

ADDRESSING BARRIERS TO SUCCESSION PLANNING FOR SMALL TO MEDIUM ENTERPRISES (2013 – RENEWED 2016)

Issue

In light of changing demographics and growing efforts by small and mid-size communities to retain and recruit human capital, the need for succession planning and transition for Small to Medium Enterprises (SMEs) has become apparent to ensure economic sustainability. However, SMEs are encountering barriers which deter them from not only planning their succession, but also from conducting a successful transition which if not addressed urgently can have a potential dramatic negative impact on the economy.

Government and industry groups, among others, have focused on the demographic shift and the looming shortage of labour supply in relation to succession planning. Yet, even where human capital is available to SMEs, technical barriers (e.g. taxes, legalities, accounting, and financing) and soft barriers (e.g. experience, interpersonal conflicts, stakeholder interests, communication, knowledge transfer, timing, finding an appropriate candidate, and training) are deterring succession planning in SMEs. While this is important to managing the broader issue of succession planning, the proposed policy resolution is intended to address barriers in existing funding programs, taxation and financing options to entice SMEs to plan, implement, and manage business succession.

Background

The Chamber conducted extensive research into the issue of barriers for succession planning and has gained convincing support on the importance of immediate action on this matter. Initially, academic and professional literature on the subject were consulted. Then, in order to test the accuracy of the information contained in the literature, primary research was conducted by doing surveys and interviews conducted with entrepreneurs, professionals, and government program representatives.¹

Industry Canada defines an SME when a business employs anywhere from 1 to 499 employees, which includes Micro-enterprises employing 1 to 4 individuals.² The large group of SMEs in Canada account for 98% of businesses, employ 48.3% of the labour force, and account for 40.7% of the GDP.³ Yet, studies have proposed that due to an aging population, 66% of SME owners plan to retire within the next decade while only 10% of owners have a succession plan in place.⁴ Succession planning is “*about finding the right strategy for handing over your business to someone else and being prepared for the transition*”⁵. Yet, 60% of SME owners do not consider succession planning to be a priority and these same owners further consider the

1 Farrow, A. (2012) Issues in Succession Planning for Small to Medium Enterprises in the Greater Nanaimo Area. Research Report: The Greater Nanaimo Chamber of Commerce, Nanaimo BC.

2 Industry Canada (2011) Cited in CBCNews (2011) 10 surprising stats about small business in Canada. Available from: <<http://www.cbc.ca/news/business/smallbusiness/story/2011/10/04/f-smallbiz-by-the-numbers.html>> [Accessed 27 October 2011].

3 Ibid

4 Canadian Federation of Independent Businesses (2011) Unnamed Poll. Cited in CBCNews (2011) Canadian businesses score poorly on succession planning. Available from: <<http://www.cbc.ca/news/business/smallbusiness/story/2011/10/20/f-smallbiz-succession-planning.html>> [Accessed 27 October 2011].

5 Canada Business Network (2011b) Succession Planning Guide. Available from: <<http://www.canadabusiness.ca/eng/guide/2654/>> [Accessed 27 October 2011].

process as something that is relatively simple and can be completed in a relatively shorter amount of time.⁶

Primary research indicated that succession planning for SMEs is an issue for concern as many businesses do not consider it a priority in terms of timing, and less than half of respondents had a succession plan in place. Additionally, almost three quarters of respondents who had a succession plan experienced some form of barrier in planning. A significant portion of respondents indicated that the primary gaps in the ability to effectively implement a succession plan were related to resources (ie: financial, human capital) and the remainder indicated that the gaps were related to legislation or infrastructure. Generally speaking, the results of the survey were congruent with the existing data on the subject of succession planning, and the following key results were identified:

- Technical issues were a deterrent;
- The ability to obtain financing for business transition presented a major barrier;
- Finding a suitable candidate and transferring tacit knowledge was difficult;
- That succession planning was not a priority in terms of immediacy;
- More simplified information on the subject of succession planning would be beneficial;
- Business owners are busy with their operations and do not have as much time as they would like to do succession planning; and
- To conduct succession planning, which requires the skills and experience of certain professionals can be costly.

The Chamber's analysis indicated that if 23% to 50% of the 66% of SME's that could potentially close, do so, the potential loss to the BC provincial budget in the form of personal, corporate taxes and PST will be an estimated \$2.1 to \$2.9 billion or more per annum based on the 2011/12 BC budget.⁷ On a long term basis, without factoring in inflation, over 30 years this would translate to an estimated \$63 billion and \$87 billion in lost revenues without including the indirect impacts to the provincial revenues from the loss of jobs and business income.

