

The Co-operative Alternative

A Support Framework Tool



THE BUSINESS OWNER'S GUIDE
to Selling His/Her Business to a Co-operative

Foreword

Business succession is an issue that is ticking away in every province in Canada. It is also a high priority for our communities. No business owner wants to think about leaving the business he/she has built up and put so much effort into. However, it will have to be addressed sooner or later.

The generation of business owners now in their 60s is getting ready to bow out of working life. It is estimated that some tens of thousands of New Brunswick business owners will be disposing of their businesses in the next 15 years. If we extrapolate from the Canadian Federation of Independent Business estimate of 200,000 for Canada as a whole, the figure will likely be between 4,000 and 5,000.

Studies have shown that 80% of business owners do not have a succession plan in place. In addition, most of them are contemplating retiring in the very near future. What will happen to all of these businesses and their employees?

The Coopérative de développement régional - Acadie (CDR-Acadie) has been active in the co-operative sector since 2004. CDR-Acadie's mission is to promote and support collective entrepreneurship in New Brunswick's Francophone regions by contributing to their economic development and preserving jobs.

The need for practical guides for business owners wishing to transfer their business to a co-operative is borne out by alarming statistics on business succession. Similar guides produced by the Fédération des coopératives de développement régional du Québec, in partnership with Orion Co-op, served as a source of inspiration for our guide. Our goal is to help those concerned understand the challenges involved and to make the transfer process easier for them.

The objective of this support initiative is clear. It aims not only to preserve existing jobs, but also especially to support the economy in our regions.

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Introduction

You've built up your business, or are continuing to do so. You are proud of that.

But, you know that one day, your business, into which you have invested time and money, will have to change hands. You will have to entrust it to someone else.

Although that day is quickly approaching, you might still not be ready. Maybe you're thinking, "What's the rush? It can wait for another few years."

However, life sometimes has a way of surprising us and forcing us to change our plans and take a different path.

You should also consider that family members could also be waiting to enjoy some pleasurable moments with you, without all the stress that often comes with running a business.

Now might be the time to stop for a moment and think about the future without your business.

The following guide examines the chief issues and challenges you will face when the time comes to pass the torch, and presents a proven approach for dealing with them.

It also reviews the different types of co-operatives you could transfer your business to, and their characteristics.

The purpose of this guide is to help you make an informed decision.

It sets out the 10 steps in successfully transferring your business to a co-operative.

Transferring Your Business:



A time for careful reflection

The issues and challenges involved in transferring your business

Did you know that a large number of businesses do not survive their founders? There are almost always two main reasons for that, either individually or combined:

- ▶ The departure was not planned properly or well enough, or
- ▶ The departure was too abrupt for the business and employees, who suddenly lose their former leader's wealth of experience and know-how, as he/she did not take the time to prepare them for the transition and pass on all of his/her unique knowledge to his/her successor.

The primary risk is that your business will not survive beyond your departure, that it will falter and fail because you will no longer be there to breathe life into it and make it flourish, and because you will no longer be at the helm to lead the way and guarantee its success.

The first challenge your business will face after your departure is its very survival.

The two resulting challenges are clear. If you want your business to live on and prosper after you leave, proper planning is needed so that your wealth of expertise and know-how is transferred to the business.

That means preparing a **Transfer Plan** and a **Knowledge Transfer Plan**.

This issue and the associated challenges focus on your business's future. However, what about your own future, your life after the business?

Did you know that many people feel anxious after they give up their businesses? The reason for that can be inadequate planning, or failure to think things through and come up with a plan for their post-business life, or a gnawing fear of suddenly having nothing to do, after decades of go-go-go, day in and day out.

Once again, for your own future, you have to take the time to think things through.

The first personal challenge you will face after leaving your business is, of course, securing your financial future and ensuring the sound financial management of the proceeds of the sale of your business. However, it may also be necessary to set things straight with your family concerning the financial proceeds of the business.

That means preparing an **Asset Management Plan** (taxes, investments, estate planning).

Your second personal challenge will be determining the type of life you want to lead after leaving the business.

Practise another profession?

Act as a mentor to other entrepreneurs or your own successor?

Get involved in your community's social life by sitting on one or more boards of directors?

Finally go on the annual vacation you always dreamed about but never had the time to take?

Many options are open to you. Some have to be prepared in advance.

Being prepared means **defining the personal objectives you want to set for your life after the business and doing so well in advance.**

Transferring a business to a co-operative: A project with a promising future

You have decided to make proper plans for leaving your business, but you are still asking yourself the big question.

Whom do you transfer it to?

