Federation of European Accountants

VIEWS

Looking to the future – business succession for family business

Planning for you, your business and the next generation

INFORMATION PAPER

HIGHLIGHTS

Planning business succession is an important element of business strategy and should be a priority. Failure to plan generational change may leave a business with heirs who are unprepared or uninterested; the result is unnecessary business failure.

The successful entry of a new generation into the top positions of the family business is not a single event, it should be part of a long-term and planned process of change. Technical issues, such as pension or tax planning are important, but they are contingent on strategies that sustain the harmony and consent of family members and employees for the proposed succession.

This guide describes best practices for passing family businesses from one generation to the next. It is ideally intended for accountants to give to their clients as part of a process of a structured review of succession issues.

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Introduction

This paper is an update of a publication originally published by the Federation in March 2000, which was inspired by a 1999 publication by the ACCA.

Too many family firms go from rags to riches and back again. All too often businesses thrive on the energy of founders who make no plans for the future. When they retire, the incoming generation of owners may be totally unprepared or unsuited for its new responsibilities, or just not interested. As a result, a viable business may be sold at a discounted price to a competitor or may drift from growth to survival to failure. Loyal employees' jobs may be lost; many of the best will see the warning signs and leave, taking key skills and knowledge with them. An investor examining a business plan will include succession planning in their risk assessment. Why should an owner/manager give the same issue a lower priority?

Planning business succession should be a priority. It is as important an element of business strategy as the identification of markets or development of products and it has just as much influence on success and failure.

This guide describes best practices for passing family businesses from one generation to the next.

The term "family" can be applied loosely and many of the issues considered can apply to any small business that is informally managed. The process suggested might be adopted in full by larger family businesses or to a lesser extent by smaller ones. The use of the term "process" is deliberate. The successful entry of a new generation into the top positions is not a single event, it should be part of a long-term and planned process of change. During this process, talent is identified and nurtured, long-term support and consent is obtained among owners and employees and the family and business pressures in the firm are managed in order to secure successful change.

Yet even when plans have been made for the future, clashes of family and commercial priorities can set the business in the wrong direction and provide a formula for sibling strife around the resulting wreckage. The harmony, and thus the success, of family firms pivots on the ability to combine sometimes contradictory family and business objectives. Succession is just one – albeit important – issue in the family melting pot.

The management of family communication, concord and of personal agendas is as much, if not more, essential to the process of generational change than any technical issue, relating to tax, funding or valuation. The psychology of the family firm and the impact of the inevitable clash of family and commerce upon succession are important aspects of this guide. The approaches suggested can be used by the professional when advising clients, or by any businessperson.

Effective succession planning will minimise the threat posed to the business and to family wealth by generational change. By thinking ahead, you can avoid pitfalls and provide the best future for your client's, or your, business. This guide is ideally intended for accountants to give to their clients as part of a process of a structured review of succession issues.

Family businesses turn first to their accountants for professional advice on a wide range of financial and business issues. As the primary adviser to all smaller businesses, accountants are also well networked with a range of other professionals and are well placed to assist businesses undergoing generational change as part of their role in supporting the life and growth of family firms. Indeed, global research undertaken by Baker Tilly International indicates that accountants are the most trusted advisors of family businesses when dealing with succession issues[1].

[1] *Developing A New Map For Effective Business Succession in Family Businesses* – Baker Tilly International http://www.bakertillyinternational.com/web/insights/developing-a-new-map-for-effective-business-succession-in-family-businesses.aspx

Summary

- Failure to plan generational change may leave a business with heirs who are unprepared or uninterested; the result is unnecessary business failure.
- Succession and generational issues will have a significant bearing on the success or failure of the business's strategy and should thus be central to the planning process.
- Business succession is not a single event. It is long-term process of identifying talent and building support for change. Technical issues, such as pension or tax planning are important, but they are contingent on strategies that sustain the harmony and consent of family members and employees for the proposed succession.
- In developing strategies to balance family and business agendas, business owners need to consider structures, such as family councils, or constitutions, to lay out agreed ground rules and objectives for the firm. These should provide methods for dealing with major decisions like succession, while minimising the risk of the business being damaged by conflicting aspirations of family members.
- The options chosen for succession will often be dictated by the business’s aims. What comes first, the family’s role in the business or the business’s profitability?
- A succession plan must decide:
    - the criteria for the top jobs
    - how continuity will be obtained
    - a timetable
    - mechanisms to reverse errors
    - methods to meet the aspirations of the retiring generation.
- The plan must be based on detailed, objective analysis of formal and informal information about the business if it is to determine the best route forward.
- A professionally qualified accountant, or other neutral adviser, can be a key to separating the objective from the subjective in business and family issues. During the process the support of a range of experts may be needed. Even if there is a lead adviser, a number of views and skills are useful.
- Expert advice may need to be taken from professional accountants and lawyers on tax and legal issues.
- Once the course of action is agreed there must be an action plan for implementation and for dispute resolution and everyone must stick to it.

Family firms - planning for the future

After creation and growth, ownership transfer is the third crucial phase in the life-cycle of a business[1].

The bonds that unite family enterprises make them highly competitive.

Yet, despite the consistency of management objectives and the long-term approach provided by family management, family ties could also be a weakness. It is, by definition, impossible to achieve a total separation of business and family values. Most family firms balance commercial and family values, preferring to emphasize one or the other. The exact point of balance can be a major point of disagreement. Family chemistry can become increasingly complex as the business passes from its founders to their children and on to a third generation of siblings and cousins.

When a family member contemplates retirement, family and business priorities can clash unless succession and retirement issues have been planned carefully in advance. Such planning is rare. It is a perennial truth that the majority of first-generation businesses fail to plan for succession. In Europe relatively few family businesses have formal rules for the entry into management of the next generation.

Progress has been made over the years in relation to some of the problems associated with business transfers but the situation across Europe remains variable. It remains an important issue. A study for the European Commission indicated that each year across Europe approximately 450,000 firms are transferred and that this involves around 2 million employees. Of these, it was said, approximately 150,000 firms and some 600,000 jobs are put at risk because of inefficiencies in the business transfers system[2].

In general, family companies find it difficult to make it past the transition from one generation to the next, especially from the founding generation to the second generation. Where no preparations are made to take the future generation of ownership into the business, firms may be left to a next generation whose first-hand knowledge of the business is gleaned from the reading of a will. Such an inheritance is often the beginning of major problems, signalling the beginning of the end for the family business.

Determining successful succession

There is no right way to ensure that a business is successfully passed from one generation to the next, or that it is sold for the best price if selling is the best option for the family. However, as the rest of this paper shows, effective long-term planning will ensure a far higher chance of success. In the first place there are a range of factors to look out for that suggest whether a firm is by nature more-or-less likely to make the generational jump successfully. Good planning in good time can make sure that desirable factors are part of the business and that the impact of undesirable factors is reduced as far as possible. The first part of the planning process is to look for these factors.

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[2] *Business Dynamics: Start-ups, Business Transfers and Bankruptcy*, final report January 2011 at http://ec.europa.eu/DocsRoom/documents/10448/attachments/1/translations/en/renditions/native

Case study: European Foods

Roger Prentice had founded European Foods in 1974, initially importing from Italy and France and then expanding to manufacture in the UK, France, and Ireland to provide specialist ingredients to a number of supermarkets throughout Europe. By 2010 the firm had a turnover of €7 million. Roger was a very controlling owner. Although his three children knew that they would each inherit a third of the business, none of them had worked in it for any time. Justin and Joanne had not wanted to work in the family firm at all and Peter left when it became apparent that Roger was unwilling to involve his son in strategic decisions. Justin and Joanne were happy to assume that Peter would one day run the business and they would simply draw a dividend income.

