

A decorative graphic element consisting of two overlapping, curved shapes. The top shape is yellow and the bottom shape is blue, both pointing towards the right. They are positioned to the right of the main title.

Visa Financial Guide

A Financial Perspective:
Starting, Managing, and
Growing Your Small Business



Private Company Services

PRICEWATERHOUSECOOPERS 

Welcome

Visa Canada is pleased to present Starting, Managing and Growing Your Small Business – A Financial Perspective. Visa Canada commissioned PricewaterhouseCoopers to create this guide with the objective of providing valuable advice and addressing important financial issues that businesses deal with during various stages of the business life cycle. Whether you're planning to start a business, or are now focused on growing a business, Starting, Managing and Growing Your Small Business – A Financial Perspective will provide some valuable insight.

The guide is divided into three sections. The first identifies four key areas when starting a business. Topics covered in this section include the importance of a business plan, source of capital for new businesses, advisors to consider and, of course, tax planning.

The second section offers advice on managing a business, from establishing credit to granting it, as well as information on managing accounts receivables and collecting payments. It also describes some best practices when considering outsourcing or improving the performance of your business. The guide offers advice on tax payment, ways to minimize taxes, reducing taxable income and preserving tax benefits – topics that are designed to help you make your money work for your business.

The third section offers advice on making sure you benefit from the hard work and time you put into your business. It outlines how to measure the value of your business and factors to consider when selling a business, as well as considerations on going public. This section also includes information on business succession plans.

Starting, Managing and Growing Your Small Business – A Financial Perspective is intended to be a guide for any business, regardless of the stage of business it is in.

Visa Canada hopes that you find this guide useful and informative.



Derek Fry
President

Visa Canada
www.visa.ca/smallbusiness

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Introduction

All businesses start with an idea. Whatever your reasons for starting a venture, your dreams are just the beginning of great possibilities, and your vision is only limited by your drive and imagination. With enough focus, patience and hard work, you can transform this dream into a reality.

This booklet gives practical advice to help you grow your enterprise, save money and build value.

To help you turn a labour of love into a sustainable source of income for you, your family and your future employees, you need sound advice from a trusted business advisor. No matter how deep and broad your experience may be, managing a small business can be tricky. You should also explore other resources on the subject. This includes talking with other entrepreneurs, seeking the advice of financial institutions, accountants and lawyers, and exploring websites dedicated to small businesses.

You've taken the exciting step of starting your own venture. Now, you have to turn that ambition into value for you and your company.

Have fun!



Eric Andrew

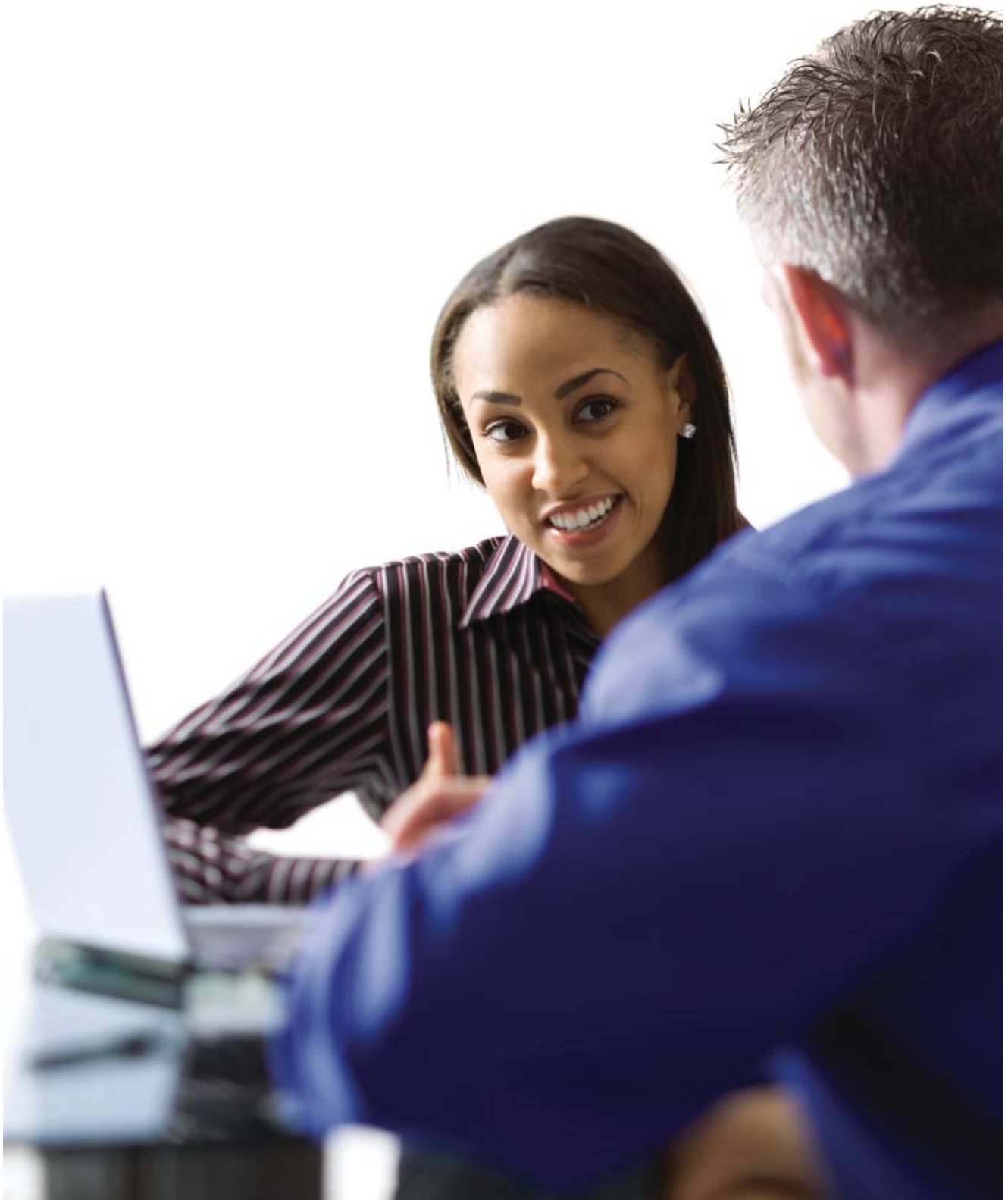
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I. Starting Your Business



I. Starting Your Business

The Importance of a Business Plan

A solid business plan is any owner's most valuable tool. It gives a framework and a clear direction for your business. With a robust business plan you can tell your story in the marketplace, demonstrating to potential financiers, business partners and other stakeholders that your idea is more than just a concept.

As you work through the various components of a thorough business plan – market analysis, product performance and potential, management strengths and the related financial story – you begin to distill the essence of your company.

A business plan will not just outline your goals but will also show how you're going to achieve them. It should be a living document that can act as an early warning for when you're off target. Remember to include targets and measures so you know how you are doing at every stage.

Quick Tip: To obtain a free business plan template, visit the Visa Small Business website at www.visa.ca/smallbusiness.

Key Components of an Effective Business Plan

Executive summary

In this section, you describe how your business makes money and what is its distinctive value; in other words, what gives your company a competitive edge. Think what makes your ideas different. Be sure to include an overview of products or services, market and industry trends, major customer groups and characteristics that differentiate your company from others. This might include elements such as the market niche you will operate in or the location or skills that make you stand out. The executive summary should focus on your core operations and identify opportunities that can add value to those operations in the future. Since this section summarizes your business plan, keep the executive summary within one page in length.

Business profile

The business profile offers a complete description of your business including the date that your business was established, the form of ownership your business assumes and the industry sector your business operates in. It also includes your

business objectives, strategy and the specific benefits your product or service provides. You should also indicate: the state of your product or service (whether it is a prototype or already in production), the market need, the product's lifecycle or factors that could extend or shorten its life in the marketplace. Steps you have undertaken to protect intellectual property and proprietary rights (copyrights, patents and trade secrets) to make sure you keep your competitive edge. Also any planned research and development activities should be included.

