

D.T1.2.1

Design of the model for the introduction and advancement of the business succession in the CE

2nd Version
03 2018

D.T1.2.2

Definition of ground rules for the business succession process

2nd Version
03 2018



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1. Objectives

1.1. General objective of the document

Introduce a model for integrating business succession concept into policy level and daily practice of business support organisations, young entrepreneurs, established businesses and their young family members. It will define basic succession principles, measures for identification and assessment of prospective successors, transfer of knowledge and accomplishment of business transfer which will be developed in detail in the later deliverables. It will consider entities to be involved, communication channels, coordination ways and feedback loops.

1.2. Specific objective of the document

Project lead partner proposes to put together models, processes and rules according to above.

It was agreed that the default model to start with will be the German model “Der Nachfolgefahrplan”, as recommended by PP5 FH Steyr. This model should be improved, new ideas should be implemented and it is to be made applicable and usable in other CE countries.

This document will try answer:

- How the German model could be improved in general
- How it can be used in daily practice by stakeholders
- What are the basic succession principles
- What are the basic succession ground rules

2. Theoretical background and notable aspects

As mentioned in the specific objective of the document, the default starting point will be the German model “Der Nachfolgefahrplan”. The model has been translated into English language and consists of three different routes in company succession, with stops at important points in succession process that are necessary to be resolved.

The aim of this timetable (Figure 1) is to show a typical progression of succession based on stations that all parties undergo. The timetable goes through four zones: (1) Information and Inventory, (2) Analysis and Strategy, (3) Concept and Business Plan and (4) Implementation and Transfer.

Three different lines for transfer, internal transfer and external transfer can be selected. Thus, the timetable is aimed at both successors and transferees. The lines give precise hints and tips for each succession planning station. The information provided is supplemented with information on which stations an additional external consultation is advisable and when the emergency planning is due.

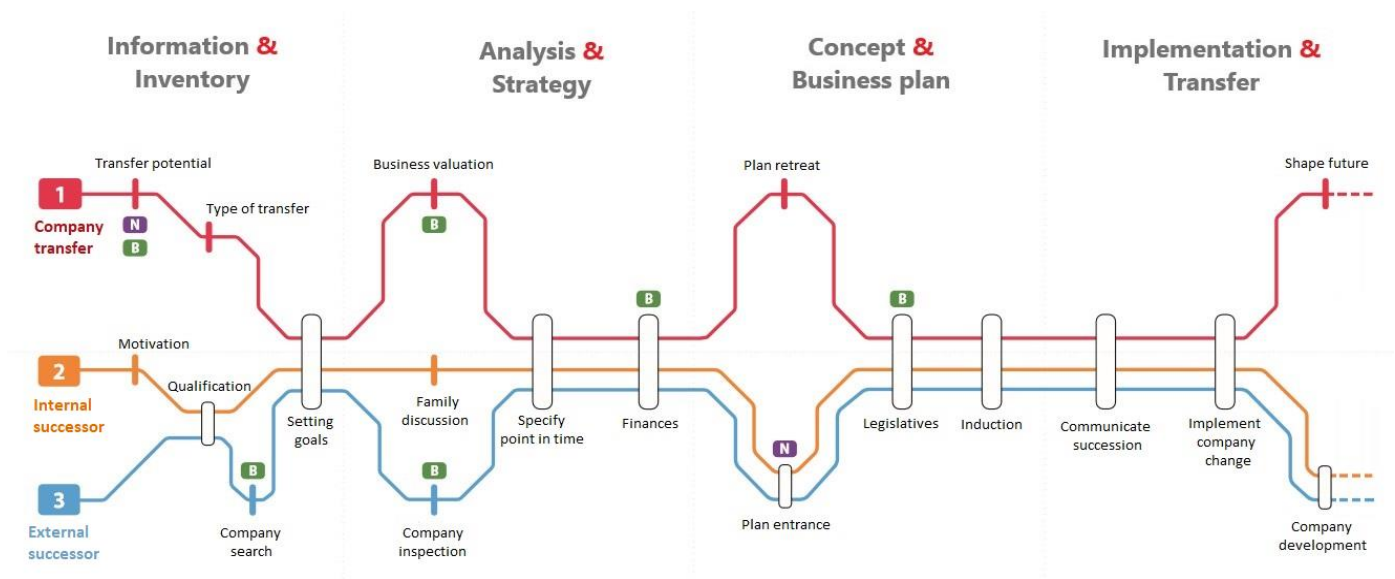


Figure 1: Business succession process in Germany. The red line presents the transfer process from the view of the “old” owner of a company; the orange line from the view of descendants who could be possible successors and the blue line represents external successors.

Source: <http://nachfolge-in-deutschland.de>; © EMF-Institut 2017. English translation: Jasmin Schiefer, 2017

Taking into account the German model for business succession, the 3M mandale could be useful when we think about 1) or 2) route in the business succession.

In route 1), the elements indicated in three circles could be discussed at the stage of **Business Valuation**, while in route 2) at the stage of **Family Discussion**.