Roger died in September 2013. After a heart attack in 2010, he had changed his will to leave a lifetime interest in 51% of the shares to his wife, Eunice. Roger had come to this decision because of Eunice's concerns about the inadequacy of her pension when the firm passed to the three children. This change was not discussed with anyone else. Roger assumed that Eunice would not wish to become involved in the business and she agreed to make Peter the Managing Director. Roger had made no other plans for succession and had not recorded or shared much of the knowledge about how he did business.

The reading of the will came as a shock, especially to Justin and Joanna. They felt that they were each entitled to 33% of the dividend income. Peter had his hands on the top job - or so he thought - but was painfully aware of how little he knew about the business. Then Eunice soon began to take a new and increasing interest in the business, despite having neither acumen nor experience. Attempts to persuade her not to interfere fell on deaf ears. She made herself Chairman and began to fall out with Peter. At Christmas the sales manager resigned after a row with Eunice. He soon had a new job with a competitor and three key members of the sales team left to join him.

Shortly afterwards the business began to experience supply problems. It emerged that Peter, who had been taking care of the finances, had been waiting 50 days to pay all creditors. He was unaware that Roger had always paid key suppliers within 21 days, with corresponding benefits to many client relationships. In January 2014 Eunice used her 51% of the business to appoint both Justin and Joanne to the board. All three awarded themselves generous remuneration packages, which had little bearing on their role in the business. Peter's attempts to sort out the finances led to a continuing deterioration of relationships.

Profits fell by 20% in the year to 30 September 2014 and three major customers changed suppliers. In May 2014 several key buying staff were poached by a rival business, taking their knowledge and contacts with them. At the end of 2014 the business was sold to the same rival. The selling price was around 60% of what had been its estimated worth at the time of Roger's death. During the first part of 2015 European foods was merged with other operations, with consequent redundancies.

Effective succession planning might well have saved the business:

- *All of Roger's family wanted to see the family business survive, even if only as a source of income.*
- *Most of the family recognized that Peter was the only family member well qualified to run the business. Proper succession planning might have brought Peter back into the business in time for him to get to know how it was run and to build bridges with key staff.*
- *All of them, Roger included, knew that Eunice would interfere if she were allowed. It would have been easy to have provided Eunice with income from a trust or pension fund. The three siblings could have been left a controlling interest while Peter managed the business.*

A well-drafted plan would have also involved an intelligence gathering exercise to record how Roger managed the business so well. It would also have provided an opportunity to make a formal record of Roger's network of contacts, customers and suppliers and how he kept on good terms with them.

Checklist 1: Succession - determinants of success and failure

The preparation level of the heirs to the business	
Formal education; an MBA may make a difference	
Training of staff and owners	
Work experience, especially outside of the firm gives a wider perspective	
Entry level position - how far the heirs have learned the business from the bottom up	
Time spent working within the firm	
Motivation	
Self-perception of preparation – do the heirs have self-confidence in their developing role?	
The relationships among family and business members	
Communication - how good is it?	
Trust	
Commitment	
Loyalty	
Family turmoil	
Sibling rivalry	
Jealousy and resentment	
Conflict -- are there current issues?	
Shared valued and tradition – these can give extra strength	
How well planned is the succession process	
How all factors are combined into the succession plan	
Financial considerations	
Legal considerations	
Tax planning	
Use of external board members	
Use of consultants and advisers	
Creation of a family council to manage the process of change	

The presence and influence – good or bad – of these factors will help to determine success, so it is wise to evaluate them.

The succession plan

What are the key issues?

Change should be planned. Introducing potential future directors or making preparations for a future sale some years down the line should be structured as part of a succession plan. Holding a family conference on the day that the managing director is hospitalised is too late! Change takes time. It is a lengthy process; introducing new members of management to the business and the business to its new managers. Only familiarisation and experience can allow ownership and direction to pass successfully from one generation to the next. Succession can never be arranged too soon, but only too late.

Entrepreneurs should consider the arrangements for succession as a crucial investment for the future of the enterprise. They will require time and resources (both human and financial) as well as top quality professional advice. As said before, there is no right way to ensure that a business is successfully transferred or sold: succession planning has to be tailor-made.

However, some “key issues” must always be carefully considered, namely:

- psychological issues
- legal issues
- financial issues
- fiscal issues

Of course, business succession is not simply limited to those individual issues; it may have an impact on every aspect of the business's future success or failure. Succession planning cannot be a secondary priority. It must be an integral part of the firm's business strategy.

Psychological issues

The character and experience of both the retiring and successor generations, alongside their personal and business priorities are the major drivers that have taken and will continue to take the business forward. The family, its relationships, history, and public and private agendas combine to create the business's culture and will determine how it reacts to change. An inclusive review of the business by its professional adviser needs to consider how the family manages these issues in the broadest possible business context, not simply in terms of succession. Structures such as family councils and constitutions usually provide effective channels for the management of psychological and emotional pressures. While this paper considers such structures in examining succession plan implementation, a family constitution and council or similar vehicles for consensus, communication, and harmony should part of the infrastructure of any family firm.

These psychological and emotional issues that colour the firm are the most important agenda items to be recognised in the planning process. If the proposed succession and the plan to achieve it cannot win support or are not a good fit with the family's culture, then all other issues are irrelevant.

It is very important to consider what is the main objective of the succession. Usually it is the survival of the enterprise, but, due to the fact that most SMEs are family businesses, very often a second objective has to be taken into account: that the ownership of the business remains within the family.

More often than not, family businesses believe that company management should be led by the family in future generations. They believe that certain characteristics of family businesses drive their success. A 2015 KPMG survey[3] identified the three main characteristics as:

- strong control over the business facilitates forward thinking and quick decision making
- the desire to keep the business successful for future generations means a longer-term orientation in business strategy, which is combined with
- the benefits of having shared values and ethos

The survey also notes that ensuring that the ownership of the capital employed in the business being in family hands only ranked in 4th place, suggesting that whilst control and independence are crucial for family businesses, there is willingness to accept some outside investment. There is also an increasing recognition that having at least some part of the management team coming from outside the family can produce many benefits – and not a few additional problems as well.

So if company management should remain controlled by the family, the key question then becomes: to what extent are family members ready to take over the business? A 2015 survey by EY[4] indicated that only 3½% of the next generation wanted to take over their parent's firm directly after leaving full time education with nearly 5% planning on doing so within 5 years of graduating.

The degree to which future generations can be induced into taking over the family business will, at least to some degree, depend on their expectations of being able to make a positive contribution. They will often base this on past experience of how much consideration has been given to their opinions in the past by the current management team. A study by PWC[5] indicates that 88% of the next generation of family business leaders want to really make a difference to the business – this may be a source of friction with an older generation unwilling to cede anything more than just nominal control.

Succession can give rise to very strong emotional issues. For example, academic and consultant Elaine Kepner suggests, in her 1983 paper *The Family and the Firm: A Coevolutionary Perspective* that there are five dimensions of family culture to be understood by anyone trying to advise a family business.

Checklist 2: Key family characteristics

The management of conflict -- how does the system manage differences among family members?	
What is the family's attitude to individualism: is it tolerated, encouraged or crushed?	
How emotionally expressive is the family -do barriers to expression force family members to suppress discussion of their individual plans and hopes?	
How does the family accept change, separation and loss?	
What are the family's myths? What are the elements of shared belief that govern perceptions of the business?	

