Succession Ready

Enabling Leadership Continuation for SMEs

Succession Readiness Training Manual

SME

Contents

Module 1
WHAT IS THE MEANING OF SUCCESSION?

This introductory module will help you to get into the succession business mind-set; to understand the challenge, the significance, and particularities of consulting a classical and family business; and to develop a deeper understanding of the reasons why succession is one of the toughest and most critical challenges that businesses face.

Length of module: 3 x 45 min.

SUCCESSION

Succession in business, as described by Gersick et al. (1997), is the intricate process of selecting and transitioning owners within a company. As the business evolves, tensions arise due to the expanding pool of potential owners, typically family members. This dynamic creates challenges in deciding who should assume ownership roles and how shares in the firm will be distributed. Complicating matters further, the roles of owners become increasingly intertwined with other aspects of the business, such as leadership and management functions.

BASIC

Germany's corporate landscape is predominantly shaped by family-owned businesses, constituting 91% or roughly 2.95 million companies. Within this vast majority, 97% fall under the SME category. This influential sector not only serves as the primary employer for the nation but also contributes to around 80% of the apprenticeships available in the country. (BVMW e.V., 2023)

With an estimated 173,000 family businesses in Ireland, they are a primary contributor to the economy. Approximately 70% of Irish businesses are family owned. According to Family Business Network Ireland, they employ more people than the State and foreign businesses combined and contribute just under €19 billion to the exchequer. Among the added value they bring is a geographic spread, making them important drivers of regional development. (Irish Times, 2023)

According to a survey by PwC, 91% of Greek family businesses expect to grow over the next two years, which is higher than the global average of 84%International sales currently account for 34% of Greek family business turnover and are predicted to account for 41% in five years. The same survey also found that 38% of Greek family businesses have a sustainability strategy in place, and 40% say their digital capabilities are strong. A study by the Family Business Research Group of the Alexander Technological Educational Institute of Thessaloniki estimated that there are more than 770,000 family businesses in Greece, comprising more than 98% of total Greek businesses. (PWC, 2021)

In Slovenia, 83% of businesses are family-run, of which 95% are micro and small enterprises, employing 70% of the working population. The same is true for other European countries, where between 70% and 85% of all businesses are family-owned and provide up to 70% of private sector jobs (Antončič, Auer Antončič and Juričič, 2019).

In the Netherlands, the impact of family businesses is significant, comprising just over 275,000 entities that contribute to more than 49% of employment and nearly 53% of the gross national product (GNP) according to Nyenrode. These businesses have demonstrated robust performance, as evidenced by 84% reporting growth and only 5% facing sales reduc-

What does the term “family bussines” mean?

The term “family business” refers to a type of business that is owned and operated by family members. It is a company (enterprise) in which the family assumes leadership roles and controls significant decisions and work processes within the business. In such a business, the owners, typically members of the same family, are actively involved in the management and operation of the company. However, this does not mean that they cannot separately transfer the leadership and ownership shares in the company to their successors when they choose to do so (Grand Thornton, 2022).

An important characteristic of family businesses is the connection between the family and the business, which can influence the organizational culture, values, employee relationships, and decision-making processes. In many family businesses, family identity and values intertwine with the business goals and strategy.

Family businesses can have several advantages, such as strong family ties, quick decision-making, long-term vision, and the ability to adapt and maintain stability across generations. However, family businesses also face challenges, such as difficulties in separating family and business life, the potential for conflicts among family members, and challenges in succession planning.

tions in the recent financial year. Looking ahead, there are ambitious growth projections, with 81% of Dutch family businesses anticipating expansion in the next two years, surpassing the global figure of 77% (PwC, 2023).

The figures alone show the importance of family businesses to the economy, as they create more jobs than other businesses, are innovative and growth-oriented. They have a reputation for conducting their business with their employees and the environment according to high standards of social responsibility, for upholding their values and for creating a favourable environment for reconciling work and private life.

The multi-generational nature of family businesses strengthens the stability of the economy, and family businesses usually play a key role in regional development, transfer of know-how and regional planning (Report on family businesses in Europe, 2014).

This data raises the pertinent question of which businesses can be classified as family businesses. It is important to note that the definition and understanding of family businesses can vary depending on the country and legal frameworks in which they operate (Inc. com, n.d.)

According to Weasthead and Cowling a family business is one where more than 50% of the voting rights of the company are held by the family, where family members are present in the management of the company, where the company is run by the second generation or there is an intention to transfer, and where the management self-identifies as a family business (Weasthead and Cowling, 1998).

The European Commission (2014) describes a family business as a company that has some of the following characteristics:

- the majority of decision-making rights are held by natural persons (or their spouses, parents, children or grandchildren) who founded the company or who have inherited a shareholding in the company,
- at least one member of the family is formally involved in the management of the company (participation in the management or supervisory bodies),
- public limited companies meet the definition of a family business if the person who founded or inherited shares in the company, or the family of such a person, holds at least 25% of the decision-making rights in the company.

According to the World Bank's definition, the term family business refers to companies in which the majority of voting rights are held by one family, which includes founders who seek to transfer ownership of the company to their successors.

The simplest way to explain the family business system is Gersick's (1997) model in image 1 of three circles, which illustrate the family business as the intersection of three overlapping areas; the firm, family and ownership, with each of the participants in the family business situated in one of the overlapping areas.

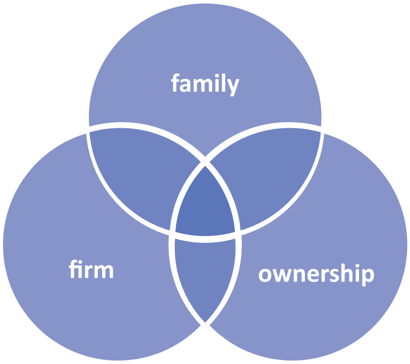

Image 1: Gersick's (1997)

MEANING OF SUCCESSION

Succession refers to a series of activities undertaken by a founder entrepreneur to successfully plan and execute the transfer of ownership and management of a business to another person or entity. Succession means the handing over of the business to a successor on agreed terms and the partial or total withdrawal of the founder from the business. Withdrawal from the undertaking shall be effected in such a way as to ensure the continued existence of the business. Succession can be carried out within the family, through management buy-outs (sales to non-family management/employees) and sales to outsiders or to existing companies, including through acquisitions and mergers (European Commission, 2013).

In Slovenia, there is no unified name for this set of activities, so authors (Ahej 2008, Kociper 2016, Vadnjal 2008) use a range of terms:

- succession; the term is the best translation of the established designation in English (succession) and German (die Nachfolge) and denotes "the acquisition of a certain position, office directly from someone else or the acquisition of property or certain rights directly from someone else (SSKJ, 2017)",
- transfer of ownership; it emphasises the transfer of ownership interests and does not refer to the transfer of management,
- transfer of a business; it is the broadest term, covering transfer to a family successor, sale to outsiders, MBO, but is not the most appropriate term to use when closing a business,
- transition; the term describes the activities of the transfer itself, the process.

In this publication we use the terms succession and transfer of business. However, when referring to the period of succession building, we use the term transition.

It should be pointed out that the transfer of ownership of a business can mean the transfer of activities (in the case of sole traders) or the transfer of ownership, i.e. of shares, in the case of a limited liability company. These two forms are most common among small and medium-sized enterprises, of which family businesses are the majority. Transfers of business in other limited liability companies and partnerships should not be neglected, but from a legal point of view these transfers require separate treatment (Pirc, 2015).

At EU level, 480 000 business transfers take place annually. It is estimated that up to 150 000 companies (600 000 jobs) go out of business annually due to the many problems associated with ownership transfers. Family businesses are heavily represented among these businesses, which member states of EU should allow to pass on smoothly to the next generation and to keep the activities within the family as a family business (European Commission, 2013).

REASONS FOR SUCCESSION

Like living beings, businesses go through life cycle phases. A company is conceived, born, survives, reaches maturity and if the entrepreneur had not taken care of succession, the company would have been dissolved after a certain period of time. Succession is thus seen as one of the phases in the life cycle of a company that every company will face. These phases have their own characteristics and entrepreneurs mostly know how to deal with a particular phase, but they are less familiar with the succession phase. This can happen at any time in the life cycle of a business, depending on when the entrepreneur wants or needs to hand over the business. The succession phase, like the other phases, requires good strategic planning, attention and not procrastination, such as deciding to grow or launching new products when the need arises.

The reasons for succession are divided into two groups, namely personal and business reasons. Personal reasons are in most cases linked to old age and retirement or illness. The entrepreneur may also decide to change profession or lack of time for family may force him to sell the business and start a new business that will allow him more free time. There may also be emergencies such as illness in the family, divorce, etc. (European Commission, 2013).

Business reasons can include unprofitable business operations or tight market conditions that require additional skills and fresh capital that the entrepreneur cannot provide and either has to sell the business or at least needs help to run it. Some entrepreneurs sell the business at a stage of intense growth, when they may not be able to provide the financing and guidance themselves to grow and the business is then achieving a high value in the market. Alternatively, they sell the business at a stage of maturity, when the business has reached its optimal size, the business is relatively stable and they no longer feel they are needed in the business.

Partly personal, partly business reasons can be classified as sales by “serial entrepreneurs”, as persons who are very successful in identifying business opportunities are called. They set up several businesses in their lifetime and sell them shortly after the businesses start to grow and reach their expected value on the market.

The reason for transferring a business has an impact on the entrepreneur can arrange the transfer and on their ability to plan accordingly. As will be discussed below, it is appropriate to plan at least 5 years in advance for the transfer of the business how to prepare adequately for it in terms of succession planning, optimisation of business functions, taxes, etc. HOW the entrepreneur will carry out the transfer depends on the performance of the business. In the case of an insolvent business, the company will go into bankruptcy or liquidation. However, in a successful or at least solvent business, the entrepreneur has several options, including some that he does not often consider.

Some of the possible ways of transfer are:

- transfer to the next generation within the family,
- transfer within the extended family or sale to employees (MBO),
- hiring an external manager,
- market sale of the business,
- strategic partnerships,
- franchising.

IDENTIFYING READINESS FOR SUCCESSION MANAGEMENT

This article is talking about Readiness for Succession and identifying if the company owner has ability to perform and move to the target position.

Identifying Readiness for Succession Management

If you want to explore more, there is another tool available that can help you gain additional knowledge about the topic.

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PREPARING FOR SUCCESSION

Entrepreneurs who have completed the succession process shared some tips for those who are just starting the succession process. Several entrepreneurs admitted that if they were going through the succession process again, they would have a more thorough discussion with their family members about their wishes and feelings. One entrepreneur pointed out that there is nothing positive about a founder trying to manage succession on their own, as his other friends have a lot of experience to learn from. His message was also that there are knowledge and support institutions that can facilitate the process. It is up to each founder to decide whether to seek this help.

OBSTACLES TO SUCCESSION PLANNING

The transfer of a business is a complex process, involving much more than the legal transfer of ownership in exchange for consideration. There are many obstacles to overcome for a successful transfer, including those of an emotional and psychological nature. The transfer of a business has several important characteristics that distinguish it from the sale (or gift) of most other assets (European Commission, 2013). It is a critical period in the operation of a family business, which, in addition to the change of director, also involves a complex combination of ownership, organisational, legal, financial, tax and, last but not least, emotional factors (Kociper, 2016).

Succession planning is essential, but founders often delay the start of planning as they face the thought of transience and retirement, as the transfer of the business goes hand in hand with ageing. In addition, they will lose their entrepreneurial lifestyle, decision-making, control and power after the transfer of the business. They also postpone planning because they do not realize the seriousness of the problem and hope that things will work themselves out. Deciding who to leave in charge is also not the easiest decision if they have several possible successors or no successor at all. An additional problem after retirement will be insufficient income, as many entrepreneurs do not pay themselves adequate salaries and, consequently, pension contributions. Once they have met the conditions for retirement, there is a moment of sobering up, as the pension is not sufficient to maintain the standard of living to which they have been accustomed. Unfortunately, these reasons are not usually isolated but occur in all sorts of combinations and intertwine. Because planning is delayed and because the transfer is complex, it too often happens unprepared.

STRATEGIC PLAN

A task as important as succession requires a strategic plan. The main reason why strategic planning is so important is the potential for conflict within the family. Another important reason is of a business nature, namely planning allows for good business performance in the long term, which is the goal of most entrepreneurs.

Leach (1991) recommends that the plan should be in writing as it proves to be a good tool to help make the succession process more structured. A document that has been co-drafted and agreed by all those involved will reduce the potential for conflict.

The plan should contain a number of substantive areas that the founder should plan for when preparing for the transfer of the business. The vision, mission and objectives of the company should be defined, a timetable for the transfer should be established, continuity in the company should be planned and an appropriate structure should be established. When transferring a business, it is necessary to obtain an estimate of the value of the business, which will be useful in several situations; if the entrepreneur decides to sell the business, to close it down, as well as when transferring it to a family member, as the value must be entered in the Transfer Agreement. The most important part of the strategic plan is the decision on how to transfer the business (family succession, sale, etc.). The latter will determine how the business will be repaid and handed over (Ahej, 2009).

The plan should be co-designed by the entrepreneur together with family members and other important people in the company. It should then be presented to the extended family, perhaps also to customers and suppliers, the bank, accounting, etc., i.e. those who have a strong connection with the business and are affected by the succession. This will demonstrate the company's seriousness and provide reassurance about planning for the future success of the business.

Unfortunately, entrepreneurs are not very aware of the importance of planning, as shown in a short survey (Ahej, 2009), where 43% of entrepreneurs answered that they are already planning the succession of their business. Worryingly, 38% of them consider that it is soon enough if they start planning the transfer a few months before the transfer itself. The remaining 19% do not think that succession planning is necessary and will look for solutions as and when needed. (SPIRIT)

A strategic business plan is a document that gives the entrepreneur the opportunity to show himself and other stakeholders inside and outside the business how he envisages the business operating in the future for a certain period of time. The business plan is used to check how successful the business is expected to be and whether any changes may need to be made on the revenue or cost side. The business plan also makes very clear the activities that need to be carried out to get to the intended results.

In large corporations with dispersed ownership, strategic and operational planning is necessary and quite formalised. Planning is carried out according to a set annual schedule in specially organised business units or departments. The strategic and operational plans provide the framework for the business. No one doubts the necessity of preparing such documents. However, in small and medium-sized enterprises, the question of the real need for such planning is more frequently raised, as they are by nature more flexible and also more susceptible to unforeseen changes. The planning process is not part of regular activities and is not systematic. (M. Ahej)

VISION AND STRATEGY

The formulation of a corporate vision and strategy is a prerequisite for a successful business transfer and for the decision on how to transfer the business. The vision is how the entrepreneur envisages the business in 5 to 10 years' time and the strategy is how the vision will be achieved.

The entrepreneur needs to ask and answer the following questions:

- What do I want my business to look like in 5 to 10 years? What will be the main products and markets? Do I have the knowledge to realize this?
- Do I need additional capital to realize the first bullet point? Can it be provided by family, banks with credit, external investors?
- Do I want the business to remain family-owned and/or family-run?
- Where do I see myself in relation to the business after retirement? Who will run it?

Once the entrepreneur has answered these questions, he or she has largely answered the question of how succession should take place. If family members will not be able to manage or financially control the business, then they should consider selling. If they only need additional capital, it makes sense to consider a strategic partner. However, if the business is already failing, markets are closing or competition is too strong, and the entrepreneur does not have a family successor, then it makes sense to consider selling part of the business or assets and closing down. We will discuss succession methods in more depth below.

The following model is intended to illustrate how to effectively manage the all-important family component or family circle during the succession process.

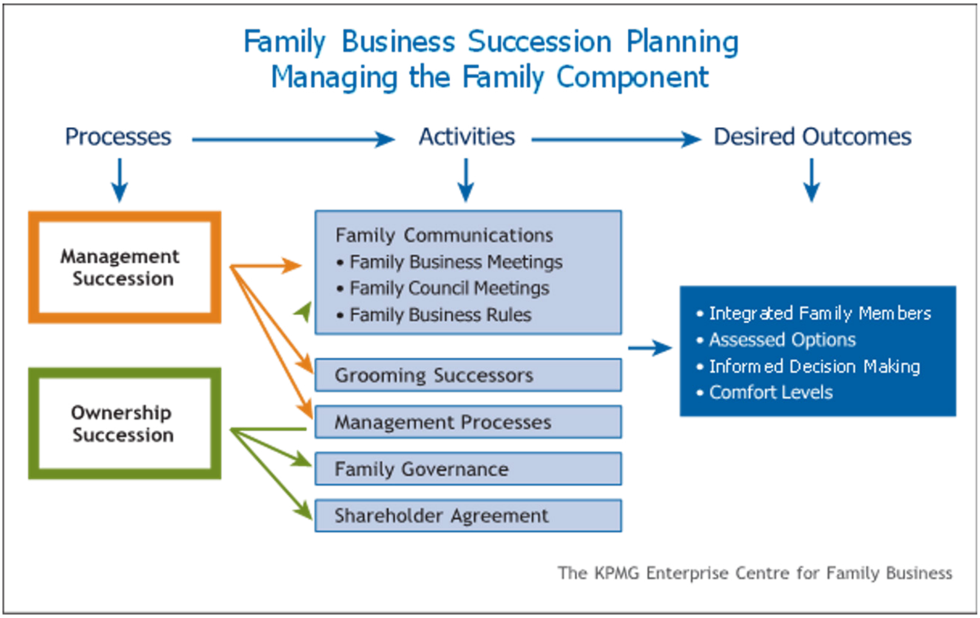

Image 2: KPMG, 2011

Succession Processes

The family business succession plan comprises two processes, the 'management' succession process and the 'ownership' succession process. Numerous succession activities are outlined for each of the two processes to achieve the desired succession outcomes. The management and ownership succession processes can be undertaken simultaneously or one at a time. It is recommended that the management succession process be carried out first so that the ownership succession plan reflects and supports the management succession.

Succession Activities

The model shows a number of family business succession activities intended to integrate family members into the management and ownership succession processes. The activities are also intended to make family members feel comfortable with both the succession process and its outcomes. The ultimate goal is to allow family members to make informed decisions about their individual and collective futures in the management and ownership of the family business.

Establishing family communication activities, such as family business meetings for the active family members, family council meetings for the broader family, and family business rules, will serve to guide the overall succession process. These communication activities will pave the way for the effective management of the all-important family component. The management succession activities also include the grooming of successors and integrating the active family members into a number of key management activities.

The model also shows the ownership succession process including a list of succession activities involving family members. These activities comprise the same channels of communication as indicated in the management succession process. The ownership succession activities also include family governance and shareholder agreement issues.

The management and ownership succession activities can be carried out simultaneously. You will notice that the proposed activities to manage the family's communication (family business meetings, family council meetings, and the family rules) are the same for both the management and ownership succession processes. What will differ is the type of succession issues that are addressed at the family meetings. It is strongly recommended that regardless of which of the management or ownership succession processes are undertaken, you start with the family communication activities.

FAMILY BUSINESS GUIDING PRINCIPLES

In working towards the desired succession outcomes, the process or discussions may become stalled or challenged due to the number and sensitivity of management and ownership issues, and the corresponding number of possible outcomes.

Decisions made affect not only the future of the business, but also the future of the family as a family unit. Family business practitioners have learned that the succession process is greatly facilitated if the family business owners and/or their successors steer the process and their decision making based on proven family business succession guiding principles.

Applying these guiding principles facilitates the discussion pertaining to the specifics/details of the succession plan. The following are some of the more pertinent family business succession guiding principles worthy of consideration:

- **Beware of the tax driven/cost savings succession plan:** The research on family business continues to indicate that far too much attention is allocated toward the technical components (tax, trusts, insurance, shareholders agreements, wills) of the succession process and far too little attention is allocated to the non-technical components (i.e. wishes and aspirations of the family members, family harmony, family legacy, family dynamics, integrating and preparing the next generations). This guiding principle has also lead many successful family businesses to forego tax and other cost savings in favour of family harmony. In other words, if a particular succession strategy is viewed as helping to safeguard family harmony, it is often considered a priority over cost savings.

- **Creating a legacy:** Most successful family businesses adopt the concept of creating a lasting legacy. This is based on the guiding principle that the founders of the family business have created a family asset that the family would like to continue to cultivate in order to establish a lasting legacy for the founders. Applying this guiding principle to the succession process means that the family wants the business to stay in the family and, as such, all future generation of owners should act as 'stewards' of the family business. As 'stewards,' they are charged with the responsibility to safeguard the family business, grow it, and make it even better for the generations to come.

