

**Family Businesses**

# **Succession Planning - Why is it Necessary?**

**Report Prepared For:**

[Client Name]

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## 1. Why Talk About Succession Planning?

Well-managed businesses plan and budget for sales, expenses, cash flow and growth. At the same time they should also plan for and anticipate the various changes that occur to a family business which are caused through death, disability or retirement of a key person or any other event that may cause problems within the business.

It is estimated that the vast majority of family owned businesses do not have a formal succession plan in place. Ignoring considerations as to the financial arrangements and rearrangements that will be necessary in a family or business in the event of the death, disablement or retirement of family members, can dramatically affect the value of a business. The worse case scenario - the business itself could collapse and the family would be left with immense problems.

Unfortunately, just as night follows day, retirement and then death will occur to all business operators. After all the sweat and toil that has gone into establishing a business, some consideration should be given to what will happen to that business when the current principal or key persons are no longer available. The best time to start succession planning is at the very beginning of the life of the business.

What would happen if ...? Is a good question to start with.

## 2. What Would Happen If ...?

All persons operating family businesses should give consideration to these questions:

- What would happen if s/he were unable to perform his/her normal duties?
- What would happen if s/he were run over by the 'proverbial bus'?
- Who would take over the business?
- Who knows the secrets of the business?
- Who knows the secret formulas, recipes or deals that have been done with suppliers?
- How would the bills be paid?
- Would the bank call up the loan?
- How would the principal's family survive?

Key questions to be answered include:

- Has the principal written out a set of instructions on what should happen to the business if something should happen to him/her?
- Has this list been given to a Solicitor or placed somewhere safe where it will be found if something happens to the principal?
- Has adequate insurance been effected on the life of the principal and on the life of any partners in the business?
- If a Partnership or a Company with outside shareholders, has a formal 'Buy/Sell Agreement' been entered into?
- Have the secrets of the business been written down, so that they are available in the event of the demise of the principal?

- Such things as:
  - Suppliers' agreements
  - Intellectual property (which might only be known at this stage to the principal)
  - Arrangements with overseas customers
  - Agreements with key staff
  - Who does the principal believe should lead the business, if the principal is not available?

These are all very important questions, which are an integral part of the consideration of succession planning in family businesses.

### **3. Key To Prosperity**

A well thought out and defined succession plan is one of the key attributes to prosperity, both within a business and a family.

The benefits of an effective succession plan can be tremendous. Good staff and accumulated knowledge and experience retained, loyalty and morale are enhanced and the direction of the organisation is more certain. The need to identify, develop and encourage staff with potential is particularly important. Establishing and monitoring a succession plan also provides excellent ongoing opportunities for reviewing an organisation's aspirations and strategies.

The prosperity of the business and the family will be significantly influenced by the intelligent handing over of the reins of ownership and management from one generation to another.

### **4. Who's Going To Be The Boss?**

Deciding who is going to take over from the boss when s/he has gone is the biggest concern facing many small business owners.

Not everyone in the family can be the boss. Too often family members are chosen to manage a business simply because they happen to be family members, rather than because they have demonstrated any particular management skills, while notching up a few years in the business.

Often it is appropriate to have the proposed family member independently assessed for suitability in the same way as assessing an external applicant for the position. This allows the owners to assess a potential manager in relation to the real market. Many organisations are now recognising that it is sometimes better to bring in new management from the market place.

### **5. Select The Correct Person**

The role of a person in a small enterprise is often more important to that enterprise than the role of any single person in a larger organisation. One bad egg in a small enterprise can do a lot of damage. Yet so many small businesses devote few resources to selecting the right people.

## **6. Keeping It In The Family - Can Present Problems**

Keeping your business on the rails can be hard enough at any time, but passing the reins to your son or daughter can present problems, if it is not appropriately handled.

## **7. Succession Planning Must Begin Whilst The Founder Is In Charge**

It is important that succession planning commences whilst the Founder and current Chief Executive Officer is still in charge of the business. It's no use leaving it until the current occupant wants to retire. It is a long term planning process to determine:

- Is there a suitable family member who can take over the leadership of the business?
- Is there a need to employ outside management to act as a coach or mentor for younger family members, who are being developed?
- Should external management be hired so as to enable the family to 'skip a generation' before the next member of the family capable and willing of leading the family business emerges?

## **8. Don't Delay Abdication**

Delayed abdications can cause bitterness and in the long term hurt the business' performance. If there has been a proper plan implemented and appropriate training undertaken, then at a given time, the Founder or current Chief Executive Officer of a business should be able to stand aside and enter into a well earned retirement period. If there has been proper planning on management training, staff training, superannuation and retirement funding planning, an agreement on the ongoing role of the Board of Directors and the former Founder or Chief Executive Officer, then the transition period should be able to be implemented without too many problems.

However if the Founder delays retiring, this will ultimately cause immense problems for the business.

## **9. Assets Being Squandered**

One of the major problems and real obstacles to effective succession planning is the Founder's concern that the business or assets being passed on to the next generation will be squandered. If a proper plan has been implemented and appropriate training given over a number of years, then the likelihood of assets being squandered should be substantially reduced.

## **10. Planning For Succession Is Essential**

The vast majority of New Zealand businesses do not reach the second or third generation. In most cases the reason for this is that there has been improper planning and the reluctance to accept the inevitable that all business people must retire and die at some stage. The market place evidence indicates that only businesses that have properly nurtured and developed the obvious successors within their business, both family and non-family, are likely to defy the statistics and succeed into the second and third generation.

## **11. Checklist For Succession To The Next Generation**

- The Founder or current Chief Executive Officer of the business should commence succession planning early in the life of the business and not when the person is within sight of retirement
- Encourage family involvement and debate
- Family meetings once or twice a year should be encouraged to review the operations of the business
- The agreed management succession process and associated family and staff training programs should be documented and frequently checked to ensure that all aspects of the succession plan are being progressively implemented
- The Founder should set a retirement date and work towards it
- A properly funded superannuation scheme should be implemented so as to enable the Founder or current Chief Executive Officer to retire with dignity
- The successor should be selected as early as possible in the succession planning process and then appropriately trained, developed and introduced to other key business people
- It is important to obtain family acceptance of the person selected as the leader for the next generation
- It is important that the Founder or current Chief Executive Officer ensures that there is a current detailed list of all of the business' secrets and proprietary knowledge, including intellectual property, trade secrets, comments on competitors, agreements with suppliers, agreements with key staff, etc.

## **12. Professional Assistance**

Succession planning in a family business is not easy and most families will require the assistance of a skilled Accountant and Solicitor and/or a business mentor to assist in the logical planning of family succession issues. The involvement of this professional group could be on an ongoing basis over many years as the development of the family members who are going to lead the business in the future are chosen and trained.

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