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Contents

Explaining the truths and dispelling the myths of **SR&ED tax credits**

According to a recent report by Canadian Manufacturers & Exporters (CME), and co-sponsored by Grant Thornton LLP, "Compared to…previous years, manufacturers and exporters are spending a greater percentage of their revenues on research and development, product design, engineering, prototyping and product testing, plus process re-engineering and production scale-up." Yet one in four Canadian manufacturers and exporters surveyed say they are unaware of the Scientific Research and Experimental Development (SR&ED) tax credit program.[1]

"The SR&ED program represents the most significant source of federal government support for research and development undertaken by businesses in Canada," says Brian R. Leve, Partner, SR&ED Tax Specialist, Grant Thornton LLP.

What is the SR&ED program? It is a tax incentive program offered by the Canadian federal government to encourage and support Canadian innovation. SR&ED tax incentives are available to all businesses, in all industry sectors, for qualifying research and development activities that lead to technological advancements resulting in new or improved products, processes, devices or materials.

Leve challenges and clarifies the truths and myths that prevent companies from taking advantage of a potentially valuable benefit.

True or false: Companies must be profitable and have taxes payable.

False. Due to the strengthening of the Canadian dollar, some companies, particularly manufacturers, are struggling to achieve profitability. Provided that certain conditions are satisfied, many companies will receive a cash refund from the SR&ED program even if the business is not profitable and has no taxes payable. This cash flow can be critical to the company's future success and longevity.

True or false: The SR&ED project must be successful.

False. The commercial viability or success of the project is not relevant to whether or not the project is SR&ED eligible. In fact, one of the criteria used to determine if a particular project qualifies for the incentives is whether it has addressed a scientific or technological uncertainty.

1. Canadian Manufacturers & Exporters. 2007. 2007-08 Management Issues Survey. (Grant Thornton LLP is a co-sponsor).

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Even incremental innovations in products, services and processes can yield significant results. The fact that the outcomes are unknown at the start of the project actually helps qualify the project for the incentives.

True or false: Research is only done by scientists.

False. Research is often interpreted as work that occurs in a laboratory. Businesses such as non-scientific research companies don't realize that the work done on a daily basis to improve products or business processes can be, and usually is, recognized as research for SR&ED tax credit purposes. Leve explains, "If a business creates a new product, the methodology behind that creation process could qualify the business for a tax credit, even if the business decides not to sell the new product."

True or false: A business can only qualify for one government grant.

False. Many managers are skeptical about the availability of government financial assistance. Often they believe that they can only qualify for one government grant or tax credit program. Managers may be surprised to learn this is untrue. "Even if a business receives money from a different source of government funding, the business may still qualify for significant SR&ED tax credits; although the amount will be reduced," Leve explains. "Other grants simply reduce the total amount of qualified expenditures, a percentage of which becomes tax credits so the reduction is not dollar for dollar."

True or false: The application is complicated and time-consuming.

True. The reality is that for first time applicants the process is complicated; however, if they seek guidance and expertise, the process generally becomes quite straightforward thereafter. Also, over the long term, having professionals involved in preparing the application will usually benefit the business more as employees can continue to spend that same time establishing new contracts or increasing sales. In addition, the tax savings or refund generated from the SR&ED program can provide seed money to develop new products, pursue additional enhancements, improve processes or allow the business to remain viable in the face of difficult market competition.

At Grant Thornton, we have helped hundreds of our clients complete successful claims for tax credits. Managers who work with a Grant Thornton adviser, especially first-time applicants, benefit from having a dedicated, experienced tax practitioner working on the claim to help ensure it is completed correctly and submitted on time. We also work to educate employees and put a process in place to ensure that future year claims are better understood and documented to enable businesses to better capture future expenditures linked to SR&ED.

"Being innovative is essential to success," says Leve. "It's important that Canadian business owners and managers take full advantage of any incentive programs, such as the SR&ED tax credit program, to help them be successful in the global market place."