Family psychology is particularly likely to express itself at critical points as the business grows or changes. Changes come in varying degrees of magnitude. A minor fluctuation, such as the admission of a new board member, may lead to a clash of family and business values, but should not lead to major changes in the

[3] *European Family Business Barometer, 4th Edition – Determined to Succeed* – KPMG and EFB http://www.kpmg.com/acor/en/IssuesAndInsights/Documents/the-european-family-business-barometer-fourth-edition.pdf

[4] *Coming home or breaking free? EY Center for Family Business*, 2015 http://www.ey.com/Publication/vwLUAssets/ey-family-business-coming-home-or-breaking-free/$FILE/ey-family-business-coming-home-or-breaking-free.pdf

[5] *Next Generation Survey 2016*, PWC, 2016 http://www.pwc.com/gx/en/services/family-business/next-gen-survey.html

family/business balance. However, a major change, such as appointing a new chief executive, may require a similarly major shift in the way the family deals with problems.

Ask five key questions – family vs. profit?

How well a business faces the key succession challenges depends on the answers to five questions:

Checklist 3: Five key questions about how the business faces succession

The basic philosophy of the business needs to be agreed. Is this primarily a family business or do commercial interests come first?	
How strongly do family members want to keep the business or to retain an active role in management?	
What are the long-term goals for the business? If the owners want to go public, rather than to keep the enterprise in the family, the answers to succession questions could be very different.	
How will family members be admitted to, and promoted, in the business?	
What is the firm's attitude to outsiders? Will future managing directors come from within the family? Alternatively, will the new finance director have the assurance that he or she could compete for the top job on an equal footing?	

Where possible, a family constitution should set down answers to these questions or criteria to provide a framework for discussion.

Legal issues

Changing the legal form of a business

In some cases, the legal structure of the business is not adequate to prepare the transfer in the best possible way and therefore a change of the legal form of a business (conversion) can be suitable.

A recent European Commission report[6] has dealt with the issue of changing the legal form of a business. It indicates that in 28 of the 33 countries surveyed it was possible to alter the legal form of a business to facilitate a business transfer and in 22 of the countries it was possible to establish a public limited company with a very small number of shareholders. Even in countries where changing the legal form is permitted, the possibility of tax issues arising from the conversion should be carefully considered.

Therefore, in planning for the succession, all the pros and cons of a change in the legal form of the business should be carefully considered.

Generally speaking, it could be observed that sole traders and partnerships – the legal form of most smaller enterprises – are legal entities depending on their members and can have a great deal of difficulty in continuing their existence after the death of one of its members. Indeed, the aforementioned report indicated that more than 50% of respondents considered that sole-proprietorship businesses are more vulnerable to failure to transfer the business, compared to only 13% for limited liability entities.

On the other side, limited companies – which are from the legal construction independent from their members and therefore can continue to exist after the death of one of its members – imply higher administrative burdens.

Many countries offer a simplified version of a company limited by shares suitable for smaller businesses. These often come with restrictions – such as restrictions in the transfer of shares or restrictions in whether shares can

[6] *Business Dynamics: Start-ups, Business Transfers and Bankruptcy*, final report January 2011 at http://ec.europa.eu/DocsRoom/documents/10448/attachments/1/translations/en/renditions/native

be offered to members of the public. It is possible in some countries to forgo public disclosure of financial information by surrendering limited liability. Consequently, selecting the preferred legal form of the company can be quite a complicated decision that has a long-term impact on the business.

Of course, exemption from regulatory procedures, such as audit, does not mean that they should always be discarded. Certainly any family business going through succession planning should look to audit in order to verify the business information that will inform succession decisions and which family members will rely on when deciding whether or not the plan is compatible with their aspirations.

Assuring the continuity of the business

The transfer of a business involves the transfer of a great number of external relations (e.g. with business partners, with the public administration, etc.), which form part of the intangible assets of the firm – what accountants refer to as the goodwill. Many relationships in family businesses are based around the owner/manager and need to be reallocated appropriately, as will be shown later in this guide. Some other relations have a legal basis, and it is therefore vital to assure their legal continuity.

The legal principle of the continuity of a partnership is by no means universal within the EU, with the European Commission study indicating 22 countries have rules to ensure the continuity of firms in case of the death of an owner. Remaining partners are permitted to take decisions with or without the heirs of a deceased member in 20 of the 33 countries surveyed.

The continuity of partnerships can be protected by giving entrepreneurs a right to transfer his or her trading authorisation, even provisionally, to a member of the family, in case of death, sickness, or another permanent incapacity to continue the business.

A very effective way to ensure the legal continuity of the business is the creation of a trust, or of other forms similar to it where permitted by local law.

It can be also very useful to conclude future succession pacts, which are allowed in some EU countries. Where future succession pacts are prohibited, so-called business or family agreements can often be used to maintain a certain number of management rules throughout the change of generation.

Checklist 4: Legal issues

Change of the legal form of a business – should it considered to switch to …	
Partnership	
Limited company	
Single-member limited company	
Public limited company	
Single-member public limited company	
Consideration of the tax charges arising from the conversion	
Assuring the legal continuity of the business	
Do national laws contemplate a legal principle of continuity?	
Use of pre-emption rights (where allowed)	
Introduction of a trust (where allowed)	
Use of succession pacts (where allowed)	
Use of business/family agreements	

Financial issues

Business transfers often require significant financial resources, for example in order to fund the acquisition costs. Moreover, a take-over often results in the need for a strategic reorganisation of the business that may require a considerable amount of additional capital. Obviously, certain succession options will require considerable financial planning and preparation over a number of years, a process that will have to be managed with the business's professional accountant.

Special funding

In some EU countries, businesses can have access to special funds whose purpose is to support transfers. The precise details of such schemes tend to change frequently, but a professional accountant or enterprise support body, such as a chamber of commerce, should be able to help.

Evaluation and valuation of the business

As part of the succession planning, it is necessary for the future sustainability of the business to subject to serious consideration. In this context, sustainability is not just limited to environmental, social and governance issues but also to the future viability of the business as a whole.

In the last ten years we have seen the exponential increase in new businesses disrupting the business model of traditional businesses, many of whom have operated in fundamentally the same way for decades. It is highly likely that this trend will increase and even accelerate.

Consequently, it is highly important that the family has an open and free ranging discussion about whether the current business model will be sustainable for any length of time after the business is taken over by the next generation. If there is a significant risk that the business could be badly affected by future technological and social developments, then serious consideration should be given to selling the business now to obtain the best price possible.

This discussion is in itself a potential flash point for family discord as it will highlight differences between different generations of the family. For example, the current owner/manager may have run the business very successfully for decades and may show understandable resistance to the idea that his or her life’s work could be rendered obsolete overnight. It may be that even the next generation don’t see the risks either.

It is with this issue that the younger generations of the family should play their part – by analysing how they interact with the market in which the business operates they may be able to give some indication as to whether the business has a relevance for their generation. If it doesn’t, it may need to change its business model considerably or it just may be better to sell the business whilst it still has a value. This then brings us on to the next issue – how to establish the value of a business.

Money is at the heart of many family disagreements. A valuation exercise is an important part of succession planning. Even the most altruistic family members want to know what the business is worth and thus what they are going to have to pay to buy out the elder generation. The valuation will also be important if the planning process points to a sale of all or part of the business and will be invaluable in identifying tax considerations.