Ownership and management

This section lists the people that own, manage and advise your business. Potential investors look for strong management. Your company will live or die by the strength of its leadership. By tying the talent of your people to operations and sales, you highlight your business' strengths and weaknesses. The skills and talents of your executive team are your most valuable and unique assets.

Market analysis

A market analysis is an assessment of your current market and highlights areas where you either need to streamline efforts or expand your product line. This includes industry trends, your competitive position and customer information. To start your research, federal government websites, such as those maintained by Statistics Canada and Industry Canada, can be helpful in determining market size and trends.

Marketing plan

A marketing plan outlines the activities that will allow you to meet sales targets. Since the market strategy helps you deliver your product or service to the customer, it should also include distribution channels, promotional or advertisement plans, the size and nature of your sales force, and an analysis of sales costs.

Operations

In the operations section, you outline your production procedures and delivery capability. Be sure to describe how you will manage your operations, source inventory materials, and produce or provide your goods and services. Also outline any competitive advantages your company may have in technique, experience and economies of scale.

Quick Tip: Make sure the activities of your staff align with your operational goals and that your operations align with your overall strategy. This sounds obvious but few companies get this right and those that do gain a real advantage.

Financial statements

Financial statements – including balance sheets, statements of income, cash flows and a recent history of your company tell your story in numbers. They state whether your business is making or losing money.

Appendix

The appendix contains all the supporting documentation and research to substantiate the claims you made throughout your business plan. Information can include evidence of credit worthiness, letters of reference, current leases for facilities, equipment, cars, etc. and any legal documents related to your business.

The business plan as a living document

As you grow, you can use your business plan to tell your company's story to prospective investors, such as financial institutions or venture capital firms. To explain your ideas effectively and accurately, you need to have an updated plan that adapts to shifts in the business environment including changes in customer requirements, suppliers, stakeholders and economic conditions. A thorough business plan demonstrates your competence and helps you meet goals and objectives.

Over the long term, a business plan can help you:

- Get your financial and management house in order;
- Manage your business effectively;
- Raise your profile in the business community;
- Establish professional relationships with key advisors; and
- Plan and consider alternatives for future goals and objectives.

Sources of Capital

You can't run your business on sweat alone – you also need a consistent supply of capital to sustain the business. You can achieve financing objectives through commercial borrowing, institutional investment, venture capital, private placements of equity, joint ventures and partnerships, and against the future sale of the company. The healthier your business presents itself financially, the better your chances to secure potential investors.

The right financing option depends on your company's situation. Talk to your business advisors, such as your banker, financial planner, accountant and lawyer, who can help secure new capital. They can also help work out the financing solution that's best aligned to your needs and circumstances. The following chart outlines various scenarios and potential financing solutions that may match your current situation.

When choosing a potential financing option, it's important to consider factors such as the financing process, owner dilution (which comes from selling shares to financiers) and covenants (agreements or contracts). The following are some financing solutions you may want to consider when making your decision.

Commercial Loans

The commercial loan you choose depends upon your company's borrowing base of assets and cash flow. Although commercial loans involve borrowing costs, they don't require a share of equity in the business. The following are types of commercial loans, with associated terms and security.

	Asset-based Revolver	Senior Term	Subordinated Debt
Definition and Use	A loan secured by a percentage of accounts receivable and inventory	A fixed amount of debt used to finance a portion of the company's fixed assets	Quasi-equity that is used to finance a portion of the company's working capital, fixed asset requirements or acquisitions that cannot be financed by operating lines or senior debt (debt that has priority for repayment in case of liquidation)
Lender Security	General security over the asset and current asset values	Asset values	Cash flow
Security Ranking	First charge (has first priority for repayment in case of liquidation)	First charge (has first priority for repayment in case of liquidation)	Second charge (has second priority for repayment in case of liquidation)

	Asset-based Revolver	Senior Term	Subordinated Debt
Standard Terms	Typically 3 years	Typically 5-8 years	Typically 5 years
Amortization	N/A	Typically straight line but can have a larger payment at the end of the term	Flexible and matched to circumstances
Interest	Floating, based on prime or banker's acceptance	Fixed or floating, based on term of Government of Canada bonds plus a risk premium	10% to 15% coupon with target returns of 20% to 25% achieved via "equity" participation. Equity participation is earned at the end of the term loan.
Covenants (A promise in a debt agreement that certain activities will or will not be carried out)	Minimum tangible to net worth and fixed charged ratios	Debt to equity and debt service, usually improving over time	Generally, less onerous than senior debt

Private Equity

A private placement of equity has some similarities to going public, and aspects of securities legislation often apply. Although companies that pursue a private placement aren't required to file a prospectus with the securities commission, they usually prepare an offering memorandum, which is similar to a prospectus, to gain private equity. In a private placement, the company offers securities to a limited number of investors who see growth potential in the business. Although private placements can be completed faster than the initial public offering (IPO) process, at a lower cost and with generally no security and covenants, they do cause ownership dilution. Historically, private equity placements have resulted in lower valuations, but this trend is reversing as private equity firms today have an abundance of capital. Private equity placements are also becoming a popular exit and/or financing strategy.

Joint Ventures and Partnerships

You may find that pursuing a joint venture or partnership can offer favourable financing, synergies and enhanced industry presence. However, if you select an ill-matched joint venture or partnership, you can also risk losing a portion of your company's assets, the freedom to develop manufacturing or marketing capabilities and the ability to determine production levels or customer base. If you decide to select this type of financing, be sure that you choose a joint venture or partnership that's aligned to your goals and business profile.

Venture Capital

Venture capital firms are generally interested in equity investments. They typically focus on companies that have significant growth or new technology potential and are planning to go public. Their experience and reputation can be a boon to most new companies but most venture capitalists will insist on playing an active role in managing the company. Although this financing option is generally quite expensive, venture capital firms are often prepared to take on new company risk that is outside the comfort level of other traditional lenders.

The following chart outlines various scenarios and potential financing solutions that may match your current situation.

Situation	Potential Financing Solution
A historically profitable company has recently experienced poor financial results but has a large borrowing base of assets including property, accounts receivable, inventory, plant and equipment or personal home equity.	A combination of asset-based revolver and term debt may replace traditional bank financing.
A company has grown rapidly through high-levered acquisitions and considers selling a non-core division to reduce debt. It needs to act quickly, requiring short-term financing.	A bridge loan (short-term financing that is less than one year) may be used to pay down bank debt. Proceeds from the sale of the non-core division are used to repay the bridge loan.
A moderately leveraged company with strong cash flows requires additional capital to fund a financing shortfall but wants to avoid significant ownership dilution.	A subordinated debt financing solution may be available with or without "equity" participation.
A viable company is at risk of violating traditional bank covenants and has a large borrowing base of assets.	The company should consider an asset-based financing solution.
A high-growth private company requires financing but lacks sufficient cash flows to service debt and has a small borrowing base of assets.	The company should consider private equity, joint ventures or partnerships.
A new high-growth private company with potential growth and/or a promising proprietary product requires financing but lacks sufficient cash flows to service debt and has a small borrowing base of assets.	The company should consider venture capital investors, raising private equity, and joint ventures or partnerships.

Quick Tip: In addition to these financing options, you can also research a number of government programs that may provide financial assistance to small businesses. Visit the federal government websites Canada Business Services for Entrepreneurs at <http://canadabusiness.gc.ca> or Strategis, Canada's Business and Consumer website, at <http://strategis.ic.gc.ca>.

Identifying Key Advisors

You may already enjoy a strong relationship with your bank manager. However, you should also consider forming relationships with other professionals – such as business advisors, accountants and lawyers. This additional support team will give you access to business knowledge and make it easier to get the advice you need, when you need it.

Select experienced professionals who share your values, have a profile in your industry or area and can give you timely information to help you make the right decisions. Here are some of the key services you can expect from your network of professional advisors.

