

Succeeding at succession: identifying and engaging successors

December 2011

Who to choose? That is the question facing an increasing number of individuals seeking to transfer ownership of a privately held business.

The first decision is deciding among three options: selling, passing ownership and management to family members, or allowing family to retain ownership but not management. According to a Grant Thornton International Business Report, 43% of business owners choose to pass ownership to family members or sell to employees.¹

While privately held business owners and managers are usually adept at dealing with change, the same cannot always be said for identifying and grooming their successors. Why? Because they worry about how the business will fare after their departure. They are concerned about meeting the needs of managers and family members who are not in line for succession. And they are afraid of compromising personal relationships or creating irreconcilable family rifts. Overwhelmed by worry and fear, they let their emotions get the best of them, making poor decisions or the wrong choice altogether. Others postpone the inevitable, clinging to the notion that

nobody has the right skills to take control. The consequences are predictable enough: a business that took years to build begins to crumble because of low employee morale, strained family relations and declining performance.

Then there are the business owners and managers who come to grips with succession planning, making thoughtful, strategic decisions through the process of identifying and selecting a successor. What's their secret? They take time to develop and implement a succession plan that identifies a successor with appropriate skills, communicate responsibilities to all stakeholders and compensate their successor fairly. They also recognize that every position in an organization needs a successor, and that finding a successor isn't something that starts and stops. It's ongoing.

Keeping your emotions in check

Identifying a succession candidate from among people you know, such as family members and employees, may limit the number of choices, but it does not eliminate the psychological challenges of choosing a successor.

Many owners start their business so they can take control of their lives. When it's time to let go, and lose control, they are understandably reluctant to hand the reins to someone with less experience. It's never easy giving someone the freedom

to make decisions that could damage or destroy a business.

Family dynamics also create emotional challenges. If several children are active in a family business, it can be difficult to objectively evaluate each child's capabilities. Not to mention having to tell a child that they are not in line for succession or trying to make sure that all children are treated fairly.

Sometimes, perhaps selfishly, parents want to transfer the business to their children with instructions to maintain its vision and strategy. Children are often reluctant to do things the same old way—a tendency not lost on most parents. Indeed, some parents may consider this determination to do things differently an unacceptable risk to the family legacy, leading to a search for an external candidate who is prepared to maintain the status quo.

It's not just owners who face psychological challenges. The next generation may consider leadership and equity ownership a birthright, which can lead to disappointment and frustration if what they believe is meant to be never happens. Moreover, some children dislike taking orders from parents or employees because they see themselves as the owners ultimately.



¹ Grant Thornton International Ltd, International Business Report 2009, www.internationalbusinessreport.com



“Business owners are generally self-directed people who like to be in control. Letting go can be extremely challenging for them. Ultimately they need to give their potential successors the opportunity to make mistakes. It’s the best way to learn.”

Jol Hunter
Grant Thornton LLP, Canada

Notably, these emotional challenges can persist long after a successor is chosen. No matter who you choose, your successor and his/her skills will inevitably be questioned by family members or employees. You can keep everybody’s emotions in check by:

- identifying the skill set needed to run the business
- providing your successor with sufficient training to support continued business growth
- designing a compensation package to reward performance
- communicating the roles and responsibilities of your successor to stakeholders

Identifying your successor

Sometimes it’s obvious—the employee or a child is such a natural. Or so you thought. Your choice for a successor may seem clear, but there’s a danger in assuming that an individual is interested in ownership or leadership. And even if the person is keen, he or she may not be right for the job.

The first step is to identify the skills that your successor needs to run the business. Determining those skills can be made easier by establishing or confirming the long-term goals of your business. For example, it requires a different skill set to hold the course for a business than it does to transform or reinvent it. The key is to understand the drivers of the business and to put its strategy and the organization of the firm first.

The next step is to establish an open dialogue with the candidate to determine what he or she really wants. Those conversations can lead to the realization that the person isn’t prepared to upgrade his/her skills or consider leadership under any circumstances. Sometimes this screening process is best handled by a facilitator who can assess skill sets, identify gaps and hold candid conversations to find out what really interests the individual. The aim is to have your successors pursuing their true passion, not to have them say “yes” because they think that’s what you want to hear. This is particularly important with children.

The process of identifying candidates within your family can be less structured and start much earlier. Informal chats with young children can help to explain the family business and its objectives as well as its importance to the family. If these conversations generate a spark of interest, then you can take steps to get your children involved in the family business, even if it’s just casual weekend work. If there’s little or no interest, it doesn’t matter. What counts is the reaction and knowing where you stand. You can always revisit the idea later.