However, valuing the business is not an easy exercise. Also, it cannot be completely separated from the course of the succession. A problematic succession can decrease the value of the enterprise. Conversely, value can be increased by a smooth and successful transmission. In addition, the evaluation’s purpose can be different in case of transmission to a third party or to a family member. Logically, in case of transfer to third parties, the only purpose is to obtain the highest price. Successions within the family have to take into account other factors.

For example, it will need to recognise the performance of the family members who have contributed to the value of the business or to distinguish between inheritance involving risk or not involving it.

Fiscal issues

Tax planning considerations vary, depending on whether the succession plan points towards a disposal or retention. In addition, the tax treatment differs significantly among Member States.

The European Commission report *Business Dynamics: Start-ups, Business Transfers and Bankruptcy*[7] demonstrates the considerable variations in tax treatment of business transfers across Europe:

- only 14 of 33 countries have rules reducing taxes on the transfer of business assets by gift or succession
- 12 countries permit the spreading or deferment to heirs of gift or inheritance taxes
- Only 8 countries permit the tax assessment of the business to reflect changes in the value of the business some months after transfer
- 6 countries have special taxation measures for transfers to employees
- 9 countries provide tax incentives for the re-investment of profits from the sale of a business a non-listed business

The business's tax advisor should deal with this complex area, particularly as the rules and reliefs often change.

Selling the business

The tax treatment of capital gains

Capital gains related to the sale of a business, of an interest in a partnership, of shares in a limited liability company or in a corporation by an individual are in principle subject in all countries to personal income tax. The same rules apply in the majority of countries on the sale of a business and on the sale of a partnership interest, albeit with the partnership interest being based on a pro-rata of total partnership value. Some Member States differentiate between current income and capital gains by applying different tax rates to capital gains. In addition, capital gains realised on the sale of shares are often treated differently than capital gains from the sale of a business or a partnership interest.

The tax treatment of capital gains varies considerably among Member States.

Methods for the determination of capital gains

Capital gains related to the sale of a business, the sale of an interest in a partnership and the sale of shares in a limited liability company or in a corporation are quantified using different methods. If relative uniformity exists for gains related to the sale of a business, the determination of gains arising from the sale of an interest in a partnership and from the sale of shares in a limited liability company or in a corporation varies considerably across EU Member States. In particular, with regard to capital gains on the sale of shares, in many countries the taxation depends to a large extent on whether the shares are held as a business asset or whether they are owned by an individual as a private (non-business) asset and whether the shares sold represent a significant participation in the company.

[7] https://ec.europa.eu/growth/smes/promoting-entrepreneurship/advice-opportunities/transfer-business/index_en.htm

Thresholds/allowances/reduced rates

Thresholds and/or allowances related to gains arising from the sale differ substantially among EU countries. Moreover, while a reduction of tax rates is sometimes applied, some countries may provide specific tax reliefs and/or the use of indexation factors to adjust the value determined in order to reduce the impact of inflation. All these factors influence in a fundamental way the determination of the taxable base, which diverges significantly in all EU Member States.

The transfer and the deferral of these capital gains

The roll-over of a capital gain arising from the sale of a business into other assets is allowed, under certain conditions, in some EU Member States. A roll over of capital gains arising from the sale of interest in a partnership into other business assets and a roll-over of a capital gain arising from the sale of shares is allowed in Ireland and in the United Kingdom. The reliefs available are constructed to ensure that resources stay in viable businesses, but the rules need to be complied with to minimise liability.

Losses from sale of a business, a partnership interest or shares

The tax treatment of losses from the sale of a business, of an interest in a partnership or of shares in a limited liability company or in a corporation varies widely in the EU.

Some countries allow such losses to be applied against other taxable income in the same year or to be carried forward for later use; other countries allow losses to be applied only against current capital gains (e.g. sale of other shares or real estate) but not to be carried forward to future years. Other countries do not allow losses from the sale of a business, of a partnership interest or shares in a corporation to be applied against other income at all.

VAT treatment

Generally, the sale of a business, of an interest in a partnership or shares in a limited liability company is not subject to VAT (outside the scope). However, this is a Member State option under the EU VAT Directive so it cannot be guaranteed that this will apply in all EU countries.

It must also be remembered that it is only the sale of a business or part of a business that would not be subject to VAT on sale. If the entire business is sold VAT should not normally be an issue but, for example, where a business is being broken up and sold to different parties only those assets sold as part of a business that will be carried on by the successor will be exempt from VAT – any assets sold separately would be subject to normal VAT rules.

Other taxes

In some Member States the sale of a business is subject to real estate transfer tax to the extent real property is included in the assets. Stamp duties, registration tax and other taxes are also applied in the majority of countries.

Such taxes are, to a different extent, charged also on the sale of an interest in a partnership and on the transfer of shares held in a limited liability company or in a corporation.

Keeping the business in the family: transfer without consideration

The tax treatment of the capital gains

In the majority of countries, the transfer without consideration of a business, of an interest in a partnership and of shares in a limited liability company or in a corporation effected by an individual is not a taxable event or a tax exemption is available as far as income tax is concerned. In some EU countries, such gains are subject to income tax but, under certain conditions, can be partially or totally exempted.

In these latter countries if the transfer is made by a partnership, the taxation of each partner transferring his or her interest is subject to the same tax treatment as individuals transferring a whole enterprise or their respective participation.

The period during which shares have been held and the method of accounting for the participation can also influence the effective tax load.

Thresholds/allowances/reduced rates

Where Member States treat a transfer without consideration of a business, of an interest in a partnership and of shares in a limited liability company or in a corporation by an individual as a taxable event, reduced income tax rates may be available.

Gift and inheritance tax

The transfer of a business, of an interest in a partnership and of shares in a limited liability company or in a corporation as a donation is typically subject to gift tax in EU Member States. Exemptions are possible in some cases, but the gift may instead have an impact on the recipient’s income tax liability.

The transfer "mortis causa" of a business, of an interest in a partnership and of shares in a limited liability company or in a corporation, is subject to inheritance tax in most countries, although relief is available in some.

The gift and inheritance taxes generally apply with progressive rates and vary substantially among countries. The determination of the tax depends also upon different criteria such as basic allowances, the taxable base (either the value of the business or the proportional value corresponding to the interest and of the shares), the number and qualification of the beneficiaries. Specific exceptions or allowances are implemented in several countries.

On the transfer mortis causa of shares, differences among Member States are mostly linked to the determination of the taxable base and the tax rates. Elements such as the value of the transferred shares, the fact whether such shares are quoted or not and specific allowances also play a significant role.

VAT treatment

Generally, the donation of a business as a whole is not subject to VAT. Some peculiarities could apply. In all countries the donation of an interest in a partnership and of shares in a limited liability company or in a corporation as well as the transfer mortis causa of a business, of an interest in a partnership and of shares in a limited liability company or in a corporation are not subject to VAT.

In general VAT does not seem to be a major issue for the transfer without consideration of SMEs.

Other taxes

As stated before in connection with the sale of SMEs.

Double taxation

There are at present very few double taxation treaties between Member States covering inheritance and gift taxes. Double taxation can be a major problem for the succession of business assets other than land when the business operates with branches in more than one Member State.

