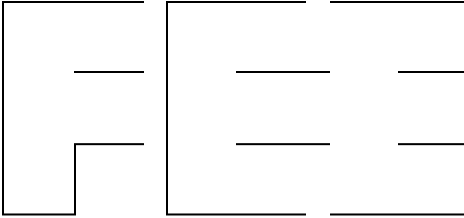

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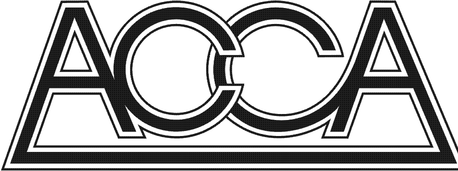

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INTRODUCTION

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 new 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 fire sale 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. Any investor examining a business plan will include succession planning in risk assessment. Why should an owner manager give the same issue a lower priority ?

Planning business succession cannot be a secondary priority. It is as important an element of business strategy as the identification of markets or development of products and has just as much influence on success and failure. This booklet 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 in 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 choice of the word process is deliberate. The successful entry of a new generation into the top jobs is not a single event, but a long term 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 managed 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 wreckage. The harmony and thus the success of family firms pivots on the melding and contradictions of family and business values. Succession is just one - 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 on succession are important aspects of this guide. The approaches suggested can be used by the professional when advising clients, or by any businessman or woman.

Effective succession planning will minimize the threat posed to the business and to family wealth by generational change. By thinking ahead you can avoid the pitfalls and provide the best future for your clients 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. Across Europe, 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 best placed to assist businesses to review succession and generational change, as part of their work monitoring the life and growth of family firms.

FEE, the (Federation of European Accountants) has published *Keeping it in the family*, through its SME Steering Group, which champions the role of the accountancy profession in supporting SMEs across Europe. The booklet was prepared with the assistance of ACCA (the Association of Chartered Certified Accountants) which has published and commented widely on succession issues through its Small Business Unit. Later FEE publications will deal in greater detail with the vehicles that can be used to manage family harmony, such as family councils and family constitutions.

The Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe, currently grouping together the 38 leading institutes in 26 countries, including the 15 Member States, Cyprus, Czech Republic, Hungary, Iceland, Israel, Malta, Monaco, Norway, Romania, Slovenia and Switzerland. Between them these bodies have a combined membership of approximately 400.000 individuals of whom about 45% work in the public practice, providing a wide range of services to clients, whilst the other 55% work in various capacities in industry, commerce, government and education.

March 2000

SUMMARY

- Failure to plan generational change may leave a business with heirs who are unprepared or uninterested; the result -- 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 winning support for change. Technical issues, such as pension or tax planning are important but are contingent on strategies that sustain the harmony and consent of family members and employees for the succession proposed.

- 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 minimizing the opportunity for the business to be damaged by the conflict of family members' personal aspirations.

- 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 suggest 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 help of a range of experts may be needed. Even if there is a lead adviser, a number of views and skills will be 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 the creation and growth of the business, the transfer is the third crucial phase in the life-cycle of a business[1].

The bonds that unite family enterprises make them highly competitive. On average, the shares of listed family companies outperformed the FT All Share Index by almost 30% between 1970 and 1991.

Yet, despite the consistency of management objectives and the long-term approach provided by family management, family ties can sometimes 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 arrangements are rare. For instance in England a recent study shows that just under 45% of first-generation businesses plan for succession and which only 43% have a will that deals with ownership. According to another recent survey in more than 20 countries (European and non-European), only 25% of the family businesses has formal rules for the entry into management of the next generation. Informal rules exist in 47% of the family businesses surveyed, while the 38% do not have any. Also, it should be noted that southern European enterprises pay less attention to the transmission than the northern European ones. Transmission has not been considered by 40% of the southern enterprises, but only by 27% of the northern enterprises[2].

Recent studies have come to the conclusion that more than 5 million enterprises in the European Union, representing about 30% of all European enterprises, will have to face their transfer throughout the next years. Moreover, it is expected that about 30% of those enterprises, i.e. 1.5 million, will disappear because of poor preparation of their transfer[3].

