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Inadequate Business Succession Planning —A Growing Macroeconomic Risk

by Benjamin Tal

The demographic reality of Canada suggests that succession planning is no longer just a micro issue that impacts the businesses involved, but also, increasingly, a macroeconomic issue, capable of affecting the growth potential of the economy as a whole. And in survey after survey, business owners reveal that they are ill-prepared for the inevitable ownership transition that is quickly approaching. Admittedly, there is nothing new in this lack of foresight as this has been the case for many years. But this time around, the consequence of inaction will be more costly.

Business Exit Rate to Rise Rapidly in Coming Decade

Succession planning is the norm for large corporations, but for small and mid-sized companies it is an overwhelming issue that is too often dealt with only in emergency situations such as death or illness of an owner/partner or when new partnership is needed following a cash flow crisis.

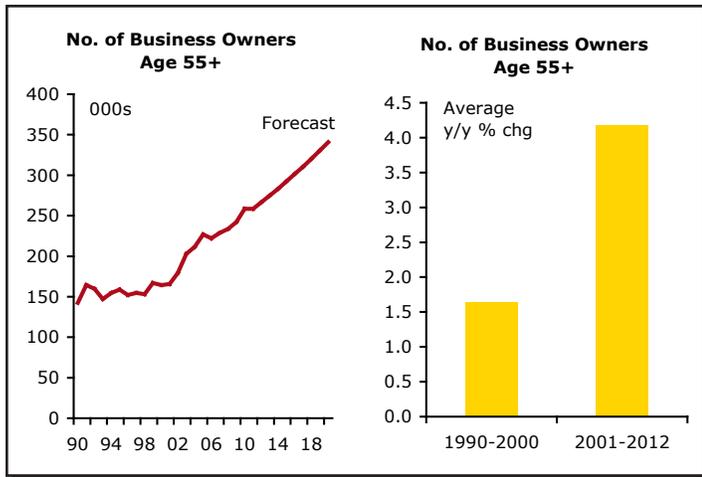
The reasons for that are clear and somewhat understandable. They include limited resources, a struggle to maintain or improve profitability along with some softer factors such as lack of common vision among partners, lack of an effective communication framework and difficulty dealing with conflicts between interested parties. More often than not, the inability

to agree on a well-defined succession plan is an indicator of even deeper problems such as the lack of a clear business plan. And the cost to the business is not trivial. In addition to putting the business at risk by alienating potential successors and buyers, it can lead to a loss of focus by owners, causing inefficiencies and profit loss. Owners may fail to realize the full value of their firm, and it may be difficult to obtain long-term financing, further damaging the growth potential of the firm.

As long as the number of businesses that face transition issues is small relative to the size of the economy, the lack of succession planning is mostly a micro issue impacting the business itself with little consequence to the economy as a whole. But the changing demographic landscape of Canada suggests that this is no longer the case. The sheer number of business owners that will retire in the coming decade is turning this micro issue into a potentially damaging macro problem.

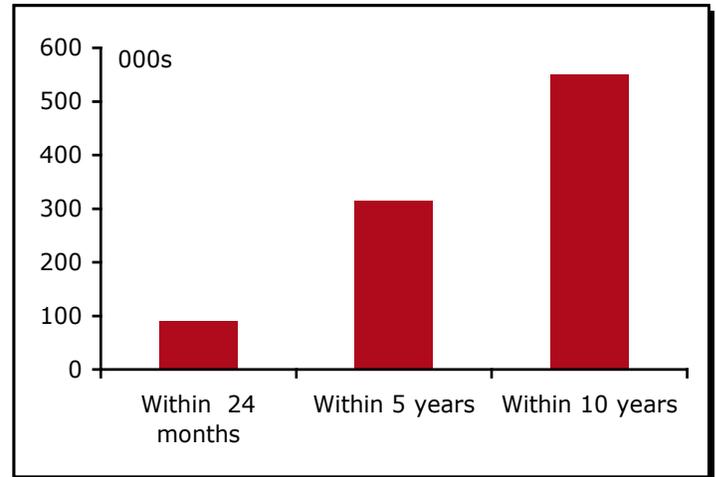
No less than 250,000 business owners¹, or one-fifth of all businesses with employees, are now aged 55 and over. And their number has risen by 4% a year over the past decade. That's more than double the rate seen in the 1990s. By the end of the decade, close to 350,000 business owners will be over the age of 55 (Chart 1).

Chart 1
Business Owners Getting Older



Source: Statistics Canada, CIBC

Chart 3
Number of Business Owners Planning to Exit



Source: CIBC calculations based on the Leger Marketing Poll (July 2012), Statistics Canada

No wonder then that half of all business owners plan to exit operation in the coming decade (Chart 2).

The practical implication of this reality is that close to 30%, or 310,000, of business owners will exit ownership or transfer control of their businesses within five years. Within the next ten years, one-half (or 550,000) of owners will exit their business (Chart 3).

