

The succession strategy – four steps to a successful succession

by Prof. Dr. Peter May

Family businesses and entrepreneurial families are multi-generational projects. That is why there can be no successful family business and no successful entrepreneurial family without a successful succession. However, succession is not an easy issue, and is often accompanied by difficult decision-making processes. Many company transfers fail in the long term due to a lack of will or ability or because of disputes between successors – and the fact that the underlying issues have been suppressed for too long.

Why a structured process is helpful

Succession is not only about the company, but also about the entrepreneurial family, private assets and legal and fiscal matters. A structured process helps to remove the fear of rational and emotional complexity. “Reducing complexity - eradicating fears - creating structures - making individual solutions possible” – I developed the concept of a succession strategy with this claim. It consists of four steps:

1. Conduct a good analysis.
2. Clearly define the target structure(s).
3. Make the right findings and combine them to form a coherent succession concept.
4. Implement the plans with consistence.

The first step: the analysis

The basis of a good concept is an accurate analysis of the initial situation. Only those who know where they stand can judge which path must be taken in order to reach their goal. This also applies in the case of succession. A good analysis is the first step towards a good succession strategy. For this analysis, I recommend using the INTES (Integrated Owner Strategy) principle I developed in 1997, which considers all four fields of interest: company, family, assets and the persons affected. The analysis requires a rational stock-take: What is the current situation? Which strengths can be used and which weaknesses should be taken into account? What opportunities exist? And where are risks lurking? In other words, the analysis of the initial situation for succession is about transferring instruments already known and tested in the corporate sphere, e.g. the SWOT analysis, to the other fields – assets, family, person(s) as well as law and taxes.

Analysis of the company: The company analysis to be prepared for the succession can bring important initial findings to light: What does our company do? Where is it active? How big is it? Who are

the main competitors? Who owns it? What is its structure? What is its profitability? How is it financed? What governance structures exist? Who are the key people? How high is the value of the company – not only in economic terms, but in emotional terms, too? What are the most important strengths? What weaknesses do we need to address? Where are new opportunities? What risks do we have to consider?

Analysis of other assets: A number of questions also need to be answered for the analysis of other assets: What other assets exist and what income do they generate? Who owns them? How are they structured? What financing exists? What about liquidity? Is there an asset strategy? This is followed by an analysis of the strengths and weaknesses as well as the opportunities and risks of the existing portfolio.

Analysis of the family: The professional analysis of the family includes a brief description of the family members and the answering of questions concerning family values, goals and the self-image as an entrepreneurial family. Is there a family strategy or a family constitution? And what is the family cohesion like? Do any conflicts or fields of conflict exist? Strengths (e.g. good mutual understanding) and weaknesses (e.g. rivalry) of the family should be summarized just as honestly as the opportunities that the succession process can offer (e.g. promoting cohesion through a joint project) and impending risks (e.g. aggravating existing rivalries through different treatment).

Personal analysis: Not only the head of the company and potential successor should make an honest personal analysis, but all family members involved: What is the situation regarding their own age, health, relationships, abilities, experiences, strengths, weaknesses, opportunities and risks?

Legal and fiscal analysis: Under no circumstances should the legal and fiscal analysis of the initial situation be neglected. A thorough inventory covers all existing contracts (in particular partnership contracts, marriage contracts, gift contracts, inheritance contracts, waiver of compulsory portion agreements) and unilateral dispositions (wills, powers of attorney, living wills, etc.) and checks them for legal validity, completeness and fiscal consequences. This is followed by an orderly assessment of existing strengths, weaknesses, opportunities and risks.

The analyses described cannot be performed without outside help. Equally as important, however, is that the whole family is involved in the creation process and learns the results of the analysis and discusses them with each other.

The second step: determining the goals

Subsequently, the family must determine which goals are to be achieved in connection with the succession. In accordance with the logic of the INTES principle, this involves concrete goals for the four fields of interest of companies: other assets, family and personal interests as well as goals for the field of law and taxation.

Goals for the company: In determining the succession goals for the company, it is important to develop as concrete and realistic an idea as possible of the future of the company after the generational change. Ask yourself where the company should be in X years. Should it still be a family business? And who should own it? Which role should the family play in the company and which other interests (e.g. of employees) should be taken into account?