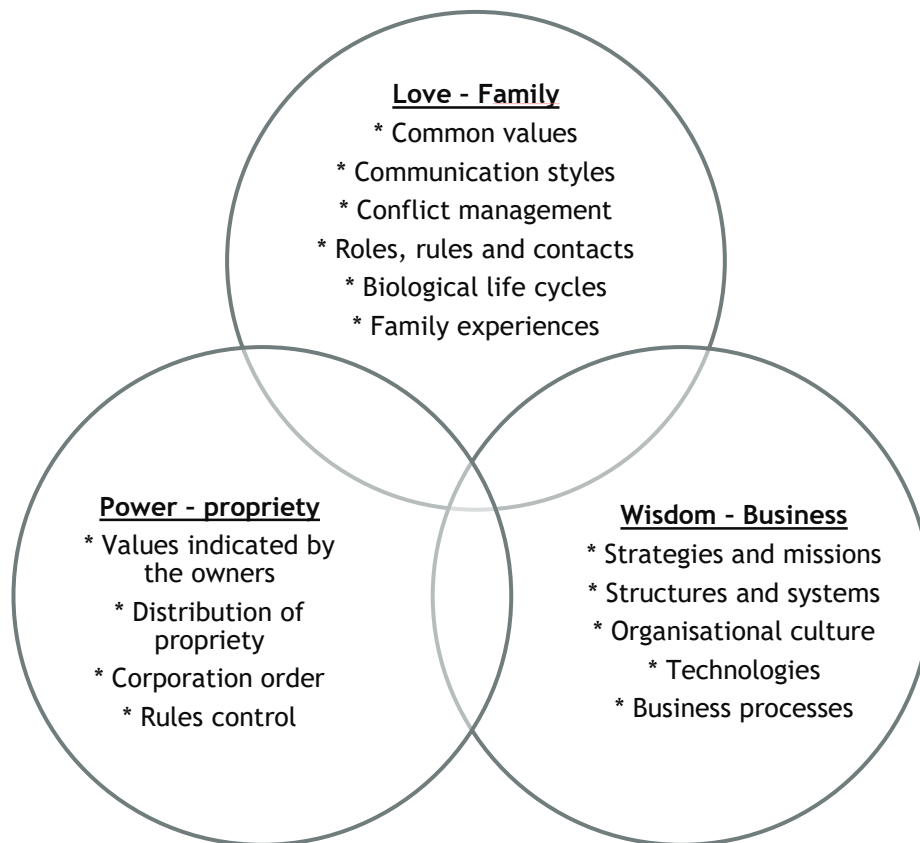


Figure 2: 3M mandale

Source: T. Budziak, 2012

As far as it concerns the **education**, it must be taken into account twofold:

- Either the education is a pre-requisite for business succession process. It means that before we start thinking about business succession process, we supervise the education of the potential successors in order to prepare them to manage the company effectively;
- Or we assume that the potential successor has already required qualifications and we take into account the possessed qualifications in the business succession process.

It seems that in German model the education is perceived like in point 2 - we already have a person with specified qualifications.