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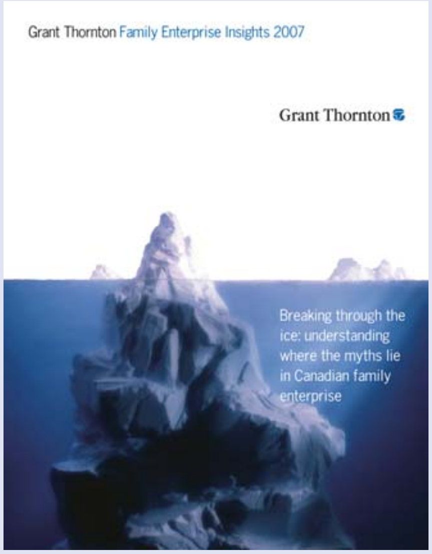
Grant Thornton practitioners release a new thought leadership report: *Family Enterprise Insights 2007*



"Canada is essentially a large country made up of many small communities. These communities breed the family enterprises that are the real engine of the Canadian economy."

Jim Mills,
Partner, National Leader, Family Enterprise,
Grant Thornton LLP

That's a very thought-provoking statement. Family enterprise—as a business model—reflects what we are as a nation, culturally and economically. And yet, since family enterprises have historically been privately held, holding their cards very close to the vest, they have been little understood, giving rise to myths and misperceptions.

With decades of experience serving this sector, we felt it was time to share what we know about what drives this sector's success, and to delve deeper into the stuff that drives family enterprise, that drives our economy.

Three pivotal questions rise to the surface:

Is the need for effective succession planning being adequately addressed?

What are family enterprises doing to innovate and compete?

How are they addressing sector specific issues such as the loss of long-term clients and the competition for new talent?

In an effort to answer these questions and explore the themes surrounding them, Grant Thornton commissioned interviews with business owners and senior executives at 201 private mid-sized family enterprises about the issues that matter most to their businesses.

Some of the answers were surprising, some were reaffirming. We learned that family enterprises

- are optimistic about the Canadian economic outlook;
- are generally more prepared for succession than is widely perceived;
- fall short when it comes to investment in innovation; and
- are under-prepared for potential sudden loss of key personnel, customers and suppliers.

The interpretation and expansion of these questions—*Family Enterprise Insights 2007*—draws from in-depth interviews with Grant Thornton practitioners who provide insights from their client- and sector-based experience, and with experts who support Canada's family enterprise sector.

We discuss what still lies beneath the surface. We also explore solutions to the challenges faced by this sector, such as the need for family enterprise leaders to understand succession planning, not just as an event, but as a highly involved process that requires substantial and ongoing communication.

To request your copy of the report visit **www.GrantThornton.ca/FamilyEnterprise**

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Selling family businesses in Canada

According to the Grant Thornton *Family Enterprise Insights 2007* report, more than half of mid-sized family enterprises in Canada anticipate a change of ownership in the next ten years, with two-thirds of those expecting the change to occur in the next five years. Given that family enterprise is by far the dominant form of business in Canada and is a driving force in the mid-sized sector, there is going to be tremendous opportunity for both sellers and buyers in the next decade. The importance of understanding Canada's family enterprise market is clear.

Selling a family business involves a host of unique challenges

Succession planning

Considerable attention has been paid to the issue of succession planning in the Canadian family enterprise sector. With 23% of the family enterprises surveyed for the Grant Thornton report expecting the business to remain in the family, the focus is justified, and many businesses have had difficulty navigating those waters. If the business is to be sold within the family, a formal succession plan must not only be in place, the owner and concerned family members must be prepared to carry it out. Communication is crucial to an in-family succession transaction. Legal and financial processes must be clear to all involved, and a competent and willing successor must be selected.

There is clearly, amongst family enterprises, the desire to self-perpetuate. A business that can re-seed from within has a particular advantage with the coming labour crunch. But family enterprise owners must ask themselves if selling within the family sphere is the best choice in terms of getting the best value, looking out for posterity and ensuring the long-term success of the business.