Checklist 5: Fiscal issues

Sale of the business	
Methods of calculation of capital gains	
Fiscal treatment of capital gains	
Thresholds/allowances/reduced rates/reliefs	
Incentives	
VAT consequences	
Real estate transfer tax (to the extent real property is included in the assets)	
Stamp duties, registration tax and other taxes	
Transfer without consideration	
Gift tax	
Inheritance tax	
Methods of calculation of capital gains	
Fiscal treatment of capital gains	
Thresholds/allowances/reduced rates/reliefs	
Incentives	
VAT consequences	
Real estate transfer tax (to the extent real property is included in the assets)	
Stamp duties, registration tax and other taxes	

Devising the Plan

If the family wants to keep the business, their succession plan needs to settle five key matters:

Checklist 6: The key issues to be settled by a succession plan

What are the criteria for selecting the next chief and other senior family appointees?	
How will business continuity be maintained to ensure that business practices, contacts and procedures are passed smoothly to the new generation?	
When will the change occur?	
What happens if wrong choices have been made? Can a family council, for instance, provide opportunities to review errors and omissions?	
How are the retiring family members' aspirations on retirement to be met? Will a capital sum and a pension be enough or will the retiring chief want to keep some kind of active role?	

Contents of the succession plan

The plan will contain the following elements:

Checklist 7: Contents of the succession plan

A statement of the distribution of ownership	
The identity of the new leader or leaders	
How the new leaders are to be trained for their roles	
A definition of the roles of other key members of the business during the transition	
Mechanics for the purchase or sale of stakes in the business	
Taxation and legal considerations	
Financial considerations	
Retirement considerations	
A procedure for monitoring the process and dealing with disputes and problems	
A timetable	

The succession process falls into three stages:

- devising the elements of the plan
- implementation
- and evaluation of the results

Once the family agrees on the broad answer to the key questions about the business, it is usually better for an external adviser to put together the succession plan. Alternatively, a structure where a number of independent professionals represent the interests of different members of the ownership group may work where adversarial owners insist on personal representation. Certainly, a wide range of external input will be required to achieve a broad perspective.

Whoever advises should prepare a proposal based on the family's predetermined criteria. A draft should then be brought back for debate at the agreed forum, whether that is the board, a family council or a wider meeting of all shareholders. It should be possible to work out a plan that goes in the direction that the family wants. Equally, the information-gathering process may unearth major obstacles or suggest an alternative course of

action. The key to success is careful preparation and research to ensure that the planners know as much as possible about the business, both the written and the unwritten.

The family and the professional adviser

Bringing in the expertise and neutrality of a family adviser is usually a key part of a successful succession planning process. Someone has to contain family pressures! The business's professional accountant may be a particularly suitable candidate for this role as he or she has to maintain a degree of distance and objectivity from all family members.

Considerations for the professional adviser

There are four key considerations for the professional adviser:

1. To make a successful contribution, an adviser needs to understand the psyche of the client. The stresses and emotional pressures of the family business in question form the backdrop to the process.
2. Leading family members may feel under psychological strain during a succession. There are difficult choices to be made. Should they earmark a family member as the next managing director or bring in an outsider with a proven track record but uncertain commitment? How should family members be appraised? Will hard decisions provoke unpleasant family confrontations? Many owners swing from a family to a commercial approach then back again, with inevitably damaging results for the business through the failure to apply criteria consistently.
3. The possibility of conflict needs to be considered at the outset. As family tensions are going to surface regularly in a family business, potential issues must be identified and put in a framework. While clear-cut answers may be unlikely, it is possible to find ways to manage the contradictions. Neutral forums for collaborative problem-solving that help to separate ownership and management issues could be a useful. These may be supported by a family constitution that defines the nature of the business and proscribe agreed approaches to key issues. For instance, the constitution might determine that family members be independently assessed by non- family non-executive directors (NEDs).
4. There should be a process to ensure that the succession plan can be adapted. Business, as well as individual circumstances can change. A family council may be the place to discuss changes to the plan and a family constitution should lay down a binding process for review and modification.

Knowing the business

The draft plan must consolidate the entire body of knowledge about the business. For a service sector business in particular, the value of the firm will be locked inside a range of intangibles, such as the goodwill of the business, and including items ranging from contact networks to the skills and character of individual staff members. Checklist 8 details the areas that need to be researched when preparing a succession plan. Information drawn from any of these could have a major impact on succession decision-making. It may be necessary to bring in legal advice if this process brings to light complex issues.

It is important to consider informal information. For example, if the current leader has many of the business's customer contacts stored in his or her head, this data needs to be documented and recorded and measures put into effect to ensure that existing networks are preserved. Likewise, informal information about employees may also be important.

Case study - Cadiz Print

Cadiz Print was formed by three brothers. Two of the brothers, Ferdinand and Carlos, had brought many other family members into the business, including two sons, two daughters and their respective spouses. The third brother, Roderigo, had held a passive stake of 20% of the business for years but lived in Florida. One son and one daughter, Pedro and Maria, had places on the board. Pedro worked full time in the family business, but Maria also ran a small design business with her husband Ivan. Two other children, Nuno and Nic, worked in the business. All members of the second generation had been given shares. The finance and sales directors were not family members. All three brothers recognised that the time had come for the next generation to take over the business.

At the family Christmas party Ferdinand and Carlos told the rest of the family their proposal for the future of the business: Ferdinand and Carlos would soon retire. Pedro, Ferdinand's eldest son, would take over as Managing Director, Maria, Carlos's daughter, would take the title of head of operations and their two siblings would then join the board. Ferdinand and Carlos would sell their stake to their children for €7m EUR.

Far from achieving universal acceptance, their plan had only served to bring a range of issues into the open.

- *It seemed that Maria had been planning to leave the business the following year, the design business had reached take-off point and needed all her attention. Ivan was pressurising her to resign immediately, at a time when her network was essential to the family business.*
- *Shah, the Finance Manager, who was not a family member, could see no future for himself with the business as less experienced family members had been put on to the board, despite intimations made to him that promotion was in the pipeline.*
- *Shah saw no way in which the business could afford to buy out Ferdinand and Carlos to the tune of €7m EUR.*
- *Matters came to a head when Pedro confronted his parents. Pedro did not believe that he could effectively share authority with Maria and also resented his younger sisters' and cousin's appointment to the board ahead of Shah. Agreement to put these two on the board had caused uproar across a range of family members.*
- *Roderigo had given his two brothers a free hand to put a succession plan together, but was furious that he had not been consulted about the details. He could see power in the business passing away from his side of the family. His daughter Rowena had plenty of business experience and was thinking of moving back to Spain. Furthermore, she needed a job.*
- *Since they did not believe that they would now be brought into the business, three grandchildren asked to sell their shares. Inter-family relations rapidly deteriorated.*

Ferdinand later admitted, "Our plan had no chance of succeeding. We had not bothered to do any homework or to consult. We thought people would talk to us about our ideas but since we ran the business by telling everyone what to do, all the talking happened behind our backs. It was very destructive. You know, we'd never got round to asking the children or the employees about the future of the business; no-wonder they were all so angry. Since we retired Shah's experience has proved to be essential to counteract the inexperience of some of the new family directors and to rebuild Roderigo's trust. Thankfully we kept him and put him on the board. Pity about losing Maria; it's taken a while to rebuild her contacts: seems that most of them were Ivan's. Neither Ivan nor their two kids felt very appreciated."