The US Wharton Center demonstrated that only 33% of family companies survive from the first to the second generation, while only 15% make it to the third. Manchester Business School have demonstrated that only 4.3% of SMEs survive beyond. The Stoy Hayward/ BBC Family business index demonstrated that "a significant number of companies ... indicated that they had no family members other than those on the Board". Where no preparations are made to take the future generation of ownership into the business, firms may be left to a next generation whose

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[1] European Commission :Integrated Programme in favour of SMEs and the Craft Sector, COM (94) 207 final of 3.6.1994.

[2] Source: ENSR – European Network for SME Research

[3] The European Observatory for SMEs, Fourth Annual Report, 1996, page 183.

first-hand knowledge is confined to the reading of the will. Such an inheritance is the beginning of major problems, often the beginning of the end.

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 is a range of characteristics to look out for that suggest that a firm is naturally 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 they are maintained. The first part of the planning process is to look for these factors.

European Foods - the worst laid plans

Roger Prentice had founded European Foods in 1958, 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 1993 the firm had a turnover of Euro 7 million. Roger was a very controlling owner. Although his three children knew that they would each inherit 1/3 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 1995. After a heart attack in 1993, 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 Managing Director. Roger had made no other plans for succession and had kept much of the knowledge about how he did business in his head.

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 1996 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 1996 and three major customers changed suppliers. In May 1996 several key buying staff were poached by a rival business, taking their knowledge and contacts with

them. At the end of 1996 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 1997 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 presence and influence -- good or bad -- of these factors will help to determine success, so it is wise to evaluate them.

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, to date, the owners have planned and control 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 SUCCESSION PLAN

What are the Key Issues ?

Change should be planned now. Introducing potential future directors or making preparations for a future sale eight 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 put under doctor's orders and told to slow down is too late! Change takes time. It is a process; introducing new members of management to the business and the business to 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 crucial investment for the future life 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, and namely:

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

Business succession does not simply impact on those individual issues but may have an impact on every aspect of the business's success or failure. Succession planning cannot be a secondary priority. It must be part of the process of setting the firm's strategy.

Psychological Issues

The character and experience of both the retiring and successor generations and their personal and business priorities are the major drivers that have taken and will 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.

According to a paper from the European network for SMEs research (ENSR) "the survey of family businesses across more than 20 countries indicated that 65% believe their company's management should remain in the family's hand in future generations. … It is also observed that more family businesses in Southern Europe [about 80%] than in Northern Europe [about 60%] prefer the family retain ownership and managerial control".

Three reasons were found for this preference:

- a greater chance of survival of personal ideas and value systems of the transferor;
- the feeling that a life's work is in good hands;
- the possibility of keeping contact with – or even a certain influence on - the business.

Then a key question is: to what extent family members are ready to take over the business?

The same paper from the European network for SMEs research (ENSR) mentions that:

- in Finland, the main reason for the fall in the number of transmissions is the lack of interest among the children (mentioned by 41%);
- in Greece, family members are not ready to continue the business in about 30% of family businesses;
- in Germany, family members are willing to continue the business in only the 43% of the family businesses.

Successions can give rise to very strong emotional issues. Academic and consultant Elaine Kepner suggests that family sub-systems dictate how firms operate as family spills into commerce. Kepner believes 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 surpress 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 crunch points as the business grows or changes. Changes come in varying degrees of magnitude, smaller or greater. A minor fluctuation, such as the admission of one new member to the board, may lead to a clash of family and business, but should not lead to major changes in the 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 5 key questions - Family Vs profit?

How a business faces the key succession issues depends on the answers to 5 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? Is the next managing director but two going to come from inside the family? Alternatively, will the new finance director have the assurance that he or she will have a chance to 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

Change of 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 a change of the legal form of a business (conversion) can be suitable.

However, some EU countries impose quite burdensome requirements for the conversion, or even the winding-up of the business and the creation of a new one. Also, the tax charges arising from the conversion can be significant.

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 from their members and can have a great deal of difficulties in continuing their existence after the death of one of its members. 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.

"Partnerships, although very widespread among SMEs in continental Europe, are inherently weak forms of association when it comes to resisting the tensions which often arise in the course of a transfer. This is particularly true in cases where several heirs claim their share in the enterprise and require that it be paid out in cash. As a result, the partnership is usually dissolved and the business ceases". It should also be noted that "in many EU Countries the private limited company (SARL, GmbH) does not permit the issuance of bearer shares, making this form of company less suitable for the transfer of companies from the second to the third (or further) generation - where generally the needs of a larger number of heirs must be taken into account"[4] - than public companies limited by share capital (S.A., AG).