If you feel someone in your family (son, daughter, nephew or niece) is ready to take over from you, you already have the answer. You will prepare for your departure with that person.

But if you do not have a family successor, or if the potential family successor is not interested, then your question is still unanswered.

Do you sell it to one of your executives? If your business is big enough to have an executive team, though, are you sure one of them has the fortitude and desire to take over?

If you are your business's only leader, do you sell it to a stranger and hope for the best? You will need to ask yourself: Will that person want to keep the business and make it prosper, or will he move it elsewhere, or close it down for the sole purpose of keeping your customer base?

Finding the right buyer is not an easy task. That is why we are suggesting a tried and true solution that will enhance your business's prospects for continued prosperity after your departure: **a co-operative solution.**

There are, in fact, many forms of co-operative alternatives for transferring a business. Your co-operative development advisor can help you determine which option is best for you, taking into account the specific nature of your business.

If you operate a small business with fewer than three employees, it could be a **consumer co-operative** or a **multi-stakeholder co-operative** (also known as a **solidarity co-operative**) if there are different stakeholder groups who have a stake in your business's survival.

If your business has more than three employees, it could be, for example, a **worker co-operative** or a **worker-shareholder co-operative** made up of your employees.

If your business represents an important market opportunity for your suppliers, they may be interested in turning it into a **producer co-operative**.

Whatever the type of co-op that seems most appropriate for taking over your business, it is important to remember that they all have common features conferred under the *Co-operative Associations Act*, and that those features make them sound, profitable businesses with survival rates that are significantly higher than those of private companies:

- ▶ their democratic governance structure is set out in the Act; lines of authority and each person's roles and responsibilities are clearly defined;
- ▶ their management logic is different but just as effective as, if not more effective than, that of a private company, because the owner members have every interest in their co-operative being profitable and prosperous;

- members of a **consumer co-operative** or a **multi-stakeholder co-operative** (**solidarity co-operative**) need the business to procure the goods and services they want to access locally at good value for money;
 - members of a **worker co-operative** or **worker-shareholder co-operative** have an interest in their co-operative prospering because their wages and working conditions depend on it;
 - members of a **producer co-operative** need their co-operative because it is the key market for their products.
-
- ▶ the way co-operatives work is that members may not benefit from the eventual sale of their co-operative. They can recoup only what they have personally invested in it, and not a cent more. As a result, they will always administer and manage their co-operative with a view to ensuring its longevity, as opposed to achieving short-term gains. A co-op is inalienable, so to speak.

Consequently, the co-operative alternative is a very attractive option for transferring a business upon the departure of its owner:

- ▶ By its very nature, it has a promising future;
- ▶ It is sure to retain local control over the future of the business;
- ▶ It provides the owner with the perspective of seeing his/her life's work and his memory perpetuated within the community.

Successfully Transferring Your Business to a Co-operative:



The 10 Steps to a Winning Strategy

The 10 Steps to a Winning Strategy

Before the transfer

- Step 1: Provide your co-operative development advisor with all the necessary information
- Step 2: Develop your **Transfer Plan**
- Step 3: Prepare the business for the change of leaders
- Step 4: Sign a joint **Commitment Letter** with the co-operative's steering committee

During the transfer process

- Step 5: Reach an agreement with the co-operative's steering committee to determine the value of the business by means of a neutral expert assessment
- Step 6: Negotiate a mutually beneficial agreement with the co-operative's steering committee for buying your business
- Step 7: Develop **your Asset Management Plan** (taxes, investments, estate planning)
- Step 8: Develop the scenario for transferring your managerial powers
- Step 9: Develop your **Knowledge Transfer Plan**

After the transfer

- Step 10: Advise the new managers and/or transfer your knowledge and skills to the business's new management team

Before the transfer

Step 1: Provide your co-operative development advisor with all the necessary information

Your co-operative development advisor's mission is to assist you in your transfer process, to help the co-operative that will eventually buy out your business to properly organize its management and governance system, and to act as an intermediary between you and the co-operative to find the optimal win-win solution for both parties.

To do this, it is essential that the co-operative development advisor have access to the information he/she needs, subject to a written statement of confidentiality, to properly analyse the issues and challenges, as well as the strengths and weaknesses that characterize your business.

The advisor will provide you with a list of the necessary information. This information will not be communicated to the members of the co-operative's steering committee until they have also agreed to maintain the confidentiality of the information by signing a commitment letter (Step 4).



Step 2: Develop your transfer plan

The co-operative development advisor can assist you in developing your **Transfer Plan**. You can also do this with one of your personal advisors.

Transfer Plan

It sets out the **WHO, WHAT, WHEN** and **HOW** of the transfer process.