Keep in mind that choosing your successor involves more than finding a new leader. You’ll also need to consider senior management positions that are equally important to maintaining continuity today and in the future.

Grooming your successor

Once you identify a potential successor, you need to develop a skills-related succession plan, one that is aligned with your timeline for retiring or winding down your involvement. This training may seem unusual for business founders who had to figure things out for themselves. But a thriving business is also an excellent training ground for developing leadership skills, understanding the nuts and bolts of the organization and acquiring the myriad skills to assure a seamless transition. To be effective, the succession plan must provide full details on requirements for education, exposure to business operations and levels of competency. Your candidate must understand and accept these requirements, and the company's culture and values. A mentor or executive coach might also be considered to help implement your plan, guide your successor's training and accelerate his/her development.

As your successor's skills and capabilities grow, involve him or her in business decisions, the board of directors and industry associations. These activities demonstrate that your successor is engaged in and contributing to the business, and will build confidence in your candidate throughout the organization and with stakeholders.

In some family businesses the children are born ready. But ready or not, there are still things to learn before they take over the top spot. Depending on the children's experience, it may be appropriate for

them to work in functional roles in your business or to gain experience outside the firm. Regardless of where they start, leadership roles for your children should be considered only when you believe they are the right people for the job.

Judging your successor's leadership ability is a key decision point in the grooming process. You may be able to develop leadership, but if your successor lacks it, he or she may never be able to step up. So be open and honest with yourself and your candidate in this regard. If it becomes apparent that the person isn't right, don't hesitate to recruit someone else.

Identifying more than one potential successor isn't unusual and has its benefits. Although several candidates can create problems, it avoids pinning your hopes on one person, only to have them fail to live up to expectations. Whether your candidates are family members or staff, you'll need clear job descriptions, career paths and appraisal reviews to prevent people tripping over each other while vying to become your successor. You'll also need to articulate the criteria for choosing your successor.

Still, mistakes happen—the wrong person is selected or the needs of the business change. A family council or board of directors can reduce that risk by providing oversight during the early years of succession and assisting with future succession planning.



“Owners need to begin by expressing the attributes they expect in a successor. They must also understand that it may take several years for an identified successor to cultivate these. You need time to identify talent gaps and close them if you hope to leave the business on solid footing.”

Laurent Prost
Grant Thornton, France

Designing a compensation package

Most entrepreneurs succeed through drive and determination. You want your successor to embrace similar values, while ensuring that he or she is paid fairly and motivated properly. So, better to link your successor's compensation to moving the business forward, not to moving into the corner office. That means tying the compensation package to objective metrics and aligning it with industry standards. The criteria for rewarding performance and the consequences for failing to meet objectives must be completely transparent and followed without exception.

For your management team, it may be necessary to offer equity ownership or a profit-sharing scheme to provide an incentive to facilitate the succession rather than undermine it. Management will feel less threatened by your succession plans and more inclined to increase the value of your business if they are rewarded for growing the company.

Compensation plans for a family-owned business can get complicated. Your successor's compensation should be performance-based and tied to a transition plan that gives them control and decision-making responsibility. Children who were not chosen as your successor need to be treated fairly and shown how they can make a difference in whatever role they play in the firm. For those not actively involved in the business, you may need to convince them that fair doesn't necessarily mean equal.

The majority of business owners have their personal wealth tied up in the business. So make sure you extract value from the business before you leave. The last thing you want is to be dependent on your children for an income in retirement.

An effective compensation plan for your successor ensures that:

- remuneration is market-based
- annual performance reviews are conducted
- bonuses are based on objective performance criteria
- employment rewards are separated from ownership rewards
- job descriptions or service contracts are in place for all company executives.

Playing fair to avoid conflicts

Let's face it. Not everybody gets to be king or queen even for a day. Most people understand and accept that reality. So the more pressing issue after you identify a successor is to play fair with the rest of your family and employees. Your selection will be easier to understand and accept if you express your wishes clearly beforehand and manage expectations throughout the transition.

As for control of the business, we recommend that one person receives majority control to avoid deadlocks between equal owners. If this decision isn't perceived as fair or handled with sensitivity, the family may be divided by irreconcilable rifts.

“Identify your successors early. Train them. Make sure you have true incentives to reward them. And when it's time to hand over the reins of ownership, step back. If you don't demonstrate trust in the successor you select, neither will your other stakeholders.”