We can say that the independence of a legal entity from its members – and therefore its suitability to a successful succession – is inversely related to its administrative complexity.

A simplified company limited by share capital is available in Germany (kleine Aktiengesellschaft), where the law provides for a number of reliefs in establishing such a company and in its functioning, as for instance fewer formalities at the annual general meeting for companies below a certain size, exemption from the requirement of having a supervisory council for companies with less than 500 employees, and the possibility of excluding a priority right to purchase new shares[5].

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 to verify the business information which will direct some 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 is not only the transfer of a mean of production. It is also the transfer of a great number of external relations (i.e. 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. Some of those relations have been built around and are very much based upon the character of the head of the enterprise (and therefore an appropriate handing out is needed, as it

[4] Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs
[5] Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs

will shown in the following part of this guide). Some other relations have a legal basis, and it is therefore vital to assure their legal continuity.

"Many small and medium-sized businesses are set up without the entrepreneurs using legal advice. This should of course remain possible, but in some cases leads to a situation where strategic choices and legal derogations are not used in an optimal way, especially concerning the case of an unforeseen death of the entrepreneur. Therefore, many businesses are subject to legal provisions, obliging them to be wound up"[6].

It should be noted that the legal principle of the continuity of partnerships exists only in Italy and Portugal.

In other EU Countries (Luxembourg, Belgium), the continuity of partnerships can be ensured by a right of the entrepreneur to transfer his or her trading authorisation, even provisionally, to a member of the family, in case of death, sickness or other permanent incapacity to continue the business.

A very effective way to ensure the legal continuity of the business is the creation of a trust (in the UK), or of other forms similar to it, as the "fiducie" (in Luxembourg).

It can be also very useful to conclude future succession pacts, which are allowed in the majority of EU Countries. Where future succession pacts are prohibited (Italy, France, Belgium, Spain, Luxembourg) the so-called business or family agreements (pacte d'entreprise, protocole familial) can be used in order to maintain a certain number of management rules throughout the change of generations.

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?

[6] Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs

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 high financial requirements, 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. A study carried out by the Deutsche Ausgleichsbank has shown that the capital requirement for take-overs is 60% higher than for business start-ups (DM 400.000 for take-overs against DM 250.000 for start-ups)[7]. 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 business can have access to special funds whose purpose is to support transfers[8].

- in Belgium, a special fund for financing business transfers (Fonds de Transmission) offers preferential interest rates for loans facilitating business transfers within the family or to third parties. The loan is granted for a minimum period of 7 years and a maximum of 20 years. The interest rate is 3% during the first five years, and rises by 0.25% points thereafter with an upper limit of 3.75%. No guarantee is required to secure the loan.
- in Germany, the Deutsche Ausgleichsbank (a public institution) has promoted the transfer of businesses through its Eigenkapitalhilfeprogramm (equity capital assistance programme). More than 20,000 business take-overs have been supported through subordinated loans at very favourable interest rates.
- in France, where loans are available at a rate of only 3.5% through the State owned financial organisation SOFARIS,
- in the United Kingdom through the Small Firms Loan Guarantees Scheme,
- in Austria through the BÜRGES-Förderungsbank,
- in Finland through the state owned financial institution Finnvera Ltd.

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7 Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs

8 Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs

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.

Need to evaluate the 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, the evaluation of 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, while it 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 such 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 of a succession differs significantly among Member States. Possible tax considerations are considered below in brief, being based on the findings of the 1999 edition of the FEE Survey on the Fiscal Treatment of the Transfer of SMEs - considering that there are continuous changes in national laws, comments and figures cannot be considered as definitive[9]-. The business's financial adviser should deal with this complex area, particularly as the rules and reliefs often change.

As an example of the tax burden in the various EU countries, you will find annexed to this guide:

- a table summarising the tax burden on the sale of SMEs (percentage of the capital gain), and
- a table summarising the tax burden on the transfer of SMEs without consideration.

Selling the business

- The tax treatment of the 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 in principle are subject in all countries

[9] FEE will regularly update its Survey on the Fiscal Treatment of the Transfer of SMEs, further information can be obtained from the FEE Secretariat.

to personal income tax. On a pro-rata basis the same rules apply in the majority of countries on the sale of a business and the sale of a partnership interest. 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 notably 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 in the various countries. 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 is the result of the application of different procedures in several EU Member States. In particular with regard to capital gains on the sale of shares 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.