Business Advisors:

- Review your game plan and help develop your strategy, sharing with you their experiences with other companies of similar size and industry focus
- Work to align your business with your goals
- Advise on budgets and forecasting
- Maximize your operational and financial efficiency
- Evaluate when and whether it is in your best interest to seek outside financing
- Help establish reasonable timetables
- Help you plan your exit or succession strategy

Auditors:

- Audit financial statements
- Issue comfort letters to regulators and underwriters
- Provide attest services on special-purpose reports, such as rent and royalty statements, commenting on their fairness or accuracy
- Advise on internal controls and financial operating systems

Lawyers:

- Prepare and amend articles of incorporation
- Deal with pending litigation
- Amend your corporate charter and bring the capital structure into line with accepted principles

- Review and draft required contracts
- Issue legal opinions or comfort letters to underwriters
- Help prepare and review prospectuses
- Flag and resolve outstanding issues and problem areas that could adversely affect a public offering
- Verify disclosure for accuracy, completeness and consistency

Effective Tax Planning

Once you have grown your idea into a business plan, secure financial backing and picked your advisors the next thing to sort out is minimizing your tax exposure. The less tax you pay, the more of your hard-earned money you retain. This simple equation is the basis of an effective tax plan. While some steps for tax planning are relatively simple, others are more complex and could be financially risky.

The tax-related comments in this booklet are general in nature, outlining how the system works and suggesting actions for consideration. They are not sufficient for creating a tax strategy. For that, please seek professional advice from a trusted source.

In Canada, the main types of tax and similar levies are:

- Income tax, which includes tax on capital gains (federal, provincial and territorial)
- Capital tax on corporations (federal and provincial, except Alberta)
- Goods and Services tax (federal)
- Sales tax (in the provinces of British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island)
- Customs excise duties and excise taxes (federal)
- Property tax (municipal) and business tax (municipal)
- Payroll tax and health care premiums (some provinces and territories)
- Land transfer tax (provincial and territorial)

Additional tax planning tips and information on tax incentives and credits are outlined in the Tax Minimization and Recovery section of this handbook. Key aspects of corporate income tax and federal and provincial sales tax are outlined below.

Types of Canadian Corporations

Corporate taxation depends on how a company is classified. For tax purposes, Canadian-resident companies or corporations are divided into three main categories: public corporations, foreign-controlled private corporations and Canadian-controlled private corporations (CCPC).

A public corporation is a corporation that resides in Canada and has its shares listed on a prescribed Canadian stock exchange. A public corporation that doesn't have a class of shares listed on a Canadian stock exchange may elect to be treated as a public corporation if it meets certain conditions.

A private corporation is a corporation based in Canada that is neither a public corporation nor controlled in any manner by one or more public corporations.

A CCPC is a private corporation that isn't controlled directly or indirectly by non-residents or public corporations and is basically a wholly Canadian owner-managed business. A foreign-controlled private corporation, however, is a corporation that is controlled directly or indirectly by non-residents of Canada.

Corporate Income Tax

If your company is incorporated, it will have to pay corporate income tax. Corporations residing in Canada are subject to Canadian tax on worldwide income. As a general rule, a corporation is also considered to be residing in Canada (and is therefore Canadian) if its central management and control are exercised in Canada.

If your company operates in more than one country, it can avoid double taxation through Canada's international tax treaties, the foreign tax credit mechanism and deductions for foreign taxes paid on certain foreign-source income.

Taxed Income

Corporate income includes income derived from a business or property and half of net capital gains realized from the disposition of capital assets. Income is generally computed on an accrual basis, but capital gains and losses are taxed when realized.

Corporations pay tax on income at the applicable corporate rate, regardless of whether the income is distributed to shareholders. To prevent double taxation, Canadian individuals and trusts receiving dividends can apply for a tax credit, which recognizes the underlying corporate tax being paid. In some instances, a corporation may receive a dividend refund when it pays a dividend.

Investment income (including half of capital gains but excluding dividends from Canadian corporations and certain dividends from foreign affiliates) of a CCPC is subject to a different tax rate than active business income. Essentially, there is an extra federal tax that is applied to the investment income, which increases the applicable federal corporate tax rates by 6 2/3%. However, a portion of the corporate tax paid (26 2/3% of investment income) is refunded when taxable dividends are paid to shareholders.¹

1. Rates are accurate as at April 2007, but are subject to change.

Dividends received by one Canadian corporation from another may generally be deducted to determine the recipient's taxable income. Dividends on certain preferred shares are an important exception. Inter-corporate dividends between Canadian corporations may be subject to a special refundable tax.

GST/HST

The Goods and Service tax (GST) is a 6% tax on the supply of most goods and services in Canada. Three provinces – Nova Scotia, New Brunswick and Newfoundland and Labrador – combine the provincial sales tax with the GST to create the Harmonized Sales Tax (HST). HST applies to the same base of goods and services as GST, but at the combined rate of 14%.²

If your business makes taxable sales, you can claim a refund on the federal GST or HST paid on non-salary costs. This includes any GST paid to the Canada Border Services Agency for imported goods at the time of customs clearance.

GST/HST returns must be filed monthly, quarterly or annually, depending on the annual taxable revenues made in Canada by your business and by persons associated with the business. In certain situations, you may file on a more frequent basis than otherwise required under GST/HST legislation.

If your business is not entitled to a full GST/HST refund because, for example, your company supplies GST-exempt property or services, you may deduct the non-refundable portion of GST/HST as a business expense or include it in the capital cost of those assets that qualify for capital cost allowance.

Quick Tip: Businesses or divisions that regularly file GST/HST refunds or businesses that make “zero-rated supplies” (i.e., GST at 0%) and file more frequently may receive their tax refunds quicker.

Quick Tip: Register for a GST/HST account before you start business operations so you can claim refunds on any tax paid on start-up expenses.

2. Rates are accurate as at April 2007, but are subject to change.

Provincial Sales Tax

British Columbia, Saskatchewan, Manitoba, Ontario and Prince Edward Island, levy sales tax on a wide range of tangible personal property consumed or used in the province and on the purchase of selected services. Products sold outside a vendor's province are not taxed in the vendor's province but are instead taxed in the province of delivery. Alberta does not levy a sales tax and the provinces of New Brunswick, Nova Scotia and Newfoundland and Labrador have combined their sales tax with the GST under the HST.

If you do business in Canada, you may have to register as a vendor for retail sales tax purposes in several provinces and collect the applicable tax. Unlike GST, businesses are unable to obtain a refund or credit for retail sales tax paid unless amounts are paid in error. Inventory purchased for resale is not subject to retail sales tax. A number of provinces provide exemptions for machinery and equipment used in manufacturing and production.

Quebec Sales Tax (QST) is calculated at the rate of 7.5%³ of the GST-included cost and applies to the same goods and services as the GST. Businesses generating taxable sales can claim a refund of QST paid on non-salary costs.

3. Rates are accurate as at April 2007, but are subject to change.



II. Managing Your Business



II. Managing Your Business

Credit and Receivables

Establishing a Credit Policy

The credit policies you adopt for your business will have a direct and indirect impact on revenue, expenses and overall profitability. To establish an appropriate credit policy, you should consider the following:

- Type of industry – Credit policy may be driven by traditional industry practices.
- Competition – Investigate your competitors' credit policies. Discover what works for them and learn from their mistakes.
- Seasonal business – You may have to periodically review and revise your credit policy to meet the impact of seasonal cash flow.
- Liberal versus conservative credit policies – Both options possess advantages and disadvantages. A liberal credit policy will increase sales and potential market share, but will also incur additional costs associated with increased collection efforts, cost of capital and bad debt losses. A conservative credit policy will reduce collection costs and can potentially reduce bad debts. However, it can also result in fewer sales and a decline in current and future market share, thus diminishing profits. If your company is in the early stages of business growth, you may want to consider a more liberal credit policy to attract customers as well as accepting credit cards as a form of payment. As the business grows and develops a stronger customer base, you can then determine if you should switch to a more conservative, risk-averse policy.