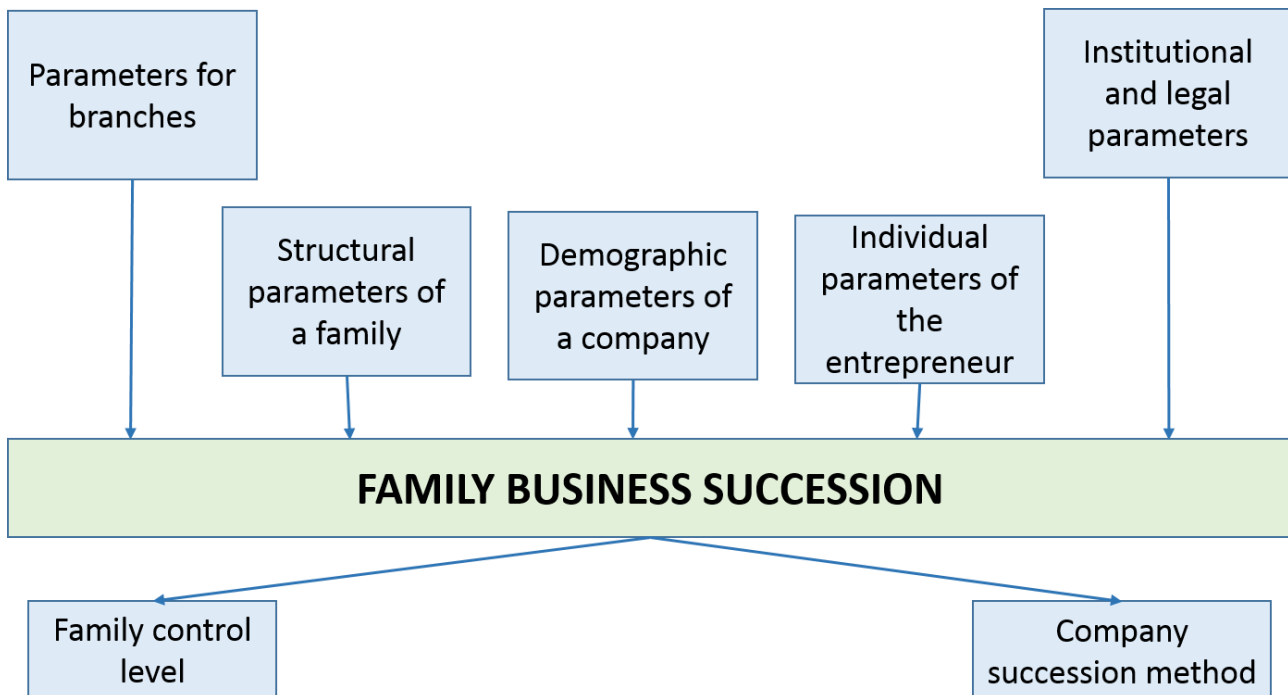


Figure 3: Elements for successful company inspection (3 route external -succession)

Source: A. Surdej, K. Wach, 2010

There are also branches of factors that are to be taken into account when considering Family Business Succession. The first group are input factors:

- Structural parameters of a family: family size, number of generations, sex of the first child, family order, relations in the family.
- Demographic parameters of a company: age, size, territory business scope, branch and sector of activity.
- Individual parameters of an entrepreneur: age, sex, educational level, business base, history of previous business activity
- Brand parameters: innovativeness level in a branch, competitiveness level in a branch
- Organisational and legal parameters: company order rules, development of a capital market, protection of minority shares, contracts execution.

The output factors here are the ones that impact the succession effectiveness: impact of the succession of the company, relation between succession and the company results and assessment of the succession process.

The variables here are the “Family control level”, which could be full control of power, majority control or minority control. The other variable is one of four company succession methods:

- Taking over by children (donation, inheritance, selling to family members);
- Selling the whole family company (to third parties, employees);
- Selling the parts of the family company (to third parties, employees);
- Entering the stock-market (selling to third parties).



2.1. The 7 golden rules for business succession

The “Junge Wirtschaft” in Upper Austria published a book summarizing all rules and principles for business succession in Upper Austria. Following information can be found in Oberthaller and Obermüller, 2017, “Die 7 goldenen Regeln zur Betriebsübergabe”.

2.1.1. Fundamental decision making

The first rule deals with the fundamental decision.

Would I like to hand over my life's work to a successor - yes or no?

Many entrepreneurs see themselves as rock in the swell, as the head of their company. Without them, they believe that success cannot be guaranteed.

These entrepreneurs often only think about business succession if they have health problems and they realize the disinterest of a demotivated successor. Then they see that they need an adequate business succession plan.

However, other entrepreneurs prepare themselves at an early stage for a possible successor. They look forward to the development of the company by the next generation. Often those entrepreneurs involve their descendants already at an early stage into the company

A key issue in this context is the time horizon in which the transferor wants to withdraw. Within the family the handover can be planned on the long term and implemented successively.

It is usual that an early fundamental decision allows all parties involved, to follow the path of handover carefully and without haste. Five up to ten years is quite a period of time between a decision in principle and succession. Making the fundamental decision is the first, decisive act of letting go by the transmitter.

2.1.2. Determine potential successors

Only when the mental and emotional hurdle of the fundamental decision are overpassed the process of finding a suitable successor can begin.

First, human and professional competencies of the successor should be defined and checked. Subjective feelings make this step more difficult within a family internal succession. A critical view from the outside can be helpful and meaningful.

The motives of all parties involved should be explained as openly as possible. Especially when it comes to the transfer of family businesses, there is a large number of unspoken expectations, some of which are unconscious and have to be taken into account in order to be able to make decisions. Very often “family laws” exist like the tradition that the eldest son “must take over” a business. If this is the case, a qualified daughter would not be considered as successor even though this would be an acceptable option- for all family members.

For some successors the burden to lead a company is too great to make a company successful in the marketplace. When the intra-family succession reaches its limits, the transmitter must also consider other models. This can be very difficult for the senior entrepreneur. Nevertheless, many transferors also take this hurdle for the benefit of their customers, their children and the company.



2.1.3. Check varieties and models

Now it's about the hard facts. Whether family or external succession - as a starting point of every handover there must be an objective valuation of the company. Transferors as well as transferees ask themselves the question, what the value of the company is. This includes a detailed market analysis.

This survey can already lead to important decisions, which may lead to a change of the plan as certain structures can be rethought and be adapted.

The term management buy-out is used to describe a process when senior executives or the managing director acquires and continues to manage a company. This can be an advantage when large decisions have to be made.

The situation is different if the company is taken over by an external management. This constellation is referred to as a management buy-in. In this case, the new view from outside can be an advantage, for example if necessary change processes and new strategies are developed in order to achieve innovative results.

However, the new buyer sometimes takes longer to recognize the working methods and structures in "his" company. Also, the building customer and partner relationships may take more time to develop than in a management buy-out.