- Thresholds/allowances/reduced rates

Thresholds and/or allowances related to gains arising from the sale differ substantially among the EU countries. Moreover, while a reduction of tax rates is sometimes applied, only a few countries admit important reliefs and 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, only in a minority of 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 countries.

Some countries (e.g. Austria, Germany and Luxembourg - only for losses from sale of a business or a partnership interest -) allow such losses to be applied against other taxable income in the same year or to be carried forward for later use; other countries (e.g. Luxembourg - only

for losses from sale of shares -) 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, whereas a third group of countries (e.g. Belgium, United Kingdom) does 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 whole business, of an interest in a partnership or shares in a limited liability company or in a corporation is not subject to VAT (outside the scope).

VAT does not seem to be a major issue for the sale of SMEs.

- Other taxes

In the majority of countries 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.

In some Member States 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 in a few cases reduced income tax rates are 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 subject to gift tax in all EU countries with the exception of Luxembourg (where only a registration tax is due in certain cases), in the Netherlands (where an exemption from gift tax applies as far as one has to pay income tax) and in the United Kingdom. In Denmark gifts are normally assessed as taxable income of the transferee unless the recipient is within the nearest family: in this case they are subject to gift tax.

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 there are exceptions (e.g. Luxembourg). Considerable relief is available only in Ireland, in Italy, in the Netherlands and in the United Kingdom.

With the exception of Denmark where a fixed proportional rate is in force, the gift and inheritance tax generally apply with progressive rates (minimum 3% and maximum 80%) which vary substantially among the EU 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

With the exception of one Member State (Austria), 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.

TRANSFER BY DONATION OF A BUSINESS

Example of tax burden (extract from the 1999 edition of the FEE Survey on the Fiscal Treatment of the Transfer of SMEs)

Facts: A (60 years old) transfers in 1999 his enterprise to his son C by donation.
Tax base (allowances not yet considered): 5 Mill. euro.

Allowance: ....euro
Gift tax rate ....%

Gift tax: ....euro = ... % of the tax base.

Germany

Allowance	2.357.356 euro	
Gift tax rate	19 %	
Gift tax	502.102 euro	10.04 % of the tax base

(Exchange rate as at 1.1.1999 1 euro= 1,95883 DM)

Italy

Allowance	180.760 euro (350 ITL Mill.)	
Gift tax rate	3-27 %	
Gift tax	1.177.245 euro	23,9 % of the tax base

Illustration of German figures

	5.000.000	**euro**	**tax base**
➽	**9.794.150**	**DM**	
./.	**500.000**	**DM**	**business property allowance**
=	**9.294.150**	**DM**	
./.	**3.717.660**	**DM**	**40% reduction of tax base**
=	**5.576.490**	**DM**	
./.	**400.000**	**DM**	**personal allowance**
=	**5.176.490**	**DM**	**amount subject to gift tax**
X	**19**	**%**	**applicable gift tax rate**
=	**983.533**	**DM**	
➽	**502.102**	**euro**	**gift tax**

(business property allowance, 40% reduction of tax base, personal allowance) -} ≈ 4.617.660 DM ≈ 2.357.356 euro aggregated allowance

=	**10,04**	**%**	**of the tax base**

Illustration of Italian figures

Year 2000

	5.000.000	**euro**	**Tax base**	
-	**180.760**	**euro**	**Allowance**	
=	**4.819.240**	**euro**	**Amount subject to gift tax**	
	1.177.245	**euro**	**Gift tax**	
=	**23,5**	**%**	**of the tax base**	

Year 2001

	5.000.000	**euro**	**Tax base**	
-	**258.228**	**euro**	**Allowance**	
=	**4.741.772**	**euro**	**Amount subject to gift tax**	
	1.171.822	**euro**	**Gift tax**	
=	**23,43**	**%**	**of the tax base**	

Recently the Government presented a bill that envisaged the following:
An allowance equal to Lit. 500.000.000 for each their heir.
A flat tax of 4%.
Goodwill to be tax exempt.

