

# Succession Planning 101



**Community**   
**Futures** PA and District

Growing communities one idea at a time.

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Succession Planning 101

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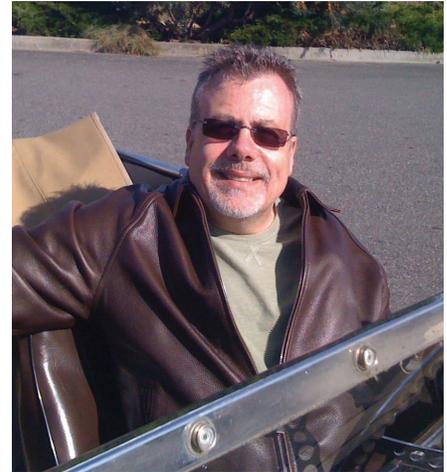
## Table of Contents

<b>Introduction .....</b>	<b>4</b>
<b>Business Succession Planning - An Overview .....</b>	<b>6</b>
<b>Critical Succession Planning: Roles and Players .....</b>	<b>11</b>
<b>What Are Your Succession Options? .....</b>	<b>14</b>
<b>Keeping the Business in the Family .....</b>	<b>16</b>
<b>Business Succession: Management Buy-Outs .....</b>	<b>18</b>
<b>Valuing Your Business .....</b>	<b>20</b>
<b>Selling your Business .....</b>	<b>23</b>
<b>How Much Does Succession Planning Cost? .....</b>	<b>25</b>
<b>The Editor's 10 Succession Planning Mistakes People Make .....</b>	<b>27</b>
<b>Business Succession Planning Checklist.....</b>	<b>29</b>

# Introduction

*The aim of this eBook is to provide a basic overview of some of the key points you should consider when developing a succession plan, and to encourage you to think seriously about starting to plan your exit strategy, whether that will be five years or twenty years away.*

*A Canadian Federation of Independent Business (CFIB) survey, carried out in 2006, found that 66 per cent of small to medium enterprise business owners surveyed planned to exit their business within ten years.*



*When one considers that one-third of the population of Canada are baby boomers (some 11 million) there will be a lot of business owners looking toward retirement in the coming years.*

*Another interesting finding in the survey was that only 10 per cent of people planning to sell had a formal succession plan, with 38 per cent saying they had an informal, unwritten plan and over half had no plan at all.*

*If you have a family business, have you thought about the future? Do you plan to work until they carry you out in a pine box, or would you like to have an exit strategy which will see your business continue, and provide some much needed income for your retirement? Perhaps you are looking for a new adventure? CFIB found that one in ten of those surveyed were selling up to start another business.*

*In either case you have a number of decisions to make when deciding your exit strategy. Are you going to pass the business on to a family member? Or will you simply find someone else to run the business for a period of time until you finally decide to sell it (sort of semi-retirement)? Will you sell it to one of your management staff, or even an employee cooperative? Or, are you selling the business to an outsider who may, or may not need you to hang around and provide training, coaching or other support? Will you retain an interest in the business, perhaps in terms of transitional profit sharing, or as a shareholder? How will the transition be financed, especially if you are handing over to a family member or employees? Of course, you could simply close the business completely and sell the assets.*

*Of course, before any of the questions above can be considered you need to get your advisors and stakeholders involved. Creating an advisory team is a good idea; bring together your accountant and lawyer, your bank manager and financial advisor, add a tax advisor (oh, yes there will be significant tax issues), family members, your company's management team, a business valuator, possibly a business broker and anyone else whose opinion you trust (a mentor perhaps).*

*But, we're jumping the gun a little here; before you do anything you need to sit down and clearly think through what your long-term goals and objectives are, both in business and personal terms. Once you've gone through this process, discuss your thoughts and conclusions with everyone involved (all stakeholders) and see whether they share your vision.*

*This short list of considerations should show you that a succession plan is vital if you are to be successful in transitioning out of your business.*

*Selling your business, or simply exiting it and letting someone else run it, can be traumatic, after all we get emotionally attached to our businesses, especially if we have been in business for many years, but it will be a great deal more stressful if you put your head in the sand and expect succession to just happen.*

*Even if you don't plan to retire anytime soon, start succession planning now, remember, it's a long-term process, not a one-time event. Treat the challenge of exiting your business as just another great opportunity and you may end up with one of the best business experiences of your life.*

**Mike Wicks**

*(Publisher: Blue Beetle Books Inc.)*

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*Warning: This book provides a basic overview to the subject of succession planning only and the authors make no warranties as to the accuracy of information as it relates to the reader's specific business, or circumstance. Do not act on any information contained in this publication without first consulting an accountant and lawyer.*

# Business Succession Planning - An Overview



When it comes time for a business owner to hand over the reins to someone else, it's important that there is already a plan in place outlining the logistics of the transition in order to ensure a smooth hand over. This plan is a business succession plan.

Succession planning can be a complex process, although breaking it down into its component parts makes developing one a whole lot easier. Many factors need to be considered including: determining the value of the business; settling tax and debt obligations; choosing and working with successor(s); and communicating the plan to all interested parties.

## **Why Is a Succession Plan Necessary?**

Entrepreneurs give their lives to building their businesses, it's one of the crowning achievements

of their lives, so they often have a deep-seated desire to see them continue after they retire. They feel a commitment to their customers, or clients, to their community and even their suppliers.

Without a clear succession plan many businesses fail after the original owner retires, sells the business, or passes away. This is a great pity, a waste of resources and usually affects the livelihood of many people.

For larger companies it is critical to implement a succession plan across a broad segment of the company, from lower supervisory roles to high-level managerial positions. This approach is more conducive to identifying, developing, and keeping key leadership personnel, and avoiding the a shortage of skilled and knowledgeable staff during and after the transition period.

## When Should Succession Planning Be Done?

It is never too early to begin succession planning. In fact, it should be done even when it seems things are going well and the current owner has no plans to step down from a leadership role, or retire. Sometimes, a sudden and drastic change to the physical or mental health of the owner, or their untimely death may make it necessary for a business to be either sold or transferred to the ownership of someone else. These unforeseen circumstances are not so disruptive if there is a comprehensive succession plan already in place long before they occur.

Planning well ahead makes sense. The owner can supervise the development of the succession plan and build into it all the necessary steps to ensure an efficient transition from current ownership to the next, regardless of whether they are available to handle it themselves.