Weigh these options carefully to select a credit policy that best suits your needs. And be prepared to revise and update your credit policy to meet the demands of your growing company and increased competition.

Assessing Credit Worthiness

Once you've established a credit policy, you must assess your clients' credit worthiness to determine an appropriate credit limit. The Five C's of Credit provide a useful framework to help you evaluate your clients' reliability. The Five C's of Credit are:

- Character – The desire to pay when debts are due
- Capacity – The ability to pay when debts are due
- Capital – The long-term financial strength to pay debts
- Collateral – Assets that may be pledged as security, if required
- Conditions – Events which may be beyond the applicant's control, but affect his or her ability to pay e.g., legislative changes

Be sure to give practical consideration and perform proper due diligence to identify appropriate credit limits that will help you to encourage sales and prevent potential losses.

Practical Considerations

- **A credit application** – A credit application formalizes the applicant’s request for credit and provides a structured format to collect his or her credit information. Depending on your business and the credit limit you’re willing to offer, the application can be as simple as a one-page form or as complex as a multi-page document. Since a credit application will provide valuable information about potential clients, it should be kept on file and periodically updated.
- **Consumer versus commercial applicants** – There is no legal requirement to obtain written authorization from an incorporated business to investigate credit. However, you are required to obtain written authorization from consumer and sole proprietor applicants prior to commencing a credit investigation.
- **Credit reporting agencies** – Credit reporting agencies can check the credit worthiness of an applicant quickly and efficiently.
- **Costs** – Weigh the cost of gathering more credit information against the benefit of receiving more accurate credit assessments. On small-exposure accounts, you may be unable to justify the extra time and money spent on gathering information. On the other hand, you may consider these costs small compared to potential losses you may have to bear due to bad debt exposure.
- **Credit cards** – Most retail businesses find that accepting credit cards improves sales and offers a convenient way of completing and managing a credit transaction. Signing up with an acquirer to accept credit cards is a way of “outsourcing” the credit-granting and collection process as well as reducing the amount of time and resources you devote to evaluating each customer’s credit worthiness. The proceeds of credit sales are deposited promptly into a company’s account, improving its cash position. Customers often feel businesses that accept credit cards are more trustworthy and reputable.

Due Diligence

- **Credit investigation** – Gather information about potential clients. The amount of information you require will depend on the type and amount of credit being extended. The greater the credit requirement, the more extensive the investigation process.
- **Information resources** – These include but are not limited to: credit reports, trade and bank references, Internet research, trade publications, annual reports, financial statement reviews, land title registries, corporate registries and personal property registries.

Granting Credit

The next step in the process is to develop credit granting procedures that are within your level of risk.

To determine if your applicants are within your acceptable level of risk, classify them appropriately based on information you've gathered during the investigation process (extremely low, low, average, risky, extremely risky). If you decide to extend an applicant credit, establish the appropriate credit limit and determine suitable terms of sale.

Accounts Receivable Management

One of your business' most important assets is its accounts receivable. If properly managed, accounts receivable will improve cash flow and generate better profits by reducing cost of capital, allowing for capital expansion and lowering losses caused by bad debt.

If improperly managed, accounts receivable will contribute to poor cash flow, increase the cost of capital, reduce overall profitability, delay capital expansion and increase bad debt losses. Your business may be unable to meet its financial obligations and, in extreme cases, cause insolvency.

You can manage accounts receivable, maximize profit and minimize bad debt losses by:

- Determining your risk. Leave higher-risk sales to the competition.
- Continuously monitoring and identifying delinquent accounts for immediate follow-up.
- Considering accepting credit cards as a form of payment.
- Being proactive and conducting periodic credit limit reviews.
- Monitoring your client payment trends.
- Watching for danger signs such as:
 - Changes in attitude;
 - Changes in buying patterns;
 - Changes in ownership;
 - Staff instability; and
 - Change in financial institution.
- Conducting periodic client site visits. Not only does this establish better working relations with clients but you also get a visual "audit" of the business.
- Approaching disputes in a cooperative and professional manner.
- Being prepared to advise customers if their dispute is invalid, and continuing to press for payment.

- Documenting all disputes and maintaining accurate records of verbal and written communications between you and a delinquent client. This information may be required later if legal action is taken.

The Collection Process

The collection process is intended to expedite payment on past due receivables. Approach customers in a polite and professional manner to maintain goodwill and to encourage them to adhere to your company's credit terms.

If standard terms of credit are net 30 days and a customer hasn't paid within that time frame, you should consider the customer past due or delinquent by the 31st day. Immediate follow up on past due receivables is advisable. As more time goes by, the less likely a receivable will be paid.

You can follow up with customers in a number of ways through letters, statements, phone calls, e-mails and site visits. While no one collection method will work with every client, you can use standard industry procedures and best practices to improve your chances. Here's an example of a collection timeline for past due receivables with net 30 day credit terms:

Timeline	Action
Day 1	Deliver product/service, record receivable and render invoice. Send statement immediately. Do not wait 30 days.
Day 31-35	Review and identify delinquent accounts and send a reminder letter.
Day 40	Follow up with first telephone contact.
Day 45	Send a second reminder notice with slightly more direct content but not accusatory in tone.
Day 50	Make second telephone contact and offer assistance.
Day 55	Make third telephone contact or conduct a site visit to discuss the issue in person.
Day 60-65	Send a third reminder notice that is stronger in tone, but still maintains professionalism.
Day 70-75	Make fourth telephone contact and/or agree to meet and discuss.
Day 80-85	Send a final demand for payment.
Day 91	Decide the best course of action, whether to refer to a third-party collection agency, proceed with small claims court action or refer to legal counsel.

To help alleviate the collection process, one option you may want to consider is accepting credit cards which provide you with practically immediate payment, thereby removing you from the collection process.

Personal Payroll and Salaries to Family

How you determine appropriate levels of compensation for you or members of your family who contribute to your business will generally depend on your business' immediate and long-term needs, tax regulations, profitability and the maturity of your company.

Compensation can include:

- Salary and bonus;
- Dividends;
- “Perks” (perquisites) such as a car, operating expenses and club memberships, conference attendance, and entertainment allowances; and
- Benefits, including medical, life and disability insurance.

Small business owners often determine income based on the immediate needs of their business. For example, you may choose to minimize your income to increase funds that will be used to improve operations or expand the business. A business owner with a growing company may take lower compensation to achieve growth, while the owner who neither expects to grow the business nor intends to hand it over to the next generation may pay himself more.

Due to the complexities of tax regulations and the urgency that surrounds year-end tax planning, you may not be aware of the range of personal and corporate income tax strategies available to you. An annual compensation plan will limit current and future personal and corporate income tax liabilities.

As a business owner, you should carefully review family-related or income-splitting arrangements. Related-party arrangements must be identified, carefully reviewed and well documented. Some options for family members include income splitting to reduce taxes, or foregoing current income for increased equity or expected future equity in the business. Don't forget to include your own compensation levels and research benchmarks to keep you and your company solvent and in good financial health.

Assurance and Internal Controls

Regardless of your size, a system of internal controls will protect your assets, ensure only authorized transactions occur and provide effective inventory control. Successful internal controls consist of two simple components: consistent risk assessments and effective controls that address risks.

Factors that affect internal controls include:

- Nature and size of the business;
- Diversity and complexity of operations;
- Methods for processing financial information; and
- Applicable legal and regulatory requirements.

Risk Assessment

As an owner of a business, you need to identify risks, understand their impact and address them by developing and implementing action plans. Risks are usually due to:

- Variances between actual and expected results;
- Problems with operational or financial data;
- Concerns about operational issues, such as production processes, inventory shortages and procurement practices;
- Complaints and other communications received from customers or vendors; and
- Communications received from regulators and other third parties.

Controls

Even small companies with few employees can adequately divide duties by assigning responsibilities wisely. If you find that this isn't possible, you can provide the necessary control by directly overseeing tasks and responsibilities.