- **Opportunity versus entitlement:** Successful family businesses ensure that future generations clearly understand what the family business can do for them. In other words, what exactly is being offered and how should this be interpreted? In applying this guiding principle, future generations are constantly informed/reminded that the family business can provide them with an opportunity to work in the business as well as an opportunity to be an owner in the family business. Each is based upon meeting agreed upon criteria in order to eliminate the notion of 'entitlement.' This guiding principle also promotes the view that the business is very important since it's the business that is allowing the family to enjoy this opportunity, which in all likelihood they would not find elsewhere. The business needs competent family leaders that are supported by competent key employees.

- **Family ownership:** This guiding principle could well be the most important in support of creating the legacy. Research clearly indicates that those family businesses that only allow active senior family members to own shares have fared much better in the succession process. This is based on the premise that those family members who have generated the business wealth should be allocated the business wealth. Those family members who have not participated in the generation of the business wealth (by choice) can be allocated wealth from the family's non-business assets. When this guiding principle is applied, it greatly facilitates the discussion on who can own shares and how it is funded.

Exit strategies: It is widely known that the best exit strategies for a family business are those for which the terms and conditions of the exit (death, disability, and voluntary exit) are pre-determined, agreed upon, and outlined in the shareholders agreement. This has proven to reduce much of the family conflict that can and does arise when a family member exits the ownership ranks of the family business. It also removes much of the uncertainty surrounding the impact to the business and to the family. As previously mentioned, in order to achieve this objective it may be necessary to forego tax efficiencies.

Taking the lead: It is strongly recommended that the next generation of leaders/owners take the lead in the succession process by addressing all of the management and ownership issues (facilitated by a family business practitioner) and, once they have reached a consensus, present their recommendations to the current owner(s). After all, if they are going to lead the boat, they should be able to agree on its future course.

Compensation for active family members: Compensation is often cited as one of the most contentious issues facing family businesses. If not effectively dealt with, this issue can cause a great deal of conflict and disharmony among active and non-active family members. The guiding principle is to remunerate active family members fairly (not necessarily equally) so that their remuneration reflects, to the degree possible, fair market values (i.e. what a non-family member would be paid to do the same function). Benefits and what constitutes 'benefits' is an even more contentious issue in family business. Family members pay close attention to what each is receiving and make their own interpretations of the fairness of these benefits, unless, of course, there is a clear policy that outlines who is entitled to what and why. How remuneration will be determined today and in the future needs to be clearly understood and agreed upon by all family members.

Compatibility: It would be naive to think that just because family members are part of the family, they are compatible to work together. Siblings are different; they have different skill sets, different interests, different expectations, and different visions for their future and the future of the business. Assuming that all of these differences will simply line up in conformity over time and that harmony is assured by the bond of family blood has far too often plagued family businesses. We need to accept the fact that the next generation will be different than their parents and that there will also be differences among siblings. Given this, we need to ensure that those family members who aspire to leadership and ownership roles are compatible. It is clearly not advisable to force children to work together if they are not compatible. Therefore, we need to incorporate the test of compatibility as part of the assessment criteria for leadership and ownership in a family business.

Accommodation for family members: This principle may be seen as contrary to conventional business wisdom, but is a reality in the world of family business. The principle is based on the premise that most family business owners want their children in positions of leadership and ownership even if there may be other more competent non-family members to lead the business. In other words, as we plan for the leadership and ownership succession of the family business, we need to accept the fact that we will need to accommodate to the degree that is reasonable the active family members. As one family business owner put it, "If my sons were not family, they would not be the leaders of this business. However, as family, we need to do what we can to accommodate their wishes and aspirations and surround them with competent managers and continue to groom them to become good leaders."

Informed decision making: It is the view of many family business practitioners that success in succession is the ability of each family member to make an informed decision about their individual and collective futures in the management, leadership, and ownership of the family business. In order to make an informed decision, the family members must know the options, be provided with the kind of information that enables them to assess the options, and be provided with a forum where they can discuss and express their views and decisions.

GAP ANALYSIS

This is a classic tool where participants are asked to identify the gaps between the current situation and the desired future situation in order to focus on the gaps when solving problems.

Gap analysis

MAKING USE OF OUTSIDE ADVICE?

When a business grows beyond the level of a craft workshop (or would like to), it will be difficult for the owner or entrepreneur alone to coordinate all the key functions, and it will be difficult to organize “departments” to look after individual areas, as this would be far too expensive. The simplest and cheapest option is therefore to hire external staff and consultants.

WHEN IS IT A GOOD IDEA TO HIRE A CONSULTANT?

The first step is to identify the problems in your company and address them. The help of a consultant is welcome if disagreements within the family and the company are affecting the business or causing serious conflicts. Or when the company is facing important milestones such as succession, reorganization of legal status, sale of the company or formation of a supervisory body. Sometimes the adviser is also “just a listener and mediator” in conflicts.

Many problems we could tackle ourselves, but we are too emotionally invested in the company, we are limited by our knowledge of the past and we know that “blood is thicker than water”. We can help ourselves with various manuals, but they give the same advice for all businesses, and we know that ours is different from our neighbours.

In family businesses in particular, the problem is communication. It is needless to say once again that it is never too early to talk about succession. There is a lot of emotion and subjective views in the family when talking about the business, and some family members do not dare to speak their minds in order not to offend others. Meetings can end in tears, if not in serious conflict and recriminations. This is why an independent adviser is needed to guide the conversation and identify obstacles. The purpose of counselling is to find solutions that suit both the family members and the company and to continue the family business through frank discussion.

The adviser's aim is the long-term survival of the business, without personal (and emotionally driven) interests in the business. The adviser is a person who is familiar with a wide range of areas, from interpersonal relations within the family, some even being family mediators, to tax and legal matters. This broad spectrum distinguishes them from specialized tax or legal advisers. The latter may be able to draw up an adequate succession plan from a legal point of view, for example, but their possible lack of knowledge of the tax regime for family businesses can be very costly. Changes in a family business can also be very emotional, e.g. sale of the business, retirement, selection of a successor, and the right adviser will also take into account the emotional component and understand the situation better, as they often have their own experience of the family business. He or she will also be able to advise on training programs suitable for the founder or successors, perhaps visiting groups where entrepreneurs with similar problems meet or a specialized advisor if necessary.

WHAT DOES COUNSELLING LOOK LIKE AND WHAT CAN WE EXPECT?

The counsellor will work with you to identify the issues and develop a plan that takes into account the specificities of your business, taking into account the values and goals of both the business and the family. He or she will give an opinion, present the situation in a neutral way and propose solutions, but will not make decisions for you.

Counselling often starts with the entrepreneur explaining the problem beforehand, the counsellor preparing accordingly and meeting the family. Depending on the relationships within the family, the counsellor will meet with all the representatives together and/or with each family member separately. After summarizing the findings, the consultant presents them to all family members, who then draw conclusions. If there is a longer-term involvement, this may be followed by written instructions, telephone conversations, etc. The counsellor also prepares a report on possible complications and suggestions for solutions.

Shorter consultations, e.g. one-day consultations, are intended to advise on the tax and legal optimization of succession transfers, on the change of legal form and the preparation of the relevant contracts, on issues such as how to provide for the founder's financial security after retirement, the status of family members who are not involved in the company, etc., but the basic guidelines must have been agreed within the family beforehand. In most cases, the guidelines cannot be agreed within the family, in which case it makes sense to hire a consultant for a longer period of time and several meetings. These are designed to professionalize management, to develop a strategy that will support the long-term viability of the company, to design decision-making methods and to communicate effectively. After discussions with the family members, the advisers draw up a succession plan, identify potential successors and those family members who do not wish to take over the business, advise on the distribution of the business and assets among the successors, and participate in the implementation of the succession plan and the drafting of the family constitution. As business advisors, they may be involved in the introduction of a successor to a management position, the sale of the business, etc. In medium and large-sized companies, they also advise on the establishment of a management and/or supervisory board, which may include, in addition to family members, other persons such as owners, other entrepreneurs, consultants.

HOW TO CHOOSE A CONSULTANT?

First of all, make sure they have expertise in the area and that they are a family business adviser. Find out about their training, experience and references. Choose someone you can trust, as you will need to share details of your business and family life with them. Often the root of the problem lies in events that go back in the family history that we have swept under the carpet and will have to confide in the adviser. Not all family members may be interested in the idea of a consultant and it is important to decide and choose one together. You will only get results if everyone involved cooperates and trusts the counsellor. So let the adviser tell you whether you will work with him/her alone or whether he/she will involve other colleagues.

The cost of the consultancy is small compared to what you stand to lose, so don't let price be the criterion and don't skimp on the number of meetings. If the consultant wants to make a good assessment of your situation and help you, you will need to meet with him several times during the process. The market offers counselling sessions that last from a few hours to a few months (Kociper, 2016).

COUNTRY SPECIFIC IMPLICATIONS

Any country specific requirements for succession planning are driven by different factors such as:

- globalization has eliminated borders and unified the processes;
- ease of communication has impacted how we do business;
- COVID pandemic has normalized working remotely;
- language is still a barrier but likely to be overcome in future;
- labor laws in all EU countries are based on EU guidelines.

Most EU countries follow similar HR policies and procedures. There may be some variations in the law of succession for ownership roles, specially for family businesses.

In next module we will introduce you the potential solutions and business challenges.

USEFUL LINKS AND OTHER MATERIALS TO EXPLORE

Personio - Proven Succession Planning in 7 Easy Steps

What is Succession planning - Techtarget

Developing Leadership Talent, David A. Day

Paul Ballman, Consultancy.eu, Sep 2021

Succession Planning in different cultures - Munich Business School

Succession Planning in Family Business

Succession Planning Challenges
(Source: Talent Management, GreggU, 2021)

HR Basics: Succession Planning
(Source: HR Basics, GreggU, 2020)

Successful Succession Planning
(Source: Training and Development Concepts, GreggU, 2019)

Succession Planning - CEIBS Zurich
(Source: China Europe International Business School, Zurich ,Karl Schaedler, 2021)

Succession Planning for SMEs
(Source: Bentleys Chartered Accountants TV Channel, Edi Carlesso, 2016)

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Module 2
TRANSFERRING A BUSINESS - CHALLENGES AND POTENTIAL SOLUTIONS

Module overview:

This module is designed for entrepreneurs, owners, and leaders of businesses who are considering transferring their business assets to the next generation of family members. They will find guidance on what needs to be known, done, and decided before, during, and after the transfer of the business to their successors. Also, there may be different reason that the business will not be transferred to family members. In such a case, sale of a business seems to be the only option which is also covered in this module.

After studying this module you should be able to:

- Know the advantages of timely transition planning
- Know the disadvantages of not planning properly
- Help owners and family members decide whether succession within a family is the best option
- Identify different options for giving up control of a family business
- Help owners and family members decide whether perhaps a sale is the best option for a different reason

2 case studies will help you understand the importance of succession planning

Length of module: 3 × 45 min.

ASSUMPTIONS AND LIMITATIONS

We observe that business owners still often underestimate the need for careful, systematic consideration and a well-thought-out transfer plan or strategy, as the transfer project itself can take several years. It is crucial that the successors, who will assume leadership and management roles in the business, are carefully selected and appropriately qualified, i.e. It is important that other family members who are not involved in ownership and business activities also agree with the intended distribution of assets and the choice of leadership. Furthermore, this distribution must be fair to all other potential heirs who will not be involved in the ownership and/or management of the company. Complications can arise, particularly after the business owner's death.

Owners shall start considering transferring their business assets to their children and other family members when they are no longer motivated to run the business and/or own it, when they have clearly identified their personal life goals. Among these life goals, retirement is probably the most important because it comes with a certain stage in the life cycle when an individuals physical and intellectual potential may slowly decrease.

Once the owner becomes aware of their desires and needs after retiring from active business life, they can also evaluate them financially. This can be done by assessing their income, savings, expenses, and investments in the years after retirement. They can also take advantage of all the services offered by the governmental institutions to help the transfer process run smoothly such as training courses & lectures and assistance from external advisors e.g. (tax and financial assistance).

This is especially important in today's rapidly changing economic, political, and social conditions. Based on these assessments, the business owner can determine whether a portion of his/her business assets is more of a burden (financially and in terms of responsibility) than a benefit in achieving their personal goals. Planning should commence before business owner knows his/her retirement needs and then be updated in the years leading to it. If they have suitable successors within their family circle who will handle the business assets responsibly, transferring the business to them can be a rewarding experience. However, this is not always the case. To make important decisions regarding the transfer that the business owner will not regret later, numerous steps will be necessary, and some of the key ones will be presented further in this module. In any case or further scenario, the process of the division of personal assets and business assets should be started as soon as possible, because, in reality, these two asset classes are very often very highly intertwined.

DECISION-MAKING PROCESS

A business owner typically begins by contemplating the conclusion of their entrepreneurial career, followed by the exploration of possible solutions, selection of suitable successors, making the final decision, and planning the strategy or plan for the transfer.

The transfer of assets to successors is a long-term project that needs to be managed in an organized manner, ideally following the principles of project management, and considering all potential advantages, benefits, drawbacks, and risks. The business owner is usually responsible for this part. Additionally, it is necessary to determine which family members may be involved in exploring possible transfer solutions, coordinating individual activities, and making significant decisions. Careful consideration should be given to which decisions the successor or the owner can make by themselves or with the assistance of an accountant, and for which decisions they will require the help of external consultants.

Within the transfer project, it is important to specify the individual activities, the responsible persons, and the deadlines by which these activities need to be completed. A final deadline for transferring the assets to the successors must also be established. Otherwise, the decision-making and activities related to the transfer are postponed, which adds additional stress for all participants.

Assuming that the owner knows whom, when, and how they will transfer the business to the successors, they will still need a good lawyer, their accountant, a tax advisor and a business valuator for the proper execution of the business transfer.

The business owner may also need a qualified family business advisor who can help to find good solutions if they wish to exit active executive management and ownership structure roles and transfer the business (with or without ownership) to the successors within the family. A tax advisor can assess the tax implications of individual decisions within the transfer. A skilled legal expert experienced in transferring family assets to successors within the family will help a business owner to anticipate various possible transfer methods and, in particular, the legal consequences of inadequately considered gratuitous or paid transfers of assets to family members or other individuals. Based on prudent decisions, they will be able to draft appropriate legal documents.

The business owner will be the integrator of all these advisory processes and the **ultimate decision-maker**, with an accountant serving as a valuable support in all activities if appropriately trained to participate in the transfer process.

Below you will find questions regarding self assessment in a Table 1. Read the questionnaire and find the appropriate answer that suits you. After that, you can easily structure your needs and make better decisions. This questionnaire will help you in making decisions about your desires and needs after the transfer of the business to successors structure, your wishes and needs and make decisions regarding the transfer.

Table 1: Questions for the self-assessment tool

Question	Possible Answers
Why do I want to transfer assets to my children during my lifetime?	• High maintenance costs • Too much energy required for asset management • High estate taxes • Exclusion of certain individuals from inheritance • To carry on the legacy and keep the business in the family • To leave something to my children • Other
Which assets do I want to transfer to the successors?	• Real estate • Movable assets • Private assets • Business assets
Who are the potential recipients of the assets?	• Spouse/partner • All children in equal or different shares • Only some of the children • Other relatives • Employees • Third parties (selling the company)

What will be my role in the company after transferring it to the successors?	• Complete exit from ownership and management structure • Remain as a shareholder • Remain as a shareholder and director • Remain as a director, transfer ownership to family members • Remain as an employee, occasionally work as a retire • Other
In what way do I want to transfer the assets to the successors?	• Repayment (sale agreement, life maintenance agreement) • Gratuitous (gift) • Partial repayment/partial gratuitous
To what extent/value do I want to transfer the assets to the recipient?	• In full • Partially
Do I want anything else in return for the gifted assets, besides money?	• Spending time together, visiting, sharing vacations, celebrating birthdays, life maintenance...

We dare to claim that if the owners of a family business make good decisions regarding the transfer of the business to their successors, they will carry out the transfer of the family business to their successors with a lighter heart. Nevertheless, they will need a lot of internal strength, optimism, knowledge, and skills to ensure that the transfer proceeds according to the planned strategy.

PREPARATION OF THE BUSINESS FOR TRANSFER TO SUCCESSORS

Proper preparation of the business for transfer to successors is a prerequisite for a smooth and successful transfer. In this final stage of the transfer, the business owner organizes various activities in the financial, organizational, legal, and tax domains.

The following tips can be beneficial in preparing the business for transfer to the successors (Lambrecht and Donckels, 2008):

The following case study illustrates a good practice example of preparation of succession process.

Case study 1

Business Plan Preparation: Create a comprehensive business plan that outlines the business strategy, goals, plans, family business structure, key employees, and financial projections. This document will provide the successors with a better understanding of the company's operations before taking over.

Organizational Structure: Ensure that the organizational structure of the company is clearly defined and documented. This includes job descriptions, responsibilities, hierarchy, and communication flows. A clear organizational structure will facilitate the transfer of responsibilities to the successors.

Contracts and Documents: Legal advice is crucial to ensuring proper preparation of documents and compliance with all legal requirements for operating the family business.

Review all important contracts, such as employment contracts, supply agreements, contracts with customers, and other documents. Ensure that all contracts are up-to-date, compliant with laws, and documented in an easily understandable manner. This will make it easier for the successors to review contractual obligations. Incomplete or disorganized legal matters can lead to complications in the ownership transfer, particularly due to inadequate documentation, invalid contracts, or non-compliance with applicable regulations.

Accounting: A good accountant is invaluable! Ensure professional and up-to-date bookkeeping. Regularly review financial statements, business records, tax records, and accounting documents. This will ensure that the accounting information is transparent and accessible to the successors.

Business Valuation: Arrange for a professional business valuation to obtain an objective assessment of its worth. This will help the successors understand the true value of the business and determine fair ownership ratios.

Ownership Transfer: Develop a clear plan for transferring business ownership to the successors. Include details such as the transfer process, contractual obligations, timeline, and any limitations or conditions.

Understanding the Family Business Ownership Mode

Educational session that explores the details of family business ownership exploring the different 'rooms' associated with ownership of a family business and the roles and influences of different stakeholders in the family firm.

Communication with Employees: Recognize that key employees represent a significant portion of the company's assets. Regularly communicate with them and keep them informed about the ownership transfer plans. Collaborate with them in transferring knowledge and experience to ensure they are prepared for the changes.

> Five Things to Communicate During Every Organizational Change
>
> Wendy Hirsch explains the five topics that you should include as part of your communications approach during any workplace change..

Legal and Tax Advisory: Seek legal and tax advice as needed for the ownership transfer of the company. Lawyers can assist in preparing appropriate documentation, reviewing legal aspects of operations, and ensuring compliance with regulations. Tax advisors can assess the tax implications of various possible options for transferring the family business to the successors.

Education and Mentoring: Provide education and mentoring to the successors to familiarize them with running the business and its operational procedures.

Crisis Plan: Prepare a crisis plan that includes strategies for risk management, business continuity in unforeseen circumstances, and resolution of potential conflicts. Strategies can be very different and they depend on the various influencing factors. The examples of strategies are: (i) understanding restructuring concepts across key areas of business; (ii) reducing crisis impact with measures and tolls, (iii) managing the crisis (overcoming a liquidity crisis, working capital management, quick measures for marketing and sales, procurement savings, cost reduction and production optimization); (iv) overcoming a seasonal sales and product crisis, overcoming an earnings crisis, reducing materials and reducing personnel costs; (v) other approaches including financial restructuring.

The company owner must engage in these preparations promptly to ensure greater transparency, smoother ownership transfer, and facilitate the successors in taking over and further developing the business.

COMPETENCIES REQUIRED FOR TRANSFERRING BUSINESS TO SUCCESSORS

The business owner requires a diverse set of competencies to successfully lead the process of transferring the family business to the next generation and bring it to a successful conclusion. While external advisors can guide the decision-making and transfer process, they cannot replace the successor. Here are some key competencies that the successor must possess or acquire with the help of advisors to ensure a successful transfer to the successors:

- **Strategic Thinking and Planning:** The successor needs the ability to analyze and understand the business environment and formulate a clear strategy for transferring the business to the next generation. Strategic thinking allows them to identify key challenges, opportunities, and risks and plan for the long-term success of the business post-transfer. Based on these competencies, they can strategically plan the transfer to successors, including procedural planning, setting timelines, identifying and preparing potential successors, and selecting the most suitable candidate.