There is a strong case for a succession plan to be built into the start-up business plan. Building a company from the ground up with systems in place for every department makes sense and these systems form the basis of your succession plan. Think of a Pizza franchise, everything is systemized to the point that a new franchise owner can step in and start a new store quickly and easily. At any time, but the earlier the better, carry out this exercise - pretend that you are going to franchise your business and consider what would go into the Franchisee's manual.

Once you have a plan it should be reviewed every six months or so to ensure that everything it contains is still valid. All businesses are dynamic and six months is a long time, so update your plan to reflect current situations and requirements of the company as well as to take changing laws and regulations into account.

## Key Components of a Succession Plan

Before you start, take a time-out and think about what the perfect scenario would be when it's time

for you to exit your business. That will give you a good starting point. Your plan should have a cover page, a table of contents and an executive summary, much like your business plan.

What follows is a brief overview of the key elements of a succession plan, but we advise you to pick up a template from your local bank, or Canada Business Network office. Community Futures Development Corporations also often have templates.

**Establishment of goals:** It's always a good idea to think about what outcome you want to see before you start planning. You need to ask yourself many questions before you even begin to consider the actual process of transition, such as whether you will play any active role in the company's future operations, how the sale will affect your employees, customers, suppliers, and other stakeholders in the company, whether the company itself will change locations, and whether the name of the company will change or remain the same (e.g. if the company bears your name, are you happy for a new owner to continue using it?).

Also consider what you want to get out of the deal and what your successors are, or might be, looking for. This is particularly relevant if members of your family will be taking over the business.

Are you the sole owner? Is it just you who are leaving the business, or do you have a partner, or partners to take into consideration? Be clear about who the plan is referring to and who it isn't.

Are you leaving the business entirely, or planning to work part-time? Are you considering bringing in someone else to run the business, while you still own, or part-own it, or are you looking to sell out completely? Outline the type of succession you envisage.

**Executive summary:** This is written last and will provide the reader with an overview of the key elements of the plan. It will also provide basic information on the business such as whether it is a proprietorship, partnership or incorporation and

details of what the company's primary products and services include.

**Expectations:** What are your goals and expectations, both for the business and personally? What will a successor be looking for? You may already know this if a family member is a potential successor; if not you might want to put yourself in the shoes of a prospective purchaser - what will they be looking for?

**Identification of successors:** Sometimes, owners decide to simply sell the business outright, whereas others wish to appoint a family member, close friend, business partner, or even a current employee as their successor. List each potential candidate being considered and individually note their qualifications, training, dedication, and overall suitability to run your business in the future. This should be an unbiased look at potential successors.

It is very important that you make it clear as to whom ownership of the business will go to, exactly when that will occur, and under what conditions.

**The business and it how works:** Describe the current business in more detail including its products, services, customers, competitors, strengths, weaknesses, opportunities and threats. Be honest and provide the reader with an understanding of the businesses and its current standing.

Outline the future of the business, is it growing, or contracting? Is it opening new markets, developing new customers bases? Is it re-tooling, or developing new products or services? Add sales projections and other financial statements that will provide a clear picture of the company's prospects.

Provide an overview of how the business runs on a day-to-day basis and describe the systems in place that keep things on track, and who has what



responsibilities. Then outline how these will work after succession.

Outline all those who will need to be involved in the planning process. This can include spouses, children, other family members and key employees, especially departmental, or divisional managers.

Provide details of how family, or management are involved with the succession plan and eventual transition of the business to a new owner, or family member. Also consider what role family members that are not part of the business will have in the decision-making process.

**Personnel after succession:** Create a table that lists the names and job titles of all your key employees (include any partners, or co-owners remaining the business). Now add two more columns; one that lists the relevant skills required to do that job and another that details the training they will need to move into that position.

**Identification of company structure and method of transfer:** The structural components and levels of management, roles and responsibilities of employees, and policies and procedures of the company's operations should be clearly explained. It should be clearly stated how the transfer of ownership will affect each manager and employee and what roles will change. You should create an organization chart that shows what the company will look like when you have left.

Consider and make note of how control of the business will actually be transferred, and how the assets will be handled. How will payment be made and over what timeline? Are you assisting with financing, is the successor, or purchaser handling that themselves?

**Training for successor:** What training do you intend to provide for your successor? A lot will depend on whether your successor already works in your business in a key managerial role, and the level of skill and knowledge they possess. If you are selling to a complete outsider then you will have to include a full orientation of all systems, policies, and procedures.

**The legal stuff:** You will need to detail all the administrative and legal paperwork that will be required. This will include share transfers, new partnership agreements, name changes, GST/PST/HST, domain names, memberships, business licences, permits and many more things that are currently in your name.

Any outstanding agreements or contracts will need to be legally passed over, so these should be listed in the plan.

If your business is a partnership, and you have a shareholder's agreement, then you may want to discuss with your lawyer what the terms are surrounding any buy/sell agreement and what effect this will have on your plans to sell your share of the business.

You will have to make note of, and take into consideration the tax implications of exiting your business. This is where your accountant can be extremely valuable.

**Business valuation:** It is necessary to know how much the business is worth before a selling price can be determined. This can be done by hiring a certified public accountant (CPA) a broker, or a realtor, or by mutual agreement between all partners involved in the transaction. Your plan should have a business valuation and also list all assets and liabilities.

**Timetable:** Although this may change as things progress, create a timetable of all the activities the plan requires. This will allow you to monitor progress and let all stakeholders know how things are progressing, on a regular basis.

**Communications strategy:** Outline the method by which you will keep all stakeholders informed as to developments; this should include regular meetings with all involved. Remember, you will also need to communicate with employees, especially with regard to the transition of authority from you to your successor and his, or her, new management team.

**Personal:** A succession plan does not have to limit itself to just the business activities - it's your plan, include details of how your retirement will look, how much money you will need to do the things you want to do and decide whether you will bow out of the business entirely, or keep your hand in by sitting on the board, acting as an advisor, or even doing some consulting work.

**Risk management:** Whatever can go wrong, will go wrong so you need to plan for the "what-ifs" of life. For instance, you should consider the possibility that you could die before being able to sell your business, or hand it over to a successor. You should ensure that you make it clear what your wishes are if this should happen, and make sure that you have a will that details what should happen to the business, or your shares if the worst happens. Make sure you note down in the plan, what insurance you have, where your will is and who will handle the succession if you are not around to do it yourself.

### Communicating the Plan

The importance of communicating the succession plan to all parties involved cannot be stressed enough. A plan that only the owner and upper management personnel are aware of is not going to be very helpful if an unexpected transfer of ownership has to be made. In a smaller company, all employees should be part of the entire planning process. That way, they feel they contributed to it and are much more likely to ensure that the plan is effectively implemented when the need occurs.