	5.000.000	**euro**	**Tax base**	
-	**258.228**	**euro**	**Allowance**	**(1 direct heir)**
=	**4.741.772**	**euro**	**Amount subject to gift tax**	
	178.870	**euro**	**Gift tax**	
=	**3,57**	**%**	**of the tax base**	

	5.000.000	**euro**	**Tax base**	
-	**774.684**	**euro**	**Allowance**	**(3 direct heirs)**
=	**4.225.316**	**euro**	**Amount subject to gift tax**	
	169.013	**euro**	**Gift tax**	
=	**3,38**	**%**	**of the tax base**	

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 then 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 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 the 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. The professional needs to remember four key principles:

Considerations for the professional adviser

- A professional in an ongoing relationship with a client should consider succession issues from the word go.
- An adviser needs to understand the particular psyche of the client if he or she is to make a successful contribution. The particular stresses and emotional pressures of the family business in question must be the backdrop to the process.
- Leading family members are put under particular psychological pressures by succession. 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 any criteria consistently.
- The possibilities of conflict need to be considered at the outset. As kith and kin problems are going to arise with regularity in a family business, potential issues must be put in a framework. It is unlikely that it will prove possible to find clear cut answers but it is possible to find mechanisms to manage the contradictions. Common mechanisms employed include neutral forums for collaborative problem solving which help to separate ownership and management issues. These may be supported by a family constitution to define the nature of the business and proscribes agreed lines of approach to key issues. For instance, the

constitution might determine that family members would be independently assessed by non-family non-executive directors (NEDs).

- There should be a process to ensure that the succession plan can be flexed. The aspirations of individual, as well as business 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. Particularly in a service sector, the value of the firm will be locked inside a range of intangibles, the goodwill of the business, including items ranging from contact networks to the skills and character of individual staff members. Checklist 7 details the areas that need to be researched. Information drawn from any of these could have a major impact on the succession decision. It may be necessary to bring in legal advice if this process brings to light complex issues. It is important to consider informal information. 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. It is important to remember that information about the employees may 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 Russian 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. The two founders now had 10 grandchildren. All three brothers recognized that the time had come to complete the preparations 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: Ferdi nand and Carlos would retire on 1 January 1997 in 13 months' time. 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 7 million Euros

The announcement was made at 11 p.m. No one either felt able to or bothered to say anything about the scheme, except for Ivan. His sarcastic comments indicated uninterest in the business and were ignored. Shah, the Finance Manager, who was not a family member, left the party in a huff!

On 20 January Ferdinand and Carlos returned from skiing to find their business in uproar. 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 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 Euro 7 million.
- Matters came to a head when Pedro confronted his parents. Pedro did not believe that he could effectively share authority with Maria and resented his younger sister's and cousin's appointment to the board before 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 admitted latter "Our plan had no chance of succeeding. We had not bothered to do a jot of 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 kids or the employees about the future of the business; no-wonder they were all so hacked off. Since we retired on January 1st 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. Thank God 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 that bothered about the business. I cannot blame them really."

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	
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	
Know as much about 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 that 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 contact and experience of the retiring generation and the need for it to let go and 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 going to be able to raise the cash to get one underway ?	

The Retiring Generation

Knowing about the concerns of those family members who will leave the business is central to success. Their needs must be addressed. A time will come when the founder of the business will no longer be capable of leading it. Any reluctance to surrender the reins must be minimized. 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 agree that retiring chiefs will reduce their working week well before retirement and then 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. Consider leaders' spouses, particularly if they will inherit a controlling interest. A succession plan will count for nothing if a wife or husband 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 high gearing. 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 (in countries where they are allowed) -- the funds of younger members of the family buy the older generation's shares. Unapproved benefit schemes provide a variant, lacking the revenue tax concessions, but being very flexible.

- Employee share trusts (in countries in which such 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.

- Interest in possession trust in countries in which such legal form is available – to transmit the capital to the heirs.

The Route To A Sale

The process of setting family criteria or 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 ways to sell: the trade, brokers, venture capitalists or business angel networks.

The market in small firms is highly active. On average each existing business has acquired one other firm in the last five years. Figures given in *Acquisitions Monthly* show that, in England, whereas in 1990 793 larger private companies were sold, in 1995 year the total was 1039. Average deal size had increased from £8.6 million to £17.4 million. Research findings related to the smaller end of the market suggest a similar increase in activity in smaller and one-to-five-man micro businesses.

