection of business records and right of audit
- Establish insurance coverage(s) and the indemnification of directors for contingent liabilities of the firm
- Establish provisions for partners and shareholders:
 - Wishing to retire
 - Withdrawing equity
 - Settling and estate
 - Handling arbitration of disputes
 - Expelling a partner
 - Selling to an outsider
- Establish provisions to value the share of a partner who retires, dies, becomes permanently disabled or is exiting the business for any other specified reason
- Establish rights and options for surviving or remaining partners or shareholders to purchase the interest in the business
- Establish the terms for restrictive covenants, conflict of interest and non-competition agreements for partners leaving the firm



Tax driven planning

- What are the tax consequences of the succession plan?
- Have you considered an estate freeze in the context of your succession planning?
- Are you planning to give shares to your children?
- Have you crystallized your capital gains exemption, if applicable?
- Have you considered the use of an inter-vivos family trust in the context of an estate freeze or for income splitting purposes?
- For each buy-out event in the buy-sell portion of the shareholders' agreement,
 - Will a direct sale or share redemption be used?
 - Are capital gains or deemed dividends desired?
 - Have the stop-loss rules been considered?
- What are the tax consequences to the receipt of cash from any of the following?
 - Life insurance death proceeds
 - Life insurance cash values
 - Disability and critical illness insurance income proceeds
 - Disability and critical illness insurance buy-out proceeds
 - Disability and critical illness insurance key person or business loan proceeds
- Does your executor have the latitude to do any of the following?
 - File separate returns allowed at death for specific types of income?
 - Invest in financial products other than those prescribed by law?
 - Execute post-mortem tax planning such as estate freezes?
 - Make any elections necessary under the Income Tax Act?
 - Create spousal or other trusts to hold estate assets?
- Has use of a spousal trust, where appropriate, been considered to defer tax at death?
- Have strategies been considered to reduce or eliminate probate fees on the transfer of ownership at death?
- Have strategies been considered to reduce or eliminate U.S. estate taxes, if applicable, at death and U.S. gift taxes, if applicable?
- Have strategies to give capital assets to registered charities today been considered?
- Have strategies to give capital or other assets to charities through the estate been considered and properly incorporated into your will?



Why choose Sun Life?

Sun Life is a leading international financial services organization. In Canada, we started selling life insurance in 1871. Since then, our commitment to helping people achieve lifetime financial security through market-leading products, expert advice and innovative solutions has made us a household name – a name that people trust.

Questions? We're here to help.

Talk with your advisor about Sun Life today!

For more information and resources visit sunlife.ca.
Call 1-877-SUN-LIFE (1-877-786-5433)

We're dedicated to helping you achieve a lifetime of financial security and live a healthier life.



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