Management Reporting

To effectively manage your business, you must be able to generate a snapshot or status report at any given moment. You will need information that lets you look at your current financial position, identifies areas that need attention and provides an early warning of problems.

Some tools, such as *Visa*® Information Source, help analyze travel, entertainment and other day-to-day business expenses.

Selecting Reports That Meet Your Needs

The nature of your business and the types of decisions you make will help determine the reports you need. You should also decide the level of detail you need and the frequency you need them.

Management reporting gives you an understanding of your finances. Other reports keep you informed about important elements of your business, such as sales, cash flow, productivity, receivables, payables, volume and unit cost variances, budgeting, forecasting, costing and performance. Daily sales reports can give useful input when combined with data from prior years and different

locations. Monthly credit and receivable reports can highlight problem accounts before they become bad debts. In addition, financial statements, including profit and loss statements, and quarterly financial statements will help determine whether you are on budget or whether you need to adjust your projections.

In other words, these are the reports that let you know if you are making or losing money.

You can take advantage of opportunities and reduce losses by using information from reports presenting gross margin by product, sales by location or product cost variance.

Different reports give you a different angle on your business. The more easily data can be extracted from your processes, the better your management reporting. This means you'll have information on hand to make the right decisions that build lasting value.

Quick Tip: Establish metrics that are aligned to your business plan and generate ongoing reporting. This information will help you develop a strategy that offers a competitive advantage.

Outsourcing

Outsourcing simply means hiring others to perform functional roles more efficiently, or at less cost, than you or your staff. Accounting, IT, payroll, marketing, manufacturing and security are all examples of functions that can be outsourced.

Most outsourcing initiatives can also improve your company's own core competencies by freeing up time to specialize and develop. This can be an underlying and sometimes unrecognized benefit.

Potential benefits of outsourcing include:

- Reduced cost
- Improved performance
- Enhanced flexibility, such as making fixed costs variable
- Lower capital expenditure

Here are six key practices that can help you get the most from outsourcing:

1. Retain control and oversight of the outsourced activity.
2. Determine the full scope of the outsourcing process.
3. Outsource activities based on a sound business case grounded in your organization's strategic objectives.
4. Define the outsourcing transaction, the risks and the expected outcomes.
5. Write clear requests for proposals (RFPs) to get the best response from the most qualified potential suppliers.
6. Rigorously follow through and realize the intended benefits.

By planning and continually assessing how your outsourced services perform over the life of the contract, you can gain the most benefits from your outsourcing relationships.

Improving Performance

As a business owner, you want to get the most out of your company. Boosting productivity isn't always expensive and complicated. Productivity comes down to two things: making your people more productive and, investing in technology and equipment. In every successful company, there are some common themes to high performance. The following are some of the practices that successful companies employ to improve performance:

Create a performance culture. In leading companies, performance is part of the culture, from top to bottom. Ensure that performance expectations are clear, taken seriously, driven down to the individual level and reinforced through recognition and compensation programs. Define and communicate realistic objectives; then empower people to do the job. This practice sounds simpler than it is. Your job as a leader is to establish the goals, motivate people and give ownership to those who have to live with the outcome. This is the most powerful way to ensure your employees support your company's goals and objectives.

Focus on staff effectiveness. Determine if the skills of your people fit your strategy. To improve performance, examine whether your people are performing to the best of their capabilities. You can find more details on this subject in the Managing Your People section of this booklet on page 24.

Manage communication effectively. The communication battle is won in one-on-one interactions between employees and their immediate managers. This means managing the process from the top down to ensure that messages are honest and consistent, even when the news is bad. Make sure there's regular two-way communication. This includes exit interviews or regular staff meetings. Talk to your employees. Have informal or formal communication processes in place.

Focus on revenue generation and innovation as well as cost. Most successful companies constantly review their revenue-generating processes, including customer relationship management, selling and sales management and customer service.

Quick Tip: Communicate with your customers and solicit their feedback to understand their habits. Companies that perform these tasks regularly are more likely to report increased profitability.

Managing Your People

Other than the product or service your company produces, your people are your greatest asset. They are an important factor in your company's success so it's essential that you acquire, develop and retain skilled workers who align with your business goals. However, you may find that acquiring talented people is a challenge. While there's little that can be done to solve the shortage of workers, you can take steps to retain the people you already have.

If you don't have an HR department, monitor your managers and their relationship with employees. People quit bad managers, not bad companies. Employees leave a company due to a stressful or problematic relationship with their immediate supervisors so administer proper people management procedures consistently and regularly.

Implement a system that measures recruitment, productivity and retention within your business process and structure. You can't fix the problem if you don't know what the root causes are. It's also important that people understand how they contribute to your company and how they play a part in the outcome. Look at the nature of the work, the processes, systems and resources that people have and communicate how they all fit together.

Review any training policies you have in place and ensure they are aligned to your strategic priorities. Effective training can increase revenue, reduce costs, retain staff and minimize risk. With proper training, clear guidelines and specific performance metrics, virtually all employees will naturally aspire to do a good job. Your challenge is to create an environment where employees feel compelled to do the right things and put in that little bit extra.

Assess the work environment itself and determine if your people are well suited. The key to retaining productive employees is to make their environment as conducive as possible to achieving your company goals and objectives. Also measure and provide feedback on progress.

Engage your people. Surprisingly, compensation and benefits seldom drive turnover. People stay with a company because they have opportunities to grow personally and professionally within the organization. Staff appreciate respectful communication and personal recognition.

To design the appropriate retention program, you need to take a step back and assess your relationship with employees while understanding how staff feel about your company. Engaging people is a challenge but it can be a source of competitive advantage for those who get it right.

Tax Minimization and Recovery

Taking steps to minimize tax will help you manage tax payments and filings, reduce taxes payable for the year and preserve tax benefits for the future.

If you operate your business outside of Canada or earn income from foreign sources, you may be subject to international tax requirements. International ventures usually offer extensive opportunities, but you should consult expert advice to avoid any difficulties.

Managing Tax Payments and Filings

Income tax

Effective administration of tax payments and filings is often the simplest way to pay less income tax.

Many corporations can save money or at least improve cash flow by:

- Monitoring and adjusting tax installments
- Recovering overpayments
- Avoiding interest charges and penalties

The deadlines for federal and provincial corporate income tax installments depend on a number of factors.

1. Federal installments are due on the last day of each month and may be based on either an estimate of the current year's liability or on the actual taxes payable for the previous year. If either amount is less than \$1,000, no installments are required for that year.
2. No installments are required on federal Part IV tax, which is tax on dividends from certain Canadian corporations.
3. Similar rules apply to corporate taxes imposed by the provinces and territories. Ontario installments are payable quarterly if income and capital tax is less than \$10,000. However, in Ontario and Alberta, no installments are required if the previous or current year's liability does not exceed \$2,000.

Paying installments

You can save money by choosing a method of calculating monthly income tax installments that offers the most favourable result, depending on whether your company's tax liability is increasing or decreasing.

Quick Tip: To prevent miscalculations, use current tax rates to determine the amount of installments.

If the total installments are less than the actual liability for the year, you will be charged interest on any deficiency, but only if the total payments are less than the tax payable for the previous year. You reduce or eliminate interest if you overpay other installments or pay installments before their due date. In other circumstances, however, overpayments amount to an interest-free loan from you to the government and should be avoided. You can take various steps to recover overpayments.

Avoid underpaying or paying late – you will be charged non-deductible interest. You may also be charged penalties on late or deficient payments.

Quick Tip: Budget and manage your cash wisely to ensure you can pay installments and the income tax balance after installments when necessary.

Payment and filing deadlines

For corporations, the general tax payment deadline is the last day of the second month following the end of the tax year for federal, provincial and territorial income tax. For some Canadian-controlled private corporations (CCPCs), an extra month is allowed. For example, a CCPC that earns active business income and is entitled to claim the small business deduction is offered an extra month, provided that their income is less than the business limit (currently at \$400,000).⁴ Interest is charged on late payments. The general payment deadline is four months earlier than the deadline for filing a return – six months following the end of the corporation's tax year – so corporations must forecast the amount that is due.