2.1.4. Make clear agreements

Perhaps the most important of all the rules is that transferors and takeovers negotiate in such a way that all needs and circumstances are taken into account.

Once you have decided on a model of handover, it makes the process much easier if all subsequent steps are carried out on the basis of the most concrete agreements possible. Whether task sharing, taking over of responsibilities, binding time frames or the time frame- there are many topics in which the transferor and transferee can still work together in the company.

Clarity and transparency help both sides during these steps. Empty promises or delaying tactics (which can exist on both sides) do not support business succession. This can be avoided by written agreements.

2.1.5. Promote and challenge the successor

In all the above-mentioned forms of transfer, it is of crucial importance that unrestricted trust is placed in the successor once defined. This is especially important at family internal successions.

A close involvement in all important decisions is of great importance. However, the art of correct timing is crucial here. Collecting experience from the senior entrepreneur is not enough. The successor must learn to take responsibility. This is done best by the gradual transfer of responsibilities and tasks.

Many senior entrepreneurs want their successor within the family to prove themselves like external managers. This also increases acceptance among employees, customers and suppliers.

The time frame in which all this happens is ideally clearly structured.



2.1.6. Enthronement of the successor

After a succession the company can only survive if the transferor puts his trust in the transferee. This trust is not only based on a personal matter between the transferor and the transferee, but rather must also be publicly demonstrated. This includes important key customers at a conference or at a trade fair, in front of a large number of customers, the house bank and the general public. A little dramaturgy/party of the handing over (there are no limits to your imagination) creates added clarity about the new management situation.

Not only the transferor, but also employees and customers can benefit from this. Especially for the employees it is important that the transition is clearly communicated.

In the event of an official handover, the transferor should place his or her trust in his or her successor. This also motivates longstanding employees to support the new boss.

2.1.7. Retreat of the transferor

In this phase comes the “letting go #2”, which starts with the fundamental principle at the very beginning.

Especially in family-owned companies, it is often the case that the generational change is carried out on paper, but the senior boss is still in charge. Employees then often have the feeling of being the servant of two masters. There is a lack of clarity and irritations in the working climate.

For the generation of the transferors, the phase of the succession can be used with planning of life after the succession. Pioneering spirit is needed again and the young entrepreneurs of the 60+ generation have the additional advantage of being able to work on a very large number of experience and contacts. Another working model is to offer the knowledge for young entrepreneurs as mentor or consultant

It is important that the outgoing senior company owners ask themselves how they define a good life, how they want to live, and which targets they still want to achieve. The target can be a single-handicap in golf or work in a non-profit organization.

2.2. Biz-Up Family Business Succession Model

This model is based on research and the stakeholder interviews carried out in A.T1.1 of the project.

No specific timeline is provided as each family company has its own unique situation - its own DNA.

As with all models, this model as well reduces complexity. Different paths may be chosen in different situations. Still it provides an ideal decision and planning process in the family business succession.