In larger companies, it is a good idea to create committees representing all levels of employment, from non-management workers through to top level management so that input from all departments can be considered during the planning stages. When all parties who will be affected by the succession plan feel they took part in its development, they are more likely to want to see its successful implementation.

When the time comes to initiate the plan, outside parties such as customers and suppliers should

be made aware of how the change in ownership will affect their relationship with the company.

### Professional Services

In all but the simplest family owned business successions, it's highly advisable to retain the services of a business lawyer and a certified public accountant. These professionals will help ensure all legal ramifications have been thought out and that all required documentation, taxes, and regulations have been given proper attention. It is also important to make sure that there are no misunderstandings between the parties involved in the transaction.



When seeking out the help of these professionals it is important to choose carefully to ensure that you can work well with the personalities involved, and that they can also work well together. Ask each professional what services they can provide, along with any limitations. Make sure you fully understand the rates being charged and in the case of professionals charging hourly rates, ask for estimates as to how long each part of the process will take. 

# Critical Succession Planning: Roles and Players

Business succession represents a key strategy for the continuity of an organization, particularly its leadership and executive management in critical functions. Too often, especially with businesses led by charismatic managers or owners, succession planning takes a back seat until the very last moment when a replacement absolutely needs to be identified. By having a succession plan in place well in advance, a business can avoid this panic and thus have a better chance of choosing a prepared candidate for a leadership, or ownership position. To make the plan successful however, the right players need to be involved. This includes a variety of stakeholders both inside a business and in some cases outside, depending on their own role and interaction. Each one plays a critical role in helping a smooth succession.

Remember it's often not just about new ownership; it can also involve members of the management team, who may be part of the owner's family, or who just consider the transition of ownership a good time to retire. In other cases the new owner may decide to bring in their own executive management team. So in this chapter, we'll look at management succession as well as ownership succession.

## Family

Succession planning always involves family members in one way or another. If the plan is to see the business ownership and management transition to a son or daughter, or another family member, they should be involved as early as possible in the planning process. If they are young and the planned transition is many years away, they can be



introduced to the business by way of part-time work and thereby groomed to take over, potentially over several decades. If they are already in the business, then they should be an integral part of the transition team.

Even when there is no plan to have a family member take over a leadership role in the business, they should still be an integral part of the transition plan. As an owner exits a business that has been a major part of their life for many years the impact will be felt across their whole family.

### **Top Management**

A successful transition of ownership relies on support from all levels of management. Executives have worked long and hard to build up protocols and systems that have improved the business considerably. It is important to get them on side so that they will support the new owner and train them, and any new management staff to ensure that the company continues to operate as efficiently as it has in the past.

### **Middle Management**

Middle management is the backbone of a company and a new owner, or new executive team are going to need the support of front-line employees. Any resistance from middle management could easily thwart efforts to transition a new management team into the business.

### **Staff**

It is important for a new owner to take over a motivated staff, so rank and file employees should not be forgotten when developing a succession plan. They should be involved, when the time is right, and their opinions sought wherever possible. The last thing an owner wants when touring a potential successor around his, or her, business operations is for staff to be surly, or show any level of discontent.

### **Business Partners**

Very few businesses and companies are able to operate on their own without the help and partnership of other businesses. This may be in the form of supplies, services, outsourced

functions, shared markets and selling, etc. The list can be extensive. Leaders of a business need to be connected with critical business partners, as shared agreements can represent significant lifelines for a company's immediate future. As a result, external business partners can have an influence on succession planning in a company, especially if a potential successor does not work well with such vendors and supporters. While at best the external perception may end up being just an opinion, it's one that executive management should be paying close attention to for continued growth and cooperation.

### **Banking and Financing Partners**

Succession candidates need to be aware and understand who the financial players are that help a business operate and thrive with regard to banking and financing. While these players do not directly make decisions on a company's direction, they can have significant say on the funding needed to pay for such operations.

Look to your bank account manager for advice on financing the succession planning and business transition itself. They will also be able to provide information on financing options for family members, management, or others considering buying the business. They can also be a source of industry information and have a good handle on the current economic situation.

Accountants will help with a whole range of things including developing financial statements, advising on tax issues, assisting you if there is any restructuring of the business to attend to, and making you aware of any tax implications, or ways to reduce taxation. They will also be an integral part of assessing how much your business is worth.

### **Lawyers**

Your lawyer will play an important role in your succession planning, and ultimate exit from the business. They will draft any purchase, or sale, agreements you might need, prepare wills, help with powers of attorney, set up trusts, offer tax advice and deal with anything to do with the restructuring of your business.

## Business Valuators

It is wise to get a professional valuation carried out on your business to ensure you will get the maximum amount possible for it. There are dozens of different ways to value a business so trying to do it yourself is unlikely to provide a valuation that is sound enough for the majority of potential buyers. A professional valuator has the skills to assess the value of the shares in your company. Not only that, they are able to offer an unbiased valuation, which will give potential buyers, or investors, confidence that the valuation is credible.

## Brokers

Business brokers are like realtors, they will hopefully find a buyer for you and help you prepare your business for sale, by giving you advice on making it more attractive to potential buyers.

## Counsellors or Mentors

In every region in Canada, and in most communities there are Community Futures Development Corporations, Enterprise Centres, and Chambers of Commerce that often have counsellors, or run mentorship programs that can assist small business owners with their succession planning. In addition the Canada Business Network has an excellent website offering advice, and regional offices throughout the country that are a good place to start when searching for help [www.canadabusiness.ca/eng](http://www.canadabusiness.ca/eng).

## Facilitators

There are facilitators that specifically work with family businesses, not only to guide them through succession planning, but also to act in a mediation role when families find themselves unable to agree on matters. The Canadian Association of Family Enterprises (CAFE) is a great organization to check out, whether you are dealing with transition, or other issues involving your family in business. The home page of their website proclaims: Helping Business Families Through Shared Experience, which sums up their mission. They may well have a local group in your community that may be able to recommend a facilitator, or provide the help you need within the chapter. They also publish a book called: Family Business Succession, which may be well worth checking out.

## Conclusion

The above list is not meant to be exhaustive as there are other players and groups that may, or at least should have a say in your particular businesses succession plan. The key thing to remember is that succession planning is a systemwide issue and, when managed correctly, incorporates the input of both internal and external stakeholders. 