Vanity value versus real value

When it does come time to sell, the vanity value of the business, that is the owner's sense of what the business is worth, is not always supported by reality. Having invested a tremendous amount of time, effort and sweat equity in building and running the business, owners find it extremely difficult to impartially answer the question, "What is this business really worth?" This goes back to the fact that, from day one, many family enterprise owners do not proceed with a complete understanding of what creates value in a business, though they may have an in-depth knowledge of what drives profitability. They may begin with an understanding of the basic financial aspects of starting up and running a business, but there is less understanding of how to build overall value, especially when day-to-day functions may occupy virtually all of an owner/operator's time. Market share, market positioning, and management strength: understanding and building competencies in these areas is crucial for owners who expect to see a large return when it comes time to sell. There is, of course, no absolute measure for the value of a business other than to try and sell it, but owners can certainly increase that potential value by understanding what drivers can materially impact valuations.

Mid-sized family enterprise owners are undoubtedly taking note of the huge sums large businesses are being sold for and wondering how they can cash in on that trend. Again, the vanity factor comes into play and can skew owner expectations. The simple fact that there is a premium attached to businesses with a sustainable size is often lost on family enterprise owners, and building with that in mind is often neglected strategically.

What is the size plateau where a company is seen as a more lucrative opportunity? This distinction is mediated by the type of buyer a sale is attracting. Strategic buyers are concerned with viability and with how a business purchase can add to the value of an existing platform. They may be purchasing to acquire a specific strength, so the depth of the acquired company's management team, for example, may not figure in the valuation.

Financial buyers—such as private equity sponsors—are concerned with management and infrastructure because they are investors and are not buying the company to run it. They are looking at benchmarks, income, etc. They are looking to deploy capital quickly, but are more selective about which opportunities they will pursue.

The basic lesson—and this is as much about strategic thinking as it is about economic fact—is the bigger your business, the more potential interested buyers. Firms with lower EBITDA will attract a smaller amount of interest because they will be seen as less sustainable. As EBITDA increases, buyers' interest and value grow, and the universe of potential buyers expands significantly.

Family enterprises need to be open to the full scope of potential suitors. More and more private equity capital is being invested in buyout funds, and this money must be deployed. If the number of available deals doesn't increase proportionally to the availability of investment capital, the value of individual deals goes up. Despite this, the Grant Thornton *Family Enterprise Insights 2007* report shows that only 14% of mid-sized family enterprises anticipating a change in ownership are considering bringing in private equity or bank investors.

Canadian family enterprises also tend to be much more domestically focused than their European counterparts, but since Canadian buyers tend to be more conservative, better valuations might be found through a foreign buyer. Moreover, there is an associated tendency to sell to family members or acquaintances. This frequently means that the seller won't be able to—or even be motivated to—take advantage of a higher price.

According to the CVCA (Canada's Venture Capital & Private Equity Association), U.S.-based private equity funds led Canada's buyout market in 2006.[1] Canadian businesses, however, have an opportunity to be the North American foothold for transactions with European and Asian markets, based on cultural similarities. Therefore, to maximize value, Canadian firms could consider actively pursuing strategic buyers from Europe and Asia.

The onus is, of course, on the business agent to locate and facilitate such transactions, but first the business must actually hire such an agent, not only for the actual sale process, but to prepare the business—before it goes on the market—to achieve its maximum value. This process requires foresight and strategic planning and ought to be entered into well in advance of the projected sale date. At this juncture, Canadian family enterprises in the mid-sized sector could do much more to prepare. Taking advantage of the comprehensive assistance a professionally managed process can provide would certainly help sellers find the best opportunities and achieve the greatest value for their businesses.