In another sense, stable or growing economies require flow of income to move from businesses to households (as well as other businesses) which in turn gets spent back in to the economy through consumer purchases. In terms of succession planning, or the lack thereof, business closures mean less available resources and services for sale as well as less financial resources in the economy for spending due to the jobs affected. All of these pressures affect supply and demand taking a cyclical pattern and eventually leading to shrinking economies until a stimuli occurs to restart the circular flow in a positive direction.⁸ The potential exists for a negative effect in many sectors, and if the national ratios and data are congruent to the provincial level in

6 TD Waterhouse (2011) Business Succession Poll. Cited in CBC News (2011) Canadian businesses score poorly on succession planning.

Available from: <http://cbc.ca/news/business/smallbusiness/story/2011/10/20/f-smallbiz-succession-planning.html> [Accessed 27 October 2011].

7 BC Stats (2011a) BC GDP at Market Prices and Final Domestic Demand 1981-2010. Available from: http://www.bcstats.gov.bc.ca/data/bus_stat/bcea/bcgdp.asp?> [Accessed 20 January 2012].

8 Industry Canada (2012) Canada Small Business Financing Program. Available from: <http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/home>

[Accessed: 13 May 2012].

BC (and there is no reason or available information to suggest they do not), the potential for a significant negative economic impact at both the provincial and federal level exists.⁹

Further research into the availability of resources for succession planning led us to examine sources of financing for SMEs, existing government financing programs, the cost/benefit of financing, and other possible stimulus programs.¹⁰ What is important to note is that SMEs have historically been, and continue to be, vulnerable with respect to receiving approval for financing from lending institutions. While there are a variety of factors that contribute to a lender's decision to provide financing, a study conducted on behalf of the BDC indicated that there is a strong correlation between age/experience of the potential borrower and the approval for financing by the lender.¹¹ This not only includes entrepreneurs starting a brand new business, but also those looking to purchase an existing business, as in the case of succession. Nationally, the Canada Small Business Financing Program (CSBF) is a federal government program with mandate to increase the availability of loans for establishing, expanding, modernizing and improving small businesses by encouraging financial institutions to increase financing availability to small businesses, yet it does not include succession planning as a reason for a business financing.¹² BDC's study show trends of superior results by SMEs who obtain CSBF funding to SMEs obtaining funding elsewhere.¹³ While CSBF does not currently allow for the financing to be obtained for the purpose of succession planning, BDC's study proved through historic evidence that financing programs to SMEs do work and help contribute to economic stability and growth.

In British Columbia, the Employee Share Ownership Plan (ESOP) and Employee Venture Capital Corporation Tax Credits provide tax based incentives for investors to provide financing to businesses for a variety of purposes.¹⁴ Tax based incentives allow for employees to invest in companies and receive tax credits. While the money can be used by the receiving business for succession planning, there are severe limitations to the programs that have made them ineffective. At present, BC has provided the ESOP to facilitate direct investment by employees in their employer's company, and the succession ESOP which is a special application of the standard ESOP which facilitates a transfer of control of the business from the current retiring or departing owner(s) by involving the employees over a period of time. The succession ESOP plan also does not assist in succession of the large number of SME's that are not incorporated or the many instances where the successor wants to buy the corporate assets rather than the shares.¹⁵ Barriers associated with these programs have created a deterrent effect towards people wishing to use them.¹⁶ Some of the barriers to this plan include the requirement of at least annual or even quarterly share valuation reporting to the employee shareholders. This alone is

9 Lovewell, M. (2010) Understanding Economics. 5th Ed. Toronto, McGraw-Hill Ryerson.

10 BDC (2011) SMEs At A Glance. Report. Montreal, QC.

11 BC Government (2012) Finance – Personal Income Tax Credits. Available from:

<http://www.sbr.gov.bc.ca/individuals/income_taxes/personal_income_tax/tax_credits/esop-taxcredit.htm> [Accessed 16 May 2012].

12 Statistics Canada (2009) Economic Impact Study of the Canada Small Business Financing Program. Report: Industry Canada, Ottawa.

13 BDC (2011) SMEs At A Glance. Report. Montreal, QC.

14 Farrow, A. (2012) Issues in Succession Planning for Small to Medium Enterprises in the Greater Nanaimo Area. Research Report: The Greater Nanaimo Chamber of Commerce, Nanaimo BC.