# What Are Your Succession Options?



Running a business can be an extremely rewarding experience both financially and emotionally. However, regardless of how well you do at running a business, it can't last forever. As a business owner you have a responsibility to your employees, customers, and potentially the community, to start thinking about what you will do with your businesses when you decide to retire, or move onto another challenge. As an owner of a company, evaluating your succession options can be challenging. When you find yourself in this situation, there are three primary options to consider. All of these options come with a few pros and cons, but depending on your situation, one may stand out as the obvious choice for you.

## **Pass to a Successor**

The first option to consider is passing your ownership interests on to a successor. This successor could theoretically be anyone you want. You could pass the business on to one or more of your children, to your spouse, to a business partner, or to a good friend. When you pass a business on to a friend or family member, you have the ability, if you so wish, to give away your share of ownership in the company.

When passing ownership of your business to your children there are several useful tax planning opportunities you might want to take advantage of, such as estate freezes. This is a process by which you take steps to stop, or limit, the future growth of your assets and provides for future growth to accrue to the benefit of your spouse or children. An estate freeze is normally accomplished by the transfer of capital assets into a company in exchange for preferred shares in the company and a promissory note, or by the exchange of common shares in a company for preferred shares having a redemption value equal to the fair market value of the common shares. When holding shares of an existing company, a freeze can be accomplished by reorganizing the capital or stock dividends.

Of course, getting the advice of your accountant, and perhaps a tax consultant specializing in succession planning is vitally important if you are to minimize the tax implications of handing your business over to family members.

## **Transfer to an Employee or a Management Buyout**

Another option to consider when it comes to creating a succession plan is transferring ownership of the business to an employee, or allowing a partner to buy out your share of the company. With either of

these options, the party who plans on buying your share of ownership in the business will pay you a set amount for the value of your shares. The good thing about this approach is that it can sometimes generate a large amount of cash that you can use during your retirement years, or to start another business.

One of the challenging things about using this strategy is that it can be difficult to accurately value your share of ownership in the business. To value a business, you may need to hire a certified public accountant or a business appraiser. There are many different ways to value a business and, it can sometimes be difficult to ensure the estimate is accurate.

After coming up with an agreed-upon amount for the transfer, or purchase of ownership, many business owners set up a buy-sell agreement. With this type of agreement, the exact terms of the sale will be discussed and put in writing. The terms could include an event that triggers the sale of the business ownership and the amount to be paid for the ownership share. For example, the business owner could set up a buy-sell agreement with a minority partner in the business. When the primary owner dies, the minority owner will pay a set figure to the estate of the deceased owner to get his share of the business.

To come up with the money for the transaction, many buy-sell agreements use life insurance policies. For instance, each partner in the business may take out a life insurance policy on the other partner. This way, when one partner dies, the others automatically get enough money to buy out the deceased owner's share.

## **Selling the Business**

The third option to consider is selling your business. Instead of coming up with a long-term succession plan, you simply sell the business immediately. With this option you can list your business for sale with a business broker, or try to sell the business on your own. The buyer pays you a sum of money and then you turn the business over to them. This is often the simplest option and doesn't require much planning on your part.

## **Transition Periods**

Regardless of which option you choose, you may need to allow some time for a transition period. When you pick a successor, you will, over time, teach that successor everything they need to know to run your business efficiently. This will allow you the satisfaction of knowing your successor will be competent to carry on your legacy in the business.

If you sell the business, you may arrange with the buyer to stay on for a period of time to show them the company's systems, policies and procedures and introduce them to staff and key customers, or clients. This period can be in the form of a paid consultancy, or included as part of the sales agreement.

## **Conclusion**

Before you make a decision what route you think will be best for you and your business, research in more detail the options discussed above and again later in this book in more detail. Gather all your stakeholders together and explore the options that make sense for your business. Remember, this is your exit strategy and it's important to you and your company's future

Things to consider include:

- What is best for the business?
- What makes sense financially?
- What makes sense with regard to potential tax implications?
- Are there any family members ready and capable of taking over, or will they need grooming over time?
- How will any decision affect family unity?
- How important is it to you that the business retains its reputation in the community?
- How important is it to you to protect your employee's jobs?
- Is it important to you that your customers continue to be serviced?
- Do you want to remain involved with the business, or are you ready to cut all ties? 

# Keeping the Business in the Family

Keeping a family business in the family requires a great deal of thought and planning. One of the first important steps may be for the founder, or current business owner, to clarify why he or she wants to keep the business in the family. If the purpose is simply to provide a livelihood for his or her heirs, the same purpose might be accomplished by selling the business, setting up a trust, and letting the heirs receive interest payments for the rest of their lives. If the founder, or current owner of a business, wants his or her heirs to be self sufficient and have to earn a living, ensuring a livelihood for them could be accomplished by financing college educations and allowing them to

follow their own interests.

Completing a written mission statement can help clarify reasons for keeping a business in the family. Many people who own family businesses believe that their business provides a service that people in their community need. A family that operates a hardware store may believe that their friends and neighbors would not be able to find the products they sell at reasonable prices at a large home improvement centre, for instance. Other families strongly believe that an art or craft that is part of their family tradition, is worth preserving and sharing to enhance the quality of life in their community. Whether the business is large or small,



having a mission for the business is critical to keeping the business in the family.

Once a clear mission has been established, succession planning must begin. An important first step may be to simply ask the potential successors if they are interested in spending their lives working in the family business. They may not be. If they are undecided, conditions or time limits should be set. This will prevent conflict between family members in the future, should a family member fail at a career, or become disenchanted and want to come back into the family business. A founder or owner must make clear who he or she wants to succeed them. Other family members may have made erroneous assumptions that need to be dispelled. If a successor or successors have been clearly designated, and are interested in following the family tradition, they must be properly trained and educated.

The successors need to have specialized, as well as general, training. Much of this training can be provided by the founder or current leader, but it is also important to receive outside training. If, for example, the family business is a restaurant, the restaurant could benefit from having the successor complete culinary school. Beyond that, a successor needs to have an education in general business.

They need to know about finance, human resource management, marketing, and need to develop leadership and decision-making skills. Critical thinking skills will help a young



person, whether or not they stay in the family business and if they do stay, these skills will make the business far more likely to succeed.

An important part of a successor's education may be to take a job outside of the family business, after graduation from college or technical school. If nothing else, this step will determine whether the potential successor is employable. One of the reasons that many family businesses fail after the founder has passed the business on to his or her offspring, is that their child would have great difficulty finding, or holding down, a decent job if not for the family business. A potential successor who is successful outside of the family business will gain the confidence needed to run the family business successfully, and will thus have credibility with the employees. They will be seen as having earned their leadership position rather than simply inheriting it.