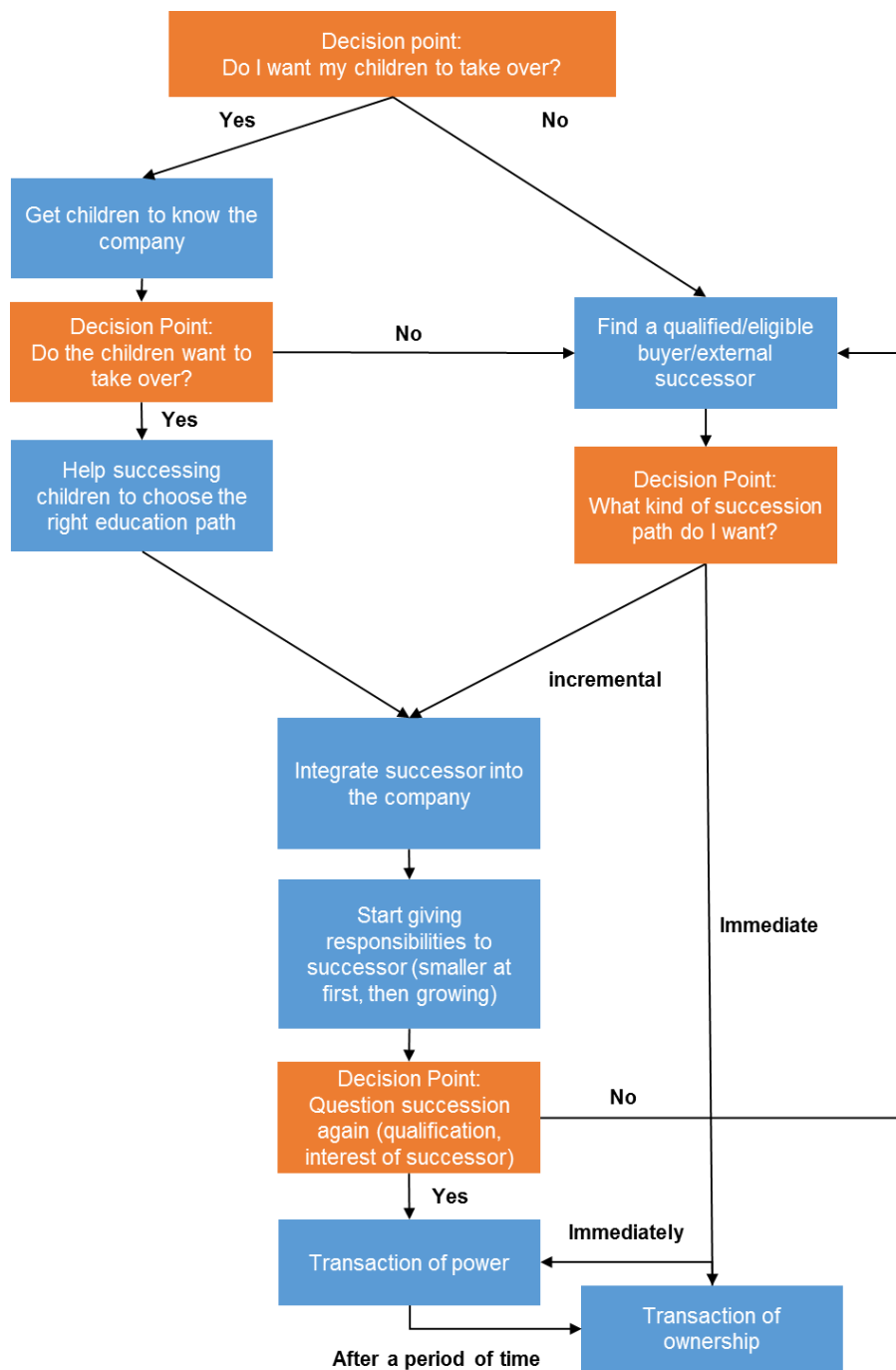


Figure 4: Biz-Up Family Business Succession Model.

Source: own research, Biz-Up, 2017

2.3 Six Stepping-Stones model

Lambrecht (2005) distinguished six stepping-stones to the transfer of the family business: entrepreneurship, studies, formal internal education, external experience, official start in the family business (beginning at the bottom of the ladder, freedom for and by the successor(s)), and written plans and agreements (see Figure 5).

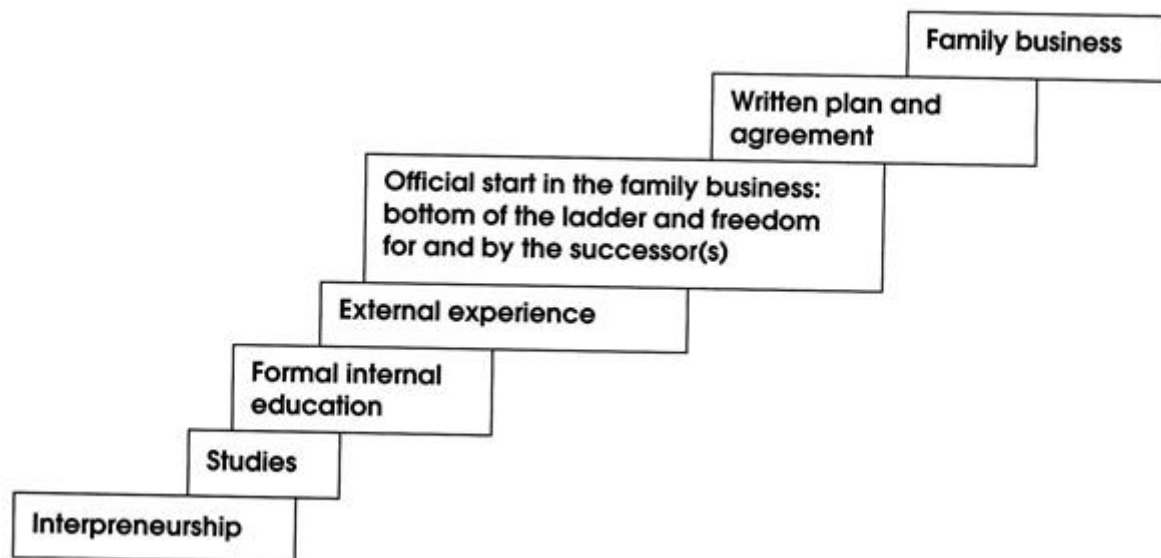


Figure 5: Six Stepping-Stones to the Transfer of the Family Business

Source: J. Lambrecht, 2005

The first stepping-stone was entrepreneurship, which stands for the transfer of professional knowledge, management values, entrepreneurial characteristics, and the soul of the family business to following generations. Distinguished are three life stages of the child that influenced the transfer of professional knowledge. The business was a playground and a play thing up to age 11. Possible successors performed light activities in the family business (during weekends and vacation) from ages 11 to 15. They performed work that was more serious in the family business from age 15 to 17. In this way, potential successors at a youthful age learned the secrets of the product and the tricks of the trade. It was important that the child not be a slave of the business and that the transferring generation not transmit stress from the business to the child. Otherwise, the young family members would experience the family business as a yoke, which they would later want to shake off. In other words, the transferring generation must display enthusiasm. Management values were transferred via upbringing, where the mother often played the major role. Honesty and respect were family values honoured in dealing with personnel. The family values of honesty, partnership, and restraint punctuated commercial policy. Hard work and perseverance were entrepreneurial characteristics central in child rearing. Symbols such as the family home, portraits, and names were conduits for the soul of the family business. They forged the relationship between the family and the business and between the different generations.

