

# Succeeding at succession: identifying and incentivising successors

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

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

While privately held business owners and managers are usually adept at dealing with change, the same cannot always be said for identifying and grooming their successors. Why? Because they worry about how the business will fare after their departure. They are concerned about meeting the needs of managers and family members who are not in line for succession. And they are afraid of compromising personal relationships or creating irreconcilable family rifts. Overwhelmed by worry and fear, they let their emotions get the best of them, making poor decisions or the wrong choice altogether. Others postpone the inevitable, clinging to the notion that nobody has the right skills to take control. The consequences are

predictable enough: a business that took years to build begins to crumble because of low employee morale, strained family relations and declining performance.

Then there are the business owners and managers who come to grips with succession planning, making thoughtful, strategic decisions through the process of identifying and selecting a successor. What's their secret? They take time to develop and implement a succession plan that identifies a successor with appropriate skills, communicate responsibilities to all stakeholders and compensate their successor fairly. They also 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.

### Keeping your emotions in check

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

Many owners start their business so they can take control of their lives. When it's time to let go, and lose control, they are understandably reluctant to hand the reins to someone with less experience. It's never easy giving someone the freedom to make decisions that could damage or destroy a business. Family dynamics also create emotional

challenges. If several children are active in a family business, it can be difficult to objectively evaluate each child's capabilities. Not to mention telling a child that they are not in line for succession or making appropriate financial arrangements for all concerned.

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

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

Notably, these emotional challenges



<sup>1</sup> Grant Thornton International Ltd, International Business Report 2009, [www.internationalbusinessreport.com](http://www.internationalbusinessreport.com)



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

**Jol Hunter**  
Grant Thornton, Canada

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

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

#### **Identifying your successor**

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

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

The next step is to establish an

open dialogue with the candidate to determine what he or she really wants. Those conversations can lead to the 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, it doesn’t matter. What counts is the reaction and knowing where you stand. You can always revisit the idea later.

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

**Grooming your successor**

Once you identify a potential successor, you need to develop a skills-related succession plan, one that is aligned with your timeline for retiring or winding down your involvement. This training may seem unusual for business founders who had to figure 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 his/her development.

As your successor's skills and capabilities grow, involve him or her in business decisions, the board of directors and industry associations. These activities demonstrate that your successor is engaged in and contributing to the business, and will build confidence in your candidate throughout the 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 spot. Depending on the children's experience, it may be appropriate for them to work in

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

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

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

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



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

**Laurent Prost**  
Grant Thornton, France

### Designing a compensation package

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

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

Compensation plans for a family-owned business can get complicated. Your successor's compensation should be performance-based and tied to a transition plan that 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 firm. For those not actively involved in the business, you may need to convince them that fair doesn't necessarily mean equal.

The majority of business owners

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

An effective compensation plan for your successor ensures that:

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

### **Playing fair to avoid conflicts**

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

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

Consider this: the success rate for the

**“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.”**

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**Bernard Doherty**  
Grant Thornton, Ireland

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

### 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?

shareholder set up a viable equity structure to ensure a smooth transition?

### Consider these questions if you own a family business:

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

### Making the most informed choice

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

Find out how our professional advisers can help you identify and incentivise your successor(s), contact your local Grant Thornton specialist through the global reach section of [www.gti.org](http://www.gti.org) or contact: [alex.macbeath@gtuk.com](mailto:alex.macbeath@gtuk.com)

- has the CEO, founder or majority

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