Checklist 8: issues to be researched before drafting a succession plan

Formal knowledge	
Review the company's history	
Examine the state of its current operations	
Critically examine its future sustainability and susceptibility to "disruption"	
Review business plans	
Review financial statements	
Review management accounts	
Discuss and review pertinent legal issues and documents with lawyers	
Informal information (goodwill)	
Discuss and record business practices for key areas where there is no documentation.	
Make sure that customer / supplier / other business networks are recorded	
Which business roles do management team members really perform?	
Workings of the family	
Understand the day-to-day workings of the family in both business and family roles	
Try to observe the family's chemistry and relationships. How do these work? Who has influence? Is influence active or passive?	
What are the ambitions of family members?	
Are there family stakeholders who are not in the business? Who are they? What sort of influence will they have on the succession decision? What role do spouses play?	
Are there any family members qualified to take over from the retiring generation?	
Should selling the business be an option?	
If there is no obvious heir, could the family look outside for a new managing director, while retaining ownership?	
What are the needs and concerns of the retiring generation?	
How best can a balance be struck between retaining the experience of the retiring generation and the need to pass on the business?	
The employees	
Which employees might leave if the business were sold to outsiders?	
Could a loss of key staff be a barrier to the sale of the business or lower its worth?	
Are there any employees with the skills to run the business and who might want to do so?	
If a management buy-out is a possibility, are the employees able to raise the cash to get one underway?	

The generation retiring

Understanding the concerns of family members who are to leave the business is central to an orderly succession. Their needs must be addressed. A time will come when the founder of the business is no longer capable of leading it. Any reluctance relinquish control must be minimised. He or she can either sell their stake or receive a secure retirement package; either way on terms that will secure their future finances.

What if retiring family members see themselves as having a continuing role? If a dominant figure looks likely to retire in name alone, the conflicts of authority, as the former leader outstays his or her welcome, can be highly

destructive. Many family businesses see retiring chiefs reduce their working week well before retirement and thereafter they become non-executive directors, again with an agreed limit on time spent on the premises. However, a retiring family member should never be lost entirely and the departure process must be planned to ensure continuity and to pass knowledge from one generation to the next. Another consideration is the leader's spouse, particularly if they are to inherit a controlling interest. A succession plan will count for nothing if a spouse tears up the plan with the intention of exercising control.

If the succession plan cannot guarantee a secure retirement to those who will leave or sell the business, it is not going to be accepted. Frequently, retiring family members will be happiest if the business buys their stake with a lump sum that they can invest independently. This may be impossible. Funds may not be available and the new management may be reluctant to see their business saddled with debt. Alternatively, it may be possible to defer payment to give the business time to sort out any liquidity problems. If family members are to be paid a pension, the new owners need to be sure that the liabilities incurred can be met. Effective pension planning should allow for the establishment of a pension scheme before retirement.

Some other popular exit routes when the main interest in the business is sold to other shareholders can include:

- Self-administered pension schemes (where allowed) - the funds of younger members of the family buy the older generation's shares.
- Employee share trusts (where such a legal form is available) - the trust acquires the shares and distributes them to the employees, buying out the proprietor, or other form of transmission to employees.
- Share-for-share exchange - the vendor receives shares in the acquiring company.
- Trusts, in countries in which such legal forms are available – to transmit the capital to the heirs.

The route to a sale

The development of the succession plan may suggest that the best course for the family is to prepare to sell the firm. Whether independently or through professional advisers, there are a number of routes to sale, e.g. acquisition by a competitor, or sale via a broker, venture capitalist or business angel network.

The market in SMEs is highly active but difficult to quantify. A worldwide study by Baker Tilly in 2013 indicated that nearly 27% of family businesses would be sold rather than passed down[8].

The 2015 European Family Business Barometer published by KPMG and European Family Businesses (EFB)[9] indicates that approximately 21% of European business owners facing a strategic change are contemplating selling their business to 3rd parties – also highlighting that this figure has increased considerably in the last two years.

Exit routes will usually revolve around a sale to another shareholder or to a third party. Trade sales are still the preferred means of disposal to a third party and the acquirer's primary motivations are gains in market share and economies of scale. For micro firms, vertical integration and market share seem to be most important.

Trade sales and the marketplace

The primary concern for the vending entrepreneur is getting a fair value to re-invest or to secure retirement. Finding a suitor in the open marketplace is not always easy - luring a range of competing suitors is even more

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[8] *Developing A New Map For Effective Business Succession in Family Businesses* – Baker Tilly International

[9] *European Family Business Barometer, 4th Edition – Determined to Succeed* – KPMG and EFB http://www.kpmg.com/acor/en/IssuesAndInsights/Documents/the-european-family-business-barometer-fourth-edition.pdf

difficult. Trade sales have one great weakness; they rely on a limited network inside the industry. On the whole, a vendor's contacts will be limited to the industry and only a small pool of firms will be interested in buying at any one time. The pool may be so small that the buyer is forced to set a price far below what might be achieved were there to be many interested bidders. Few sellers know how to attract a wider range of potential purchasers. Some buyers may only be interested in intelligence gathering about a rival. There may be no intention of making a serious bid. Advertisements placed in the companies for sale columns of the press or their online equivalents may produce equally poor results.

Finding a buyer depends on a good network, which usually means employing a third party with such a network to manage the process. This is also a good idea as the sale process will benefit from expert experience. As this process can hit a number of obstacles, vendors needs to ask themselves whether they can manage the firm, without extra help, at the same time as selling it!

Anyone selling a very small firm will often find it difficult. The scale of company brokers' and the larger accounting firms' fees may rule out the possibility of using their services. It is increasingly difficult to judge the advisability of using some of the smaller agencies that will try to engineer the sale or purchase of a business. The networks of some smaller firms of accountants and solicitors may be limited.

Some Member States have helped establish national and regional networks to bring potential buyers and sellers together. There are also an increasing number of online platforms dedicated to buying and selling businesses (such as BusinessForSale.com, Opportunity Network etc.) – such platforms may not necessarily reduce the amount of work involved in the process of selling the business but may be useful to expand the list of potential buyers beyond the owner's existing network of contacts.

Business angels and informal investment

Some of the business angel networks may be a good starting point in seeking a wider field of potential buyers and sellers for businesses at the smaller end of the market. A business angel is "A knowledgeable private individual, usually with business experience, who directly invests part of his or her personal assets in new and growing unquoted businesses. Besides capital, Business Angels provide business management experience for the entrepreneur."[10]

While most business angels look to make investments in a business, some may be open to buying. Some EU countries have networks of business angels, often running in conjunction with other sources of venture capital.

A 2012 report by a European Commission Expert Group[11] indicated that there could be around 250 000 business angels active in Europe. However, it also indicated one of the pitfalls for businesses hoping to engage with such individuals – it is difficult to locate a suitable buyer as fewer than an estimated one-seventh of business angels are registered with networks.

Buy-outs and buy-ins

Management buy-ins (MBIs) and buy-outs (MBOs) are also increasingly popular. They can provide a secure future for the business and guarantee its independent identity. However, they tend to be concentrated at the top end of the SME market and deal sizes tend to be in millions rather than hundreds of thousands of euros.

Usually in a MBI, a team of external managers looks to come into a business that has lost its way. The teams tend to rely on networks of venture capitalists and on accountants or industry contacts to alert them to opportunities. Having advertised their competence in the industry and their ability to raise the cash, the teams

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[10] Definition used by EBAN, the European Trade Association for Business Angels, Seed funds and other Early Stage Market Players)

[11] *Evaluation of EU Member States' Business Angel Markets and Policies- Final report* https://ec.europa.eu/growth/access-to-finance/funding-policies/business-angels/index_en.htm

hope that they will be kept on file as a ready-made buyer. Some buy-in teams will be interested in improving sound companies, perhaps by adding skills in areas where the business could be stronger. This can be far tougher than turning around an ailing firm where obvious improvements can be made quickly. Usually finding and executing a buy-in relies on professional advisers who can act as a 'dating service' to bring the buy-in team and the business together.