- **Understanding the Financial Implications of Transfer:** The successor must have a good understanding of finance to assess the value of the business, explore different financial options for the transfer, and comprehend the long-term financial stability implications of the transfer.

- **Knowledge of Legal Procedures:** Understanding the legal aspects of transferring the business is crucial. The successor should be familiar with legal procedures, documentation, contracts, and other legal requirements related to the business transfer. This enables them to properly structure the legal framework and ensure compliance with various regulations.

- **Knowledge of Tax Implications of Transfer:** Familiarity with the various tax implications of the transfer is essential in making decisions regarding the transfer of the family business to successors. Therefore, when considering different transfer options, it is necessary to always take into account the tax consequences of each model. A certain transfer method may seem favourable to the successor but may have unfavourable tax implications, which will be discussed further.

- **Communication Skills:** The successor needs good communication skills to effectively communicate with successors, employees, advisors, legal professionals, and other stakeholders. Clear and open communication helps in understanding and aligning goals and reduces the likelihood of misunderstandings and conflicts.

- **Leadership Abilities**: Transferring the business to successors is a demanding project, so the successor must also be a good project leader who can guide and inspire successors and other employees throughout the business transfer process, which can be very stressful for all involved. Leadership abilities enable them to delegate tasks, motivate the team, resolve conflicts, and create a productive work environment.

- **Mentoring and Development:** The owner must have the ability to mentor and develop the successors. This includes mentoring, guiding, and preparing successors for leadership roles and encouraging their personal and professional growth. It is important to emphasize that successors learn best from the good example set by the successor. If the successors are personally mature, well-structured individuals with developed entrepreneurial competencies that successors have been exposed to from an early age, the transfer of the business to them will proceed almost automatically.

Table 2 shows the types of competencies that the transferor needs to manage the process of transferring the business to successors.

Table 2: A set of key competencies for succession and their purpose –

Competency	Purpose
Strategic thinking	Formulating a clear strategy for transferring the business and planning its long-term success post-transfer.
Understanding the financial implications of the transfer	Assessing the value of the business, exploring financial options for the transfer, and understanding the long-term financial implications of the transfer.
Knowledge of legal procedures	Familiarity with legal procedures, documentation, contracts, and other legal requirements to ensure proper organization of the business transfer.
Understanding tax implications of transfer	Understanding various tax implications of the business transfer and considering tax aspects when selecting an optimal transfer model.
Communication skills	Effective communication with successors, employees, advisors, and other stakeholders to understand and align goals, reducing the chances of misunderstandings.
Leadership abilities	Guiding, motivating, resolving conflicts, and creating a productive work environment during the business transfer process.
Mentoring and development	Mentoring, preparing, and encouraging personal and professional growth of successors for assuming leadership of the business.
Adaptability and flexibility	Adapting to changes, addressing challenges, and adjusting to the business environment for a successful business transfer.

Source: Fishman, A. (2008). 9 Elements of Family Business Success.

It should be emphasized that the competencies described in Table 2 are of crucial importance for the business transferred. With various types of informal knowledge acquired over time, while contemplating the business transfer and during the actual transfer process with the assistance of various specialists and advisors, the business transferrer will successfully transfer the business to the successors based on a well-designed transfer plan. In addition to knowledge, the described skills and abilities will also be beneficial in this endeavour.

The following case study illustrates a good practice example of crucial competences.

Case study 2

OPTIONS TO TRANSFER MANAGEMENT AND/OR OWNERSHIP TO SUCCESSORS

When the business owner decides to transfer the company to the successors, they must consider what to transfer first and in what manner. Ideally, if the successors are already working in the company, appropriately educated, and have gained some work experience, the transferrer can transfer both the management of a specific department or the entire company and a portion or the entire ownership of the business to them. Business and tax advisors generally advise against simultaneous transfer of management and ownership, except in exceptional cases as described. It is best if the successors first prove themselves in leading a specific smaller organizational unit and gradually take on more responsibilities. Once they excel in leadership, the transferrer can then contemplate transferring ownership.

In practice, there are various options for transferring management and ownership in a family business to the successors, which are further described below (Grand Thornton, 2023):

- **Direct Transfer:** The business owner directly transfers management and ownership to one or more of their successors. This can be done by gifting business shares to the successors or by appointing a successor to a key management position.
- **Gradual Transfer:** In this case, the business owner gradually transfers the responsibility for management and ownership to the successors. This can be implemented over several years or even generations, gradually transferring key management functions and shares of the company.
- **Sequential Transfer:** The business owner first transfers the responsibility for managing the business to the successors. Once they deem the leader successful and the company performing well, they can also transfer the ownership stake to them, but it is not obligatory. The business share can also be inherited, and the owner continuously enjoys participation in the company's profits, which serves as a kind of rent. Therefore, it is also worth considering this

aspect. Successors can participate in the ownership structure of the company by making their capital contributions.

Mixed Model: Some family businesses employ a mixed model that combines elements of the previously mentioned options. This means that management and ownership are shared between family members and external managers, gradually involving successors in key management roles over time.

When choosing the appropriate transfer option, the specific circumstances of the company, the competence of the successors, and the goals of the family business must be taken into account. It is also important to consider the legal and tax aspects of the transfer and engage in comprehensive planning for a successful transfer of the business to the successors.

LONG-TERM SUCCESSION STRATEGY FOR BUSINESS TRANSFER TO SUCCESSORS

Planning a long-term succession strategy is crucial for a successful transfer of the business to the next generation. This strategy encompasses various aspects that need to be carefully considered and planned.

The planning process starts with assessing the current state of the business, including its financial position, ownership structure, organizational culture, key personnel, success factors, and potential future challenges. This assessment helps gain a comprehensive understanding of the business and identify areas that need improvement or adjustment for a future transfer.

A good business owner believes they know exactly which of their children have the talents, skills, and inclinations that form the foundation for taking over the management and ownership of the business. However, the selection process should not be based on emotions but rather on rational and professional considerations. The business owner needs to work with external neutral advisors in selecting candidates who possess the relevant skills, knowledge, and managerial abilities. The focus should then be on their development, which includes education, mentorship, and gaining practical experience (Aronoff, McClure and Ward, 2003).

A key aspect in achieving the goal of transferring the business to the successors is setting a definitive deadline for the transfer of management and/or ownership based on the chosen model. This deadline should take into account the long-term goals of the business, the age of the current owners, and the qualifications and expectations of the successors. Clear timelines need to be established for the transfer, allowing sufficient preparation time for both the transferrers and the successors. A transitional period should also be defined to ensure a smooth completion of the business transfer to the successors (Hoang and Gimeno, 2010).

Financial planning is also essential for a successful business transfer. To ensure a fair distribution of ownership shares, the estimated market value of the business, the business and financial goals of the successors, and the financing capabilities for an instalment transfer by the successors should be considered. This may enable the transferrers to receive a form of rent or purchase price if an instalment transfer is agreed upon. The long-term financial stability of the business after the transfer should also be assessed. For example, if the transferrers decide to withdraw all accumulated profits from past and current years before transferring ownership shares to the successors, it may deplete the company's liquidity Mazzi, 2011).

Transferrers and successors (hereafter referred to as participants in the transfer) must ensure that the business operations continue seamlessly and that there is a harmonious collaboration between generations based on the succession strategy. Together, they should strive to maintain the company's identity, values, and competitive advantage in the future. As the business transfer process is lengthy, a transitional period needs to be defined, during which the focus should be on the transferrers' involvement in mentoring and supporting the successors in their new roles, ensuring knowledge transfer, and facilitating a smooth transition of responsibilities.

Furthermore, the successors should also adapt to their new roles. It is advisable for all participants in the transfer, once they have determined their new management and ownership roles within the company, to establish a family constitution (code of conduct).

Lastly, the business transferrers must ensure the transfer of key knowledge, skills, and best practices to the successors. Consistency in performing key job functions and ensuring uninterrupted business operations can be achieved through documenting critical business processes, strategies, and operational procedures (Stubbings, 2015).

The succession strategy should be regularly monitored and adjusted based on changes in the business environment, family dynamics, and company objectives. All participants in the transfer need to recognize that the readiness to adapt the strategy to emerging challenges and opportunities is crucial for a successful transfer of the business to the next generation.

On the next page you willl find different strategies for succession planning.

Family Business Succession Planning Model, Rob Tetrault

Estate and asset planning is an important part of family business succession planning. Both are closely linked to sound business and personal finance practices. The video discusses the interlined processes of those three dimensions of planning.

Why Family Businesses Fail to Do Succession Planning

A major challenge that family business leaders face today is inefficient and ineffective succession planning. There is every reason to get it right, but too often the process is not given enough consideration. Have you ever thought why this might be the case?

PROJECT MANAGEMENT OF BUSINESS SUCCESSION

Various models can be used for the project management of transferring a business to the next generation, depending on the preferences of the successor, the size of the business, the involvement of successors in the existing business, and the inclusion of external experts. It is important for the SME/transferrer, to select someone who can contribute to the successful execution of the transfer and ensure a smooth transition of the business.

The successor can choose from different ways or models to manage the succession project, including:

Successor as the project leader: This model is characterized by the successor personally managing the transfer of their business to successors. It is typical for sole proprietors, as well as micro and small companies. The business owner consults with the family regarding the transfer and seeks advice from their accountant and possibly a tax advisor. Then, they visit a notary to draft the agreement for transferring the business or ownership share to the successors. The business continues its operations along established lines, often with the presence of the successor.

Engaging an expert for the transfer: This model involves hiring an external individual or consulting firm with experience and knowledge in family business succession. The transfer expert leads the project, determines critical steps and processes, makes decisions regarding the transfer, monitors progress, and coordinates different opinions among family members.

Formation of an internal transfer group: This model involves an internal group of family members responsible for executing the transfer. The group may consist of family members already involved in the business or those specifically selected for this purpose. This group leads the project, makes important decisions, oversees the transfer, and aligns the opinions and interests of family members.

Combination of external advisors and internal group: This model combines transfer experts with an internal group of family members. Advisors offer an external perspective, professional knowledge and experience, while the internal group of family members contributes their familiarity and strategic thinking regarding the family business. This combination allows for a comprehensive approach to the transfer and facilitates the alignment of different opinions.

The process of transferring a family business to successors may also involve the use of a family business governance model. This model defines the structure and processes that the family employs for managing and leading the business. It includes the designation of roles and responsibilities for family members, the establishment of decision-making mechanisms, the creation of communication channels, and the coordination of various interests and opinions.

Table 3: Models of managing the project of transferring a family business to successors

Leadership Model	Role	Responsibilities	Functions
Model A	Chief Leader	Planning transfer strategy	Making strategic decisions
Model B	Collaborative Approach	Collaboration and communication with family members	Achieving consensus in decision-making
Model C	External Consultant	Advisory services and expertise	Conducting assessments and providing transfer recommendations
Model D	Combination	Leading the transfer in collaboration with the family business	Aligning family interests with business needs

Model E	Hired External Manager	Operational management of the family business	Determining implementation plans and monitoring execution

Source: Adapted from Mehner (2023)

The models presented in Table 3 provide a clear comparison of different management models for the project of transferring a family business to descendants and their key roles, responsibilities, and functions. It is important to consider that the actual implementation of the transfer project may vary depending on the specifics, opinions, interests, and needs of the participants (owners and employees) of the family business.

Each model offers a unique approach to managing the transfer process, taking into account factors such as decision-making, collaboration, external expertise, alignment of family interests with business needs, and operational management. By understanding these models and their associated roles, responsibilities, and functions, stakeholders can make informed decisions and develop an effective strategy for the successful transfer of the family business to the next generation.

It's important to note that while the models presented in Table 3 serve as a useful framework, the specific circumstances and dynamics of each family business may require customization and adaptation to ensure a smooth and successful transfer process.

KEEPING THE FAMILY INFORMED

There are two important points in this article. One is that there must be communication between all of the family members before a succession plan is developed. The second is that there is no single plan that will work for every family.

Keeping the family informed

THE PROCESS OF IDENTIFYING, EVALUATING, AND SELECTING SUCCESSORS AMONG POTENTIAL CANDIDATES

The most important step that a business owner takes before the transfer is correctly identifying suitable successors among their descendants. This involves identifying family members who have the interest, motivation, and capabilities to take over the management of the company. The successor must focus on their abilities, knowledge, experience, and leadership qualities. They should look for family members who have demonstrated a passion for the business and those who have already been actively involved in its operations. In cases of doubt regarding the correctness of their selection or even before that, the successor is advised to hire an appropriate external expert who can assist in selecting suitable successors among their descendants.

EVALUATING AND SELECTING THE MOST SUITABLE SUCCESSOR

The successful transfer of the business to the next generation depends on how the successor conducts the process of identification, education, mentoring, preparation, and evaluation of the successors. By carrying out these steps, the family business successor ensures that the chosen successor possesses the necessary skills, knowledge, and managerial abilities, which will secure the ongoing operation and success of the family business in the future.

Table 4: Areas of evaluation and selection of successors

Areas of Evaluation and Selection of Successors	Description of Evaluation Methods
Assessment of Abilities and Knowledge	• Use of assessment procedures • Competency tests • Interviews and feedback from mentors and key employees
Evaluation of Motivation and Passion	• Discussions about the successor's goals and motivation • Discovering their passion for the business and industry • Monitoring their engagement and perseverance
Alignment with the Company's Strategy	• Checking if the successor understands and supports the company's strategy • Assessing if their vision and values align with the company's goals • Analyzing their adaptability and innovativeness
Experience and Achievements of the Successor	• Reviewing their work experience and achievements • Analyzing the suitability of their experience for management • Evaluating their leadership potential and accomplishments

Teamwork and Leadership Skills	• Assessing the successor's collaboration with other employees • Verifying their abilities to lead, motivate, and develop a team • Analyzing their conflict resolution skills and accountability

Source: Adapted from Gatrell, J. (2003). Family Enterprise - Identifying and Developing Successors

As evident from Table 4, when evaluating and selecting the most suitable successor, it is important to use a combination of different assessment methods that enable a comprehensive evaluation of their abilities, knowledge, motivation, and alignment with the company's strategy. Approach the process with objectivity and consider both qualifications and personal attributes of the potential successor. The final decision should be the result of careful evaluation and coordination among all involved parties.

HOW CAN LEADERS CHOOSE THE RIGHT SUCCESSOR?

This short video presents three basic tips that will help you in understanding the process of selecting a successor.

How to choose the right successor?

PODCAST BUSINESS TRANSITION

Succession Stories is an award-winning podcast guiding entrepreneurs from transition to transaction. Succession Stories explores the entrepreneurial stages of a business   growth to maturity focusing on value creation, exit planning, succession, and M&A for owner-led companies. If you are an entrepreneur looking for inspiration to create a more valuable business, or an owner who wants to figure out the best way to transition or sell their closely held company, you should listen this podcast.

Business Transitions

Succession Ready
Enabling Leadership Continuation for SMEs

PAID TRANSFER AND TRANSFER OF BUSINESS

The discussion about the transfer has been so far based on the assumption that the majority of SMEs are and remain family businesses in one way or another (regardless of the several definitions) so there is an often-unwritten intention that the ownership of the business will remain in the hands of the family and the transfer of the ownership shares will be free of any payments. However, it happens more and more often, that there may be other scenarios rather than unpaid transfer to, in most cases, legal successors (usually children) of the existing owner(s).

These reasons may be (or a combination of them):

1. There is no successor at all or the successors are not interested in continuing the family business tradition. The underlying reasons for such a situation may vary from very natural to very deep, from the fact that the business owner might have no children to the lack of interest from the potential successors coming from psychological reasons or different professional aspirations.
2. The business owner(s) would need some cash because, very often, they have not taken adequate care of their retirement financial plan.
3. The business is operating in market conditions in which certain scaling is necessary to stay competitive but there is no additional fund-raising capacity in the family. There may also be a lack of other resources, for example, R&D capacities which direct long-range thinking about the business which may include some strategic alliances including acquisitions and mergers.
4. There is simply a good opportunity to sell the business and earn a good return on investment.
5. A sudden death of the owner or the potential successor. If there was no written will and accompanying planning, the inheritance process will, with no doubt, generate some cash flows both within and outside the family and the result is (also for tax reasons) the successors are forced to sell the company.

No (interested) successors

In this case which is not uncommon, the worst possible solution, yet very usual is that the business owner, often also the manager would just wait for the solution to pass by. However, this does not happen as years go by. If nothing is undertaken, the business is sooner or later jeopardized and failure is unavoidable. In such a case, the best scenario is to try to sell the company. The advantage of this is double for the owner. He/she may be entitled to some cash which would improve his/her retirement financial situation and he/she can peacefully leave the company in good hands which is a good care for the psychological barriers because business owners are very often emotionally attached to the company. Also, the jobs can be saved and the company may face new prosperity under the new management.

There are several ways to sell the company, depending on different circumstances. The whole company (the equity) can be transferred in exchange for cash and this seems to be the most elegant option because the same company as a legal entity continues to operate. Second, only the assets (hard and intangible), together with IP rights can be sold and the company is left empty but full of cash which after a controlled process of liquidation belongs to the owner(s). Third, the company can be merged with another company and paid with shares of the other company. This last option is more common for the listed companies and not that usual for smaller companies.

Need for cash for the retirement

It happens very often that business owners were not thinking about their retirement plans when it was time to do so but they preferred to maximize their in-pocket cash. Thus, it happens very often, that the majority of their private assets are locked in the business while the pension will be too small to sustain the lifestyle that they were used to. In such cases, the complete or partial sale of the company seems to be the only solution. The company can also be partially sold to the successor, for example: 80% of the value can be given and for the rest, the successor shall find sources to pay for it. The company can be also offered to outside investors or a combination of both which is all dependent on the capital market conditions which cannot be controlled.

Market conditions for the business

In many cases, the market conditions and business environment change since the foundation of the business which may be slowly approaching the moment in which it may become odd. This will be demonstrated in the lack of competitiveness with the business's product or services which may be the combination of several business reasons such as too high cost, under-capitalization, delayed R&D, business processes that have not been updated, old-fashioned marketing approaches and several others. On the other hand, such businesses still keep their intrinsic value of reputation, quality, reliability, tradition etc. However, this value descends as years go by, so the business owners need to face the truth about their business as it is long-range prosperity. Admitting that it is time to sell the business or go down to the bottom in the next years seems to be crucial. The sooner this decision is made, the higher the chance to get a good price paid for the company.

Good opportunity

Some ambitious growing companies base their growing strategies on acquisitions of other companies in the industry for geographical expansion, vertical or horizontal integration, know-how and IP, staff or other reasons. Such companies regularly scout for target companies and make offers to the owners. Several business owners are found surprised and even frustrated when they get an offer for an acquisition on the table and the price listed in this offer is very reasonable, perhaps even with some room for negotiation. To be ready for this, business owners should work on the emotional detachment from their business and start understanding that business is just an asset that can be exposed for sale for a good price.

At this point, we may stress out which may be potential buyers for a business. Generally, they can be distinguished between strategic and portfolio investors. Strategic investors are in most cases companies that would, by acquiring a target, somehow integrate it into their core business activities. In some cases, the strategic investor would also buy into a company for the reason of diversification into a new industry or a new market for the acquiring companies.

The other sort of investors are so-called portfolio investors who would invest in a company or buy it exclusively for long- or short-term financial games. The acquisition by the portfolio investors is very often followed by the "cleaning" process which includes severe cost-cuttings, selling off the assets and, what original owners are hurt most by laying off employees who might have loyally served the company for years. Portfolio investors commonly follow a two-step strategy. Initially, they focus on maximizing cash flow, extracting as much as possible. Subsequently, within the portfolio investor community, there are those with a specific objective to foster company growth, often represented by venture capital or private equity funds. Nevertheless, it's infrequent for mature businesses, especially those still closely managed by their owners, to possess sufficient growth potential to attract interest from venture capital funds.

Another option while selling a company is to establish a project in which the new owners of the company shall become the existing (key) employees of the company who are interested in keeping the company in their control instead of letting it be acquired by somebody else.