It is important to continue to receive feedback from both inside and outside of the family, even after succession has taken place. Many family businesses establish family councils, or forums, to help the successor remember the mission and vision of the business. Such groups can also serve as a vehicle for succession planning into the next generation, and can arbitrate disputes among family members. Boards of directors, and non-family members in senior management positions, will help a successor focus on ensuring the business remains competitive.

An important part of succession planning is for the founder or owner to actually retire once the succession is complete (once orientation and training has been carried out). Continuing to have a hand in the business after succession can undermine the successor's confidence and cause unnecessary conflict. The founder needs to know when it's time to quit and hand over the reins to the next generation.

One of the keys to success of a family owned business transition is to involve stakeholders from the outset. The owner of the business must communicate with every family member involved

# Business Succession: Management Buy-Outs

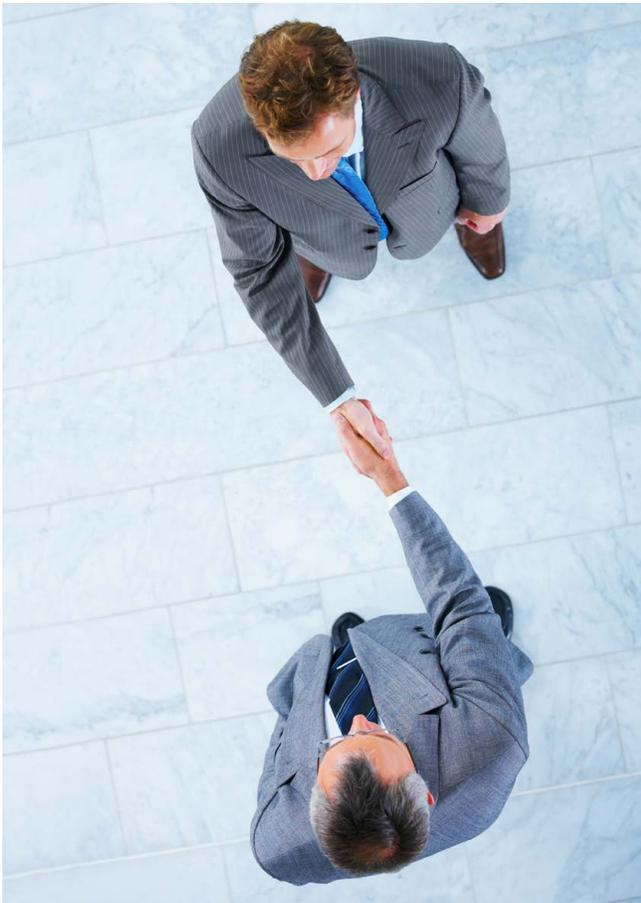
what he, or she is thinking of doing, and then include them every step of the way during the development of the succession plan. <sup>SBS</sup>

A management buyout differs from a leverage buyout, where a financial sponsor takes a controlling interest in a certain company. In the case of the former, existing managers take a significant part of the assets of a company.

## Targeted Companies

The following characteristics of a company will make certain companies more likely to be targeted for a management buyout:

- Very low to no debt
- Decreased price of stock to reflect market conditions



- Hard assets as low cost collateral
- New management producing a boost in cash flow from new operational improvement

When companies begin to meet these conditions, management may start considering undergoing a buyout.

## How Does Management Buyout Work?

There exist a number of benefits of a management buyout rather than other sorts of buyouts. For example, the process of due diligence does not take as much time since the management is already aware of the ins and outs of their own company. In fact, the managers will typically know more about the operational practices than the sellers themselves, which provides sellers the opportunity to give them only the most basic of warranties.

The knowledge the managers have of the company can also be a concern for owners because this knowledge provides some threat of an unfair advantage.

Generally, private companies are the target for management buyouts. Should public companies be acquired, then chances are good that the manager will close the deal by making the company private. The primary reason that management buyouts occur is because the managers fear their jobs could be in jeopardy, if an outside source were to acquire the company. During the process, the managers gain the benefit of better profits should the company remain a success.

## Approaching Employees

During a management buyout, the managers will generally ask employees to submit an application, so that they can decide whether or not they want to hire them back after the buyout. Should

they hire them, new employment terms will be discussed, including insurance, salary and more. Depending on how the buyout goes, the terms will dictate how employees are paid for any vacation days that were accumulated, or if they will be carried over into the new agreement.

## Challenges With Management Buyouts

There are many challenges with management buyouts. For example, the quality of the management team, the financing of the transfer, and the future dynamic of the employees.

Above all else, the management must be able to provide a strong team with good skills and a good balance of knowledge. The investors and financial partners that become a part of this team will want to know that the company and its team is solid, and that they can easily work with one another to further the company's business. The biggest challenge is to convince investors that the team one has built is strong.

It is entirely possible that some managers will not be included in the buyout process. They might choose to leave the company, which can result in some destabilization, especially if they were key team members with unique skills. Not only does the new team need to figure out where there is tension, but they must also prevent and eliminate dissension by, for instance, adopting profit measures and redefining roles in order to generate loyalty.

On one hand, since the managers are fully aware of how their businesses run, the purchase offer that they make will generally be closer to fair value than third party offers. Of course, they also know what their talents and skills can contribute, so the negotiations may be more arduous than outside offers.

The owner-manager will also need to consider what should happen if there is a breakdown when negotiating with employees. When this occurs, the

employees may not want to go with a third party and decide to resign, potentially lessening the company value.

## Management Buyout Financing

Getting the finances for the buyout typically requires the managers to meet with a number of sources. The first thing they may do is try to get financing from a bank. However, the risks involved can make banks a bit wary of making these types of loan. If a bank does not want to get involved, then the next step is usually private equity financing. Private investors are the most common source of management buyout financing, and investors gain a portion of the company shares.

If the firm is actively soliciting a number of bidders, the management team must be able to quickly assess numerous factors before placing their own bid:

- The value of the company from the perspective of management
- The value of the company from the perspective of other competing buyers
- The ability of the company to support the financing -- as well as the subsequent options like private investors or bank lenders -- available to managers

This information makes it possible for managers to compete equally when they are up against another bidder. With the right information, managers can save their jobs through management buyout.

Although management buyouts are becoming more popular, smaller businesses may not be best suited to this form of exit strategy. They are complicated and often it is difficult for management to access the financing required. Another issue is whether your business has employees with the requisite skills and leadership qualities. Therefore management buyouts can often take a lot longer to come to fruition than simply selling the business for instance. 