Goals for other assets: As other assets in entrepreneurial families usually play a subordinate role in relation to corporate assets, the questions regarding the goals of the assets usually go in a different direction: What purposes do the other assets serve during and after the generational change (e.g. provision for old-age, compensation for children disadvantaged in the distribution of company assets) and should they be managed jointly or shared among family members?

Goals for the family: A family business is inconceivable without a strong family behind it. The succession puts the entrepreneurial family through a tough challenge. It is therefore important that the family determines at an early stage in the succession process what is important to it with a view to the family future. Questions such as: Which self-image and which values should guide the family? How important are cohesion, family peace and unity to us?

Personal goals: Perhaps most difficult is the determination of personal goals. It confronts us like no other field of interest with ourselves, forces us to reflect upon ourselves and to be honest with ourselves. For a successful succession, everyone involved should be aware of their goals – and those of the others, too. So ask yourself what you want to achieve, what is important to you, what role you want to play in the company and what skills you want to develop.

Targets for legal and fiscal structuring: Against the backdrop of an overview of existing legal regulations and their fiscal effects, it must be clearly formulated which goals the legal and fiscal structuring should achieve.

Determine target hierarchy: It is rarely possible to achieve all goals fully and to an equal extent. Often, the realization of one goal leads to the impairment or prevention of another. Therefore, you should jointly determine the significance of the individual goals and resolve any possible conflicts between them.

Even more so than in the analysis, it is advisable to include all affected family members in the determination of the goals. A professionally guided exchange of individual ideas for goals often reveals important insights and forms an indispensable basis for a functioning succession concept.

The third step: The creation of a succession concept

Once the analysis has been performed and the goals determined, it is time to make decisions. On the basis of the knowledge gained, a suitable successor concept is now drawn up. The most important specifications are now made for the four interest areas of companies, other assets, family and persons involved as well as for dealing with pending legal and fiscal issues. It is best to start with a few general and higher-level specifications that precede the succession concept in the sense of a preamble. Subsequently, the succession concept should answer the following questions:

Specifications for the company: Who will become the owner of the company and what will the future management and control structure of the company look like? What role does the family play in the company and what financial benefits does it receive? When will the transfer of ownership and management take place and what preparatory measures are required?

Specifications for other assets: Should other assets be kept together and managed jointly or should they be shared? Who gets what? What is the future management and control structure for jointly managed assets?

Specifications for the family: Who will be part of the family of entrepreneurs in the future and how can we ensure cohesion? How do we ensure the loyalty of the entrepreneurial family to the family business?

Specifications for the individual person(s): What is my future role in relation to the company, other assets and family and how do I prepare myself for it?

Specifications for legal and fiscal structuring: Which legal documents (e.g. wills, inheritance contracts, marriage contracts, partnership agreements, powers of attorney, living wills) are required? What essential content should they contain? What structuring should we conduct with a view to tax optimization? And what should we not conduct?

What is right for the analysis and goal definition is even more important for the development of the succession concept. The more the entire family is involved in the process, the more certain it is that the concept will be supported and implemented by everyone.

The fourth step: consistent implementation

Once the succession concept has been drawn up, it is time for implementation. It should be absolutely clear from the succession concept what needs to be done and this can be as individual as the families whose succession must be designed. Within the **company** it can be a matter of defining a selection process and requirement profiles, organizing familiarization and handover, looking for an external manager, setting up a foundation, looking for a new external partner or starting a sales process. **Asset** restructuring or greater asset diversification may become necessary, claims may be justified or the structure of management professionalized. For the **family**, the development of a family constitution can be envisaged, a targeted training program for the next generation or measures to strengthen cohesion in the growing family can be initiated. The **individuals** involved will draw up plans as to how they will prepare for their future role and life and work through them step by step. Finally, all the necessary **legal documents** are adapted or newly created and the restructuring and other legal acts necessary to achieve the fiscal goals are carried out.

Closing remarks

The following applies to a successful succession process: The transferor, the successor and all family members will only identify with the decisions made if they are involved in the process. Find experienced consultants and experts for the succession process and all legal and fiscal matters. The money spent on them is a good investment. Incorrect designs and unseen opportunities cost many times as much. And last but not least: Talk about the succession process in the family at an early stage. Difficult decisions are easier to make if the rules were created at a time when the topic was still relatively abstract.