Bernard Doherty
Grant Thornton, Ireland

Consider this: the success rate for the transfer of family-owned businesses to the first generation is just 30%. By the time the second generation takes the reins, the success rate drops to 15%. The third generation has a mere 5% chance of success. Why? In 80% of the cases, the business failed because of family dynamics.²

Asking the right questions

Experience tells us that the companies that survive leadership and ownership transitions are the ones that are run like a business, no matter who owns it. You can prepare for succession planning by answering the following questions:

- is the business dependent on the current management team?
- is there a training plan for successors?
- are there predetermined criteria for selecting the successor?
- are there adequate safety nets to reduce the effects of mistakes made by the successor?
- is there a contingency plan?
- is there a timeline for handing over control?
- are career paths for other executives mapped out?
- do we have the right skill base in the new management team; what gaps need filling?
- what will the CEO's role be after retirement? How about the role of potential heirs?

- has the CEO, founder or majority shareholder set up a viable equity structure to ensure a smooth transition?

Consider these questions if you own a family business:

- do family members working in the business have the necessary skills to perform their jobs?
- do the owners want their children to work in the business?
- do they know what their children's aspirations are?
- do the children want to work in the business?
- is there an education policy for family members?
- are family members expected to gain relevant outside experience prior to joining the firm?
- is family involvement in the business positive?
- are there mechanisms to resolve conflict, such as a family council?
- is there a shareholders' agreement?

Making the most informed choice

Selecting and grooming a new successor can be one of the most challenging tasks of a business executive. You can smooth the transition to new leadership and ownership by treating minority shareholders equitably. This might include a division of assets, a share of profits or a family trust, but it should not include management control. Providing non-

involved stakeholders with management authority can confuse business decision-making and often result in a recipe for disaster.

As you make these arrangements it's important to clearly communicate your succession plans throughout the process. The last thing you want is to surprise people. By discussing your plans openly and early, you and your employees can work toward a common goal of building your business under new leadership in an organization structured effectively for the next stages of its life.

To help ease this transition, it's important to work with experienced specialists who can help you put programs in place to achieve your succession planning goals. Grant Thornton LLP can help. From estate and tax planning to transaction advisory and wealth management, we can help you build an effective transition strategy. With our global reach, proven track record, integrated suite of services and in-depth knowledge of privately held businesses, our practitioners truly act as your trusted guides to help you navigate the succession planning process.

To find out how our professional advisers can help you identify and motivate your successor(s), contact your local Grant Thornton succession and estate planning specialist.

² Fast, John, the Family Business Doctor (Waterloo: Family Enterprise Solutions, 2007), 36.

About Grant Thornton in Canada

Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. Together with the Quebec firm Raymond Chabot Grant Thornton LLP, Grant Thornton in Canada has more than 4,000 people in offices across Canada. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member and correspondent firms operate in over 100 countries worldwide.

This list represents the countries and territories where Grant Thornton International member firms currently have operations. April 2010.

Argentina	Finland	Kuwait	Saudi Arabia
Armenia	France	Lebanon	Serbia
Australia	Georgia	Luxembourg	Singapore
Austria	Germany	Macedonia	Slovak Republic
Bahamas	Ghana*	Malaysia	Slovenia
Bahrain	Gibraltar	Malta	South Africa
Belgium	Greece	Mauritius	Spain
Bolivia	Guinea	Mexico	Sweden
Botswana	Guatemala	Moldova	Switzerland
Brazil	Honduras	Morocco	Taiwan
Bulgaria	Hong Kong	Mozambique	Thailand
Cambodia	Hungary	Namibia	Tunisia
Canada	Iceland	Netherlands	Turkey
Cayman Islands	India	New Zealand	Uganda
Channel Islands	Indonesia	Nicaragua	Ukraine
Chile	Ireland	Norway	United Arab Emirates
China	Isle of Man	Oman	United Kingdom
Colombia	Israel	Pakistan	United States
Costa Rica	Italy	Panama	Uruguay
Croatia	Jamaica	Philippines	Venezuela
Cyprus	Japan	Poland	Vietnam
Czech Republic	Jordan	Portugal	Yemen
Denmark	Kenya	Puerto Rico	Zambia
Dominican Republic	Korea	Qatar	
Egypt	Kosovo	Russia	

Find out how our professional advisers can help you establish, improve, preserve and transfer your business's value. To contact a local Grant Thornton adviser near you, please visit our Web site at www.GrantThornton.ca/contact_us



www.GrantThornton.ca

© 2011 Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd. All rights reserved.
The information contained herein is prepared by Grant Thornton LLP for information only and is not intended to be either a complete description of any tax issue or the opinion of our firm. Changes in tax laws or other factors could affect, on a prospective or retroactive basis, the information contained herein. You should consult your Grant Thornton LLP adviser to obtain additional details and to discuss whether the information in this article applies to your specific situation.

A listing of Grant Thornton offices and contact information can be found on our Web site at www.GrantThornton.ca