No extension is available to accommodate late returns, and penalties can be severe. Each corporation in a corporate group must file a separate return since consolidated returns are forbidden.

4. As at April, 2007

Federal and provincial income tax returns

Federal returns also cover provincial income tax in most jurisdictions. Corporations that have permanent establishments in Alberta, Ontario and Quebec must also file separate tax returns for those provinces, regardless of whether any tax is payable. Ontario and Quebec returns cover both income and capital taxes; the Alberta return covers income tax only. Corporations with permanent establishments in other provinces that levy capital tax must also file capital tax returns and may be required to pay capital tax installments to those jurisdictions.

A corporation's financial statements must accompany its tax return. If they exist, audited financial statements must be provided.

Assessments

Within a few months of a corporation filing its income tax return, and following a brief office review of the return, an initial assessment notice is issued. To ensure the taxpayer complies with tax legislation, the Canada Revenue Agency (CRA) tends to conduct field audits on the taxpayer's premises. Many larger corporations have their returns audited annually. Smaller corporations are generally subject to less frequent audits, covering more than one year's return. The CRA will issue a reassessment notice that sets out any adjustments required as the result of a field audit. Taxpayers have an opportunity to discuss proposed adjustments with the CRA before reassessments are issued.

A reassessment of the tax payable for a CCPC may be made within three years from the date the original notice of assessment was mailed. For non-CCPCs, a reassessment may be made five years from the date the original notice was mailed. These periods may be extended if transactions with non-arms length non-residents are involved or if fraud or misrepresentation occurred.

Reducing taxes

A corporation can reduce its income tax by finding the most favourable rates it can legitimately use and adjusting its taxable income. The corporation's owners, as individuals, must also consider the corporate tax implications of income they receive from the corporation.

Manufacturing and processing credits

Newfoundland and Labrador, Ontario, Saskatchewan and the Yukon offer manufacturing and processing tax credits. But a credit claim will likely be challenged if the activity is not clearly related to manufacturing or processing,

if the goods are not for sale (e.g., if they are merely ancillary to the provision of services) or if the cost of the manufacturing and processing activity is overstated.

In some circumstances, you may gain the maximum benefit of the manufacturing and processing credit if labour and capital related to manufacturing and processing are segregated from other labour and capital. However, if the proportion of labour and capital used in manufacturing and processing is high, combining manufacturing and non-manufacturing activities could increase the proportion of total profits eligible for the manufacturing and processing credit.

Scientific research, experimental development and investment tax credits

Federal, provincial and territorial investment tax credits for scientific research and experimental development (SR&ED) can significantly reduce tax. Within certain limits, CCPCs can refund federal SR&ED credits for cash. Rules for provincial and territorial SR&ED incentives vary. Keeping a CCPC's taxable income below certain taxable income and taxable capital thresholds optimizes the refunds that can be claimed. Non-refundable and unused investment tax credits can be carried back three years or forward twenty years to reduce taxes payable.

Investment tax credits on general expenditures are available for certain property locations in the Atlantic provinces, the Atlantic offshore region and the Gaspé region.

Small business deduction

The federal small business deduction gives CCPCs a reduced rate on the portion of active business income, but to a limit. The reduction was 16% on up to \$400,000 of income when this booklet was written.⁵ The provinces (except Quebec) and territories also provide reduced small business rates. Please check with your provincial tax authority to determine if other small business deductions may apply.

Selecting a jurisdiction

A corporation that operates in several provinces may be able to establish or expand its operations in a province with a lower tax rate and favourable tax credits. When making this decision, the owner should also consider non-tax costs and issues.

Quick Tip: Payroll taxes should be one factor when determining where to set up or expand operations.

5. As at April, 2007

Quick Tip: Consider a periodic review of payables to ensure that you've claimed all available refunds of GST.

Capital taxes

Although the federal government no longer imposes taxes on capital employed in the corporation's business, six provinces – Manitoba, New Brunswick, Nova Scotia, Ontario, Quebec and Saskatchewan – impose taxes on capital employed in the corporation's business. Financial institutions are subject to capital tax in all provinces except Alberta. Provincial rates and exemptions vary considerably.

To minimize capital tax, consider:

- Restructuring a corporate group to shift taxable capital to jurisdictions with no capital tax or a lower tax rate
- Meeting minimum holding periods for bank deposits and bankers' acceptances so they become eligible for provincial investment allowances
- Using a trust rather than a corporation to acquire real estate

Customs duties are included in the cost of the inventory of goods for sale unless they relate to the purchase of a capital asset. In this case, they are capitalized as part of the cost of the asset.

Quick Tip: Take advantage of any provincial sales tax exemptions that are applicable to your business.

Reducing taxable income

A corporation can reduce its taxes by decreasing its taxable income, for example deferring the recognition of income or accelerating the recognition of expenses and deductions.

Deferring recognition of income

If you run a corporation, consider the following techniques to defer the recognition of income:

1. Change the corporation's method of accounting with respect to the timing of income inclusions.
2. Use reserves produced by uncollected proceeds from the sale of a property (which raises ordinary income); amounts received from certain undelivered goods and unrendered services, or uncollected proceeds on the sale of a capital property.

3. Make reasonable inter-company charges to obtain a tax-effective consolidated position within a related group of companies.
4. If a corporation is part of a larger group, reduce the income of one of the corporations in the group by charging interest on funds previously advanced interest-free by an affiliated corporation or by replacing equity with interest-bearing inter-company debt.
5. Reduce the income of a corporation by replacing inter-company arrangements that reimburse expenses with an agreement to provide services at cost plus a reasonable mark-up.
6. Acquire qualified replacement property and properly elect to defer capital gains and recapture.

Quick Tip: Examine your previous year's tax returns to see if you can carry forward any amounts to your current tax return, particularly for capital and non-capital losses. You can carry non-capital losses back three years and forward twenty. They can offer more advantages if they aren't used at the first opportunity. You can also carry capital losses back three years and forward indefinitely but they can only be applied against capital gains.

Accelerating the recognition of expenses and deductions

A number of techniques that may enable a corporation to use expenses and deductions against its taxes earlier than otherwise possible are listed below.

- Discretionary expenditures, such as charitable donations and political donations, can be accelerated and used when the tax benefit is the greatest.
- Salaries and bonuses can be accrued before the end of the corporation's year.
- Accounts receivable may reveal that a larger deduction is justified.
- Disposal of specifically identified items of obsolete inventory can offer a tax deduction equal to the cost that is claimed.
- Capital cost allowance (CCA) claims can be increased by selecting the right class; making purchases before the end of the tax year or postponing the sale of depreciable assets until after year-end; claiming CCA on assets under construction or completing construction projects in phases, and leasing assets that would have a low CCA rate if purchased.
- Investments should be sold by year-end to realize losses.

Non-deductible expenses

Keep in mind that not all expenses are deductible. Examples of non-deductible expenditures include:

1. Expenses not incurred for the purpose of earning income.
2. Capital expenditures, except if specifically allowed e.g., by way of capital cost allowance.
3. Unreasonable expenses.
4. Expenses related to exempt income. (Interest on loans used to buy shares in other companies is normally deductible even if dividends received on the shares are not taxed).
5. Reserves (unless specifically allowed e.g., for bad debts and unearned income).
6. Under thin capitalization rules, interest paid to related non-residents if the debt-equity ratio exceeds 2:1.
7. Costs to use or maintain social clubs, camps, lodges or golf courses.
8. Expenses incurred to advertise in foreign print or electronic media for advertising directed primarily to a Canadian market.
9. Federal and provincial income taxes.
10. In certain circumstances, amounts owing to related parties.
11. An amount that is expensed in one year that remains unpaid at a specified future date. The deduction of the amount will be effectively disallowed through its inclusion in income.
12. Expenses that are reimbursed to the taxpayer by way of a grant, inducement payment or would otherwise be effectively disallowed as a result of being included as an income reimbursement.
13. Deductions by a corporation for business meals and entertainment expenses are generally limited to 50%. This includes meals while traveling or attending a seminar, conference or convention, overtime meal allowances and room rentals, and service charges incurred for entertainment purposes.