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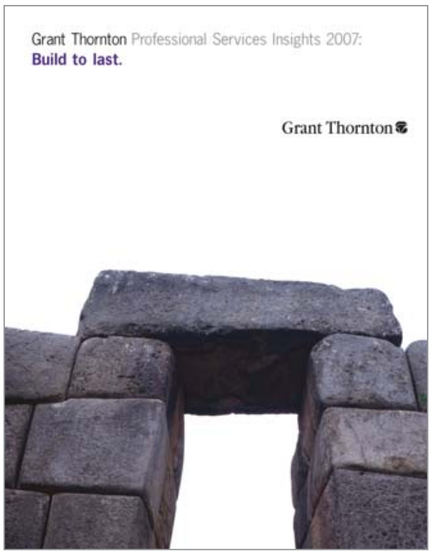
(Reprinted, in part, from an article published in the November 2007 edition of *Mergers & Acquisitions* magazine)

1. Nathan, Rick. 2007. "Canadian Private Equity Investment Achieves Record Levels in 2006," Canada's Venture Capital & Private Equity Association, February 13. http://www.cvca.ca/files/News/CVCA_PRESS_RELEASE_YE_-_PE_2006_FINAL.pdf (accessed November 1, 2007)

Professional Services Insights 2007: new challenges pressuring professional services firms



Despite strong growth, profitability and optimism, the professional services industry is facing new pressures in the current age of increased client demands, business consolidations and competition for skilled executives. Changes to the fundamental models of management that have endured for decades will be required to survive and thrive over the long run.

These are some of the insights revealed in the Grant Thornton *Professional Services Insights 2007* report. The report focused on legal, architectural, and engineering firms, and reveals an industry that, while highly sensitized to competitive threats and fundamental weaknesses, is unprepared to fully mitigate these challenges or transform strengths into opportunities.

According to Statistics Canada, recent growth in this industry has outpaced others—in April 2007, professional services posted a 3.5% year-over-year gain in GDP compared to 3.0% for service-producing industries as a group and 2.1% overall. "Professional services firms are a great success story in the Canadian economy, with strong growth and profitability. Ninety-one percent of those surveyed are predicting to have consistent or increased revenues this year," said Doug Moore, Partner, National Leader, Professional Services. "We're concerned, however, that this present success is masking some rapidly-approaching challenges."

In commenting on the report, Moore noted several trends that will shake up the industry's business-as-usual way of operating. "When different companies consolidate, or come under foreign control, it means a smaller pool of existing and potential clients for these firms, and we're seeing a lot of business consolidation and foreign purchase in Canada these days."

"Secondly," he continues, "the needs of their clients are changing. They are demanding more specialized services from the firms they employ. Greater specialization means more competition for the limited pool of practitioners with these skills, and these firms are already having trouble recruiting and retaining employees. Grant Thornton found that 90% of the respondents agree that recruiting skilled employees is a problem for their industry, and 82% believe that it is a specific problem for their company. However, under the present business model, the only way for these firms to increase revenue is to have more people accumulating more billable hours."

"Finally, the values and culture of younger employees has begun to present challenges. They might not be interested in chasing after a partnership as long as they are being paid well and are stimulated by their work, but that kind of thinking is at odds with the traditional culture at these firms, particularly legal practices. The iconic corner office for senior partners in the high-powered world of professional services will be vacated as a new generation of talent ushers in a 'firm-first' approach to replace the current 'me-first' approach in the sector. This will fundamentally change how client relationships are built."

Mr. Moore concluded, "The importance of this industry isn't just limited to its immediate employees and managers. Professional services firms are responsible for vital advice, counsel and innovation that Canada's industries rely upon. Canada's professional services firms are facing a culture of change. Heads of these companies should immediately begin thinking about what the impending future holds for their businesses, and create management plans that will support that vision."

Request your copy of the Grant Thornton *Professional Services Insights 2007* report, visit **www.GrantThornton.ca/ProfessionalServices**

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Focusing on **recruitment and retention**

Grant Thornton proprietary research featured in the *Professional Services Insights 2007* report confirms that recruitment and retention are significant challenges for Canadian mid-sized professional services firms. Respondents at 90% of the firms surveyed agree that recruitment is a challenge for their industry, while 82% indicate that it is a challenge for their firm in particular.