Sudden events in the family

No family can avoid sudden events like illnesses, accidents, deaths etc. which tremendously change the situation and operations of the business. However, not only a business but also family life is subject to change and new needs for cash are often unavoidable to finance new needs and also potential appetites. To be prepared for a situation like this, it may be a good idea to always keep the company in good shape to be "investment ready". Otherwise, the sales of such a company owned by people who are in trouble would be a "fire sale" and the revenues from such sales are always heavily discounted.

In next module we will introduce you psychodynamics of family relationships during the succession process.

> Knowledge Bank: Thomas Zellweger on "family business succession"
>
> Succession is one of the biggest challenges facing an entrepreneur, particularly in the context of family businesses. Thomas Zellweger, Professor of Business Administration with specialisation in Family Business, KMU-HSG and CFB-HSG, explains different forms of succession and why businesses should follow a six-step-process.

USEFUL LINKS AND OTHER MATERIALS TO EXPLORE

9 Elements of Family Business Success

https://www.thealternativeboard.com/blog/9-elements-of-family-business-success

Bank of America Merrill Lynch

https://www.ml.com/articles/smart-ways-to-transfer-the-family-business.html

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NOTES

Module 3
PSYCHODYNAMICS OF FAMILY RELATIONSHIPS DURING THE SUCCESSION PROCESS

Module 3 will introduce you to different roles in the business environment and help you understand the strong interplay between personal and business relationships. Deep understanding of emotions, relationships and communication are key to a successful business in the family and outside.

After studying this module you should be able to:

- **Gain an overview of how to deal with the emotional component within family business and wider**
- **Understand the importance of preparation for communication in the succession process and importance of relations inside and outside the family**
- **Understand the importance of education outside the family business**

3 case studies will help you understand the importance of relationships in the succession process.

Lenght of module: 3 x 45 min.

BASICS OF PSYCHODYNAMIC

The concept of psychological transfer and countertransference involves all individuals who project their unconscious feelings and attitudes onto others. This can also apply to groups. Group members may transfer their feelings about authority or past experiences to group leaders or other members. Countertransference refers to the reactions of group leaders, directors or owners to these projections by the colleagues they lead. Psychodynamics seeks to understand how unconscious group processes can influence decision-making, cohesion and the emergence of group conflict. Understanding these hidden dynamics can help organised groups and companies to operate more effectively.

PSYCHODYNAMIC APPROACH AND THEORY

The psychodynamic approach refers to the psychological understanding of human behaviour and mental processes, which is rooted in the theories of Sigmund Freud and his successors, most notably Melanie Klein, Carl Gustav Jung, Wilfried Bion and some others. The essence of the psychodynamic approach lies in the following insights:

Psychodynamic theory holds that a large part of human thoughts, feelings and motivations are unconscious, meaning that they are not always accessible to our thinking and insights. These unconscious processes greatly influence our behaviour and can lead to undesirable psychological reactions, behaviours and actions within the work group. According to psychodynamic theory, internal conflicts between different parts of the mind (such as the ID, ego and superego in Freud's model) can cause psychological distress and symptoms. These conflicts often involve a struggle between instinctive desires and social or moral constraints, which may be reflected in the individual's attitude towards the company group.

People use various defence mechanisms to cope with the anxiety and discomfort that arises from unresolved conflicts and unacceptable desires. These defence mechanisms help individuals to protect their self-esteem and maintain psychological equilibrium. In understanding the development of defence mechanisms, it is crucial to learn about an individual's experiences in early childhood. Psychodynamic theory emphasises the role of early childhood experiences, particularly those involving interactions with parents and caregivers. These early experiences largely shape a person's personality, attachment style and patterns of relationships with others. From this, the individual's relationship to future authority figures: mentors, leaders, directors, is shaped through various processes of transference.

In applying a psychodynamic approach to understanding groups, the emphasis shifts from individual dynamics to group dynamics. Psychodynamic theory views the group as a social system with its own dynamics, norms and unconscious processes. Just as individuals have unconscious conflicts, groups as a whole may have hidden tensions and conflicts that affect their functioning. It is therefore necessary to study group interactions and relationships in order to understand power struggles, group norms, leadership dynamics and the ways in which unconscious processes shape group behaviour. All of the above are manifested in the processes of ownership and management of succession in small, medium-sized and family firms.

A distinctive feature of family businesses is the strong intertwining of personal and business relationships. Ownership, management, control and strategy all remain within the immediate or extended family. European statistics show a worrying picture of the transfer of ownership of family businesses to the next generation. The paradox is that, while most of the original owners would have wanted ownership and management to be passed on to the next generation, this process is only successfully completed in thirty percent of family businesses.

The family is a person's primary social environment from birth to old age. In the family we are protected, understood, accepted, learn social skills and invest in relationships. Unfortunately, it can also be the other way around- for many people, the family is a cold environment, where warm feelings are absent and children do not receive accepting, supportive relationships. This is often the case even within the domestic four walls of highly successful family businesses. The key words to better understand the challenges of succession are therefore: understanding emotions, relationships and communication. In the following chapters we will look in more detail at individual emotions and the kind of psychological dynamics that take place within families where personal, partner and parental relationships are intertwined with business relationships. What can the original owner, the manager, the family and the supportive environment do to ensure that the transfer of ownership to the next generation is as smooth as possible and that family relationships are not damaged or even broken? Similar dilemmas arise when, in addition to family members, it is planned to involve external collaborators in the succession process.

EMOTIONS, RELATIONSHIPS AND POTENTIAL CONFLICTS

There are many types of emotions. Here we will describe the ones that often occur within corporate relationships and divide them into positive and negative ones. The division may be rough but it makes sense given the possibility of development and psychological investment in relationships. When it comes to each emotion, our own experience of it, its manifestation and its impact on other people, we need to ask ourselves whether each emotion supports or hinders us in the development of our relationships. At the end of the description of each emotion, we will look at the types of conflicts that can arise from unrecognised, marginalised or unconsciously repressed emotions of this kind. Note, however, that we will only look at some of the potential conflicts, i.e. the possible negative consequences of each emotion. It is not necessarily the case that the problems described will always arise, since the emotional life of a family business is very complex and is largely located in the sphere of the unconscious.

POSITIVE EMOTIONS

Happiness

A person feels happiness when he or she feels that one of his or her most important desires has been fulfilled or that one of his or her essential values has been confirmed. Satisfaction is felt when an important desire is fulfilled and happiness is felt when the most important desire and, above all, value is fulfilled.

Today's economic environment is very dynamic and unpredictable, and the established equilibrium is constantly being upset. Employees' sense of happiness is constantly shifting, weakening, changing and constantly re-establishing a new equilibrium. Absolute happiness can therefore only be a transitory feeling. Adults are primarily responsible for their own happiness, and this is especially true in the sphere of entrepreneurship.

The suppression of the feeling of happiness can be one of the processes in workaholism, as the career workaholic thinks that if he achieves happiness he will be full and in a way empty, without goals. Workaholism is a very common phenomenon among members of family businesses.

Potential conflicts:

If an individual invests in only one, often over-valued, area or goal, he or she is on a fine line between experiencing happiness when he or she succeeds and, on the other hand, feelings of disaster when he or she fails. Feelings of hopelessness can result in general human decompensation and consequently a poorer outlook for achieving other, equally important goals. All this is passed on to other family members and other employees, who watch the owner, manager or colleague oscillate between moods of happiness and despair, with a negative impact on overall motivation in the company. At the same time, doubts, or rather feelings, may arise as to whether the business is really viable, stable and as such worthy of being taken over within the family- regardless of the consequences, which are unpredictable.

Confidence

Believing and trusting in ourselves means that we feel a sense of self-reliance. This is especially true when it comes to difficult and distant, important goals that are achieved with perseverance, knowledge and entrepreneurial skill.

It helps a child to have parents who support him even when he is not at his best. Parents should provide a positive image and meet the child's basic needs and build basic trust in the child. Here too, however, there is a need for moderation and not for exclusion in the sense that the family alone is good and trustworthy while the environment is bad and threatening.

A mature person must be able to assess his or her own abilities, otherwise we can speak of an inflated, grandiose self, which often leads to failure. Others perceive such a person as arrogant or arrogant. A person needs to assess the risk of investing his time, skills and stamina.

Potential conflicts:

Sensitivity and a sense of reality are crucial when it comes to feeling confident in yourself and in a family-owned business. An owner-director who is prone to narcissistic thinking and behaviour, while at the same time being an authority figure, can mislead family members into behaving in a similarly cavalier manner, thereby losing their sense of economic reality in the long term. Worse still, if the current owner is arrogant and conceited towards family members, they will rebel against him and show their rebellion by refusing to be taken over within the family. In this case, the process of rejection will be the result of the lack of value and attention shown by the current owner to the family members, the would-be acquirers.

Pride

We feel pride when we are judged to have done something in a way that makes our authority think positively of us. Our own positive self-image is therefore validated by our authority. This is something we learn at an early age and is important for making realistic judgements about our capacities in the mature period of life. Approval of our behaviour by authority figures means that we are socially accepted and worthy. Authority can also be a group (e.g. a group of professionals in a company), not just an individual- an owner, manager or director. Sometimes it is enough to think (phantasm) that someone is happy with us, even a distant or deceased person. This is noticeable in some family businesses, where a kind of authority is represented by the deceased owner with his past way of thinking and acting, which remains as a kind of unwritten rule among the family and colleagues and is largely stored in the sphere of the unconscious.

We can also be proud of another if that person is part of our social circle, where we feel emotionally close and have a sense of having contributed to that person's success. Pride is a very unstable emotion because it depends on the opinion and acceptance of authority. It is necessary to accept oneself, not just to follow authority uncritically.

Potential conflicts:

Pride can quickly turn into uncritical feelings of superiority. The behaviour of the company's leader- the owner, the CEO- plays a decisive role in this. Many times we observe the so-called introjective pride in which e.g. a mother is proud of her daughter because she has introjected- internalised- her daughter's achievements due to her own failure and identifies with her in a phantasm. If the daughter is the acquirer of the business, she will have to shake off the emotional burden of continued success that she still carries for her mother, who has run the business less successfully in the past.

Uncritical acceptance of authority is a common phenomenon within family businesses, where the authority may come from, for example, the father, who is also the founder, owner and director, who has developed the business from a craft workshop into a modern manufacturing firm in a few decades. Such a director, who is also a 'pater familias', combines all these roles in one person and can be an authority figure who limits creativity and causes discomfort, even fear. In these cases, healthy authority turns into authoritarianism, which has a negative impact on development.

Love

Love is the result of the mechanism of emotional attachment. The feeling of 'being loved' is one of the first emotions in development where a child receives love from a parent; it represents primary love. Over time, the baby begins to return love because it is loved. Infantile (immature) or symbiotic attachment is a normal stage in child development, but in adults it is a sign of immaturity and dependency tendencies. Many of these phenomena can be observed in the family circle of a company, where individual family members or colleagues may be totally dependent on the manager without even realising it. We need to recognise the difference between respect and love and between self-respect and self-love. Many times we are in a position where we have to decide between our own interests and the interests of a loved one. Mature persons understand that it is not negation of a loved one to give priority to one's own desires. Unconditional love is usually only parental. In adulthood, such expectations are infantile. Conditioning love in terms of one's own values towards a loved one is mature behaviour, but conditioning behaviour or even emotionally coercing an individual or a group is distinctly immature. A child needs love, acceptance, because it motivates him or her to perform actions that may not be merely pleasurable. If he does these things well, he feels accepted and loved by his parents, otherwise he is in fear of being rejected if he is not perfect. The child needs to get the message that it is his bad actions that are unacceptable, not him as a person. The same applies to the relationship between co-workers and their manager in the company.

Potential conflicts:

A mature adult does not accept criticism of an action as a rejection of the whole person. This would be a sign of infantile thinking as a young child thinks that the anger of his parents means that he is no longer liked and therefore fears rejection and separation from his parents and family. These feelings are very common in the expectations of young adopters, when they expect unconditional approval from the parents- the current owners- for any behaviour. At the same time, prospective acquirers need to understand disapproval of a course of action only as criticism of a particular course of action and not as an absolute rejection by the parents. It is true, however, that parents must reinforce such a distinction in the course of education from an early age onwards. This is where the personal maturity of the parents, the owners on the one hand, and the would-be adopters on the other, comes into its own. Do they distinguish between roles, behaviours and actions that are very intertwined?

NEGATIVE EMOTIONS

Anger and aggressivnes

Anger is one of the most basic and simple emotions. It is constructive when it helps us to stand up for ourselves, change an inappropriate attitude or assert an opinion. The higher the level of negative, inappropriate conflict resolution between parents, the less emotionally available they are to the child and the worse the family relationship. Overt aggression is usually linked to the verbal expression of anger by mum and dad and the physical expression of anger by the latter from early childhood and beyond. Children who were exposed to angry parental conflict were more likely to express anger, have more conflictual attitudes in relationships, express more perverse forms of anger and stab other children.

Paradoxically, anger seems to be a strong interpersonal emotion and is therefore most strongly expressed in those we love or those with whom we are in closest contact. One can immediately think of the complex relationships within the family members of a company who, because of family circumstances, are close to each other, making the relationship very tense or even ‘combustible’. Anger always represents a symbolic demand for change in one’s fellow human beings, in one’s surroundings. Even when it is directed at an object or events.

There are several types of aggression: it can be an aggression that stems from fear or as a defence against restriction. Aggression can take the form of dominance and a struggle to assume a higher position in a hierarchically ordered community. Aggression can be directed at a frustrating object- a person or group that arouses feelings in another that make them aggressive. There is also aggression linked to immature sexual competition, e.g. between a son and his father for his mother’s (wife’s) affection and love, or rivalry between a daughter and her mother, who have to fight over and over again for space with her (husband’s) father.

Potential conflicts:

Aggressive behaviour has a divisive effect on company relations and often masks the real causes of conflict. A distinction must be made between the triggers (individual momentary actions) for aggressive behaviour and the real causes, which are hidden in the sphere of the unconscious. This is particularly important if the aggressive behaviour is repeated. It does not matter whether it is the director, the manager or the colleagues who often behave aggressively. There may be a lot of unrecognised, unspoken resentments and unprocessed fears behind the scenes, which make it very difficult when ownership and management should be handed over to successors.

Envy

Envy is the desire to have something that another person has. We may envy a material good, a possession, an event, a show of honour, etc. Envy is not merely an attitude towards the good, but rather an attitude towards the one who possesses it. Envy arises when we judge that the other person does not have a right to that good or that we have at least an equal, if not greater, right to that good or a similar good.

Underlying this is the desire not to be in an inferior position in relation to another. Envy is a typical social emotion and belongs to the group of antipathetic attitudes. We have to start learning to process the emotion of envy at an early age, where parents play a key role. In the case of a family business, the father or mother is also the person who has to recognise envy in the everyday life of the business and be able to manage these feelings.

Depending on the process and the outcome, we distinguish between destructive and constructive envy. Destructive envy leads to the mutual destruction of an asset, a position, sometimes even a loved one or even an entire company. The person believes that if one gains, the other necessarily loses, which is not necessarily always true in emotional processes. This is especially not true in psychodynamic processes within work groups. Constructive envy, on the other hand, is based on the recognition that someone else's possession of something or someone else's success does not necessarily mean our failure. It allows us to mobilise our capacity, good qualities and competences to achieve or acquire something worthwhile ourselves.

In some companies and families, the expression of feelings of selfishness, self-esteem, even anger, is highly unacceptable and therefore repressed. This teaches the child, and later the adult, that if they are envious and express it, they will lose the love of their parents and later the affection of their boss or life partner, and will be rejected. Sometimes strong feelings of envy can turn into hatred of another who has something. This is usually when envy is mixed with jealousy, all of which have their roots in primary relationships (the relationship between parents and one child and the other).

Jealousy is not envy. For envy it takes two, but for jealousy there must be a third person actively involved in the relationship. It all comes from the primary family- if parents offer, give or favour something to only one child, then the emotions of envy, jealousy, aggression and shame quickly mix and flow into each other in the deprived child.

Potential conflicts:

From what has been described, it is easy to imagine that unprocessed feelings of envy and jealousy can be a major obstacle to the transmission of succession in family businesses. Sibling rivalry between siblings or nephews, which the parents are unable and unwilling to parry, can be fatal in the way that in the end neither of them wants to take over the business. Parents, who are also the current owners and managers, have to make a lot of effort to recognise and, together with their successors, to start to clean up the relationships in the company if they are overwhelmed by envy and jealousy. Significant progress can usually only be made with the involvement of an experienced external coach or consultant who specialises in the psychodynamics of family businesses.

Jealousy

Fear of losing love is natural and a normal part of a love relationship. Jealousy is the fear that the object of our love will begin to love, to prefer, someone else. In the context of our problem, we are talking about love in the parent-child relationship and vice versa.

The emotion of jealousy comes from early childhood, when it becomes clear to us that when a younger brother or sister is born, love must be shared or accepted, that mum and dad share love between everyone. Love is experienced as exclusive, and the fear of loss can occur in all close-knit groups and in relationships with authority. The intertwined nature of relationships in family businesses is a perfect breeding ground for jealousy in all kinds of relationships. Childhood and later adult (but infantile) jealousy is usually accompanied by separation anxiety, envy and hatred. Mature behaviour on the part of the parents- the current owners- is essential for the processing of these emotions.

Potential conflicts:

Initial jealousy that is not recognised and processed slips into an emotional-behavioural sequence: anger-attack, hatred-destruction, sadness-withdrawal or fear-pleasing. In adults, the first stage (anger-attack) is usually directed at the object of love- e.g. the mother, the current owner of the business, whom the younger daughter jealously accuses of preferring the older, more experienced one and of handing over the business to the older one (even though the older daughter may not want to do so and may not recognise the background of the younger sister's aggressive impulses towards her mother).

The loved one, who is both the current owner and manager, is, according to the affected child, the one to blame for the confusion, as she is setting the scene and failing to put the company in order, especially with regard to the takeover and succession. Unfortunately, in the 'hate-destruction' phase, fatal, tragic outcomes are also possible.

Fear

It allows rapid, automatic assessment of the threatening situation, mobilisation and adaptation. Evolutionarily, fear means self-defence, survival and the protection of values. But we can only evolve when we are free from fear, when we feel safe and secure. The emotion of fear can refer to a current situation or to a future situation. Then we speak of anxiety (alertness, foreboding, trepidation, trepidation, anxiety). Fear varies in intensity and duration.

In fact, it is not the other person or the situation as such that one is afraid of, but the action or action that may threaten oneself or one's values, except that sometimes it is difficult to recognise this. This is often the case with the original owner of a company, whose fears are caused by the act of handing over the company to successors, because he does not know to what extent the values on which he has built the company will be respected by the successors, and what will actually emerge from the company that he still controls for the time being.

Separation anxiety- the fear of separation- can be strong. In mentally healthy, autonomous people, this fear is not pronounced, as it is mostly already processed. In contrast, an immature adult with separation anxiety maintains a symbiotic relationship with his or her parents or tries to create a symbiosis with another strong figure who will take care of him or her and take responsibility. Often such a person subordinates his or her whole life to another (biological or symbolic parent) and in a sense, annihilates him or herself.

Potential conflicts:

Situations are more complicated when we are divided and only one part of us is frightened. This can result in a mix of emotions between aggression, destruction and fear. The idea of our own powerlessness can contribute to the use of maximum force. It happens that the assignee, who is not sure of his or her own professional or organisational competence, aggressively refuses to accept a new, responsible position, even though the family environment and the current owner- father, mother- expect him or her to do so. Aggressive reactions are usually associated with feelings of fear and insecurity. The would-be acquirer may aggressively serve the parents with completely banal, trivial criticisms or reasons why he/she cannot or does not want to take over the business. It is necessary to recognise the reasons for this fear and the ambivalence of the feelings. The frightened person needs protection and reassurance at the outset, only then can he describe and rationalise his fear. It is very important to know how the parents reacted when their children were scared, who are now on the verge of taking over their parents' company, and the roles are repeated and at the same time upgraded, since it is not only the parent-child relationship but also the manager-manager-to-be relationship that is at stake.

Potential conflicts may lie in separation anxiety, which makes the acquirer anxious because he knows that in this way he will have to become independent of his parents and become an autonomous person- a leader, a manager who will probably also manage colleagues who are not part of the family circle. This emotional state can also manifest itself as a rejection of the takeover by the acquirer's communication strategies, which are the result of his psychological defence mechanisms.