Studies formed the second stepping-stone. Most successors earned an advanced degree before full-time entry into the family business. In a number of cases, the studies were oriented toward the sector of the family business. In other cases, potential successors were free to choose a discipline. Often, the diploma was a condition for being able to work in the family business.



The literature demonstrates that larger family businesses sometimes provide formal internal education for family members at a young age. This formed the third steppingstone. Successors learn about the figures of the business, its future, and its values during organized training sessions and attendance at meetings of the board of directors. Along with learning about the conduct of the family and the business, this formal internal education seeks to identify the brighter members of the next generation and to allow directors to become familiar with potential future managers. The mentor can be either a family member or a nonfamily member.

The fourth stepping-stone was the acquisition of outside work experience in other companies, whether or not abroad. Along with knowledge and worldly wisdom, the successors gained self-confidence.

The fifth stepping-stone occurred with the official start in the business. I distinguished between beginning at the bottom of the ladder and freedom for and by the successor(s). Before the succeeding generation held a management position, it generally passed through the various departments in the business (cases 5,6,8, and 9). In this way, the successors proved themselves, won the confidence of employees, and discovered the business, the sector, and the customers. Leadership by the succeeding generation meant the acquisition of credibility. Both transferors and successors underscored the importance of freedom for the new generation when it officially started in the family business. Successors must receive the necessary breathing and manoeuvring room from transferors to learn from their mistakes, to give innovative impulses, and to discover who best assumes the respective responsibilities. Freedom for the successor(s) entailed taking responsibility, respecting the previous generations, asking for advice from the transferor(s), and understanding that the past denotes the foundations and provides a lead to the future.

The sixth stepping-stone related to written planning and agreements. There must be a consideration given to measures needed in the event of doomsday scenarios, such as the death or resignation of a family member. However, written plans were not an absolute guarantee for a successful transfer, and poor planning could prove costly for the business and the family. For the sake of family peace, a taboo might rest on timely written agreements.

Figure 6 presents the principle of sound governance on which a family dynasty is based: the understanding that the individual belongs to the family, which belongs to the business. The new explanatory model replaces the conventional representation with three overlapping circles: business, family, and ownership. The conventional model misses the fact that there are business families that no longer have ownership but still have day-to-day management. Moreover, in the conventional model, management or governance can just as well replace ownership. The keywords in the three concentric circles in my explanatory model are the levers that can move the family business to further generations and are derived from the use of a variety of research sources. The time axis indicates that the individual, the family, and the business, and the interaction between them, are not static. Because they evolve constantly, they form a dynamic whole.