You develop it based on

- ▶ your business's objectives up to the date of the transfer;
- ▶ your vision of the business's future after the transfer; and
- ▶ your personal goals after the hand-over, your life plans (parameters of tax and estate management of your assets; and new professional, social and recreational activities).

To determine your business's objectives, proceed as you would for any strategic planning process, starting with an assessment of your business's strengths and weaknesses, as well as the issues and challenges of the market(s) in which it operates.

Once done, by drawing inspiration from the standard, step-by-step process outlined in this **Guide**, you can create your own schedule of activities.

Step 3: Prepare the business for the change of leaders

Nothing can be less motivating to a group of employees than learning on the day of your departure that you are leaving and selling your business. Preparations are needed so that people can be psychologically prepared.

Some will probably wonder about their future: “Will I keep my job?” “Will my working conditions stay the same?” The uncertainties that result from a lack of information may drive some of your employees to consider seeking employment elsewhere. This could lead to a loss of expertise that may impact the value of your business.

That is why it is important to develop open channels of communication between you and your employees. It may be worthwhile to develop an “Internal Communications Plan.”

You know your business well. It is up to you to determine how and when to tell your employees and reassure them about their professional future.

Step 4: Sign a joint Commitment Letter with the co-operative's steering committee

Once the steering committee has been set up with the help of the CDR-Acadie advisor, negotiations leading up to an agreement on the terms and conditions for buying your business will be officially launched.

Commitment Letter

The purpose of a commitment letter is to protect both parties, who agree to respect the absolute confidentiality of all information collected during the process.

The two parties mutually agree on key parameters for their negotiations:

- ▶ the players involved, for example, a business valuation firm, your notary, your financial consultant, the experts that the co-operative development advisor will need;
- ▶ the steps in the transfer process;
- ▶ the timetable for the process.

If the transfer process involves the business's workers, the letter must also set out the conditions pertaining to "leave for co-operative business" for their representatives who are members of the steering committee (the equivalent of leave for union business, as provided for in collective agreements), the work hours they can take off for co-operative business, space available for committee meetings, etc.

Such a letter of undertaking is similar to a letter of intent when buying a house. It contains a timeline and an exclusivity clause. Its purpose is to protect both parties.

During the transfer process

Step 5: Reach an agreement with the co-operative's steering committee to determine the value of the business by means of a neutral expert assessment

Estimating the value of your business is at the heart of the transfer process. Generally, owners tend to overestimate the value, whereas buyers, be they individuals or co-operatives, tend to underestimate it.

The co-operative development advisor will suggest you avoid this conundrum by having a neutral expert conduct an objective valuation. If your business is relatively large, it may be worthwhile to have this done by a person designated, for example, as a Chartered Business Valuator (CBV).

Your co-operative development advisor can refer you and, if need be, guide you in your choice of an external expert.

What is important is that the expert, or firm of experts, performing the valuation has the confidence and prior approval of both parties—you and the co-operative's steering committee, so that the findings are not questioned.

Step 6: Negotiate a mutually beneficial agreement with the co-operative's steering committee for buying your business

You have agreed on the selling price for your business. Now you have to agree on the payment arrangements. There are two possibilities:

- ▶ You receive the full buyout price on transfer; or
- ▶ You obtain a partial payment on transfer (always significantly more than half of the agreed-upon price) and receive additional payments spread out over a pre-determined period.

The second option is more common in the case of business transfers. It can also include an “earn-out,” that is, the balance of payments is indexed based on the business's earnings over, for example, the three years following the transfer.

The buyout method with a “balance of sale” is often preferred because it suits all three parties to the transaction:

- ▶ You, the owner, because it may be accompanied by supervisory authority over the business's management (advisory function or mentorship role), which enables you to ensure that your business continues to be managed properly;
- ▶ The co-operative buying the business, because it is easier for the co-operative to raise the financial resources it needs; and
- ▶ The institutions financing the buyout, because the former owner's ongoing presence is an additional guarantee that the business will be managed properly and, consequently, that their loans will be protected.

Offer to purchase and financing

Once an agreement has been reached on the price and conditions, a letter of intent, or an offer to purchase, will be submitted to you by the co-operative's steering committee.

In all likelihood, the letter of intent, or the offer to purchase, will include a request to conduct due diligence, or a second detailed evaluation in several areas (legal, accounting, organizational, etc.) before the sale is concluded. Potential buyers usually require this type of audit.

A number of institutions can provide financing for co-operative projects. They include the Fonds intercoopératif de développement – Acadie, the Caisse populaire acadienne, and Community Business Development Corporations.

Once this process has been finalized and you have completed the negotiations to your satisfaction, you will then be able to sign the contract of sale for your business.