Respect and self – esteem

The definition of respect is a specific feeling towards a person who we believe has qualities that are worthy and that we value. This feeling can also be reinforced by the experience of what other people see and recognise in that particular person. A child who is convinced that his father is valued and respected by his business partners is likely to respect his father from this perspective himself. Similarly with self-esteem: we respect those qualities in ourselves that we otherwise value and we have the experience that others value those qualities in us.

Respect as an emotion is a sign of a friendly, positive attitude. The opposite of respect is an emotion: contempt, ingrained hatred, envy, etc. However, we must be mindful of the fact that the feeling of respect is not an attitude towards another person as a whole, but only towards his or her individual qualities. It is therefore a partial attitude and is different from the so-called unconditional love that we have already mentioned. It follows that we can also respect and take into account the qualities of a person whom we dislike, dislike or dislike as a rival in business, or even in the planning of a business acquisition. To illustrate the phenomenon, consider a sporting match- the two rivals dislike each other, may dislike each other, but respect and pay attention to the individual qualities of their opponent.

The same is true of self-esteem- a mature person respects, values the qualities that have been shown experientially to be positive, pleasant, useful, rather than the whole self, which is usually a sign of a narcissistic personality structure.

It should be stressed that awe is not respect but a form of fear. It is a fear of symbolic destruction by a person who is more powerful or hierarchically superior and on whom we depend, and therefore we prefer to show respect. Awe is an attitude of antipathy, not of sympathy, and sometimes it is only a step short of denial, even destruction, of such a person. Respect for others is usually expressed as kind and respectful behaviour, but we can also express awe in similar ways.

Potential conflicts:

In these cases, too, the family is on thin ice between recognising and respecting the qualities that are manifested in respect for authority, but also for the child-takers. We need to recognise unwanted feelings, such as awe, which are not a good basis for taking over a company, still less for developing it. A daughter or son who takes over a company with a feeling or even a compulsion of awe will probably find it very difficult to identify with the company's mission and development will stagnate.

On the other hand, attention should be paid to would-be acquirers when they display unambiguous narcissistic traits (assumed omnipotence and perfection in all areas, colleagues only as a means to an end, superiority, etc.) to mask their insecurity and low self-esteem.

USEFUL TOOL

This article will help you understand the importance of your own coach during the process of succession.

5 reasons why you need a bussines coach

“Communication is a skill that you can learn. It’s like riding a bicycle or typing. If you’re willing to work at it, you can rapidly improve the quality of every part of your life.” – Brian Tracy, motivational public speaker

COMMUNICATION

The development of human civilisation is closely linked to the development of communication skills and tools. However, it sometimes seems that the expression of emotions has given way to all other modes and contents of communication. Let us not forget- the expression of emotions is quite common in the animal world, not only in direct but also in very sophisticated ways. But the experience of the last hundred years teaches us that bottled up, unrecognised and unexpressed emotions can be a major obstacle to the full-blooded practice of human beings in all spheres. Psychological science and psychoanalytic approaches to understanding human beings and work groups have contributed greatly to these insights. Much of this can also be detected in family businesses, and we have found that the real reasons for the low rate of internal takeovers of family businesses, even very successful ones, have to be sought outside the sphere of economics or law.

TIPS AND TRICKS
A GUIDE FOR CONDUCTING OPEN CONVERSATION

This useful guide will help you to navigate open and honest discussion.VBefore a new family member or a person outside the family circle enters the business, and especially before handing over ownership and management, there should be a frank discussion.

There are leading steps how you can do it.

STEP 1.: The current owners who run the business must first find the answers to the questions within themselves:

- What are their expectations of a new family member joining the company?
- Why a family member and not an external expert? Helpful keywords: reflection on attitudes, emotions, expectations and differences in management style between a family member or an external professional?
- What vision, better still, plan does the current owner have for his/her own career, business and private life? Are family members- life partner, children (including those not involved in the family business) and other family members aware of this?
- Are the values of the company and the business by which it has operated to date clear to all?
- Is the current owner prepared that the values may change over time if a younger family member takes over the business?
- Do we know the aspirations, values and goals of the family member entering or taking over the business?
- The owner should try to find the answers to the above questions first with himself or herself, and later with the family member with whom he or she is emotionally closest- spouse, life partner, adult children, maybe even a brother or sister.

STEP 2.: The current owners must then discuss all of the above with the family member entering or taking over the business.

Afterwards, the family member should have sufficient time and opportunity to express all his/her expectations, clarify his/her own values and disclose any fears, concerns and ambiguities in a safe mental and physical space.

Guidelines for the conversations: tolerance, time, emotional closeness, safety, readi-ness to change.

Important: Always write down the essential findings of the conversations!

Note: It is very helpful for the family to seek the help of an experienced psychodynamic counsellor in these cases, who will provide guidance and support to the family members, but will not be present during the discussions.

TOXIC COMMUNICATION PATTERNS

Below, we will look at some of the toxic communication patterns that are destroying relationships within family businesses, complicating family ties and fatally confusing roles. The confusion is even greater when the company is made up not only of family members but also of non-family colleagues.

Toxic communication patterns that sabotage effective communication

Criticism, contempt, resistance, defensiveness and retreating behind the communication "wall" are toxic communication patterns that sabotage communication in family businesses. Let's take a closer look:

Criticism- when delivered in an inappropriate way- that criticises the personality of the individual, especially if it comes from past experiences in parent-child relationships. For example, if we criticise someone: 'you always', 'you never', 'you don't care', 'you don't understand', etc., we will usually provoke a defensive attitude from the other person and constructive dialogue will be impossible.

Contempt, accompanied by insults on a personal level, is unacceptable in any circumstances because of its (more or less covert) aggressive nature. This includes scolding, ridiculing, eye-rolling, disregarding dissent, humiliating, making people feel incompetent, worthless. Such communication may appear to be peaceful, but it contains clear elements of belittling the person as a whole: "I'm really worried about how you're going to run the company one day...".

Resistance and defensiveness arise as a result of inappropriate criticism and contempt. The other party reacts angrily, refuses communication offered, responds with feelings of guilt or mutual recrimination, which progresses to excuses, withdrawal, aggression, excessive passivity and denial of responsibility. Such attitudes can bring the company down from within by the family members themselves. This is a difficult situation, especially when our colleagues are also individuals who are not family members.

Retreat behind a wall occurs when an individual no longer sees the purpose of his or her role. Communication is broken and the group feels as if we are all standing on our own. Unresolved conflicts turn into silence, inwardness, we are overwhelmed by emotions and feelings that float on the surface of pent-up aggression, much of it sinking into the unconscious.

Coaches and consultants in psychodynamic orientations have found that, unfortunately, there are still too few family businesses built on healthy foundations, where family members- colleagues- are able and capable of communicating openly with each other, while being aware of their roles. Only family firms in which family members have a proper separation of roles and an awareness of responsibilities can have a significant competitive advantage in the market and a development perspective. Courage is the clear recognition that there is something wrong with the relationships in a company run by family members. Ultimately, this will show up as a decline in the desired economic results, burnout, absenteeism, etc. At the extreme end, it can also be seen as an inability to hand over ownership and business operations to successors. That is also the end of the consolation that things will sort themselves out. A period of inadequate management, poor use of resources and a development crunch culminates in the loss of the business to the family.

The solution lies in tolerant communication

As mentioned earlier, many people find it difficult to empathise with the emotional experience of the other person. At the same time, they are reluctant to talk about their own feelings and hide them, often unconsciously repressing them. This is the legacy of an inadequate upbringing in those primary families where the expression of emotions is discouraged or even forbidden. Empathy, which means feeling and understanding one's own emotional experience and that of the other person, is absent. Such family environments are relatively numerous, especially in the industrial-technological world, where everyday functioning, form and material success have overshadowed genuine human relationships.

It is therefore necessary to learn to recognise and understand our own feelings and the feelings and experiences of the people around us. In the case of family businesses, these are family members who are also important colleagues, managers, directors. A psychodynamic coach or an experienced organisational psychology consultant will be of great help.

The next, or better still, a parallel process, is to talk openly about whatever is causing distress, fears and doubts in family members and other colleagues who are part of the company's management or are in any way involved in its key business decisions. It is very important that all family members are aware of the roles they play both in the company and in private. These roles have a strong tendency to intertwine, as the boundaries between different roles, personal integrity and economic pressures within and outside the family are sometimes barely perceptible. However, a successful takeover of a family business is unthinkable without comprehensive and frank discussions, sometimes involving only family members, sometimes only the director- the father and daughter who will be the acquirer, and at other times open to the wider management team.

We deliberately use the term “conversation” rather than “meeting” because we believe that the word “meeting” should remain reserved for structured and pre-planned communication in an economic and business sense, which is of course also unavoidable. However, a discussion about the difficulties and challenges of succession facing a family can also be focused and with a predetermined (at least partial) objective. Family members should have the opportunity to talk openly about all their concerns, hardships and anxieties, as well as about the joy, plans and other pleasant feelings that will accompany major shifts in the company and the family.

The unconscious sphere is very active

We need to be aware that many of our emotions are stored and hidden in our secret personal unconscious sphere. This does not mean that the depths of our unconscious mind are dormant. They are very active, and their activity can manifest itself in a multitude of seemingly illogical behaviours, thoughts and strangely concluded actions. Yet such incomprehensible actions and oddities are often unconscious defence mechanisms against unpleasant realisations that are seeping from the depths of the unconscious.

At a crucial moment in the development of any family business, which is undoubtedly the takeover of the business with all its existential and family-relational implications, the unconscious sphere of each individual is therefore very active. The consequences of an emotionally cold upbringing, where for years the only thing that mattered was achieving goals and where the child’s wants and needs were marginalised, could become apparent. It is hard to imagine how such a child, now an adult, educated person, will be happy and motivated to run the family business in the long term.

On the other hand, there are many families that try to identify the wants and needs of each member, while having clear boundaries between business and private life. It is best if the children in a family supported by their own enterprise grow up in a spirit where they will not be labelled ungrateful, lazy or in any way bad if they want to pursue a career and make a name for themselves outside the family environment.

EDUCATION OUTSIDE FAMILY BUSINESS

»It's never too late to learn.« It sounds like a corny phrase, but it is also very true when it comes to opening the eyes, hearts and minds of all family members to ensure that the process of taking ownership and management within the family business will work as all stakeholders want it to. However, guidance, education and consultation will flow more easily and quickly if the new acquisition of knowledge and experience takes place outside the parent company.

THE IMPORTANCE OF EXPERIENCE OUTSIDE THE FAMILY BUSINESS

Here's a look at why it is advisable for potential successors to work and train outside the family business for at least a few years. It is undesirable that the phenomena described occur. This can be largely avoided if the prospective successor spends a year or two, perhaps more, in a company that has no business links with the parent family company. While it is useful from a practical point of view to be in the same or a similar industry, often even this is not the most important thing. The most valuable experience after the placement will consist of drawing the line between business and private, delegating effectively by respecting personal boundaries and motivating the team by role modeling. What do we want to avoid?

Gifted status in the company

A sense of a kind of gifted status that is enjoyed by the successor is very common and can be identified in many family businesses. A potential acquirer may feel that something has been given to him, which has the effect of making him work less hard because he feels that he is related to him. He may behave in such a way that he is entitled to a position and all the benefits just by appearing in the company and others will work for him.

Another aspect of this same challenge is that a successor who enters the company completely inexperienced, without any skills or even added value to the company, has to prove himself twice as much as the others. No matter how much work he does and how much added value he creates for the company, he is still seen by his colleagues as having more or less given everything away.

However, when a potential successor's first experience is outside the family business, he has to prove himself by the work, knowledge and skills he possesses and is rewarded accordingly, can be promoted and, ultimately, is paid accordingly.

Failure to complete formal education

It is often the case that work, practical experience and full involvement in work processes are more highly valued in family businesses than the completion of professional training. Thus, in many family businesses, there is still a successor without formal relevant education. Too often the thinking is that they are working for themselves and their company anyway, where they will not be penalised, dismissed or denied the status that is theirs by virtue of their family ties for not finishing school. Motivation to complete a vocational school or degree can thus wane and many never finish. But we know that gaining professional knowledge and a broader view of business is essential, especially in today's uncertain and rapidly changing economic circumstances.

By encouraging their successors to develop their own skills and careers outside the family business, business owners motivate their children to be better educated and to acquire many of the much-needed skills that will benefit them as they continue in business.

Running out of creativity

Doing things the way they have always been done' is the motto of owners who do not encourage their successors to expand their horizons beyond the family walls. However, if successors are given the opportunity to train in a foreign environment, when they return to the family business they can add value to the company with new ideas, fresh approaches and creative solutions.

Ignorance or neglect of the rules of entrepreneurship

Relationships in a family business environment cannot exist only between the CEO and the employee, but only if the CEO is also the mother or father and the employee is the daughter or son. Business and private life are thus intensely mixed, there are disagreements, conflicts, personal resentments and, in the end, it is no longer clear whether Sunday lunch is for a family reunion or for a meeting that we did not manage to finish during the week.

However, if the successor is trained in a company where he or she is merely an employee and has no family ties, he or she learns the rules of the game, the respect for authority, the bottom-up view, the order, the structure and the rules of operation that form the basis for the successful continuation of any family business after the takeover. Therefore, the acquisition of experience, knowledge, skills and competences outside the family business is of great importance for every owner and acquirer of a family business.

Developing open communication

As we have mentioned many times before, it is of the utmost importance that all family members who are involved in any way in the running of the company learn communication skills that will enable everyone to feel safe, accepted and motivated. This can be achieved, first and foremost, by introducing regular meetings that address not only business in the strict sense, but also all the concerns, embarrassments and fears that accompany increasingly complex business and, above all, interpersonal relationships.

PREPARING TO BE AT THE WHEEL

This article will help you understand how personal development is important when takingover the business activities.

Preparing to be at the wheel- Why family busness education matters

TIPS AND TRICKS
COMMUNICATION PLAN

To foster transparency, build trust and facilitate successful business acquisitions, it is crucial to establish clear quidelines and protocols troughout the process.

In table 5 on the next page you will find precise communication plan with instructions how to use it. For better understanding of communication plan use also our guidelines in our presentation.

Table 5: Communication plan (Lobnik, Ambrožič, 2023)

CLEAR OBJECTIVES

Define why, what and to whom:

- why will you communicate,

- what do you want to achieve?

- what will you communicate?

- to whom will you communicate?-

- timeline of communication

COMMUNICATION STAKEHOLDERS

Identify the target groups to whom you will communicate during the succession process:

- family members

- employees

- key customers

- suppliers

- other business partners

- the public

CONTENT

clear, appropriate to the target group

- emphasise the importance of the company and stability

- reassure different stakeholders

- pave the way for successor

TIMELINE

- 6-12 months before transfer the business-internal preparation of employees

- 3-6 months before transfer - preparation of key suppliers, customers and business partners

- 1-3 months before transfer - in-depth & frequent communication with deadlines

INTERNAL COMKMUNICATION

- meetings with key staff

- answering questions, reassuring, opening up potential dilemmas, reducing uncertainty

EXTERNAL COMMUNICATION

- meetings with key customers, suppliers, business partners

- esential is trust and sense of safety

USEFUL LINKS AND OTHER MATERIALS TO EXPLORE

Psychology Today

ResearchGate

St. Louis Psychoanalytic Institute

Daily Mail

VIDEO

Becoming Independent From Your Parents

How to cope with narcissistic family?

The role of psychological capital in family business succession

CASE STUDIES

If you would like to gain more knowledge please refer to case studies. In described examples from practice, it is explained why it is good that trainings, workshops, coaching and consultations are always conducted under the guidance of an external expert. Only someone who is not involved in the business in any way or is not related to the company or its owners or managers can approach and direct the process of developing relationships and communication in a family business or wider without any burden. At the same time, the external expert represents a kind of projection screen for the client's emotions and experiences, which represent valuable material that the consultant and coach use to understand and plan the client's development process.

Case studies

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NOTES

Module 4
FINANCING PLANNING PROCESS

This module will introduce you to the essential knowledge, tools, and strategies needed to navigate through the financing process of a successful succession.

After studying this module you will achieve the following learning outcomes:

- You will get an overview of the financing planning process works
- You will understand the difference between theoretical and practical planning
- You will understand the importance of communication among all stake-holders
- You will be equipped with knowledge about different successor financing options

Length of module: 2 × 45 min.

THEORETICAL FINANCING PLANNING

Handover of Figures to the Successor

In this section, we will explore the crucial aspects of handing over financial figures to the successor during a company's succession. We will discuss the importance of accurate and comprehensive financial documentation, including financial statements, balance sheets, income statements, and cash flow statements. Additionally, we will cover the significance of providing historical financial data and insights into the company's performance, as well as the effective communication of this information to ensure a smooth transition for the successor.

Handing over the company information to the successor is an important step in the process of company succession. This step is about handing over all the important information about the company to the successor so that he or she can continue to run the company successfully.

The information to be transferred can vary widely. It may include, among others, the following areas:

- Financial information

- Customer information
- Supplier information
- Employee Information
- Processes and procedures
- Knowledge and experience

The transfer of information should be carefully planned and executed. It is important that the information is complete and up-to-date. The successor should have the opportunity to ask questions and have the information explained in detail.

The transfer of information can be done in several steps. The first step is to create a document that contains all the important information. This document should be created jointly by the seller and the successor. The second step is to conduct training for the successor. In these trainings, the successor is taught the most important information and processes of the company. The third step is to accompany the successor in the initial phase. In this phase, the seller is the contact person for the successor and provides him with advice and support.

The handover of company information is an important step in the process of business succession. Careful planning and execution of the handover can help ensure that the business succession is successful.

Here are some tips for handing over company information:

- Start planning the handover early.
- Involve the successor in the planning.
- Create a document that contains all the important information.
- Conduct training for the successor.
- Accompany the successor in the initial phase.
- Be patient and understanding.

The handover of company information is an important task. With careful planning and execution, you can help ensure that the company succession is successful.

Different Types of Successor Financing

In this section, we will delve into the various types of financing options available to successors during a company's succession. We will explore traditional financing methods such as bank loans, equity investments, and lines of credit, as well as alternative financing options like venture capital and angel investors. We will discuss the advantages and disadvantages of each financing type, their eligibility criteria, and the potential impact on the successor's ownership and control of the company.

There are many different types of succession financing for companies and neither standard nor simple solutions. The best type of financing in each case always depends on the individual needs and situations of the company and the successor.

The most common types of succession funding include:

- Equity financing: Equity is money invested by the owners of the business. Equity can come from a variety of sources, such as savings, loans from family members or friends, or the sale of assets.
- Debt financing: Debt capital is money borrowed from third parties, such as banks or other investors. Debt capital must be repaid, including interest.
- Subsidies: Subsidies are government grants awarded to support business start-ups and successions. Subsidies can take the form of grants, low-interest loans or guarantees. In the vast majority of cases, mixed forms and combinations of all types will result in closed business succession financing.

When selecting successor financing, it is important to consider the following factors:

- The amount of financing required: The amount of financing required depends on the purchase price of the business, the cost of assuming the liabilities, and the cost of working capital.
- The term of the financing: The term of the financing should be long enough to give the successor sufficient time to turn the company around and generate profits.
- Interest conditions: Interest conditions depend on the type of financing and the creditworthiness of the company.
- Collateral: Collateral is assets that serve as security for the lender to repay the loan.

Customized Figures for the Successor's Situation

This section will focus on the importance of customizing financial figures and projections to align with the successor's unique situation and goals. We will examine how factors such as the successor's experience, risk tolerance, and long-term vision for the company can influence the financial planning process. Additionally, we will explore strategies for adjusting financial projections, considering the successor's strengths and weaknesses, to create a realistic and tailored financial plan.

There are many different key figures that are important for the succession situation of companies and must be made transparent to the company successor. These key figures help the successor to assess the financial stability of the company, the market position of the company and the future viability of the company.

Key financial information (see Section 1) includes:

Turnover: Turnover is the most important indicator of a company's financial stability. A high turnover means that the company is successful and earns money.

Profit: Profit is the surplus that a company generates after deducting all costs. A high profit means that the company is profitable and can set aside money.

Debt: Debt is the amount of money a company has borrowed from third parties. A high level of debt can pose a risk to the company, as it can lead to payment difficulties.

Liquidity: Liquidity is the ability of a company to pay its liabilities in the short term. Good liquidity is important to ensure the company's solvency.