# Valuing Your Business

Creating a succession plan, of some sort, for your business is a necessary step that all owners must take at some point unless of course you choose to simply close the business down when you retire. As part of the process of creating a succession plan, you have to determine the value of your business. Before you can pass your business interest onto an heir, or sell it to a third-party, you must first figure out how much the business is worth. Coming up with an accurate value for the business can be a bit of a challenge, as there are several methods open to you. If you want your succession plan to be successful, you have to come up with a value that is as close as possible to the company's true value.

Determining the value of a publicly traded company is somewhat simpler. You can come up with a fairly accurate value by looking at the number of outstanding shares of stock that are in the market place and multiplying that number by the market price for the stock. When coming up with a value for a privately owned company, the process is a little more involved. If there are shares of stock for your company, they are not trading actively in the stock market.

When it comes to valuing your private business, it's best to hire a professional valuator who will give you an unbiased, fair market value. A certified

public accountant, or a business appraiser could also help you put a price on your business.

What follows is a quick primer on the various ways a business can be valued; this in itself points to how complicated valuing a business can be.

## Multiple of Revenue

One of the most common ways to determine a value for a business is to use a multiple of annual revenue. With this approach, you simply multiply the annual revenue of the company by a specific number. For example, you might multiply your annual revenue by three in order to come up with a value for the business. The multiple that you use can vary significantly from one business to the next. Typically, a common multiplier will be used for an industry and type of business.



To figure out the proper multiple to use for your calculation, you may need to research the norms in your industry. This could involve checking to see how much other similar businesses sold for, or consulting with an appraiser to get some ideas.

### **Earnings Based**

This is probably the most commonly used method of valuing a business. It looks at what the business has earned in the past, and what it is likely to earn in the future. The price is based on management forecasts, which are open to scrutiny and the vagaries of the economy. It may then be combined with the method above where the annual revenue is multiplied by an industry norm.

### **Discounted Cash Flow**

Another way to gauge the value of a business is to use a discounted cash flow analysis. With this strategy, you calculate how much cash flow the business will create over a period of time. Then you use an expected rate of return, such as the rate of government Treasury bills, to calculate how much money you would need to invest to earn that rate. This helps create an upper limit for your investment so that you see how much it would take to bring in that much profit through regular investment channels.

### **Asset Value**

A simple way to estimate a value for your business is to simply look at the assets that it has. If you were to buy everything that the business owns, how much would it cost? You can typically get this information from your balance sheet. Look at the total company assets and compare them to the liabilities. The difference between the assets and the liabilities represents the current asset value of the company. But remember, this method does not take into consideration the goodwill you have built for your business, which will have an effect on future earnings. Nor does it factor in your market share, which may well influence the true value of the business.

### **Market Value**

One of the ways realtors value residential properties is to compare similar houses that have

recently sold in the same neighbourhood. This works well in this situation as usually very similar houses can be considered. In the corporate world it may be difficult to find “apples-to-apples” comparisons, but if you can then this might be worth looking at because it will at least give you a rough guide as to value.

### **Maximizing the Value**

If you are in the process of creating a succession plan, you may want to maximize the value of your business. For example, if you’re planning on selling your business at some point to an employee so that you can use that money for your retirement, you want to maximize the amount that you get. As a business owner, there are a number of steps that you can take to maximize the value of your business.

One of the important things that you need to do is get your financial records in order. This includes creating standard accounting statements such as the balance sheet, income statement and statement of cash flows. If you do not have these documents created regularly, investors will be hesitant to buy your business.

You can also maximize the value by creating systems that help keep everything running. For instance, creating a comprehensive training program for your employees so that they are all qualified to do their jobs with little oversight, can be beneficial.

Investing in a state-of-the-art inventory system could also be an improvement that adds value, or at least make the company more attractive, as it will minimize lost or stolen inventory for the new owner.

As in all businesses, nothing happens until something sells, so a company which has a first rate sales and marketing strategy, an active and skilled sales team and is exploring, and opening new markets is going to be far more attractive than one that is trading water waiting to be sold.

Disposing of any assets that are not assisting in the growth of the business, or even worse are costing the core business money is a good idea before putting the business up for sale, or starting the transition process to a family member.

Good business relationships (goodwill), and human capital, can also have an impact on the value of a business. For example, if you secure an exclusive deal to be a distributor of a new product, this could make your business more attractive. If you have really talented employees or patents on new products, this can also add value to your business.

Many banks offer advice on how to maximize the value of your business during succession planning and exiting your business.

## Considerations

While the value of a business can be determined in many different ways, it is up to you to do your best to make it look attractive to potential buyers. For instance, some businesses do not appear to be very profitable at first glance. That is, they might only show a small profit on the books. However, many businesses that only show a small profit actually pay a healthy salary and big bonuses to the owner of the business, as a return on capital invested. This makes the business appear to be less profitable, but in reality, the business can be a very successful venture.

If you're trying to make the business appear more attractive, you may need to stop taking bonuses and cash payments out of the business for a certain amount of time, to allow investors to see how much profit the company generates. Once you have done your best to maximize the value of the business, get a new valuation of the company done so that you can include the new value in your succession plan.

Don't forget human capital. The value of your company may drop significantly if key managers, and those employees with specialist skills, decide to leave during the sales process due to uncertainty, or because they are 'poached' by your competitors. Prospective purchasers want to take over a going concern, one that has the ability to continue with minimum disruption during and after the transition. Remember this when developing your succession plan and develop strategies to include your key personnel in the future of the business. This is another good reason for maintaining strong communication between your succession planning team and your employees.

Remember, the value of your business is less about its historical value, and more about its future value. How important are you, as the owner, to the success of the business? For instance, take the case of a car dealership where the name of the owner is part of the business name such as Smithwicks Subaru. If the owner has become a pillar of the community, and is a well-known local philanthropist who appears in television commercials and print advertising for the dealership, then what affect will it have on the business when he retires? If the business is being sold to a third-party, it could decrease potential revenues. If on the other hand this entrepreneur is selling to his son or daughter and has, over a period of several years, groomed family members to take over and made the business a true "family" business then the effect might be minimal. SBS



# Selling your Business



As the recent tough economic times ease, and the baby boomer generations peaks, many small business owners are preparing to sell their companies. Increased profitability, stronger revenues and increased liquidity in the marketplace are all contributing towards an environment where selling a business is again desirable. Before you make the leap, consider if this is the right time.

## **Is Now the Time to Sell?**

A solid history of profitability, a competitive advantage, growth opportunities, a great location, a strong customer base, a skilled management team and dedicated, loyal employees all contribute to a buyer's decision to purchase your business. If the company owns intellectual property rights on a product, or has a long-term contract, it can sweeten the deal for potential buyers.