However, it is wise to be wary. Not all buy-in teams have what it takes. Buy-in teams may be in the market because they were made redundant by their last employer. Team members may be tempted back into employment or may get cold feet when faced by the full consequences and risks of a deal.

An MBO is where the business' existing management acquire the business from its existing owners. This obviously requires the existing management (and/or employees) to be interested in taking control.

MBOs require a key group of managers with the credibility to put a deal together and to persuade investors that they can run the company and provide a return. The structures available can vary from a direct purchase financed by outsiders to arrangements where the MBO team offer secured pensions for the departing owners with a schedule of immediate and deferred capital payments. Tax reliefs may be available to the MBO team. MBOs often present the departing owners with the opportunity to retain a stake in the business. This can range from an advisory non-executive seat on the board, to a large equity stake.

Finance and tax considerations

Finance and tax considerations must be carefully taken into account: please refer to the previous chapter.

From Blueprint into Action

Once the information-gathering process is complete, hard decisions have to be taken. They also have to be 'sold' to the family and the employees. Having agreed criteria and gathered every relevant piece of information, who is going to fill the top spots on the succession diagram? Alternatively, do circumstances, such as the wishes of family members or the business reality, dictate another route? It may be necessary to move to identify potential purchasers, including competitors or customers, existing management, or perhaps an employee share ownership scheme. If sale is the chosen route, there needs to be an agreed target price.

Is it necessary to separate ownership and management? The incoming generation's working experience may not be at all relevant to the family business. Family members with no idea how to run the business may still be unwilling to contemplate selling it. In such situations it is necessary to find a chief executive from the wider world to run the business.

If the likely heirs to the business are willing but not yet ready to take up the reins, then, as well as considering external management, key person insurance (insurance taken out by the business to compensate the business for financial losses that would arise from the death or incapacity of an important member of the business) may be necessary. Should the founder of the business be no longer able to manage it - through death or illness for instance - insurance proceeds, while not a replacement, will pay for the recruitment of a substitute to manage the business until other family members are ready to take up the challenge.

Decisions should lead to an action plan for implementation. The plan should indicate responsibilities and set target dates. This is a crunch point. Many family business owners find it difficult to contemplate their own departure and advisers may need to give firm encouragement: it is the time to remind business owners that no-one is immortal and, if they want their business to flourish and want to protect the future of their family and of employees, then they must plan ahead. The subsequent plan needs to be regularly reviewed with the family and the other key stakeholders.

Effective communication: the key to success

Properly implementing the succession plan is hard work. Progress needs to be constantly reviewed and family members coaxed into fulfilling the roles allocated to them. There must be effective and easy to use methods of communication between family members and advisers to monitor and adapt the plan as necessary. Family disputes are common features of generational change. Whereas conflict may be unavoidable at times and may even help move the decision-making process forward, mechanisms to manage conflict need to be in place to avoid it becoming destructive.

Hidden agendas, covering a series of potentially sensitive family issues that might generate conflict during succession planning.

Psychology and emotional baggage are as likely to be at the roots of strife as real issues of strategy or management. The origins of a dispute may thus be totally irrational and subjective – but nonetheless be critical to the feuding parties. To take but one recent high profile example, the world's richest siblings, Mukesh and Anil Ambani non-competition agreements were a source of bitter dispute for years.[12]

Conflict prevention - the family council

So how can the potential for conflict best be minimised or actual conflicts resolved? Of course, the family members have firstly to want to solve their problems. Beyond that, prevention is a matter of good communications, for instance, through a family forum or council. There are at least four key reasons for setting up a council:

- To educate family members about their rights and their responsibilities within the business.
- To clarify the borders between the business and the family and to allow all members of the family, including those at junior levels in the business, or those outside it, such as spouses, to air their views. In this way, family issues can have their proper weight but only their proper weight; most importantly their influence and impact can be understood by the decision-makers.
- To separate business matters from other family matters; too many firms put business on the agenda when they get together festivities.
- As the place to generate a shared vision and to guide and discuss its development.

For the family council to be effective, all family members must know that it is a neutral forum where they can and are indeed expected to speak their mind. The family should be defined in the broadest sense, i.e. as those who work in or just have shares in the business, as well as those who manage it. The business' leaders need to make an effort to listen and to give everyone a voice, after all even those who play no active role in the business are affected by it. The smallest firms, say one owned solely by a married couple, might find taking a formal approach to establishing a council overblown for their business. However, there is no reason why the same principles should not be applied, for instance on an agreed day for talking about the business, away from the office or other family commitments.

The council’s objective is to build agreement, not impose edicts. All family members should be encouraged to express their reservations about any project or decision. These reservations - or any other message - need to be expressed face-to-face, not through a messenger who may have his or her own personal agenda or interpretation of the issues. Also, a forum should never allow for attacks on family members or the laying of

[12] http://www.cnbc.com/2011/01/31/Famous-family-business-feuds.html?slide=5

blame. It is an expression of trust and fairness. These characteristics, rather than the emotional bonds, oil the wheels of a family business.

So the council must discuss change, after all the firm is where many family members will spend the rest of their lives. Individual family members' objectives also change over time and need to be respected. Decisions taken about the business may affect different family members in different ways, leading to changes in roles and ambitions that also need to be discussed. A family constitution can provide a framework for discussion in council meetings by laying down ground rules. If all the family members have signed up, there is limited room for argument.

Effective communication means transmitting information with as much clarity and force as is necessary to achieve a desired result. Family owners and managers should communicate their thoughts, expectations, plans and decisions as early as possible to the family and to the firm as a whole. The more important the issue, the more important it is that other stakeholders should be informed and consulted, rather than left to nurse their hurt pride after finding out from third parties.

The EFB/KPMG report *Determined to Succeed* indicates that 23% of respondent companies already have family councils in situ.[13]

Setting up a council

If the business does not already have a family council, Checklist 9 provide a few points to remember, which will increase the chances of success for what will be a venture into unfamiliar territory.

Checklist 9: Setting up a successful family council

Initially, use a professional adviser as an arbiter and moderator, using his or her experience to see that things run smoothly	
Set up and follow a timetable for meetings	
Settle simple matters in earlier meetings, so that family members feel comfortable about the council and believe that it is successful. Then you can proceed to more difficult issues	
Pay attention to the quality of the meetings - make sure that the council really is a place where everyone feels comfortable	
Make sure that the council's responsibilities are clearly allocated - there should be a council chairman, who is not necessarily the business's leader	
Do not be too informal – there is serious business to consider	
Use subgroups - allowing council members discuss issues in small groups can break down barriers and provide a range of different perspectives	
Ensure that the council includes every family member with a stake in the firm, be it active or passive	

The family constitution

A family constitution can provide a long-term framework to build both the trust and best practices suggested at the family council. It is a written statement of values and objectives with regard to the business, containing:

- The objectives of the business

[13] *P23 European Family Business Barometer, 4th Edition – Determined to Succeed* – KPMG and EFB
http://www.kpmg.com/acor/en/IssuesAndInsights/Documents/the-european-family-business-barometer-fourth-edition.pdf

- The family business philosophy or vision
- Remuneration and equity ownership policies
- Policies on entering and leaving the business
- Policies on the role of non-family members
- Criteria for succession

Many family businesses may extend the process of drafting the constitution to cover a range of issues affecting internal and external relationships and conduct. If successful, this process should help to give a very strong sense of direction. Of course, the constitution may create a range of future issues and so detailed clauses on exit or entry may need to be legally enforceable. A formal dispute procedure should also be set up.