Profitability: Profitability is the ratio between profit and sales. A high level of profitability means that the company operates efficiently and generates a lot of profit.

Market position: The market position of a company is its position in comparison to its competitors. A good market position means that the company has a high market share and can successfully sell its products or services.

Market development: The future viability of a company also depends on the development of the market. Investigations and analyses should be carried out and evaluated for assessment.

Analyzing these key figures helps to assess the company's situation and identify potential risks. Early planning and preparation can help ensure a successful business succession.

Cost Structure Adjustment due to Successor Financing

In this section, we will address the adjustments required in the cost structure of a company due to the chosen successor financing method. We will discuss how different financing options may impact factors such as interest rates, repayment terms, and additional costs associated with specific financing sources. Furthermore, we will explore ways to optimize the cost structure to ensure the sustainability and profitability of the company under the successor's chosen financing plan.

The various financing options affect interest rates, repayment terms, liability, and additional costs associated with different financing sources as follows:

Equity

- No interest costs as a rule for open investments
- Additional costs such as administrative, contract costs or fees.
- Liability and risk of loss for the capital share lies with the capital provider.
- Repayment only upon sale to seller of shares

Borrowed capital

- No interest costs as a rule for open investments
- Additional costs such as administration, contract costs or possible fees

- Risk of loss and liability
- Repayment according to interest and redemption schedule

Subsidies

- Subsidies are government grants awarded to support business start-ups and successions.
- Grants usually have a low interest rate or are even interest-free.
- However, subsidies can also be linked to conditions, such as the obligation to make certain investments or create jobs.

If you are looking for a buyer as a successor for your business, you should put yourself in their shoe's when it comes to financing. Hardly any founder has the equity to pay for a company just like that. Even with mixed financing from equity, loans and subsidy programs, things can get tight for the prospective buyer.

When it comes to financing a succession process, the problem of too little equity is usually encountered by those taking over the company. In addition, the financing bank does not want to bear the risk alone. Development loans, securities and guarantees can help here.

Other risk-minimizing, confidence-building and rating-optimizing measures:

The most important contribution to successful financing can be made by the transferor himself long before the takeover by ensuring that the company has a **good rating and sufficient debt servicing capacity**.

Vendors often have exaggerated price expectations. However, the decisive factor for financing the business takeover is whether the successor will be able to repay the loans for the purchase of the company in the coming years. Banks and development banks examine the takeover concept and the ability to service the debt very closely. Lenders look at the earnings of the last three years before the takeover in order to check the plausibility of the planning and the ability to service the debt. This is therefore a good time to improve the company's rating in advance, also in the interest of the successor.

To support this, a **seller can also become a lender**:

Banks want to limit their risk. Even if a development bank provides a loan with partial release from liability for the buyer, the risk may still be too great for the bank. There is then the option of the transferor granting a loan to the successor, with the seller only receiving part of the purchase price later and in installments. However, this may be the only way to find a buyer and secure your life's work.

Another option for minimizing risk and better capital acquisition is **succession in a team**. The person handing over the business should also be open to handing it over to a group of successors. If several employees take over a business together, this can even be an advantage when it comes to financing, as it reduces the respective risk for their banks. Several buyers = shared risk.

By **optimizing the cost structure**, companies can improve their sustainability and profitability even if they have to bear additional financing costs. There are some ways to optimize the cost structure of the company to ensure sustainability and profitability even with an additional burden of financing costs that the successor will have in contrast to the transferor. This should be analyzed in advance of the financing negotiations and brought into the negotiations as possible building blocks to be implemented. Possible measures would be:

- **Reducing material cost**s: companies can reduce their material costs by finding cheaper suppliers, negotiating discounts or reducing the amount of material waste.
- **Reducing energy costs**: Companies can reduce their energy costs by using energy-efficient equipment, optimizing lighting and lowering office temperatures.
- **Reducing personnel costs**: Companies can reduce their personnel costs by eliminating positions that are not absolutely necessary or by reducing wages and salaries.
- **Optimizing logistics costs:** Companies can reduce their logistics costs by optimizing transport routes, reducing the amount of inventory and making the supply chain more efficient.
- **Reducing administrative costs:** Companies can reduce their administrative costs by reducing the number of offices, optimizing office equipment and reducing the number of administrative staff.

Derivation of Concrete Financing Requirements

This section will help users determine the financing needs for a company during succession planning.

If the company is to be transferred through a sale, the entrepreneur and successor must agree on a price. This can be made more difficult by differing opinions about the right amount. For example, the entrepreneur will set the price relatively high because the proceeds from the sale are part of the financial security after the handover and he also demands an emotional premium for his life's work.

However, the successor will start at a much lower asking prices. This is because interest and redemption charges from financing the acquisition must also be earned in the long term.

In addition, different buyer groups have different considerations when determining the price. For example, an existing management team or a strategic investor- a competitor, for example- will tend to have to pay a higher price than a family member.

Before agreeing on a purchase price, a valuation method should therefore first be selected. Various methods are available for determining the value of a company. The appropriate valuation method depends in particular on the industry, legal form and size of the company. However, the determination of the company value is often controversial, because there is no objective company value. One option to do so objectively is through external professional advise. In fact, specialised consultants can provide such service. Relying on this support may be an advisable choice, esp. for businesses of larger (financial) size.

SELL OF THE COMPANY AND TRANSFER OF BUSINESS

This free guide will help you understand the process of selling the company.
The sale itself is a great challenge both for the seller and the buyer. Determining the value of the company is definitely one of the most important elements of the sale for both sides of the transaction.

7 steps in selling your business

PRACTICAL FINANCING PLANNING

Financing Composition

In this section, we will explore the essential elements of financing composition during a company's succession. We will discuss the different sources of financing opportunities.

After determining the specific financing requirements, putting together the financing is the next step in the business succession process. The financial resources required depend on various factors, such as the purchase price of the business, the cost of assuming liabilities or the cost of working capital.

Once the financial resources needed are known, they must be allocated to various possible funding sources. The most common sources of funding are:

- **Equity:** Equity is the money invested by the new owners of the company or third-party investors (equity financing, shareholders, venture capital, angel investors).
- **Borrowed capital:** Borrowed capital is money borrowed from providers of capital and usually repaid in return for interest and principal over a defined period of time. The prerequisite is the ability to service the debt.

- **Subsidies:** Subsidies are government grants awarded to support business start-ups and successions. The form of the grants can vary.

Deciding which funding source to use for which funds depends on a number of factors, including the creditworthiness of the company, the amount of funds needed, and the interest rate terms of each funding source.

Subsidies

Subsidies can be an important source of financing for business successions. There are a large number of subsidy programs offered by the federal, state and local governments. The funding programs differ in terms of funding objectives, funding requirements and funding levels.

When planning the financing of a business succession, entrepreneurs should check whether they are eligible for subsidies. The subsidies can help reduce the financial burdens of business succession.

Finalization of Individual Financing Concept

After the required financial resources have been identified and the various sources of funding have been allocated, an individual financing concept must be drawn up. The financing concept should include the following points:

- A breakdown of the financial resources required
- A description of the various sources of funding
- A rationale for the selection of the respective funding sources
- A cost-benefit analysis of the various financing alternatives

The financing concept is an important document for business succession. It serves as a basis for negotiations with banks and other investors. The financing concept helps the entrepreneur to minimize the financial risks of the business succession.

Initiation/Approach of Suitable Financing Partners

This section will cover the essential steps in initiating and approaching suitable financing partners during the company's succession. We will discuss how to identify potential financing partners, such as banks, investors, private equity firms, or government funding programs. Participants will learn effective strategies for pitching their financing concept and presenting the business case to attract potential partners. We will also address the importance of building relationships and networking to establish trust and credibility with financing partners.

The initiation and approach of suitable financing partners is a complex process. It is important to take sufficient time and plan all steps carefully. The initiation and approach of suitable financing partners is an important step in the process of business succession. This step involves identifying and contacting potential investors or lenders.

The following steps are helpful in initiating and approaching appropriate funding partners:

1. Identify potential investors or lenders. There are a variety of potential funding partners, including banks, venture capital firms, business angels, and private investors. The following factors should be considered when selecting potential funding partners:

- The amount of funding needed
- The term of financing
- The interest
- The collateral
- The conditions

2. Research potential funding partners. Before approaching potential financing partners, you should find out more about them. This includes information on the business models, investment strategies, prospects of success and contact persons.

3. Preparation of a financing concept. A financing concept is a document that contains the most important information about the company and its financing needs. The financing concept should contain the following information:

- A description of the company
- A presentation of the business model
- An analysis of the market outlook
- A financial planning
- A risk analysis

4. Contacting potential financing partners. After you have created a financing concept, you can contact potential financing partners. When contacting them, you should keep the following points in mind:

- Introduce yourself and your company.
- Explain the funding requirements.
- Hand over the financing concept.
- Answer all the questions.

5. Negotiating with potential financing partners. When you are contacted by potential financing partners, you must negotiate financing terms with them. You should keep the following points in mind during negotiations:

- The amount of funding
- The term of financing
- The interest

- The collateral
- The conditions

Conclusion of Financing Contract / Purchase Contract

In this final section, we will explore the process of concluding financing contracts or purchase contracts for the company's succession.

The preparation and conclusion of the financing and purchase agreement is a complex process. It is important to take enough time and plan all steps carefully.

The contracts should be carefully negotiated. It is important to clarify all points in detail and minimize all risks. It is advisable to consult advisors in each case. They will provide insights into the importance of legal and financial due diligence to ensure a smooth and secure transaction.

Once the negotiations have been successfully concluded, the financing contract between the financing parties (possibly several contracts) and the purchase contract between the successor and the seller must be drawn up and concluded.

The financing agreement regulates the rights and obligations of the parties in the context of financing, and the purchase agreement regulates the rights and obligations of the parties in the context of purchasing the company.

Financing contract

The financing contract should contain the following points:

- The amount of funding
- The term of financing
- The interest
- The collateral
- The conditions

Purchase contract

The purchase agreement should contain the following points:

- The purchase price
- The objects of purchase
- The payment modalities
- The warranty
- The transitional arrangements
- The jurisdiction clause

Completion of the transaction

After the signing of the contracts, the closing of the transaction takes place. This involves the transfer of the purchase sum to the seller and the transfer of ownership of the company to the buyer.

In the next module we will introduce you to the topis of Environmental, Social, and Governance (ESG).

EBITDA & OTHER METHODS

This free guide will help you to research techniques and methods like EBITDA multiplier, discounted cash flow method and comparative sales approach. Sale of the company is the best option when the company's owner is seeking to secure funds for a carefree life following retirement. Another possible reason is also the lack of a suitable successor for the company, and the owner does not want to hand over the management of the company to a stranger.

7 steps in selling your business

USEFUL LINKS AND OTHER MATERIALS TO EXPLORE

IHK

KfW Checklist (DE Only)

FinCompare

Praxishandbuch für die Nachfolge im Familienunternehmen

Nachfolgewiki

IHK Kassel-Marburg

DIHK

NEXA

VIDEO

Nexxt Now Nordhessen

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Module 5
ESG IMPACT ON SUCCESSION

This module aims to prepare SME owners for the incorporation of ESG considerations into succession planning. The module aims to provide you with actionable insights into why and how ESG factors can significantly impact the success of succession processes.

Length of module: 5 × 45 minutes.

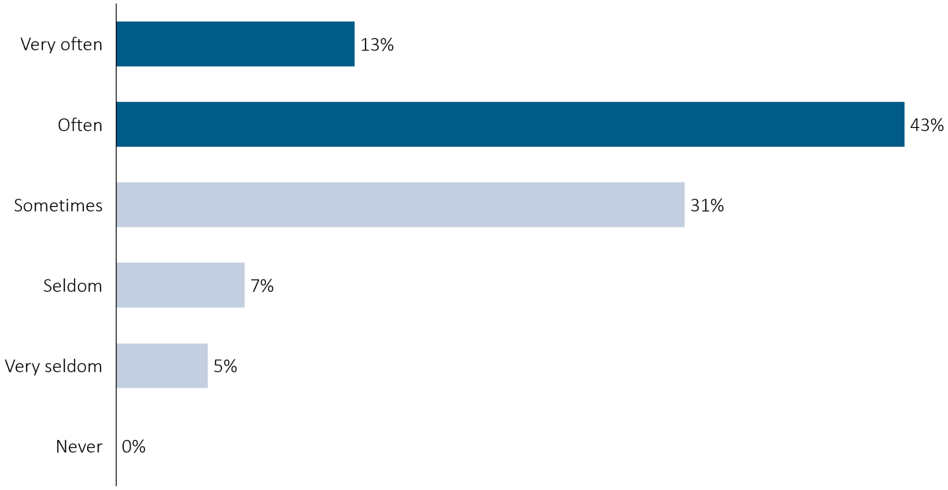
INTRODUCTION TO ESG IN SUCCESSION PLANNING

The subject of Environmental, Social, and Governance (ESG) has increasingly become a focal point in contemporary business practices. Its pertinence extends not just to day-to-day operations but also has profound implications for SME succession processes.

DEFINITIONS AND DATA

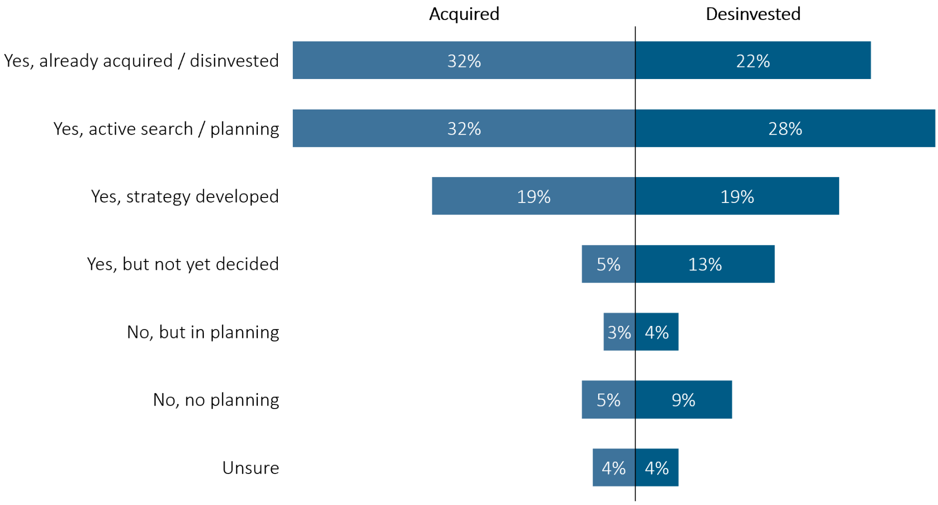
While specific data about the impact of ESG on succession planning is still limited, data pertaining to Mergers and Acquisitions (M&A) is very informative in this regard. According to a 2022 report by Deloitte, 66% of investors consider ESG issues as critical when contemplating M&A opportunities and confirm that ESG is a serious discussion topic in ongoing company transaction processes. This highlights the growing awareness and scrutiny placed on ESG factors and serves as a strong indicator of their importance in succession scenarios as well. In the same study, 49% of companies state that they have already abandoned a transaction process because of ESG concerns regarding the company they wanted to acquire.

How often is ESG a topic of discussion and decision-making factor in ongoing M&A transactions?



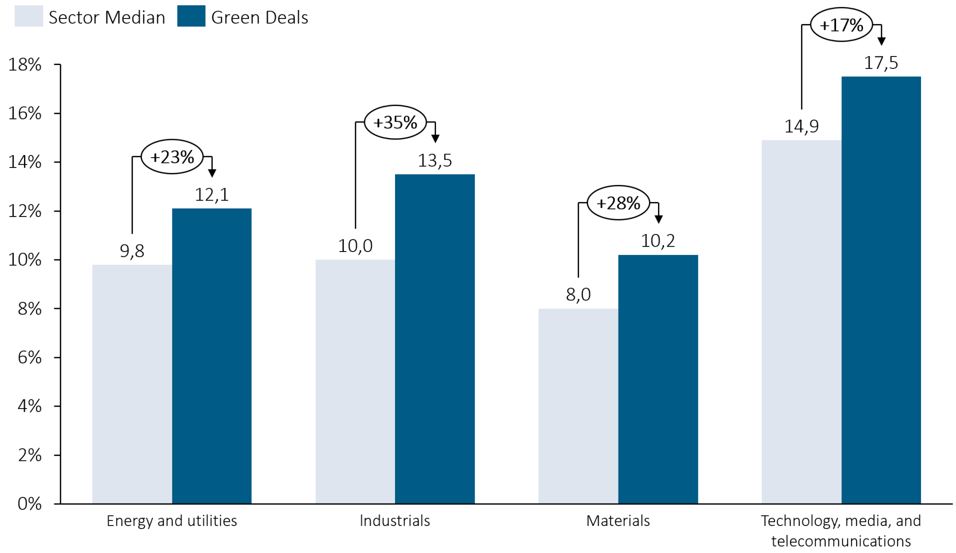
On the other hand, the same study shows that ESG considerations have a strong influence about acquisition and/or disinvestment strategies.

Has your organisation analysed its portfolio from an ESG perspective to inform decisions on acquisitions / divestments to improve its ESG profile?



While a negative ESG Performance has a strong influence on the success rate of succession and M&A Processes, companies with good ESG performance have higher enterprise values (and thus purchase prices) and the range of potential acquirers is also demonstrably larger.

An analysis of the multiples paid on the company's earnings as a purchase price, conducted by BCG, shows, for example, significantly higher purchase prices for "green companies" than the industry average. However, the differences vary from industry to industry.



Understanding ESG requires breaking down its components:

Environmental (E): This refers to a company's interactions with the natural environment. It encompasses a range of issues including carbon footprint, waste management, and ecological sustainability.

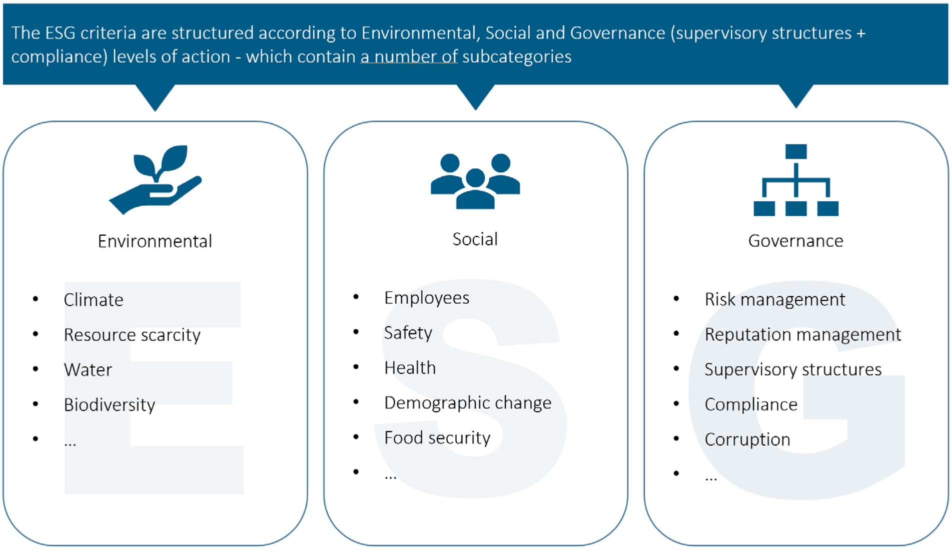
Example: If a manufacturing company invests in waste treatment facilities to minimize environmental pollution, it positively impacts the 'E' in ESG.

Social (S): This dimension considers the company's relationships with its employees, suppliers, customers, and the communities in which it operates. Issues like employee welfare, diversity, and consumer protection fall under this category.

Example: A firm with excellent employee benefits, well-established worker safety protocols, and community engagement initiatives would score highly on the 'S'.

Governance (G): This involves the structures and processes in place for the administration of the company. Governance refers to issues like board composition, executive compensation, and shareholder rights.