Emotions play a role in the decision to sell a business. Years of work can be heartbreaking to part with for the avid workaholic, or raging entrepreneur. For others, this is not an issue. If work has ceased to be fun, or you have stopped striving to expand the business, it may be time to step aside. In today's increasingly competitive market place, especially from companies selling online, many older business owners may feel too overwhelmed to continue. Whether it's just time to retire, or whether you are suffering from burnout, selling a business can be a viable option as the economy improves.

## Preparing it for Sale

Before anything else can be done, small business owners should hire an appraiser to discover the value of their business. Professionals can take stock of your business's finances and give you an accurate estimate of the value, before you decide whether to put it on the market. Afterward, you should make sure all the company's documents are in order. Being prepared shows prospective buyers that the business has been managed competently and allays any fears they have about the company's prospects. At least three years of balance sheets, profit-and-loss statements and tax returns will need to be provided. Current lists of inventory and equipment should also be included. During the due diligence phase, much of this documentation will be required as well as any contracts and agreements.

## What are Purchasers Looking for?

Purchasers are ultimately looking to find the best business they can within their price range. As they look closer into buying a particular small business, they will ask to see all the financial documents, leases and documentation. The buyer will use these tools to discover the possibility of any future problems, or current financial dilemmas. They want to see a strong history of profitability and growth opportunities in the field. Other factors that may nudge their decision could be the location, employees, or the amount of customers.

## Marketing your Business

Selling a business is impossible if there is not a buyer. Using a variety of marketing techniques, small business owners can market their own business and find a purchaser. However, many companies choose to hire an experienced business

broker to handle all of their marketing needs. If you choose to take this path, make sure the broker has references to back up their promises.

Without a broker, a small business needs to create an aggressive marketing plan. Trade publications, personal networks and on-line websites can all be used to find potential purchasers. Two marketing materials are especially important in the process. The first is a one page document that offers the businesses basic information without revealing its identity. After serious buyers are found and confidentiality agreements are signed, a comprehensive selling prospectus can be provided.

## Where to Look for Buyers?

Potential buyers can be found through numerous Internet websites that are designed to specifically help small business owners. Trade organizations, newspapers and magazines in the business's field can also be used to promote to potential purchasers. Taking out an advertisement is one of the most common ways of getting quality leads. If these methods fail, turning to a small business broker will be necessary. However, a broker will take a percentage of the purchasing price, so remember this when assessing what amount you need to get from the sale.

## Where Can you Get help?

Small business owners do not have to do all the work on their own. From appraisals to marketing, professionals exist whose entire job is to simplify the process. If the small business owner wants to do all the work on their own, they can turn to several professional organizations for advice. The Federal government, Canada Business Network website offers a great deal of advices and contact information. There are dozens of web sites that list businesses for sale and others which provide directories of small business brokers.

Selling a small business does not have to be a stressful process. With the right paperwork, marketing and professional assistance, a small business owner can achieve the results they want in a timely manner. Experienced professionals are always on hand to help out any business owner overwhelmed by the process. By carefully researching the marketplace and preparing financial statements, a small business owner can simplify and speed the entire process. 

# How Much Does Succession Planning Cost?

Succession planning for a business should be started as early as possible for many reasons, most of which have been discussed earlier in this book, but an additional benefit is the fact that when you develop a plan over time any costs incurred are also spread out of several years.

There are both internal and external costs involved, and different costs depending on whether the business is organized as a sole proprietorship, partnership or corporation. The internal costs of succession planning involve the time and other administrative resources necessary to make a clear and coherent plan. The external costs involve retaining attorneys to draft wills and other documents, hiring consultants who specialize in succession planning to audit the business and make suggestions, and perhaps hiring accountants or financial planners to advise on how to handle the tax consequences of transferring a business from one generation to the next. The internal costs associated with succession planning can be calculated in the same way as other business planning and development costs; remember to include the time required for owners, or managers

to hold meetings with potential successors to gauge their interest and expectations.

If no potential successors can be found, a plan will need to be developed to liquidate the owner's interest in the business upon retirement. The expectations of an owner will rarely coincide completely with the expectations of potential successors, so a plan to resolve differences and keep communication open will need to be developed. A balance will need to be found between the retirement income needs of the owner and the amount of income a potential successor expects. The type of business will determine the costs of training a successor to take control of the business. Training costs may include tuition to obtain a college degree, but will also include the time spent by employees of the business to train a successor on specific procedures, protocols and systems.

A business will not be taxed specifically on succession planning, but the tax consequences of any plan to transfer the assets of a business from one person to another should be one of the first things considered. A chartered accountant or



lawyer can advise on how to structure a business to lessen the tax burden. One method that a chartered accountant may advise is to use an estate freeze as mentioned earlier.

A consultant may charge between \$10,000 and \$20,000 to conduct an organizational audit to help determine everything that may be involved in establishing a succession plan. Spending this kind of money may be cost effective in many instances, as it may vastly reduce administrative and other internal costs of conducting such an audit in-house. Once a succession plan has been established, there will be costs associated with having legal counsel draft documents and provide legal advice on how to proceed. Lawyers may charge \$3,000 for an initial meeting to discuss a plan and draft a summary of how to proceed. Having a lawyer draft a will and prepare various powers of attorney may cost another \$2,000 to \$5,000. Lawyers may charge between \$300 and \$3,000 each for preparing various trusts associated with transferring the business assets, depending on the complexity of the trust document.

The Ontario Ministry of Agriculture, Food and Rural Affairs has posted clear and detailed information about farm succession planning. The information is targeted toward operators of family farms, but the principles enumerated in these documents can be extremely useful for anyone who is starting to think about succession planning. A good place to start is the Farm Succession Planning Steps and Checklist, by Peter Coughler and Christine Wenger. (Order # 10-025, March 2010) <http://omafra.gov.on.ca/english/busdev/facts/10-025.htm>.

## Financing the Transition or Acquisition

Whatever option you end up deciding on, someone has to come up with the money to buy you out. And, that is where much of the difficulties occur when trying to sell your business and decide on who will succeed you.

Of course, you may decide to help fund the acquisition yourself in some way, if your successor is having difficulty in raising the required finances.