Workers' compensation payments, employment insurance premiums paid on behalf of employees and municipal property taxes are generally deductible.

Quick Tip: If the business meal and entertainment costs are billed to a client or customer and itemized as such, you can shift the disallowance (i.e., the 50% non-deductible) to the client or customer.

Quick Tip: Rules restrict the amount of business-related automobile expenses that an employer or an employee can deduct. The GST/HST restrictions for business meals and entertainment and automobile expenses parallel the income tax rules.

The owner's total taxes

To minimize taxes, a corporation and its owners can:

- Establish shareholder agreements to govern their shareholders' actions in situations such as buy-outs.
- Plan or structure as necessary to become or stay eligible for the \$500,000 capital gains exemption related to qualified small business shares.
- Reinvest the proceeds of a sale of eligible small business investments into other eligible small business investments to defer tax on all or part of the capital gain.
- Ensure that the amount on which the corporation claims the small business deduction is "active business income."
- Pay dividends from a CCPC that generates a refund of the company's refundable dividend tax on hand annually.
- Distribute capital dividends as soon as possible, but avoid distributions to non-residents.

To reduce the amount of total tax owners pay on salaries and other forms of employment compensation, they can:

- Select a salary/dividend mix that gives them enough income but ensures that the corporation can take advantage of the small business deduction.
- Pay the owner a salary or bonus rather than dividends if the corporation's combined federal/provincial corporate tax rate exceeds 20% (generally when taxable income exceeds \$400,000) and the owner personally requires the money. If the owner doesn't need the money, a significant tax deferral may be available and the future cost of receiving dividends on this income decreases for residents of Canada.
- Defer tax if the owner's tax rate is higher than the corporation's by keeping income on which the corporation pays tax within the corporation.
- Accrue a reasonable bonus rather than paying salary, because the corporation generally can deduct the bonus in a year, even if payment is delayed (by up to 180 days).

- Ensure that all relevant factors are considered, including provincial health and/or payroll taxes, the clawback of the small business deduction (in Ontario) and the maximum RRSP contribution room and CPP contributions when calculating the optimal bonus.
- Employ family members and pay them reasonable salaries to benefit from low personal tax rates.
- Consider corporate structures that allow family members to be shareholders so that dividends can be paid to a spouse and adult children who are in lower tax brackets.
- Pay salaries from personal services businesses before year-end to ensure the corporation receives no income from such businesses.

Quick Tip: Make tax-effective withdrawals of cash from your corporation e.g., by paying “eligible dividends” to shareholders in the highest tax bracket, “ineligible dividends” to shareholders in lower tax brackets, non-taxable capital dividends (applies to private companies only) or a return of capital.

Quick Tip: As an owner, you don’t want your corporation to have taxable income that’s above the threshold. Pay deductible interest on shareholder loans made to your corporation to reduce active business income up to a threshold of \$400,000 (effective January 1, 2007).

Preserving Tax Benefits

You can reduce your taxes, especially if you face losses, by taking advantage of a variety of tax benefits. Preserve and use the tax benefits to the fullest extent before they expire or become unavailable for other reasons.

Quick Tip: To take advantage of tax benefits, increase taxable income by reducing or eliminating optional deductions or by purchasing at least one depreciable asset in a capital cost class that would otherwise be empty.

Other possible steps to consider when taking advantage of tax benefits are:

- Structuring a sale and lease-back of depreciable property to recapture capital cost allowance and capital gains.
- Negotiating a reasonable guarantee fee, or other adequate consideration, from a principal debtor on whose behalf the corporation may be required to act as guarantor.
- Avoiding transactions or arrangements that will unnecessarily extinguish debt without payment.
- Distinguishing bad and doubtful debts on your current account from those on capital account, and foregoing the deduction of a provision regarding doubtful debts on current account.

Quick Tip: Ensure that goods sold to related businesses are resold to third parties before year-end to avoid capital gains tax.



III. Going for Growth



III. Going for Growth

Valuation, Selling Your Business, Going Public

*Valuation*⁶

Measuring a company's value – called valuation – is an important part of obtaining debt or equity financing or negotiating the purchase or sale of a business. A valuation establishes what you can reasonably expect to receive in cash if you sell your business, taking into account tangible assets (such as property), intangible assets (such as investor status) and liabilities.

In Canada, the professional body that is recognized by the industry and courts as having the qualifications and experience to provide business valuations is the Canadian Institute of Chartered Business Valuators (CICBV). Members of the CICBV are financial professionals who hold the designation CBV (Chartered Business Valuator) or EEE (d'expert en évaluation d'entreprises).

There are several situations where a valuation may be recommended or required:

Change in business owner

Death, retirement, long-term illness or the withdrawal of an owner can trigger the need for a valuation. When shares are sold to family members, the CRA usually requires that "fair market value" be used as the value for taxation purposes, regardless of any other values that may be established for the transaction.

Sale or purchase of a business

If you are selling your business, a professionally prepared valuation report helps you determine a selling price, adds credibility to your marketing package and ensures a quicker, more effective business transfer. A valuation can also help identify any problems or issues you should consider during the sale or purchase of a business.

More than one equity holder

A business with more than one equity holder can create issues in valuation, especially if you plan to create an exit strategy or apply minority discounts. You can use the valuation to help you develop a carefully worded agreement with other equity holders.

6. Some text adapted with permission from the Succession Planning Toolkit for Business Owners published by the Canadian Institute of Chartered Accountants (CICA) and co-authored by PricewaterhouseCoopers, November 2006.

Business Reorganization

Merging, amalgamating or consolidating various business interests generally requires the determination of fair market value of the various interests.

Business valuation issues

The following issues may impact the valuation of your business:

Industry accepted rules and rules of thumb

In some industries, businesses appear to change hands for prices calculated using standard, industry accepted formulas. For example, professional practices change hands for a price related to a multiple of annual gross fees and radio stations sell on a multiple of annual gross advertising revenues. However, you shouldn't use these uninformed industry accepted rules and rules of thumb as a primary valuation approach. They may not take into consideration the differences, strengths and weaknesses of your business.

Agreed values and formulas

Independent valuations may be required for certain transactions among shareholders, joint ventures or partners. The situations requiring a valuation of shares are generally outlined in legal documents that govern the relationship among the parties e.g., shareholders' agreement, joint venture agreement, etc. But when the agreement does not resolve issues or no agreement is in place, disputes can arise.

Often, in an effort to expedite matters, shareholders' agreements or other documentation may require the shareholders to agree upon value in certain events. This can be a difficult situation because of differing biases.

Another approach is to develop a valuation formula. Although a formula seems to provide a simple process, it can break down with time and may not consistently reflect value.

Size of interests/shareholders

The significance of your interest (e.g., majority or minority shareholder, voting control, etc.) will have a bearing on value. Premium values (more than a proportionate share of the value of the whole) have historically been considered in valuing the holdings of a controlling shareholder or group, as controlling shareholders can generally control the return on investment and the investment's ultimate marketability.

Marketability/minority discounts

There may be issues involved in establishing value for various sized holdings of different classes of equity shares, often with varying rights. Generally, the smaller the size of the share holding as a percentage of the total issued shares, the greater the discount.

Selling Your Business

Business owners can often be too busy managing their company to address exit strategies. But the day will come when you are required to make a decision on the future direction of your business. Your main options are giving or selling to family members, selling to management or selling externally.

If you plan to sell your business rather than giving it to family, you should consider personal, internal and external factors.

Personal factors

Personal factors include your age and preferred retirement timeline, lifestyle preferences and the potential effects of work on your health. Personal finance, such as the current value of your business and other non-business assets, should also be considered.

