

Succeeding at succession: Identifying and incentivising successors

A Grant Thornton series for privately held businesses: Part three

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

The first decision is deciding among three options:

- 1 Selling;
- 2 Passing ownership and management to family members; or
- 3 Allowing family to retain ownership but not management.

While privately held business owners and managers are usually adept at dealing with change, the same cannot always be said for identifying and grooming their successors.

This is usually because they worry about how the business will fare after their departure. They are concerned about meeting the needs of managers and family members who are not in line for succession. And they are afraid of compromising personal relationships or creating irreconcilable family rifts.

They let their emotions get the best of them, making poor decisions or the wrong choice altogether.

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

Then there are the business owners and managers who come to grips with succession planning, making thoughtful, strategic decisions through the process of identifying and selecting a successor.

They take time to develop and implement a succession plan that identifies a successor with appropriate skills, communicate responsibilities to all stakeholders, and compensate their successor fairly. They also recognise that every position in an organisation needs a successor, and that finding a successor isn't something that starts and stops. It's ongoing.

“Family members often disagree about succession options, which can make the succession a particularly difficult time for the family. There can be a strong desire for long-established businesses to keep control within the family. Many families regard themselves as custodians of the business for future generations. However, successors from within the family may not be best for the business. Those who are willing to take over may not be qualified, and those who are qualified may prefer to follow a career outside of the business.”



Robert Powell
Sydney



Keeping your emotions in check.

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

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

Family dynamics also create emotional challenges. If several children are active in a family business, it can be difficult to objectively evaluate each child's capabilities. Not to mention telling a child that they are not in line for succession or making appropriate financial arrangements for all concerned. Children are often reluctant to do things the same old way – a tendency not lost on most parents. Indeed, some parents may consider this determination to do things differently an unacceptable risk to the family legacy, leading to a search for an external candidate who is prepared to maintain the status quo.

It's not just owners who face psychological challenges. The next generation may consider leadership and equity ownership a birthright, which can lead to disappointment and

frustration if what they believe is meant to be never happens. Moreover, some children dislike taking orders from parents or employees because they see themselves as the eventual owners. Notably, these emotional challenges can persist long after a successor is chosen. No matter whom you choose, your successor and their skills will inevitably be questioned by family members or employees.

You can keep everybody's emotions in check by:

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

Identifying your successor

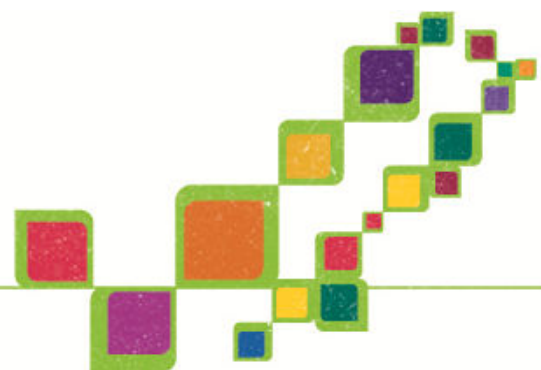
Sometimes it's obvious – the employee or a child is such a natural. Your choice for a successor may seem clear, but there's a danger in assuming that an individual is interested in ownership or leadership. Even if the person is keen, he or she may not be right for the job.

The first step is to identify the skills that your successor needs to run the business. Determining those skills can be made easier by establishing or confirming the long-term goals of your business.

For example, it requires a different skill set to hold the course for a business than it does to transform or reinvent it. The key is to understand the drivers of the business and to put its strategy and the organisation first.

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

The process of identifying candidates within your family can be less structured and start much earlier. Informal chats with young children can help to explain the family business and its objectives as well as its importance to the family. If these conversations generate a spark of interest, then you can take steps to get your children involved in the family business, even if it's just casual weekend work. If there's little or no interest, that's okay too. What counts is the reaction and knowing where you stand. You can always revisit the idea later.



Grooming your successor.

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



Gail Curtis
Perth

Once you identify a potential successor, you need to develop a skills-related succession plan, one that is aligned with your timeline for retiring or winding down your involvement. This training may seem unusual for business founders who had to figure out things for themselves. But a thriving business is also an excellent training ground for developing leadership skills, understanding the nuts and bolts of the organisation and acquiring the myriad skills to assure a seamless transition. To be effective the succession plan must provide full details on requirements for education, exposure to business operations, and levels of competency.

Your candidate must understand and accept these requirements, and the company’s culture and values. A mentor or executive coach might also be considered to help implement your plan, guide your successor’s training and accelerate their development. As your successor’s skills and capabilities grow, involve them in business decisions, the board of directors and industry associations. These activities demonstrate that your successor is engaged in and contributing to the business, and will build confidence in your candidate throughout the organisation and with stakeholders.

In some family businesses the children are born ready. But ready or not, there are still things to learn before they take over the top job.

Depending on the children’s experience, it may be appropriate for them to work in functional roles in your business and to gain experience outside the firm. Regardless of where

they start, leadership roles for your children should be considered only when you believe they are the right people for the job.

Judging your successor’s leadership ability is a key decision point in the grooming process. You may be able to develop leadership, but if your successor lacks it, they may never be able to step up. So be open and honest with yourself and your candidate in this regard. If it becomes apparent that the person isn’t right, don’t hesitate to recruit someone else. Identifying more than one potential successor isn’t unusual and has its benefits. Although several candidates can create problems, it avoids pinning your hopes on one person, only to have them fail to live up to expectations. Whether your candidates are family members or staff, you’ll need clear job descriptions, career paths and appraisal reviews to prevent people tripping over each other while vying to become your successor. You’ll also need to articulate the criteria for choosing your successor.