"It's currently a candidates' market," says John Stockwell, Senior Manager, Talent Resourcing. "The most desirable candidates, and even those with relatively less experience, are able to select from a variety of opportunities and from a number of organizations prior to making an employment decision."

Respondents of the Grant Thornton survey support this claim: 91% of firms surveyed agree that the recruitment challenge has increased in the past five years, and 45% of respondents identify a general shortage of talented, qualified professionals in their field as the leading cause.

In order to best attract leading talent who also fit well within an organization in such a competitive marketplace, Stockwell suggests that firms need to define who they are and what they stand for. "What attracts someone to a firm differs from person to person. It's also generational. 'Generation X' tends to focus on salary, compensation package, responsibilities and benefits. 'Generation Y,' however, tends to focus more on a firm's corporate social responsibility activities, environmental policies and work/life balance. Professional services firms need to define what makes them unique, and leverage this competitive advantage in to a recruitment strategy."

Although employment seekers are attracted to specific firms for different reasons, Stockwell feels there are some common influencing factors. For example, regardless of generation, employees generally want to know that they are working for a respected organization—one that can back up a strong reputation externally with reputable practices internally.

Eight-in-ten respondents to the Grant Thornton survey say they highlight the firm's reputation in the industry, the nature of the work performed by the firm, and/or the firm's culture and work environment in their recruitment efforts; three factors mentioned more than any others. This indicates that reputation as a good employer and the ability to offer a rewarding employment and work experience are critical considerations in recruiting professional talent.

Focus on retention

The same thing can be said in regard to employee retention. "If you get your internal messaging right, and are consistent, your employees will get the message out. They are your strongest ambassadors," says Stockwell. "An employee who takes pride in the firm they work for will communicate their job satisfaction. Over time they can strongly influence your external reputation."

What can professional services firms do to improve their reputation as a good employer? "There is a perception that mid-sized firms mean mid-sized or lower-level work," explains Stockwell. "But being smaller in size doesn't mean a candidate will have less interesting or less important experience. In many cases it means the opportunity to do more, faster; build quality relationships; and have the opportunity to significantly impact the work that they are doing. Mid-sized professional services firms need to communicate these employment advantages as opportunities."

Professional Services Insights 2007 presents data that indicates that 81% of those surveyed perceive retention of qualified professionals as a challenge for their industry, and those professional services firms that acknowledge facing retention challenges are perhaps contributing to the problem by concentrating on the least effective loyalty builders in an effort to keep prized employees. Stockwell finds that despite the growing numbers of candidates focusing on corporate social responsibility, for example, as one of the key factors influencing their employment decisions, many firms are still honing in on compensation strategies.

Stockwell feels these findings are an indication that professional services firms are not in sync with what is motivating job-seeking candidates today, and that firms are missing out on a big opportunity.

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Focusing on **recruitment and retention**

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Specific actions taken to retain firm's most desirable professional employees (% of respondents selecting each tactic)

Retention tactics	Firms who have a retention challenge	Firms who do not have a retention challenge
Use of non-salary financial incentives like bonuses or car allowances	65%	47%
Higher than average salary increases	56%	45%
Deferred bonuses	47%	35%
More frequent salary reviews	40%	23%

"Professional services firms need to be aware of what's happening outside their door," he says. "More often than not, an employee is not leaving for more money. Are employees getting to do the work that they want? Are they provided with learning opportunities? Are they working with clients they enjoy? If you create an environment where your people are engaged, then you will be retaining the right employees."

Stockwell also finds questions regarding corporate social responsibility activities, sustainability and green policies are being asked more often by both current and potential employees.

"Environmental policies are becoming significant employment motivators," he says. "Professional services firms will need to be prepared to explain how their firm is responding to environmental pressures. Over the next three years, we will be developing and implementing a sustainability policy for the firm that is aligned with our values, business strategy and interests of our core stakeholders. "

For a more thorough analysis of the recruitment and retention insights, plus the many other issues discussed in the *Professional Services Insights 2007* report, visit **www.GrantThornton.ca/ProfessionalServices**

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