Step 7: Develop your Asset Management Plan (taxes, investments, estate planning)

Naturally, the sale of your business will significantly impact your financial situation at the actual time of sale and during your retirement years.

All stakeholders agree that proper planning is crucial, be it investment, tax or estate planning. There is no point in rushing into things if your retirement dreams turn into nightmares later on.

Maybe you already have a financial planner or other specialist (lawyer, notary, fund manager, etc.) to advise you, answer your questions and propose solutions tailored to your situation.

Various organizations, financial institutions among them, have also developed specific integrated services in this area, offered by multidisciplinary teams made up of a variety of specialists: fund managers, tax specialists and legal advisors.

Your co-operative development advisor can refer you to specialized resources to help you develop this plan.

However, you are free to use your own financial advisor or notary, for example.

Step 8: Develop the scenario for transferring your managerial powers

In some cases, this is done abruptly. Your replacement, the person who will be responsible for the general management of the co-operative, could step in only on the day you leave.

But we never advise going about things that way, and we are sure you will agree. There are a number of ways and several possible scenarios for gradually handing off your managerial powers. It all depends on you and the type of co-operative buying out your business.

Transferring Managerial Powers

If the co-operative is made up of your business's employees and managers, you can proceed the same as you would if your son, or your daughter, were the future buyer of your business:

- ▶ **by gradually incorporating responsibilities, before the business is transferred, into the job of the person or persons who will be responsible for the co-operative's future management; or**
- ▶ **by creating an assistant manager position.**

If, however, the co-operative is made up of your business's customers or suppliers, it will be virtually impossible to go about it this way, unless it is done in the months before your departure. It may be wiser instead to reach an agreement with the co-operative's steering committee for you to assume a role as advisor or mentor for the new general management over a pre-determined period after your business is transferred.

Step 9: Develop your Knowledge Transfer Plan

This step and the **Knowledge Transfer Plan** can be combined with the preceding step if a single person from the co-operative will be assuming all of the managerial functions.



If, however, managerial functions are delegated to an executive team of two or three persons, the two activities will have to be separate, as you will be called upon to transfer different knowledge and know-how, depending on the position profiles (for example, purchasing manager, sales manager).

Your Knowledge and Know-how Transfer Plan

It sets out the **WHAT, WHEN, HOW** and **WITH WHOM** of the process for transferring your knowledge.

First off, you will be asked to specify fields and areas, a “mapping” of the knowledge and know-how that you alone possess. This is what is called tacit knowledge.

Although every case is different, this knowledge can be grouped into five major areas relating to:

- ▶ the characteristics of your network and the nature of your relations with your network of suppliers (types of contracts, negotiation methods, methods of managing accounts payable, etc.);
- ▶ the characteristics of your network and the nature of your relations with your network of customers, in the case of a business that sells goods or services to other businesses, and the characteristics of your customer base if you are a distributor to the general public;
- ▶ the characteristics of your network and the nature of your relations with your network of business partners (accountant, banker, lawyer, notary, area business association, chamber of commerce and other organizations (for example, Conseil économique du Nouveau-Brunswick));
- ▶ the “softer” characteristics of your business, your management philosophy, your relations with your staff;
- ▶ the specific characteristics of your business’s process of producing and delivering goods and services, i.e., your “tricks” of the trade.

Methods of Transferring Tacit Knowledge

Methods have been established primarily for transferring professional knowledge in certain fields, much less so for business leaders when transferring their business.

One method is mentoring. For a while, the former owner acts as a mentor for his/her successor. He/she is a role model, a “sage,” and transfers his/her expertise bit by bit through these mentoring sessions. This is a volunteer service.

Another method that can be combined with mentoring is the owner’s temporary involvement on the board of directors as an expert advisor or outside director.

A third method is coaching. The former owner intervenes, so to speak, as an instructor by guiding a person or persons, one on one, and thus transfers his/her know-how. This is a paid service.

Lastly, through special transfer sessions, it is possible to compile a certain number of bits and pieces of your knowledge in writing, although this is a profession in itself and usually necessitates recourse to a professional in the field.

After the transfer

Step 10: Advise the new managers and/or transfer your knowledge and skills to the business's new management team after the transfer of your business

This is the final step. It is optional, although strongly advised.

It is you who will decide, for your future and for the future of your business.



Helpful Addresses

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Co-operatives Branch, Industry Canada, Government of Canada

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235 Queen Street
Ottawa, Ontario K1A 0H5
<http://corporationscanada.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs03954.html>

Chartered Business Valuators

<https://www.cicbv.ca/>

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Caisses populaires
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