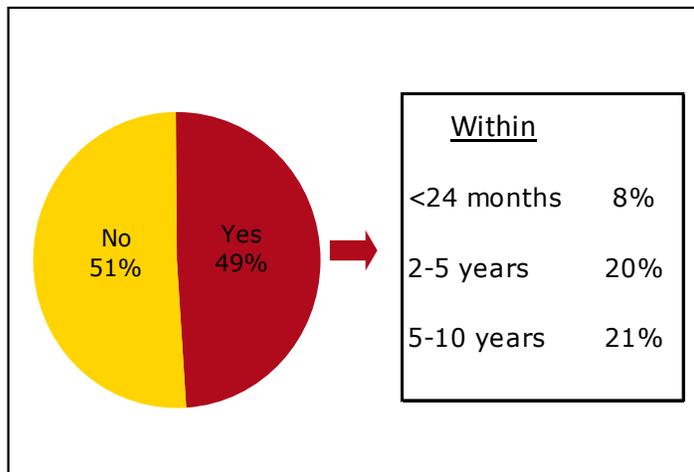
By province, BC will see the largest transfer of ownership in the coming decade with no less than 40% of businesses expected to change hands in the coming five years. On

the other side of the spectrum, businesses in Alberta are in less of a rush to transfer ownership, with only 20% planning to do so in the coming decade — almost 10 percentage points below the national average (Chart 4).

Growing Economic Cost

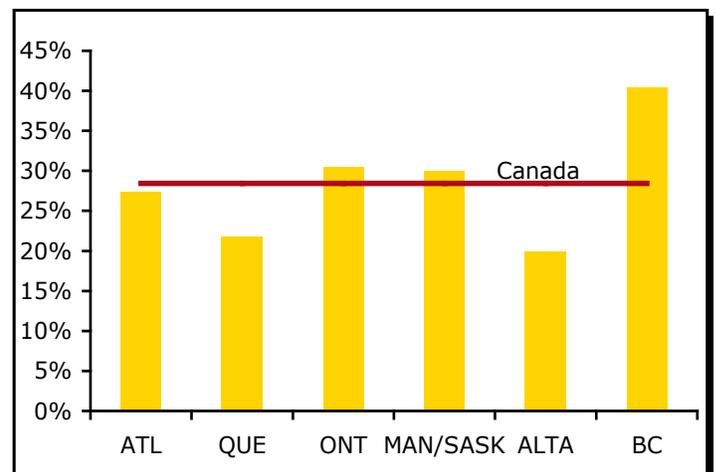
The economic implications of the accelerated pace at which firms are changing hands should not be underestimated. The demographic realities of Canada in general, and the small and medium-sized enterprises in particular, suggest that succession planning is increasingly

Chart 2
Plans To Exit the Business in the Coming Decade



Source: CIBC calculations based on the Leger Marketing Poll (July 2012), Statistics Canada

Chart 4
Share of Business Owners Planning to Exit within Five Years



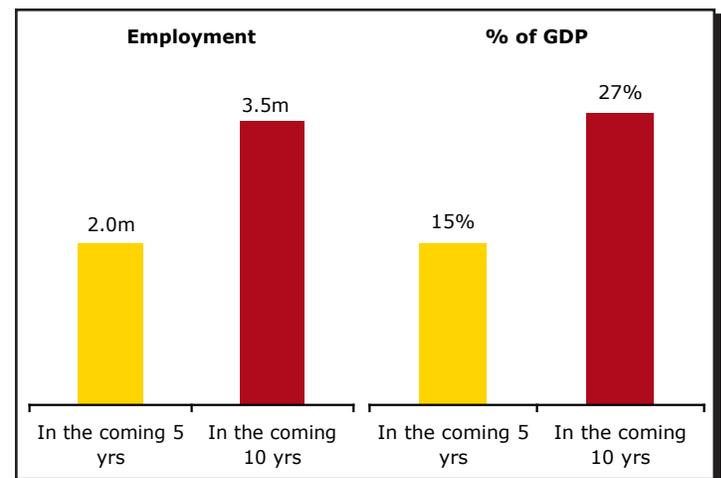
Source: CIBC calculations based on the Leger Marketing Poll (July 2012), Statistics Canada

becoming a critical issue. In the coming five years, an estimated \$1.9 trillion in business assets are poised to change hands — the largest turnover of economic control on record. And by 2022, this number will mushroom to no less than \$3.7 trillion. Given this magnitude, a faulty or badly executed succession planning process could have a ripple effect throughout the Canadian economy via reduced productivity, job losses, premature sales and increased bankruptcy rates. This potential cost is significant. Note that the firms that will change ownership in the coming five years currently employ close to two million people and account for no less than 15% of GDP (Chart 5).

At this stage of the game, a small businesses' principle strength — the reliance on the human capital of the owner in almost every aspect of the business — is also becoming its primary weakness. Adequate succession planning requires time and is often measured in years, not days or months. Still, close to 60% of business owners aged 55 to 64 have yet to start discussing their exit plans with their family or business partners.

Chart 5

Current Economic Contribution of Firms Expected to Change Ownership



Source: CIBC calculations based on the Leger Marketing Poll (July 2012), Statistics Canada

Notes

1. The focus in this analysis is on businesses with employees.

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