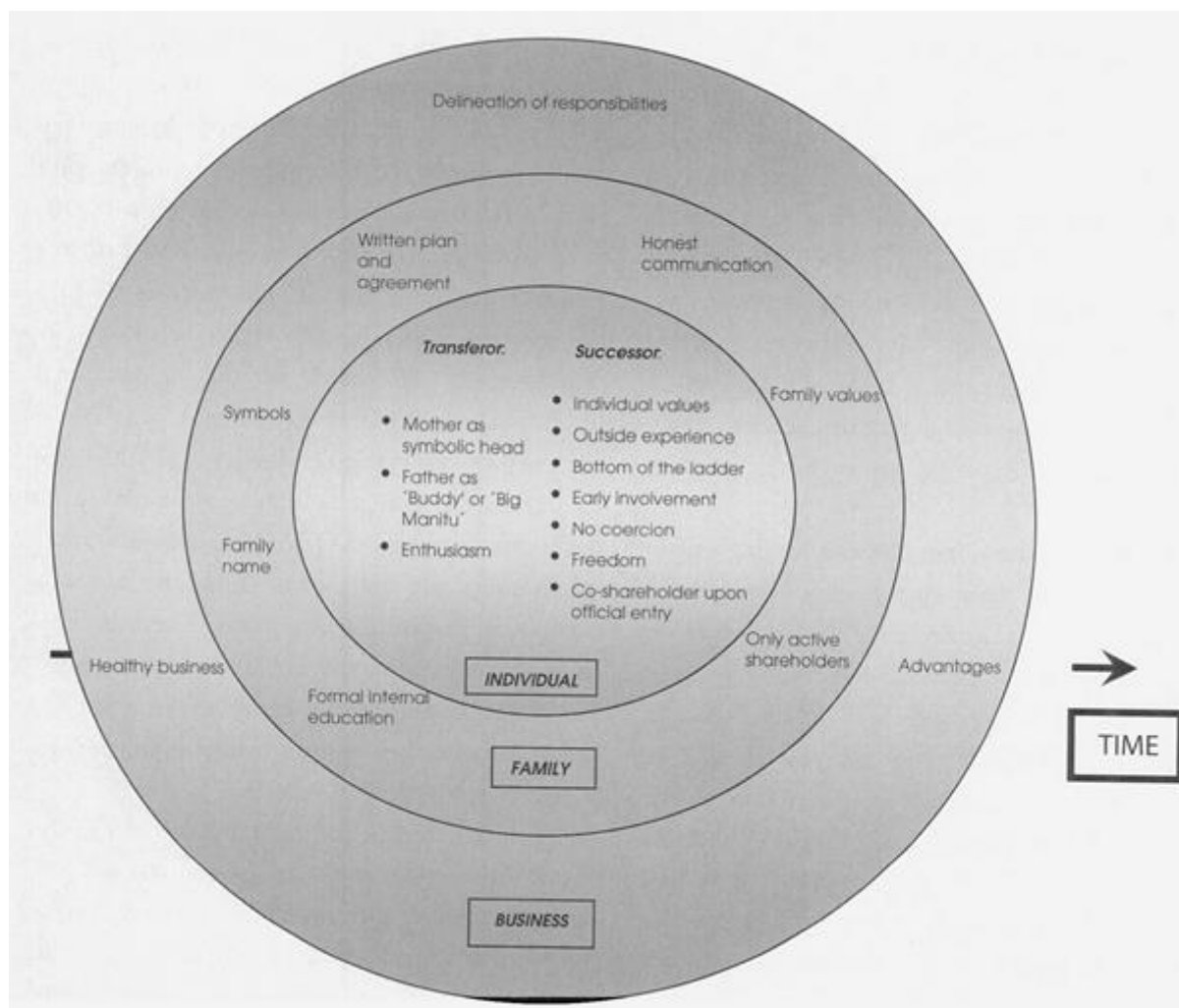


Figure 6: An Explanatory Model for Transfer to Further Generations

Source: J. Lambrecht, 2005



3. Suggestions on model improvements

In this chapter new ideas and suggestions for model improvements are presented. The most specific suggestions were sent by Czech project partners. Both suggested modifications are very similar in some of the ideas presented.

3.1. Extend the model with new lines (PP4)

PP4 suggests improving this model by creating a “dynamic model” as follows:

Currently there are suggested 3 main lines (basically business owner, family successor or external successor) to take. We would suggest to **extend the model to 4 main lines based on to whom the business can be transferred** plus there might be 1 other line in case of business liquidation.

Four lines of possible business transfer:

1. From business owner to family
2. From business owner to management
3. From business owner to employees
4. From business owner to investor

Optional other line in case the owner wants to shut down the business

5. The line of orderly liquidation

Now **each of 4-5 the lines can be further viewed from two point of views** - from the business owner and from the other side. So we suggest to elaborate 2 lines for each of the 4-5 types, so **there would be 8 to 10 lines in total**, grouped by two, based on the main options.

The main benefit of our suggestion is that the basic idea of the German model is preserved and is considered as the best existing starting point, but it is further developed based on the 4-5 main business transfer options, which makes it to be closer to reality. It would be a bit more complex, detailed and specific, but interest group will always find their individual path/road/line and can look at it from the other side as well.

To do this, we might try to draw all 8-10 lines and **start adding the individual “stations” proposed by the German model**. We could **test which stations are missing** and if there are any **specifics** in the regions, that the model **does not take into account**.

However, we believe that these “tests” cannot be done without introducing the model to the business owners and descendants during meetings that will be held in the following months.

In June 2018 we will have an expert on this issue, Mr. Leoš Kubiček, who will take up this planned position in the project. His role will be to combine knowledge with realized projects and practical experience.

The succession principles are well described in the German model at the form of stations.

3.2. Suggestions on model improvements (PP3)

The PP3 VSE team agreed the model is a good base for further development and could be adapted to the Czech environment. However, we propose several adjustments how to further develop the model:

1. The model does not distinguish clearly between potential successors of the business. The model “pathways” could reflect the differences between transferring the business to other family member, company management, company employees or external investor, as these alternatives require different approaches (esp. in the preparation stage of the business succession)
2. There is one line missing in the model: a planned closure/shut down of the company (even though is rather a rare option, some owners suggest this as preferred option over transferring business to external investors).
3. It might be beneficial to include a foregoing stage which would include strategic planning & strategic choice of the pathway the business owner will choose. This stage should include strategic testing which answers questions as:
 - does the family successor have all required competences (and interest) to engage in the business;
 - is the company management capable to take over and is it acceptable for company employees;
how long in advance should begin the business succession process;
 - what is the schedule of the succession, what steps should be taken at first;
 - is there a budget which should be dedicated to support the business succession process;
what is the know-how to be transferred;
 - what are the weak points of the transfer process, how to identify them, how to deal with them; etc.

The model should include a local policy/authority perspective (if any?) and/or other subjects (i.e. business chambers, associations, ...).

A framework or guideline(s) should be introduced for this foregoing stage of business succession.