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



Designing a compensation package.

Most entrepreneurs succeed through drive and determination. You want your successor to embrace similar values, while ensuring that they are paid fairly and motivated properly. Therefore it is better to link your successor's compensation to moving the business forward, not to moving into the corner office. That means tying the compensation package to objective metrics and aligning it with industry standards.

The criteria for rewarding performance and the consequences for failing to meet objectives must be completely transparent and followed without exception.

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

Compensation plans for a family-owned business can be complicated. Your successor's compensation should be performance-based and tied to a transition plan that cedes them control and decision-making responsibility.

Children who were not chosen as your successor need to be treated fairly and shown how they can make a difference in whatever role they play in the business.

For those not actively involved in the business, you may need to convince them that fair doesn't necessarily mean equal.

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

An effective compensation plan for your successor ensures that:

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

Playing fair to avoid conflicts

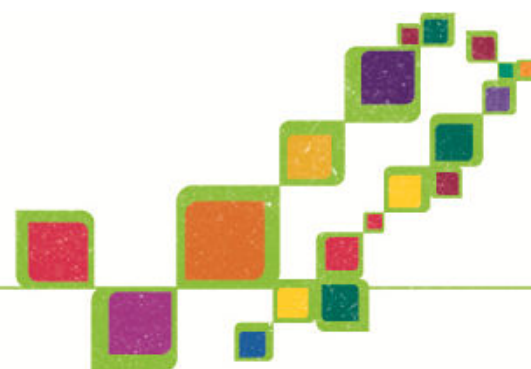
Let's face it. Not everybody gets to be king or queen even for a day. Most people understand and accept that reality. So the more pressing issue after you identify a successor is to play fair with the rest of your family and employees. Your selection will be easier to understand and accept if you express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

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

Consider this: the success rate for the transfer of family-owned businesses to the first generation is just 30%. By the time the second generation takes the reins, the success rate drops to 15%. The third generation has a mere 5% chance of success.

Why?

In 80% of cases, the business failed because of family dynamics.



Asking the right questions.

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

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

Consider these questions if you own a family business:

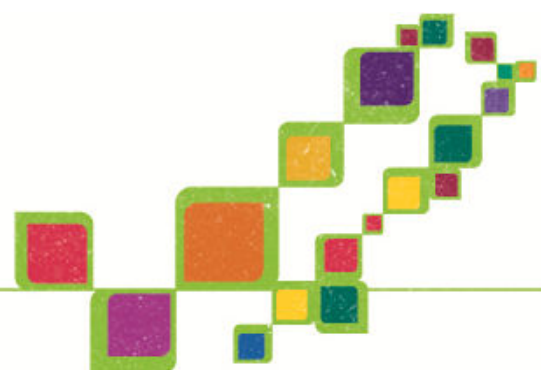
- do family members working in the business have the necessary skills to perform their jobs?
- do you want your children to work in the business?
- do you know what your children's aspirations are?
- do the children want to work in the business?
- is there an education policy for family members?
- are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

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

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



Stephen Kuchar
Adelaide



Making the most informed choice.

Selecting and motivating a new successor can be one of the most challenging tasks of a business executive. You can smooth the transition to new leadership and ownership by treating minority shareholders equitably. This might include a division of assets, a share of profits or a family trust. But it should not include management control. Providing non-involved stakeholders with management authority can confuse business decision-making and often result in a recipe for disaster.

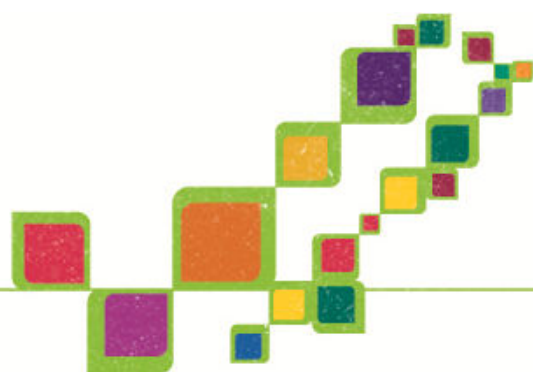
As you make these arrangements it's important to clearly communicate your succession plans throughout the process. The last thing you want is to surprise people. By discussing your plans openly and early, you and your employees can work toward a common goal of building your business under new leadership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

To help ease and support the decision making process around selecting suitable successors, it's important to work with experienced specialists who can help you put programs in place to achieve your succession planning goals.

“Communication is key, and without it the transition process will be a struggle”



Doug King
Cairns



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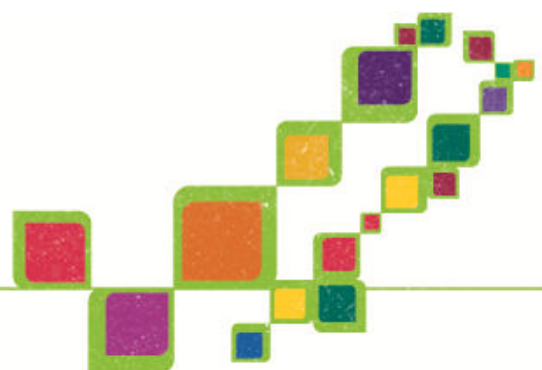
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