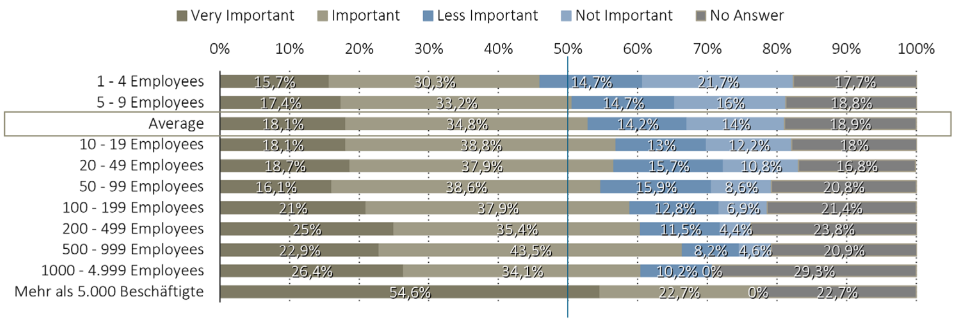
Example: A company with a transparent reporting mechanism, an independent board, and well-defined shareholder rights would reflect strong 'G' characteristics.



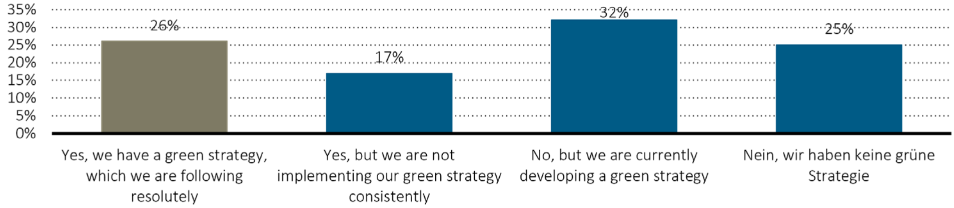
Although most companies consider ESG and Sustainability as important strategic topics, the majority of companies are not strategically prepared for the needed transformation to comply with the growing ESG demands.

Studies conducted by the Institute for Employment Research in Germany and Staufen show that while significantly more than 50% of entrepreneurs state that from a competitive perspective ESG is important or very important, at the same time 74% of the companies surveyed state that they have no strategy in this area or that they do not consistently implement an existing strategy.

A competitive perspective: the importance of environmental sustainability compared with the competition



Strategy perspective: Share of German companies with green strategy 2021



Source of graphs: Deloitte, 2022, author, 2023 and Institut für Arbeitsmarkt und Berufsforshung, 2019

IMPORTANCE OF ESG IN SUCCESSION PLANNING

Understanding the importance of ESG considerations is crucial for multiple reasons. It impacts how your business is viewed by potential successors, investors, and various stakeholders. It can mitigate a range of risks that could potentially derail a smooth transition during succession. And most importantly, it can be a vehicle for value creation, enhancing the appeal of your enterprise in the marketplace. This session is geared towards enabling a comprehensive understanding of these dynamics, thereby assisting you in making well-informed decisions as you navigate the complexities of preparing your organization for a leadership or ownership transition.

The incorporation of ESG considerations into succession planning is not merely a trendy obligation but an operational imperative. Ignoring ESG factors can significantly risk diminishing a company's reputation, stakeholder relationships, and even its valuation. Not only do these factors contribute to the attractiveness of your company to potential successors or investors, but they also impact the long-term resilience and sustainability of your organization.

RISK MITIGATION THROUGH ESG

In succession planning, the concept of risk takes on a multi-dimensional aspect. According to a study by Deloitte in 2021, firms with well-implemented ESG policies and practices have 10% less exposure to substantial financial and reputational risks.

Regulatory Risks: SMEs often assume that regulatory compliance is primarily a concern for larger corporations. This is a misconception. With the advent of legislative initiatives, such as the European Union's Sustainable Finance Disclosure Regulation (SFDR), SMEs are as much a target for regulatory scrutiny as their larger counterparts (sometimes indirectly: Some legislative initiatives target larger corporations but SMEs working in the B2B Sector with those corporations still have to comply as they are part of the value chain and have to report to their B2B customers). Failing to align your business with such regulations could result in market opportunities or even penalties, significantly affecting your valuation and appeal to potential successors. Therefore, adopting a proactive ESG strategy is not merely a 'nice to have' but an essential risk mitigation strategy.

Reputational Risks: The significance of reputation cannot be overstated in the digital age. Studies (e.g. KPMG 2022) show that customers look very closely at the ESG performance of companies and that greenwashing in particular (i.e. pretending to be environmentally conscious) can cause significant reputational risks. This is not mere consumer activism but an influence that extends also to the kind of talent and leadership that would be interested in your SME. A tarnished reputation due to ESG failings can severely constrain your pool of potential successors and may lead to a devaluation of your business. Therefore, investing in ESG practices is essentially an investment in safeguarding your reputation. In times of highly competitive markets and also a comprehensive war for talents, ESG is therefore an important factor that potential successors will also look at in this context.

ESG IMPACT ON COMPANY VALUATIONS

Several studies like the the above mentioned BCG (Boston Consulting Group) Analysis show a significant impact of ESG Performance on Purchase Prices in Company Transactions – however with a different impact in different sectors.

Potential successors and investors now increasingly use ESG performance as a litmus test for assessing the long-term viability and ethical standing of a business. For SMEs, where every valuation point could significantly affect the terms of a succession or acquisition, failing to address ESG considerations can result in a tangible financial drawback. Simply put, your ESG score is not just an ethical badge but a financial asset or liability. It is crucial, therefore, to adopt a robust ESG framework that not only complies with regulations but also seeks to create sustainable value. Such a strategy enhances your market standing and makes you a more attractive proposition for potential successors.

STRANDED ASSETS AND STRANDED BUSINESS MODELS

In the evolving landscape of corporate sustainability, the concept of “Stranded Assets” is gaining prominence. These are assets that risk premature devaluation or write-offs due to a variety of factors such as policy changes, market shifts, and disruptive technologies. The risk is particularly acute for business models that rely heavily on activities contributing to greenhouse gas emissions.

Stranded assets refer to any asset that has become obsolete or non-performing, but is still recorded on the balance sheet. In the current environmental climate, these are typically physical or intangible assets dependent on fossil fuel use, including but not limited to coal mines, oil reserves, and related infrastructures. If the concept is understood to apply not only to direct assets in terms of fossil resource use, but further in terms of traditional, non-ESG business activities, then one can also speak of Stranded Business Models.

For SMEs, understanding the concept of stranded assets / stranded business models is critical as they prepare for succession, as these assets significantly impact both valuation and the appeal to potential successors.

Climate Goals and Regulatory Changes

Global climate goals, particularly those set by the Paris Agreement, aim to limit global warming to well below 2 degrees Celsius above pre-industrial levels. These objectives are translating into stringent regulations around carbon emissions, which in turn, could render certain business models and assets redundant. In various jurisdictions, we are witnessing the phasing out of coal-fired plants, stricter emission limits for vehicles, and enhanced scrutiny on industrial processes that are carbon-intensive.

Impact on Emission-Dependent Business Models

Assets heavily dependent on greenhouse gas emissions become particularly vulnerable in this regulatory landscape. For example, fossil fuel reserves that were once lucrative can suddenly transform into liabilities due to carbon taxes or caps on emissions. If your business relies on technologies, patents, or processes that are carbon-intensive, you face a heightened risk of these becoming stranded assets.

Relevance to Succession Planning

Stranded assets can have a profound impact on the succession process. Firstly, they may significantly reduce the valuation of a company, thereby influencing the terms of any succession deal. Secondly, the reputational risks associated with stranded assets may deter potential successors who are keen on sustainability. Lastly, the financial burden of managing or disposing of these assets may complicate the legal and financial aspects of the transition.

Preventive Actions and Strategy Alignment

Being proactive in identifying and managing potential stranded assets can substantially mitigate risks. Companies should:

1. Conduct regular asset reviews with a focus on sustainability.
2. Utilize tools like CSR-Ready Assessment (see below) to evaluate their ESG performance.
3. Consider diversifying into more sustainable assets or transform current business practices.
4. Engage with regulatory bodies to stay abreast of upcoming changes that might impact their asset portfolio.

By incorporating these elements into your strategic planning, you can significantly reduce the risks associated with stranded assets and ensure a smoother, more profitable succession process.

STAKEHOLDER ENGAGEMENT

Understanding the role of stakeholders in ESG is crucial for succession planning, as they can significantly impact the valuation and appeal of your enterprise. According to a survey by Stepstone, every second potential employee is considering the ESG Performance of companies when making career choices. A motivated and committed workforce is essential for a seamless transition in leadership, which is why ESG considerations are pivotal in engaging with internal stakeholders. At the same time, a PWC Study also shows, that while many companies have ambitious ESG Targets, only 6% actually implement consistent measures consequently to reach those targets.

When considering external stakeholders like suppliers, customers, and the community at large, your ESG profile becomes equally important. Customers are willing to switch to brands that aligned with their values, particularly those emphasizing social responsibility. This indicates that ESG compliance is not just a regulatory requirement or a risk mitigation strategy but also a driver for brand loyalty and, consequently, company valuation.

So, what does this mean for SMEs? Unlike larger corporations, SMEs often have a smaller pool of stakeholders, making each relationship critical for business continuity. Poor ESG practices can disproportionately affect an SME's stakeholder relationships, thereby negatively impacting the succession process. Therefore, SMEs must adopt ESG practices that are not only legally compliant but also beneficial for stakeholder engagement.

LEGAL AND REGULATORY FRAMEWORKS

Legal and regulatory considerations are an integral part of ESG in succession planning. With the global landscape for ESG regulations becoming increasingly complex, SMEs must be proactive rather than reactive. New regulations like the EU Taxonomy and the Corporate Sustainability Reporting Directive (CSRD) can affect the transition process significantly. For instance, if your SME falls under the scope of such directives post-transition, the successors will need to be prepared for the reporting and compliance requirements. Inadequate preparation in this regard can result in legal complications that could hamper the transition.

It's worth noting that while the EU has been at the forefront of ESG regulation, different countries have varying standards and norms. As your SME may be operating in multiple jurisdictions, it's essential to be aware of the local regulations that may apply. A well-crafted ESG policy will be comprehensive, considering not just international but also local standards. This ensures that you are prepared for succession regardless of geographic boundaries.

ESG AUDITS AND DUE DILIGENCE

Environmental, Social, and Governance (ESG) audits are emerging as an essential component of a company's overall due diligence, particularly in succession planning. An ESG audit involves the meticulous review and assessment of a company's policies, practices, and performance in relation to environmental protection, social responsibility, and governance integrity.

The impetus for integrating ESG audits into due diligence stems from a growing recognition that ESG performance is not merely a 'nice-to-have' attribute but a critical determinant of a company's long-term sustainability and valuation. In the context of succession planning, an ESG audit can serve as a strategic tool to identify areas of risk and opportunity that could significantly affect the perceived value of a business in the eyes of potential successors or investors. The audit often covers, but is not limited to, waste management practices, energy consumption, labor relations, board diversity, and compliance with relevant laws and regulations. A comprehensive ESG audit can provide an indispensable roadmap for companies looking to enhance their ESG performance ahead of pivotal transitions, such as management succession.

Inclusion in M&A Considerations

The role of ESG criteria in Mergers and Acquisitions (M&A) is becoming increasingly pronounced. Historically, financial metrics were the primary focus of M&A due diligence. However, the landscape has evolved significantly. Now, ESG factors are often treated with equal importance.

In the domain of succession planning, the M&A angle becomes particularly relevant for businesses considering external successors or potential buyouts. During the acquisition process, a company's ESG performance can greatly influence not only its valuation but also the willingness of parties to transact. Inadequate ESG practices or lack of compliance can serve as deal-breakers or necessitate costly remedial measures post-acquisition. Therefore, it is imperative for companies to integrate ESG considerations thoroughly into their M&A due diligence processes.

SUSTAINABILITY AND COMPETITIVE ADVANTAGE

The integration of ESG criteria into a company's strategy is increasingly seen as a source of competitive advantage. Businesses that proactively manage their environmental and social impacts are better positioned to anticipate and adapt to legislative changes, meet consumer demand for responsible products, and mitigate operational risks.

In succession planning, a strong ESG strategy can significantly elevate the appeal of the business to prospective successors, who are increasingly cognizant of the importance of sustainability. It is not merely a matter of ethics but also a strategic maneuver aimed at long-term resilience and profitability.

ATTRACTING QUALITY SUCCESSORS

In today's increasingly socially conscious business environment, quality successors are often those who prioritize sustainability and ethical governance. Such individuals are likely to be attracted to organizations that have integrated these values into their operational and strategic frameworks.

In succession planning, a robust ESG strategy not only adds value to the business but also serves as a crucial differentiating factor in attracting high-caliber successors. It sends a strong message that the company is forward-thinking, adaptable, and well-aligned with emerging global trends, making it a more attractive proposition for capable and like-minded successors.

By integrating ESG into the succession planning process, companies can ensure a more seamless transition and a more sustainable and profitable future.

Legal and Regulatory Landscape in ESG and Succession Planning

INTRODUCTION TO THE REGULATORY ENVIRONMENT

The regulatory landscape concerning Environmental, Social, and Governance (ESG) factors has been in a state of flux, continuously adapting to the global emphasis on sustainability and responsible business practices. As succession planning involves the transfer of management and ownership, it becomes imperative to align the succession strategies with the existing and emerging regulatory frameworks. Failure to comply can lead to financial penalties, legal repercussions, and reputational damage, affecting both the valuation and the marketability of the business during succession. As such, this section aims to guide SMEs through the complexities of relevant laws and regulations that intersect with ESG factors and succession planning.

EXAMPLES OF FUNDAMENTAL LEGISLATION

European Union laws form a pivotal cornerstone of the regulatory landscape impacting SMEs in the region. The EU Non-Financial Reporting Directive (NFRD) is a seminal piece of legislation that obligates companies to disclose their operational impacts on social and environmental matters. Although the regulation is principally targeted at large public-interest entities employing more than 500 individuals, its implications are instructive for SMEs and should not be overlooked. Labor regulations, exemplified by the Working Time Directive and the Employment Equality Directive, also serve as crucial legislative frameworks within which businesses must function, thereby influencing the 'Social' aspect of ESG.

In addition to the above, the EU has advanced various environmental regulations such as the Circular Economy Action Plan, aimed at promoting sustainable resource utilization. Organizations considering succession plans must ensure strict compliance with such laws, as failure to do so could critically hamper the progression of their succession strategies.

Moreover, the forthcoming Corporate Sustainability Reporting Directive (CSRD) is poised to significantly extend the reach and depth of non-financial reporting requirements. If enacted, the CSRD will replace the NFRD and impose new obligations for sustainability reporting not only on large public-interest entities but also on all large companies and, potentially, select SMEs operating in high-impact sectors. The CSRD aims to ensure that such companies disclose comprehensive sustainability information, thereby contributing to a more transparent and accountable business environment. This directive will serve as a crucial reference point for SMEs in their succession planning, as it will likely necessitate revisions to their existing disclosure practices and possibly their overall ESG strategies. Understanding and integrating the ramifications of the CSRD into their business models will be imperative for SMEs looking to navigate the complex landscape of ESG compliance effectively.

EMERGING REGULATORY TRENDS

One of the pivotal emerging regulatory trends in the EU is the Sustainable Finance Disclosure Regulation (SFDR). It requires financial market participants to disclose sustainability-related information. While not directly aimed at SMEs, it's an example of how the regulatory framework is shifting towards sustainability and influences investor behavior. Indirectly, the Sustainable Finance Disclosure Regulation has an effect on SMEs though as it will have an impact on both, financing opportunities and financing interests which will be higher for companies with poor ESG Performance in the future.

Another essential regulation is the EU Taxonomy, a classification system for environmentally sustainable economic activities. It sets criteria for what can be considered an environmentally sustainable activity, thereby affecting investment flows and, ultimately, company valuation—a significant factor in succession planning.

COMPARATIVE INTERNATIONAL FRAMEWORKS

Although this module focuses on a general approach, it's worth mentioning the different regulatory landscapes that exist internationally. For instance, the United States has its own set of ESG-related regulations like the Dodd-Frank Wall Street Reform and Consumer Protection Act. For SMEs operating or planning to expand overseas, understanding the comparative international frameworks is crucial as these can affect not just daily operations but also the structuring of succession plans.

REGULATORY IMPACT ON VALUATION

The valuation of a company during succession is not solely dependent on its financials but also on its compliance record. Regulations like the EU Green Deal aim to make Europe the first climate-neutral continent by 2050 and directly impact industries like manufacturing, energy, and transport. Companies in these sectors must consider how compliance or non-compliance will affect their valuation. A documented history of compliance can enhance marketability and valuation, making the business more attractive to potential successors or buyers. In this regard, please also see the section on stranded assets above.

LEGAL LIABILITIES AND DUE DILIGENCE

Succession planning involves exhaustive due diligence, and part of this involves understanding the legal liabilities stemming from ESG regulations. Sustainability' goes beyond just climate, and the role that businesses can play in protecting both the environment and supporting broader issues such as human rights has caught the attention of politicians, investors, consumers, and other stakeholders. The European Commission, via its proposed Corporate Sustainability Due Diligence Directive (CSDDD), has put forward a legislative framework to oblige companies to demonstrate what action they are taking to protect the environment and human rights.

Should the CSDDD be enacted, it would impose an obligation on companies to proactively identify, prevent, and mitigate the impacts of their business operations on both the environment and human rights. This extends not only to the companies' own operational sphere but also to the actions of their subsidiaries as well as other entities in their value chain with whom they have both direct and indirect established business relationships. Companies would be mandated to create and enact 'preventive action plans,' secure compliance assurances from their immediate business associates, and engage in subsequent verification of compliance.

Affected Entities

The proposal identifies four categories of companies that would be subject to these regulations:

Group One: EU-based companies with a workforce exceeding 500 and a global net turnover exceeding EUR 150 million in the most recent financial year.

Group Two: EU entities with more than 250 employees and a net global turnover above EUR 40 million, provided at least half of this revenue is generated in sectors deemed 'high-impact' by the European Commission.

Group Three: Non-EU companies with a net turnover exceeding EUR 150 million in the EU during the last financial year.

Group Four: Non-EU entities generating a net turnover of more than EUR 40 million within the EU, provided that at least half of their global turnover originates from 'high-impact' sectors.

While SMEs may not be directly subject to these regulations, they could be indirectly impacted if they function as contractors or subcontractors to companies falling under any of the above categories.

Climate Neutrality and Human Rights Compliance

In alignment with the EU's ambition to transition toward a climate-neutral and sustainable economy, the CSDDD would mandate companies (primarily those in Groups One and Three) to adapt their business models and strategic initiatives to be in line with the objectives of the Paris Agreement. Moreover, if a company recognizes climate change as a 'principal risk' or 'principal impact' of its operations, it would be required to incorporate emissions reduction objectives into its strategic planning.

International Standards

For the domain of human rights, the CSDDD intends to adhere to already established international frameworks. These include the United Nations' Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, and the OECD Due Diligence Guidance for Responsible Business Conduct.

PERFORMANCE ASSESSMENT

INTRODUCTION TO ESG PERFORMANCE ASSESSMENT IN SUCCESSION PLANNING

Assessing ESG (Environmental, Social, and Governance) performance is a task that acquires additional gravity in the context of succession planning. Succession planning inherently involves the consideration of long-term strategies and the sustainability of the business. Integrating ESG criteria into this process not only aligns with broader business sustainability but also with the long-term stewardship of the company that the new leadership will inherit.

An effective ESG assessment is no longer simply about corporate responsibility but constitutes an essential component of a comprehensive due diligence process for succession. Evaluating a company's ESG performance as part of succession planning can have significant implications for the organization's future. For example, a firm that has not effectively integrated ESG into its operations may face challenges, ranging from reputational risks to issues that could materially affect its valuation. These are factors that future successors need to be aware of, as they would need to deal with them strategically.

Objectives and Outcomes of ESG Performance Assessment in Succession

The objectives of including ESG performance assessments in succession planning are manifold. Primarily, the assessment aims to provide a detailed understanding of the business's current ESG landscape—uncovering strengths, identifying areas of risk, and offering insights for strategic adjustments. This information becomes a critical asset for both the outgoing and incoming leadership, helping to chart the course of the company's future strategies.

Furthermore, the outcomes of an ESG assessment during succession planning are multi-dimensional. It's not just about identifying gaps or strengths; the process contributes directly to a company's readiness for leadership transition. For example, if an assessment identifies robust ESG compliance and social responsibility practices, this can make the company more attractive to potential successors, who may be more willing to continue investment in these areas.

In summary, conducting a thorough ESG performance assessment as part of succession planning is not just good governance; it is a strategic necessity. The assessment informs critical decisions, impacts company valuation, and sets the tone for the incoming leadership on how the organization perceives and acts on its corporate responsibilities.