15 Heron & Company (2007) Review of SME Loan Guarantee Programs. Research Report: Industry Canada, CSBF. Ottawa.

16 Anonymous BC Government Employee, Interview, 17 May 2012.

detering small businesses who do not have the time and resources to complete such extensive requirements.

It would also be prudent for BC to focus on stimulus for succession planning for small business that addresses the various business structures while keeping in mind that vendor's general desire to use the Federal Tax Act provisions to minimize tax on the transition. A possibility would be to provide a provincial succession planning tax credit available over the next 10 years. It could be put in place for businesses that have been operating for 5 years plus where the owners wish to retire and a serious successor(s) has been identified. The BC government would provide a 10% tax credit (matched by the federal government) to any successor who purchases assets or shares of a SME to a maximum amount of \$500,000.

The BC government, perhaps in combination with the federal government, could also provide grants to cover part of the costs of succession planning fees and government backed vendor financing loans. Government backed vendor financing could be considered in the format of the Small Business Loan Guarantee Program, but instead of guaranteeing loans to start up or expand a business, the loan guarantees to pay the vendor up to 75% of the value of the loan with a maximum loan value of \$500,000 to \$750,000.¹⁷ The loan allows the purchase of the existing business assets or shares rather than new working capital, capital assets, or equipment required for a new business. These loan programs need to shift more attention to succession rather than wholly focusing on new business. A report prepared for Industry Canada indicated that the losses related to similar programs around the world runs up to 7% loss ratio.¹⁸ Even if all these programs were put into place, the costs together are far less at \$28.3 billion over the next 10 to 20 years, than the long term potential losses to the entire economy from a lack of succession in BC according to The Chamber's analysis.

Important Points for Consideration

Overall, the results of The Chambers research indicate a need for awareness to the issue of succession planning as well as changes to existing government resources for financing to provide sellers and potential purchasers the incentives to conduct succession planning and transition effectively. There are few BC or federal programs focused on succession planning. So far, advisors and leaders of the business community, despite the many seminars, published articles and all of the advice provided on this topic, have failed to motivate succession planning to any significant degree. The BC Provincial budget and fiscal plan for 2012/13 to 2014/15 contains no mention of the risks or impacts from the current lack of succession planning and the potential impact on the provincial revenues over the next 10 years. The Chamber and its community partners believe that provincial and federal government stimulation is now necessary to motivate action by business owners, employees and the public.

The issue of business owners planning for succession does not appear to be an immediate priority to business owners. While this is an issue of importance, it should not be seen as "trumping" the other issues mentioned above. For example, if the issue of timing is addressed, and SME owners realize that they should begin to plan early and start doing so, this will not

¹⁷ Brennan, M., Miksimovic, V., and Zechner, J. (1988) Vendor Financing. *The Journal of Finance*, 43 (5), pp. 1127-1141.

¹⁸ Industry Canada (2012) Canada Small Business Financing Program. Available from: <<http://www.ic.gc.ca/eic/site/csbfp-pfpec.nsf/eng/home>> [Accessed: 13 May 2012].

alleviate the issues of the other barriers, such as obtaining financing for the planning , training or purchase, or finding a suitable successor. The components of the broader issue of succession planning are all of equal importance and should be given due consideration independently. Further, it should also be considered that when multiple municipalities undergo issues, they create and contribute to issues at provincial levels. Thus, if this happens in one municipality, it can just as easily occur in others and the aggregate of these will create a provincial issue, and perhaps a national issue.

THE CHAMBER RECOMMENDS

That the Provincial Government work with the Federal Government to:

1. expand the scope of the existing government backed vendor financing programs (such as the Small Business Loan Guarantee Program, Employee Share Ownership Program) so that existing or potential owners of SMEs may access funds to facilitate the various aspects of succession planning including capital funds for purchase of a SME business;
2. expand the scope of existing small business financing programs (such as Canadian Small Business Financing Program) to incorporate succession planning as a legitimate reason for business financing;
3. offer succession planning tax credits for business owners who have created and fulfilled an SME succession;
4. expand the scope of the current tax based incentives (such as the Succession Employee Share Ownership Plan) to include unincorporated businesses, and instances where successors buy corporate assets rather than shares; and
5. create a task force in partnership with business and government to develop and implement a program that will facilitate the efficient transition of SME's through succession planning.

Submitted by the Policy Development Committee