The EFB/KPMG *Determined to Succeed* report indicates that 19% of respondent companies already have family constitutions or codes of conduct in situ.[14]

Settling a conflict - the adviser's role

The presence of an independent outsider, such as a professional accountant, will provide the most effective check on disputes once they emerge and the best means to resolution. Checklist 10 details the basic ground rules that need to be observed if an independent third party is to retain and build trust.

Checklist 10: Conflict resolution - the adviser’s role

The first rule is that the business is the client. Thus the accountant’s (or other adviser's) allegiance is not to any one individual or group within the business	
The family must know about and accept the first rule	
Particular care must be taken to build trust at the beginning of the process, particularly with a new client	
Before recommending anything, the adviser must talk to everyone to avoid excluding anyone and to discover which family members or contacts might be useful to obtain extra leverage in decision-making	
The adviser must not rely on the views of any particular family member in making his or her judgement	
Confidentiality - family members must accept that their individual conversations with an adviser are confidential	

The adviser should not be afraid to bring in other outsiders with specific expertise to deal with particular problems. For instance, bringing in a remuneration consultant to settle a dispute over salaries makes sense, having obtained everyone's agreement to abide by the decision.

Once a conflict has started there may be existing structures in place to channel the dispute, such as through a forum. Equally, the outsider, or a group of professionals representing various interests, may be given the task of finding the answer without recourse to any family governance structures.

Working out a solution

There is no one right way to resolve a dispute, but Checklist 11 provides a sensible starting point.

[14] *P23 European Family Business Barometer, 4th Edition – Determined to Succeed* – KPMG and EFB
http://www.kpmg.com/acor/en/IssuesAndInsights/Documents/the-european-family-business-barometer-fourth-edition.pdf

Checklist 11: Conflict solution - a procedure

Define the conflict	
Interview the combatants. Obtain as detailed a story of the conflict as possible and continually update it as new information becomes available. This process will both ensure that the intermediary has a real understanding of the key issues and is given useful insights.	
Add other people's opinions	
Having an eye to any issues of confidentiality, compile a list of people who have the status and experience to give different appraisals, views and conclusions. This should not just include the immediate family, but both professional and, perhaps, personal counsellors to family members; bank managers; lawyers; priests, etc.	
Analysis	
All of this data and interpretation needs to be analysed for an answer. Depending on the nature of the family business, this might be done in the family business forum or externally.	
Draw up a solution	
The report, analysing the conflict, reporting on the brainstorming session and putting forward a solution should be the adviser's work, without input from partial family members.	
External appraisal	
Obtain a second opinion on the proposals from someone who is disinterested, but who knows the business.	

Case study - Consort Motors

Aled, the Managing Director of Consort Motors wished to retire when he was 60, in eight years. He felt paternally obliged to pass the Managing Director's chair to his eldest son David, but was uneasy about his son's management ability. He wanted to find a role for his second child, 18-year-old Richard, but wasn't sure what would suit him best. Richard had never had anything to do with the business but Aled wanted to secure Richard's future and proposed to train Richard to run sales. Aled never considered his daughter Cath as a possible director, he only saw her as a passive recipient of dividends. Yet Cath had managed to do better than any of his sales staff during her university vacations.

Previously, the three children had not thought to challenge their father's pre-conceptions. The business had never had any forum or outlet for open and frank discussion. After Aled's announcement, relations soured. Over the next few months it was clear that David was not getting on with his two siblings and the performance of all three suffered. Cath seemed to be trying to turn some of the other senior managers against David's appointment, leading to increasingly poor relations throughout the business. Richard seemed miserable and uncertain.

Consort's accountant sat the four down. David admitted that he was no leader. Richard asked to be allowed to leave the firm to pursue a teaching career. Both sons pointedly told their father that Cath had inherited the brains and the drive; could she please take the hot seat? Finally, Aled had to agree.

Checklist 12: Succession planning process chart

Define the time scale for change – take professional advice	
What is the family's attitude to the business? • How far is strategy influenced by family issues and values? • Must the business stay in the family or is selling the business an option if it would yield the best return? • How will new family members be admitted or promoted? • How does the firm view outsiders and will be able to complete for promotion on an equal basis?	
Before the plan is written, review the business to take into account everything that might shape its development • Formal knowledge about structures, contacts and workings of the firm • Informal information: what everyone knows but has not written down • Insight into the workings of family relationships • The employees: their skills, abilities, roles and attitudes • The market prospects for the business and its sector – how susceptible is it for disruption? • The retiring generation: what they want for the business; how they may impede the handover; and what benefits they can still provide to the business	
The review may suggest selling the business, rather than keeping it in the family	
Drafting a plan must settle: • The criteria for selecting the next chief and other senior family appointees • How business continuity will be maintained to preserve contacts and procedures • A timetable • A procedure for review and adaptation which gives the business a fighting chance to correct errors • The retiring family members' aspirations	
Key components are: • Distribution of ownership • Identity of new leader • Training of new leader • Mechanics for the purchase or sale of stakes in the business • Taxation considerations • Retirement considerations	
Implementation • Set timetables and make sure everyone knows the roles they will take on and how they will change • Make sure that everyone has agreed to play their part • Ensure that a structure, such as a family council, exists to review implementation, adapt the plan where necessary and provide a mechanism to solve disputes and correct mistakes	

Conclusion

Personal conflicts, strains imposed by individualism and differing perceptions of commercial reality mix together the oil and water of family psychology and commerce. In such volatile environments conflicts are unavoidable and succession issues are potentially explosive.

While using a well thought out succession plan greatly increases the chances that the business will survive and thrive, no amount of planning can deliver certainty. Drafting a solution and seeing it through to completion may be worlds apart. For instance, a dominant proprietor may be able to create a consensus between family and employees behind a succession plan. The moment the monarch abdicates, however, every rule of the family relationship may disappear in a struggle for control, wealth and/or family attention.

The advising accountant or the wise business owner needs to be able to put a succession plan in place to avoid conflict as well as structures for resolution and damage limitation, should discord occur. The succession process is one of the events in an SME's life most likely to require in-depth outside help. For both the adviser and the business owners, the most important lesson to learn is that succession is a process, not an event. During the process roles will evolve and structures will change, perhaps going through a number of stages before reaching the final objective.

Even if the accountant is the key adviser, contributions from others professionals may be. No single individual can have a complete understanding of such a complex animal as a family business. The process can, and should, take many years. What was successful and good about the business must be preserved and strengthened as a new management takes over and the business is transformed to meet the evolving needs of the family and the business.

It is not a failure should the evaluation of the succession options point to the sale of the business. It is rather a realisation that the business has outgrown the family, or vice versa, and it is to be hoped that the firm can be preserved under new ownership.

Good communication is essential throughout the process - even then ensuring successful succession is difficult to get entirely right. Breaking through family chemistry to find ways to analyse emotions and personal ambition with detachment is contrary to the usual day-to-day mix of family and commerce. However, experience suggests that the businesses that do plan and communicate well are more likely to succeed, not only at the change of generations, but in most of the other things that they set out to do as well.

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Federation of European Accountants

Avenue d'Auderghem 22-28
1040 Brussels
T: +32 (0)2 893 33 60
E: secretariat@fee.be
www.fee.be

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