THE CSR-READY ASSESSMENT TOOL

The Erasmus+ project CSR-Ready is a project that supports SMEs in implementing Corporate Social Responsibility measures in their company. In addition to comprehensive training courses, an assessment tool was developed within the framework of the project, which not only analyzes existing strategies and approaches with regard to ESG and corporate responsibility, but also generates comprehensive feedback on possible strategic approaches. The training resources and the assessment can be found on the following website: www.csrready.eu

The assessment can be a useful starting point for analyzing the company's ESG performance in advance of succession processes.

THE IMPORTANCE OF IDENTIFIABLE METRICS AND KPIs

Metrics and Key Performance Indicators (KPIs) play a pivotal role in gauging ESG performance, especially within the context of succession planning. These metrics provide a standardized and quantifiable approach to evaluate how well a business is performing on various ESG fronts. They allow both outgoing and incoming leadership to benchmark the company's ESG performance against industry standards or competitor practices. In succession planning, having a data-driven understanding of ESG metrics can offer crucial insights into the health of the business and its long-term viability.

Typical Metrics Relevant for Succession Planning

When discussing ESG metrics relevant to succession planning, one may consider several types of indicators:

1. Environmental Metrics: These include carbon footprint, water usage, waste management, and energy efficiency. These metrics are important because they can reveal potential liabilities or areas where regulatory action might affect business operations in the future.
2. Social Metrics: Employee engagement, diversity and inclusion, community impact, and stakeholder relationships fall under this category. These are critical for evaluating the company's social license to operate, which can be a deciding factor for potential successors who want to inherit a well-regarded and socially responsible business.
3. Governance Metrics: These relate to board diversity, ethical practices, and corporate governance structures. High scores in governance metrics usually indicate a well-run organization that would be attractive for successors looking for a stable, well-governed business.

How These Metrics Influence Succession

Accurate and comprehensive metrics provide actionable insights that are incredibly useful during the succession process. For instance, if a business has a poor track record in environmental compliance, it can be a red flag for potential successors, possibly affecting the valuation of the business or even the willingness to take over. On the contrary, strong performance on social metrics like employee engagement could make the organization more appealing to potential successors who value a strong, stable workforce.

Furthermore, these metrics often feed directly into ESG rating agencies' assessments, which can be public information readily available to stakeholders, including potential successors. A company with a strong ESG rating will not only attract quality successors but also create an environment of trust and accountability.

In summary, metrics and KPIs provide a detailed, data-driven layer to the subjective aspects of succession planning. They offer a concrete way to measure ESG performance, making it easier for both the outgoing and incoming management teams to make informed decisions. Therefore, understanding these metrics is not just beneficial but essential for any business engaged in succession planning.

ESG DATA COLLECTION AND REPORTING

The importance of data in ESG performance assessment cannot be understated. Data serves as the backbone for all performance metrics and KPIs, and therefore, robust collection mechanisms are essential. High-quality, reliable data is not just a regulatory requirement but also a strategic asset that can significantly impact the succession planning process. For the outgoing leadership, having a comprehensive data set allows for a more transparent handover, while for the incoming management, it ensures a more accurate understanding of the state of ESG performance within the company.

Data Sources and Collection Methods

In the realm of ESG, data can come from a myriad of sources:

1. Internal Audits: These can be either self-conducted or performed by third-party firms. Audits often provide the most comprehensive view of a company's ESG landscape.
2. Stakeholder Surveys: Polling stakeholders can offer valuable qualitative insights that augment the quantitative data gathered through other methods.
3. Public Records: These include regulatory filings, public disclosures, and even media reports, which can provide a more external view of a company's ESG performance.
4. Industry Reports: These are useful for benchmarking your company's performance against industry averages or best practices.

Reporting Mechanisms

Once data is collected, it must be compiled and reported in a manner that is both transparent and useful for stakeholders. Numerous frameworks exist for ESG reporting, such as the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and others. The choice of a reporting framework often depends on the target audience, be it investors, regulatory bodies, or potential successors in the context of succession planning.

Relevance to Succession Planning

For succession planning, ESG data collection and reporting serve multiple purposes:

1. Transparency: Comprehensive data and subsequent reports offer a transparent view of the company's current ESG landscape, aiding both outgoing and incoming leadership in making informed decisions.
2. Due Diligence: For potential successors, thorough ESG reporting is part of the due diligence process, allowing them to evaluate any risks or opportunities associated with taking over the company.

3. Strategic Alignment: Having robust data helps in ensuring that the company's ESG strategies align with the expectations and values of potential successors, which is crucial for a smooth transition.
4. Regulatory Compliance: In regions where ESG reporting is mandatory, having a well-documented history can expedite the succession process by providing assurance that the company is in compliance with local laws and regulations.

In conclusion, robust data collection and transparent reporting mechanisms are indispensable in assessing ESG performance, particularly in the context of succession planning. These data sets not only allow for a clearer understanding of the current ESG landscape but also provide a foundation upon which future strategies can be built, aiding both the outgoing and incoming management teams in facilitating a successful transition.

ESG SCORECARDS AND BENCHMARKS

In the context of assessing a company's ESG performance, scorecards serve as an essential tool to quantify otherwise subjective matters. They provide a standardized approach to evaluate how well a company is doing in each of the three pillars: environmental, social, and governance. This is particularly relevant for succession planning because an objective measurement of ESG performance can significantly influence the attractiveness of a business to potential successors, financiers, and other stakeholders.

Types of Scorecards and Their Components

Several types of scorecards exist, tailored to various aspects of ESG:

1. Environmental Scorecards: These focus on metrics such as carbon footprint, water usage, and waste management.
2. Social Scorecards: These assess employee engagement, community involvement, and customer satisfaction.
3. Governance Scorecards: These evaluate board structure, ethical conduct, and compliance with laws and regulations.

Each of these scorecards is composed of a series of key performance indicators (KPIs) that offer a quantitative look into specific aspects of a company's ESG commitments.

Benchmarking and Comparative Analysis

Utilizing ESG scorecards often involves benchmarking, a process of comparing a company's ESG performance against industry standards, peers, or historical data. This is particularly important for succession planning as it provides a measure of how attractive the company might be in the eyes of potential successors. An above-average ESG score can serve as a competitive advantage in the market, enhancing the company's desirability and potentially influencing a smoother and more favorable succession process.

Succession Planning and ESG Scorecards

In the context of succession planning, ESG scorecards provide a multi-faceted benefit:

1. Risk Assessment: Detailed scorecards can identify areas of risk that need to be addressed before the succession process, thus providing a roadmap for improvement.
2. Attracting Talent: High ESG scores can make a company more attractive to potential successors who prioritize sustainability and ethical governance, thereby broadening the pool of qualified candidates.
3. Strategic Alignment: Scorecards allow for an objective discussion between outgoing and incoming leadership about the strategic direction of the company, aiding in a smoother transition.
4. Investor Relations: A well-maintained ESG scorecard can also be a powerful tool in discussions with potential investors or financial institutions, which could be pivotal in securing favorable terms for the succession.

ESG scorecards and benchmarks thus not only serve as a tool for self-assessment but also play a pivotal role in external communications and strategic planning, especially in the context of succession planning. They enable companies to be transparent about their ESG performance, providing an empirical basis upon which succession strategies can be formulated and executed.

COMMUNICATING ESG PERFORMANCE IN SUCCESSION PROCESSES

The transparent communication of ESG performance is crucial in any succession planning strategy. Clear and accurate reporting of ESG metrics not only helps in internal decision-making but also aids in crafting a compelling narrative for external stakeholders like potential successors, investors, and the broader community. A well-communicated ESG strategy can significantly elevate the attractiveness of a business, thereby easing the succession process and enhancing the company's long-term sustainability.

The Importance of Accurate Reporting

Accurate and consistent reporting of ESG metrics is pivotal in gaining stakeholder trust. This is especially true during succession planning, where potential successors and investors scrutinize company data to evaluate the health and future prospects of the business. Any discrepancies or inconsistencies in ESG reporting can raise red flags, causing unnecessary complications in the succession process.

Channels for ESG Communication

Multiple channels can be leveraged for effective ESG communication:

1. Annual Reports: These traditional documents are often the first point of reference for stakeholders and should contain detailed sections on ESG achievements and future goals.
2. Dedicated ESG Reports: Increasingly, companies are publishing separate ESG reports, giving a comprehensive view of their sustainability initiatives.
3. Digital Platforms: Websites, social media, and other digital platforms offer a dynamic way to continuously update stakeholders on ESG performance.
4. Investor and Stakeholder Meetings: Regularly scheduled briefings can provide real-time updates on ESG initiatives, which can be especially beneficial during the sensitive period of a leadership transition.

Role of Third-Party Audits in ESG Communication

Independent audits of ESG performance offer an additional layer of credibility. These third-party evaluations are often essential for gaining the confidence of stakeholders, especially in the transition phase of succession planning. Audited ESG data provides an impartial assessment that can be invaluable to potential successors and investors alike.

Communication Strategy for Succession Planning

1. Preparation Phase: In the lead-up to succession, enhanced focus should be given to clearly communicating the company's ESG performance and strategic vision.
2. Transition Phase: During the transition, regular updates should be given to ensure a smooth handover and maintain stakeholder confidence.
3. Post-Transition Phase: After the transition, the new leadership should reiterate its commitment to the established ESG goals and, if needed, clarify any strategic changes going forward.
4. Continuous Update: ESG communication is not a one-time event but a continual process that should align with the company's overall communication strategy.
5. Crisis Communication: A contingency plan should be in place for communicating any negative ESG incidents, particularly during the sensitive period of succession planning. Being prepared to communicate effectively in times of crisis can protect the company's reputation and safeguard the succession process.

The communication of ESG performance is a multifaceted process that plays a critical role in succession planning. Accurate reporting, effective channels, third-party audits, and a well-thought-out communication strategy can significantly ease the transition process, thereby ensuring the business's long-term viability and success.

IMPLEMENTING AND MONITORING ESG INITIATIVES IN SUCCESSION PLANNING

The effective implementation and diligent monitoring of ESG initiatives are integral components of succession planning. They provide a framework within which successors can take over and continue the company's sustainability journey with minimum disruption. The process extends from initial assessment and planning to the ongoing oversight of ESG activities and initiatives.

Steps for Effective ESG Implementation

1. Initial Assessment: Before any implementation can occur, a thorough review of current ESG practices and potential areas for improvement is essential.
2. Strategic Planning: Based on the initial assessment, a strategic ESG plan must be developed, complete with goals, timelines, and metrics for measurement.
3. Resource Allocation: Adequate human, financial, and technological resources should be allocated to ensure the effective implementation of the ESG plan.
4. Stakeholder Engagement: Involving internal and external stakeholders in the planning process can provide invaluable insights and drive collective action towards achieving ESG goals.
5. Policy Formulation and Documentation: Clear policies and guidelines need to be formulated and documented to provide a reference point for future ESG activities.

Importance of ESG Monitoring in Succession Planning

Monitoring the progress of ESG initiatives is not just essential for overall corporate sustainability but also crucial in the context of succession planning. Regular audits and reviews serve to:

1. Measure Effectiveness: Determine how well the initiatives are performing against the pre-determined metrics.
2. Inform Decision-Making: Provide valuable data that can inform future ESG-related decisions, including those related to succession.
3. Enhance Credibility: Demonstrate to external stakeholders that the company is serious about its ESG commitments, making it more attractive to potential successors and investors.

Tools and Methods for ESG Monitoring

1. Key Performance Indicators (KPIs): KPIs offer quantifiable metrics by which ESG initiatives can be evaluated.
2. Regular Audits: Both internal and external audits can provide an impartial assessment of ESG performance.
3. Surveys and Feedback: Stakeholder surveys can offer qualitative insights into the perceived effectiveness of ESG initiatives.
4. Technological Tools: Advanced analytics software can provide real-time data and insights, aiding in continuous ESG monitoring.

Aligning Monitoring with Succession Timelines

The alignment of ESG monitoring with succession timelines is a pivotal element in securing the long-term sustainability and governance objectives of a company. This alignment ensures that ESG initiatives are not only integrated but are also effectively transitioned from one leadership to the next. It guarantees that both outgoing and incoming leaders have a clear understanding of the current ESG performance, and what strategic adjustments may be necessary. This congruence allows for a seamless transition, minimizes the risk of performance disruptions, and helps in fostering a culture of continuous ESG improvement. It is through this alignment that companies can most effectively sustain their commitments to environmental, social, and governance objectives throughout the succession process.

1. Pre-Succession: Prior to the transition, ESG monitoring serves as a preparatory tool, helping to identify strengths and weaknesses that need to be communicated to potential successors.
2. During Succession: Monitoring during the transition can ensure that ESG initiatives remain on track, even when focus may be divided.
3. Post-Succession: Following the transition, continued monitoring is crucial for the new leadership to evaluate the effectiveness of ongoing and past ESG initiatives, informing any adjustments that may be necessary.

Implementing and monitoring ESG initiatives during succession planning require strategic foresight, rigorous planning, and continuous oversight. These processes offer multiple benefits, not least of which is a smoother transition to new leadership that is well-equipped to uphold and further the company's ESG commitments.

IMPROVING ESG PERFORMANCE PRIOR TO SUCCESSION

IMPORTANCE OF ESG OPTIMIZATION BEFORE SUCCESSION

The concept of Environmental, Social, and Governance (ESG) has evolved from being a mere corporate social responsibility function to a critical business imperative. As businesses contemplate succession planning, the significance of optimizing ESG performance cannot be overstated for several reasons.

Firstly, enhancing ESG metrics augments the overall attractiveness of the business entity to a variety of potential successors, which may include family members interested in continuing the family business, internal leaders keen on ascending to greater responsibilities, and even external investors exploring acquisition or merger possibilities. In today's competitive business landscape, a robust ESG profile can serve as a strategic asset for attracting high-quality leadership, thus ensuring the organization's longevity and sustained growth.

Secondly, a well-rounded ESG profile increases the firm's appeal to diverse stakeholder groups including customers, regulatory bodies, and financial institutions. Customer preference trends indicate an increasing leaning towards businesses that have sustainability and social responsibility embedded in their core operations. Regulatory bodies, both national and international, are progressively tightening norms around sustainability, corporate governance, and social responsibilities, making it imperative for businesses to conform to these requirements. Additionally, financial institutions are increasingly incorporating ESG criteria into their lending and investment decisions. Therefore, enhancing ESG metrics directly correlates with broader business benefits, including better stakeholder relationships and potentially more favorable financing terms.

Thirdly, improving ESG performance can mitigate a variety of operational and strategic risks. Businesses with better sustainability practices are less likely to incur environmental liabilities. Those with strong governance structures are less exposed to legal issues related to mismanagement or non-compliance. Enhanced social practices can help in reducing the risk of labor unrest or reputational damage. Collectively, risk mitigation adds to the business valuation and can smoothen the succession process.

Lastly, a strong ESG profile provides a business with a competitive edge. It serves as a differentiating factor in a crowded market, contributing to brand value and customer loyalty. Businesses that focus on sustainable practices often find themselves better positioned to adapt to market shifts, benefit from operational efficiencies, and unlock new avenues of growth.

Considering these myriad factors, neglecting to enhance ESG performance prior to succession planning could restrict your pool of potential successors and even negatively impact the overall business valuation. In a rapidly evolving business environment, characterized by increasing scrutiny and expectations around sustainability and governance, failing to optimize ESG metrics could become a limiting factor that obstructs strategic business goals, including successful succession.

IDENTIFYING KEY AREAS FOR IMPROVEMENT

The task of identifying key areas for ESG improvement is both complex and critical, particularly in the context of succession planning. Succession is not just a one-time event but rather a continuous process that involves aligning the business strategy, risk management, and stakeholder expectations for the long term. ESG considerations are integral to this alignment.

One of the preliminary steps in identifying areas for improvement involves a thorough internal audit of current ESG practices. This not only encompasses environmental factors like waste management, carbon footprint, and resource usage, but also social elements like employee welfare, diversity and inclusion, and community engagement. Moreover, governance components such as board diversity, executive compensation, and shareholder rights must also be meticulously assessed.

Quantitative metrics offer a measurable approach to evaluate areas that need improvement. Utilizing globally recognized standards like the Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB) can add credibility to the assessment process. Organizations can also adopt a materiality assessment framework that outlines the ESG issues most pertinent to their business model and stakeholder expectations.

With regards to succession, prospective successors often look at how well the business has identified and acted upon its ESG weaknesses. A business that actively seeks improvement in its ESG practices is likely to be more appealing as it suggests an enterprise geared towards resilience and sustainable growth.

Apart from internal audits, external assessments offer an additional layer of scrutiny. Third-party ESG ratings can provide an unbiased perspective on the company's ESG performance, thereby informing both the existing leadership and potential successors about the areas requiring immediate attention.

Identifying key areas for ESG improvement serves a dual purpose. It not only facilitates operational optimization but also enhances the attractiveness of the business to potential successors or investors, thereby playing a pivotal role in the succession planning process. The CSR-Ready Assessment Tool already mentioned above can serve as a starting point to identify potential areas of improvement and provides detailed information on the rational and potential strategies for improvement. To access the free assessment tool, please visit: www.csrready.eu

DEVELOPING AN ESG IMPROVEMENT PLAN

After identifying key areas for improvement, the next logical step is to develop an ESG improvement plan. An effective plan is a comprehensive document that outlines the objectives, timelines, responsibilities, and resource allocation for each identified area of improvement. Importantly, in the context of succession planning, this plan serves as a roadmap for the transitioning leadership.

Given the complexity of ESG considerations, a phased approach is often advisable. This entails prioritizing issues based on their severity, stakeholder impact, and regulatory importance. Short-term goals might include immediate risk mitigation, such as reducing operational inefficiencies or enhancing compliance levels. Medium-term objectives could involve broader strategic alignment, like transitioning to sustainable supply chains or adopting cleaner technologies. Long-term goals often pertain to overall business transformation, rooted in sustainable and ethical practices.

The ESG improvement plan must be fluid, allowing for periodic reviews and adjustments. This flexibility is particularly crucial during succession, as the incoming leadership might have its strategic imperatives. Therefore, the plan should offer enough room for the successors to embed their vision, albeit within the boundaries of the company's overarching ESG goals.

Incorporating stakeholder feedback during the plan's development can add a layer of transparency and trust, enhancing its efficacy. Moreover, the involvement of board members, senior executives, and even external ESG consultants can contribute diverse perspectives, enriching the plan's comprehensiveness.

An ESG improvement plan is not just a tool for operational enhancement; it is a strategic document that impacts the long-term valuation of the business. Therefore, its role in succession planning cannot be understated, and it must be developed and implemented with utmost diligence and foresight.

ENGAGING STAKEHOLDERS IN THE ESG IMPROVEMENT PROCESS

Stakeholder engagement is a cornerstone of any successful ESG improvement strategy. In the framework of succession planning, this element gains further prominence as stakeholders will be crucial in supporting and participating in the transition process.

Stakeholders in the context of ESG generally include employees, suppliers, investors, community members, regulatory bodies, and customers. Each group has its distinct interests and concerns, and their collective feedback can offer a multidimensional view of the company's ESG performance.

A structured, open dialogue is the first step towards effective engagement. Methods like surveys, town halls, and focus group discussions can be implemented to collect comprehensive insights. These insights should be aligned with the areas identified for improvement and integrated into the ESG improvement plan.

Remember that stakeholder engagement is not merely a box-ticking exercise; it's a strategic process that provides both immediate and long-term benefits. Immediately, it can offer a 'ground reality check,' enabling the leadership and prospective successors to fine-tune the ESG initiatives. In the long term, sustained engagement can cultivate a culture of mutual trust and cooperation, which is indispensable during periods of organizational change such as succession.

Stakeholders can also serve as 'early warning systems' for new ESG-related challenges and opportunities. For instance, employees close to daily operations might provide early alerts about environmental risks, while investors may highlight upcoming regulatory changes that could impact the business.

In relation to succession planning, stakeholders offer a collective memory and understanding of the business' ESG journey, offering continuity and context for incoming leaders. Well-engaged stakeholders may be more supportive during the transition, potentially reducing risks and smoothing the succession process.

Effective stakeholder engagement in ESG improvement is not just a best practice but a critical strategic requirement. Its role in making the succession process seamless and aligned with long-term business goals cannot be overstated.

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