The route you take will very much depend on your specific circumstances and we could not hope to cover all eventualities in this introduction to succession planning, but here are a few things to consider that will have an affect on how financing might transpire:

- Are you selling an incorporation? As in a legal entity? Or a proprietorship, or partnership? In the case of the last two, what you are selling are personal assets.
- Are you selling just the business, or the property it operates out of as well?
- Are you selling the whole business, or only part of it?
- Are all the assets included, or just some of them?
- Do you intend to stay on in any capacity? If so will you be paid? Will you retain shares and receive dividends? This could affect the selling price and conditions, not to mention your tax situation.
- How and when do you want to be paid? There may be tax implications if you want to be paid in full at closing, as opposed to being paid out over time. Other options include selling shares over a period of time, receiving dividend payments, accepting part-payment and continuing to work in the business with the eventual goal of receiving a higher payout at the end.
- Will you help finance the purchase, or do you expect the buyer to find their own financing? If it is the former and you extend payment over a long time, then this could affect your asking price (i.e. you will expect to be paid more for the business).
- Any decision you make will have tax implications so get advice from your lawyer, your accountant and your bank manager before making any final decisions.
- No matter how keen a potential buyer, or successor, it's their ability to raise enough equity, and to finance the remainder of the price you are asking, within in a reasonable amount of time, that makes them a viable successor. If they can't do this, then look for someone else. 

# The Editor's 10 Succession Planning Mistakes People Make

This is by no means a comprehensive list, succession planning can be a minefield, but here are some of the primary pitfalls to avoid.

- 1. Starting to plan too late.** If you are in business and haven't started your plan, assuming it will all work itself out in the end, you're already behind the eight-ball. This laissez faire attitude will come back to bite you when you least expect it. You never know what's around the corner - any of us could get hit by a bus tomorrow; if it was you, what would happen to your business, and how would your loved ones manage?
- 2. Not having a set of defined goals.** You've heard this before about business planning. I know it's a pain, but you need to know what your goals are before you decide on how you're going to get there - or you may end up somewhere else!
- 3. Not involving all the stakeholders.** Succession planning is not a solitary exercise. If you intend your successor to be a member of your family, bring everybody concerned together and form a family council; start meeting, start planning - get your act together. Then there's the management team, they need to be involved - after all it's these people who run the company on a day-to-day basis.
- 4. Not getting buy-in from all the players.** If you are blind to the fact that several of the stakeholders (and this could include partners, family, management, staff) are unhappy, or nervous about your succession plan, this can destabilize your business. It can lead to family strife and the loss of key employees. Communicate the plan (it needn't be the whole



plan - remove, or black out the confidential sections) to everyone involved, ensure they understand it and get their feedback.

- 5. Trying to fit a square peg into a round hole.** I know, I know, you've always dreamed that your son would follow in your footsteps, but a degree in ancient Greek literature may not make him best suited to running your fabrication plant.
- 6. Selling cheap.** So, you really want your grandson to take over the business that took you 40-years to establish. He's keen, but he's got no money and little chance of getting enough to finance the purchase. But heck, he's family right - you can make allowances? Don't let sentimentality cloud your judgement when your retirement is at stake.
- 7. Not creating an organizational culture that encourages succession.** Companies that have a strong culture, that all employees have bought into and are empowered by, are much more

attractive to buyers. They are also more likely to breed successors. Check out your organizational culture - does it stand up to scrutiny?

**8. Not having contingency strategies in your succession plan.** “The best laid plans of mice and men oft go awry” the saying goes. Your plan should take into consideration that various things could happen to affect the strategies it lays out. Carry out a simple risk analysis and consider all the disasters that could occur over the years that might affect your succession plan, and develop strategies to deal with them.

**9. Not training your successor.** There’s nothing worse than seeing your life’s work go down the drain.



Even if you took a lump sum when you retired from the business, and its future success will have no effect on whether you have a comfortable retirement or not, watching as everything you built gets screwed up by the ineptitude of your successor will gall you - won't it?

**10. Not keeping your plan up to date.** After all the effort you put into developing your plan you put it on a shelf in your office and leave it there for several years, while life and your business change dramatically around you. At some point, the time will come when you need it and you'll discover that it's so out of date that it's of little to no use. Let's hope it's not when you have suddenly fallen ill and need to accelerate your exit strategy, or worse still when your spouse reaches for it after that proverbial bus hits you. 

# BUSINESS SUCCESSION PLANNING CHECKLIST



The Succession Planning Checklist below was kindly supplied courtesy of Community Futures Meridian Region, East Kindersley, Saskatchewan ([www.meridianregion.ca](http://www.meridianregion.ca)).

The following checklist will act as a guide to things that you need to consider now that you have decided to start work on a succession plan for your business. Treat it as both a starting point, and something to help keep you on track.

## GOALS AND OBJECTIVES

- Identify need for succession plan
- Develop vision, goals and objectives
- Establish personal retirement goals
- Identify family/stakeholder goals
- Establish a team of professional advisors

## DECISION MAKING

- Involve family members in the decision-making process
- Establish a method for dispute resolution
- Communicate your wishes to family/stakeholders

## SUCCESSOR(S)

- Identify successor(s)
  - Ownership
  - Management
- Identify required training for successor(s)
- Provide training to build vision for the future of the business
- Provide support to successors

## ESTATE PLANNING

- Address taxation implications to the owner/business upon sale or transfer of ownership
- Develop an estate and personal financial plan for owner, spouse and the succeeding generation
- Detail retirement income needs
- Provide for involved and non-involved family members

## CONTINGENCY PLANNING

- Identify potential problem areas
- Develop “What If” scenarios including action plans

## CORPORATE STRUCTURE AND TRANSFER METHODS

- Is business to be transferred to family members, or sold?
- Define roles and responsibilities for family members and key employees
- Fill key management positions
- Identify role(s) for retiring owner
- Restructure the business, if required
- Consult with professionals (lawyer, accountant, financial advisor, business broker, appraiser etc.)

## BUSINESS VALUATION

- Obtain professional input to determine a fair market value for the business
- Determine exactly what is to be sold
- Give consideration to: profitability, business location, inventory level, financing of buyout

## EXIT STRATEGY

- Determine method of transfer
- Establish a timeline for implementation of the succession plan
- Publish the plan so that affected individuals are aware
- Communicate regularly with all parties

## IMPLEMENTATION/FOLLOW- UP

- Review the Plan on a regular basis and update as necessary <sup>SBS</sup>

Prince Albert & District Community Futures is a full service business centre providing small business loans from \$5,000 up to \$150,000 to help individuals start up a business or expand an existing business. We also provide small business counselling services and workshops for new and existing business owners. Apply on line at [www.pacf.ca](http://www.pacf.ca) or drop by our office to discuss your financing needs.

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