Internal factors

Internal factors are also a major consideration in the sale process. Retiring and retaining ownership or selling to current management are viable options if management is competent and capable. Selling the business to current management is easier than selling it externally because the transaction does not require lengthy due diligence and the value of the business is generally known. If you plan to sell to management, you may need to finance a portion of the purchase price or secure a loan. An increasing number of institutions are prepared to fund a management buyout.

You can take a number of steps to enhance operating results when reviewing internal factors of a business.

1. Address tax planning and the tax consequences of selling the business to fully benefit from capital gains exemptions.
2. Meet the definition of a qualified small business corporation if an “estate freeze” is executed.
3. Seek professional advice on balance sheets and consider how finances will appear to potential buyers.
4. Consider inter-company finances that may need to be addressed.

External factors

External factors impact the current and future position and value of your business, and are beyond your control. Every industry experiences an economic cycle and selling a business or arranging a management buyout during a market upturn or strong period will result in a higher sale price. Consider changes in competitive conditions when assessing your business' market value.

Going public

An initial public offering can help your company raise capital, attract and retain the right people, enhance your market presence and grow. But turning a privately-owned enterprise into a publicly traded company is a rigorous process that demands a coordinated effort by skilled legal, accounting and underwriting professionals. Be fully aware of the implications and have a comprehensive business plan before deciding to go public.

Before you actually become a public company, you have to look and act like one. Leading public companies have a management structure with clear lines of authority, a strong and independent board of directors and a committee structure to comply with corporate governance rules and guidelines as set out by various securities regulators.

The earlier your company adopts the many legal and securities requirements, the better its chances of making the transition into a public company. Plan effectively to deliver an initial public offering (IPO) that meets the demands of investors, analysts, regulators and the financial press. Getting it right the first time allows you to obtain a better price.

IPO action plan

Corporate governance rules and guidelines differ among the various securities regulators across Canada so it's important to understand those that apply to your company. For example, the Toronto Stock Exchange (TSX) requires a Statement of Corporate Governance Practices. This includes describing your company's systems of corporate governance and how it complies with 14 specific TSX guidelines. These guidelines deal with strategic planning, risk management, communications with the public, the integrity of systems of internal control and management information, board compensation, board and director effectiveness, the roles of the board and CEO, objectives for the CEO, independence of the board and the composition and role of the audit committee.

Other considerations

Strong corporate governance is important for building confidence in a company and improving its appeal to investors, which will lead to improved shareholder value. Before you become a public company, you need to “get your house in order” and manage accordingly. Some considerations for management, internal controls and systems for an IPO include:

- Creating IPO-friendly financial statements;
- Planning for tax implications;
- Implementing reporting systems and processes;
- Implementing an effective management team;
- Enhancing the ability of the board to improve shareholder value;
- Creating compliant corporate governance policies and practices; and
- Assembling an effective team of professional IPO advisors.

Succession Planning

A succession plan deals with your eventual withdrawal from the day-to-day activities of your business. Some have referred to a succession plan as “the final test of greatness.” Planning how the business will succeed into the future is as important as the planning you undertook to start the business. Successful plans take time and care. The earlier the planning starts, the more successful the transition will be.

There are two types of succession and both must be planned for. Management succession is the transfer of responsibilities to another person. Ownership succession is the transfer of shares and voting control of the business.

Preparing a succession plan⁷

First and foremost, succession planning is a process, not an event. The more time you have to plan, the more options you can consider and the more likely you will achieve your goals.

Succession planning is a process that explores all options available to protect the value of the business and ensures the optimum exit strategies for all the key players as they transition.

7. Adapted with permission from the *Succession Planning Toolkit for Business Owners* published by the Canadian Institute of Chartered Accountants (CICA) and co-authored by Luanna McGowan, a consultant with PricewaterhouseCoopers, November 2006.

Business owners typically prepare succession plans to:

- Ensure economic independence for the retiring generation
- Provide for the short-term and long-term success of the business
- Maintain family harmony
- Minimize taxes

Generally, the most common options for exiting your business are:

- Passing the business to a successor
- Transferring ownership through a management buy-out or employee buy-in or
- Selling the business (shares and/or assets)

Each option has its own considerations. There are other options available and variations on the options outlined above. Your tax and legal advisors can help you work out which one is right for you and your circumstances.

When to start planning

The succession planning process should begin early. They should include contingency plans in case anything happens to you, your management or your family.

These plans must be fluid and reviewed or revised in the event of:

- Retirement
- Commencement or restructuring of the business
- Birth of children or grandchildren
- Death (of spouse, beneficiary, key employee or potential successor)
- Marriage or divorce (of a child or shareholder)
- Major change in circumstances (e.g., illness, disability)
- Tax or other relevant legislative changes
- Sale of all or a portion of the business
- Employment of family members in the business

How to begin

The best way to begin preparing your succession plan is to work out your objectives and those of your family. Openly communicate your plans to help preserve family and business harmony and:

- Determine if any members of the next generation are interested in taking over the business
- Prepare a fair arrangement for family members not involved in the business
- Assess whether family members not active in the business should be able to own shares

- Establish the time to which the transition will take place and
- Verify the family's vision for the future

In the case of management succession identify the right person to assume the business. To make sure the transition goes smoothly, you need to:

- Set out and communicate your process for identifying the right candidates;
- Establish measurable criteria for assessing them; and
- Get appropriate input and advice along the way.

The following 10 steps can make management succession work:

1. Develop a leadership profile
2. Identify suitable candidates
3. Identify gaps in skills and experience
4. Prepare a management development plan
5. Prepare personal development plans
6. Assign coaches and mentors
7. Evaluate successor candidates
8. Select your successor
9. Communicate your succession plans
10. Manage the transition

Transitions are smoothest when they are well thought out and timely. You also need to show commitment to the succession plan. While you are planning the succession of your business, you need to look at your various options and weigh the possible outcomes for both the business' future and your personal fulfillment.

[Seek outside advice](#)

Successful succession planning uses a team-based approach. By working with your team of advisors and collaborating with family members and key employees, you can develop and implement an exit strategy that best suits your circumstances and objectives. The following advisors can help ensure a smooth transition:

- Family business consultants who have the experience and expertise to help you and your family address and resolve family, business and ownership issues.
- Tax, legal and insurance advisors who can help you prepare the appropriate documentation to enable your intentions.
- Advisory committee members or independent board members who can provide an objective perspective.
- Peers who have already gone through or are currently going through a similar process.
- A "family council" that can provide input from the family's perspective.

Consider working with a facilitator who can keep the plan on track and manage complex and interrelated processes. Succession planning is a business issue but it raises emotional and psychological issues as well as organizational concerns. A facilitator can help you understand the tax, legal and financing considerations of a succession plan.

Estate freeze

An estate freeze is a series of steps that preserves the current value of your estate, especially a business. This allows the value of the business to grow and accrue to your children or specified individuals. Upon your death, a freeze prevents any future growth from being taxed. Estate freezes are often complicated, and may involve creating a holding company so professional advice is essential.

IV. Conclusion

Summary

As a small business owner, you face many unique challenges on the long journey to success. Unlike owners of larger businesses, you are actively involved in making every decision and determining the future success of your business. While this booklet provides some information on how to create a business plan, secure financing, manage cash flow, minimize taxes and determine future growth options, you should still seek advice from other sources and key advisors who demonstrate sound business knowledge for a well-rounded point of view.

Visa Canada

Visa connects cardholders, merchants and financial institutions through the world's largest electronic payments network. Visa products allow buyers and sellers to conduct commerce with ease and confidence in both the physical and virtual worlds. Visa is committed to the sustained growth of electronic payment systems to support the needs of all stakeholders and to drive economic growth.

Visa products currently generate more than \$US 4 trillion in sales volume worldwide. Visa enjoys unsurpassed acceptance around the world. In addition, Visa/Plus is one of the world's largest global ATM networks, offering cash access in local currency in over 170 countries. Within Canada, financial institutions have issued more than 29 million Visa cards, accounting for \$168 billion in sales volume in 2006.

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