Each “stop” of the model should be further elaborated to support the decisions. This support might be adjusted to specifics of each participating country(?). This support should include perspectives of all participating subjects (i.e. company owner, the successor, the investor). Each “stop” of the pathway could offer (weighted) self-evaluating criteria or questions to measure how much or to what extent are the partial requirements fulfilled (i.e. sort of balanced scorecard for each “stop”). Based on this the business owner receives a feedback about how likely is the transfer going to be successful. Moreover, such scoring system could reflect in which stage of the business succession process the company is and what need to be done to proceed to the next stage.

The model should be presented to the business owners to gather more feedback (esp. with respect to D.T1.2.7 Behavioural change concept towards stronger engagement of descendants to take over family business - Preparation of methods on how to counterbalance low interest of young family members to take over the business instead of pursuing career through the employment outside of the family business). PP3 VSE and PP4 JVTP will benefit from cooperation with project stakeholders and experts from the Southern Bohemian region.

4. Additional notes on model improvements

The finalized model should be translated in relevant local languages and could be uploaded at some website, together with information on detailed steps and issues, related keywords, entities/tools that could help with specific steps. **In the form of the website** the information could be easily accessible for all relevant stakeholders: business owners/incumbent, successors, agencies, policy makers, etc.

The output model should be presented as an online knowledge-based system which provides a guidance through the business succession process based on the inputs from the users. Each step should be further elaborated and supported with a detailed analysis/other tools to provide an assistance with given business succession step for all affected players (business owners/incumbent, successors, agencies, policy makers, etc.).

4.1. Follow-up after the first round of comments of Project partners

The 1st version of document has been distributed to partners through the regular weekly infomail, asking them to provide their opinions, corrections and suggestions.

Partners generally accepted the preposition of PP4 on the extension of the model by new lines and incorporation of “point-of-view” into the model, differentiating the internal and external look on business succession.

Partners also sent their corrections on mistakes and typos in the texts, which were corrected.

As partner accepted the suggestions PP4 on the model, partner was given the opportunity but at the same time very responsible task of creating draft-model with their suggestions incorporated, which should, after some discussions be used as preliminary model, that would be tested in pilots.



5. Ground rules for family business succession process

People and family are the most important part of the succession planning process and it is important to set the ground rules for any discussions. These will be unique to each family but could include decisions relating to the following:

- Each family member be given time to contribute and be listened to actively.
- Decisions are made either: democratically, by consensus, or by the older generation.
- Each family member will be valued.
- The major goals and objectives will be determined by the family or older generation.
- If general agreement cannot be met, how will decisions be made? Will it be the older generation who have the final decision?
- All decisions are to be written down, to minimise confusion from relying on memory. Communication requirements can differ between generations and by those who have partnered/married into the family. These should be acknowledged and discussed, so that everyone understands how the decisions will be made and implemented. Negative family relationships can damage communication; it is important that each family member be gentle with and respect each other, so that the succession planning process has the biggest chance of success

A wise financial columnist once gave the following ground rules for succession planning (Hillerstrom, 2018):

- Put on your binoculars.
- Include all the stakeholders.
- Don't force it on the kids.
- Develop leaders.
- Empower your successor.

While every company is, of course, different, the ground rules include early action with the professional help of an attorney, clear communication, the consideration of the vested interests of loyal employees and officers, as well as prioritization of company interests over sentiments.

In order for the succession process to be successful, certain conditions (or "rules" in our situation) should be met (Handler, 1994: Succession in Family Business: A Review of the Research):

Business Conditions

1. The transition occurred when the organization was relatively "healthy."
2. The founder moved gradually away from active involvement in the firm's operations.
3. There was a well-developing training and socialization program for the successor.
4. There was an interdependent relationship between the founders and their successors.



Family Conditions

1. The family shared common views concerning equity.
2. The family had planned for emergencies and other contingencies.
3. The family had developed mechanisms to resolve conflict.
4. The family shared superordinate goals.
5. High trust existed among family members.

Board Conditions

1. Power relationships were clear—little ambiguity.
2. The board had the necessary expertise to manage problems of both the firm and family.

Another source provides four simple rules to activate family succession, that at the same time describes the rules in the process, which are required to respect to successfully finish the process of succession:

1. Founders should understand that each high-potential family member is a unique human being with strengths and weaknesses. If they have more than one child, they should avoid treating all children as if they were all alike.
2. Founders should develop long-term succession plans, no matter how small the business. They should stop, look and listen to their heirs, note their strengths and weaknesses both as individuals and as team players, and then drive the succession process based on their observations.
3. Founders should embed an entrepreneurial attitude within the family and the business by creating formal planning structures and written rules about succession. If some aspects of the business require different skills and competences, job profiles should be drawn up and matched with the appropriate CVs of family members. Such expectations drive young family members to acquire the right skills for a job and provide for a transparent transfer of management and ownership.
4. Finally, founders should create an organisational culture that reflects the firm's family assets, heritage and identity. By establishing a family-based culture, founders can ensure that their businesses can survive long after they retire. It is essential stepping stone for future generations.

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