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 Market Place

The primary concern for the vending entrepreneur must be getting a fair value to re-invest or to secure retirement. Finding a suitor in the open market place is usually easy but luring a range of competing suitors is much more 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 may produce equally poor results.

Finding a buyer depends on good networks, 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!

The process of finding an intermediary can be pot luck when the vendor departs from the league of top-flight advisers. Most of the larger accountancy firms maintain a keen intelligence database to allow them to match a vendor with potential buyers. Company brokers, often venture capitalists, range from the very good to the appalling, but the individual vendor will find it difficult to distinguish between them. On occasions, it may not be in a broker’s best interest to go the extra mile to obtain the best price. He or she may want a quick deal to allow them to take their cut and move on to the next deal. In those circumstances, the proprietor's secondary

objectives, perhaps the interests of staff or tax planning, may be pushed down the list of priorities.

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.

Business Angels And Informal Investment

Some of the business angel networks may be a good starting point for anyone who wants a wider field of potential buyers and sellers for businesses at the smaller end of the market. "The concept of Business Angels, which is relatively widespread in the USA and some EU countries, such as the United Kingdom and in Scandinavia, consists of retired businessmen who are prepared to invest the proceeds of the sale of their own business into one or several other small and medium-sized businesses. The reinvestment of such proceeds has been made attractive for tax purposes and could well facilitate a number of business transfers. The added value of this scheme consists in the fact that the retired businessmen also offer advice to the companies in which they invest, thus assisting them in avoiding problems encountered in the transfer from one generation to the next"[10].

Business angels are private individuals of high net worth. While most look to make investments in a business, some may be open to buying. Similarly, the networks of angels run by Business Links and other organisations also include contacts who may turn out to be potential buyers. The British Venture Capital Association in the UK publishes a directory of members and of Business Angel Services. Both of these include some firms involved in the direct buying and selling of businesses, although this is generally not the primary concern of BCVA members.

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 small firms market and deal sizes tend to be in millions rather than hundreds of thousands of euros.

Venture capitalists believe that they are "entering a golden age for management buy-ins into family companies. The owners are in their late 60s and in need of a new generation of management" (Alan MacKay of 3i, quoted in the Financial Times, May 1997). Researchers see

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[10] Source: European Commission – Communication of 28.03.1998 on the transfer of SMEs. See also Commission Communication on the financial problems experienced by small and medium-sized companies, COM (93) 528 of 10.11.1993, paragraph 29; Commission Communication on the improvement of the fiscal environment of small and medium-sized enterprises, O.J. n° C 187 of 9.7.1994, page 5, paragraph 6.

an increasing number of family firms unwilling or unable to hand their business over to the next generation, a particular problem in Germany for instance. Sale to a buy-in team might be seen as a sign of family failure. A more reasonable view is that for a while the business will remain independent.

Usually in a buy-in, 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 -- from big players such as 3i down to small local players -- 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 team 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 buy-in will rely 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. Many buy-in teams are 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 may be a possibility if members of staff are interested. Ownership may be passed to all employees or to a consortium of managers. There will need to be 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 also 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 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 number two spot on the succession diagram ? Alternatively, do circumstances, be they the wishes of family members or the situation of the business, dictate another route ? It may be necessary to move to identify potential purchasers, including competitors or customers, existing management through a management buy-out, 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 next generation's working experience may be as actor, lawyer or chef. Family members may have with no idea how to run the business but may be unwilling to contemplate selling it. In such a situation it will be necessary to find a chief executive from the wider world to run the business.

If the likely heirs to the business are willing but will not be ready to take the reins for some years, then, as well as considering external management, key man insurance may be necessary. If the founder of the business is no longer able to manage it, through death or illness for instance, an insurance cheque will not replace him or her but will pay for the recruitment of a substitute to take the business through until other family members can take up the challenge.

Decisions should lead to an action plan for implementation. This 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 will need to give firm encouragement. Now 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 plan that results from this process then needs to be regularly reviewed with the family and the other key stakeholders.

Effective Communication: The Key To Success

Making the succession plan work is hard work. Progress needs to be constantly reviewed and family members cajoled and coaxed into fulfilling the roles allocated to them. There must be effective and easy to use methods for communication between family members and advisers to monitor and adapt the plan as necessary. Family disputes are common features of generational change. Some researchers think that a little conflict may be a necessary oil on the wheels. There certainly need to be mechanisms to manage the occasional family eruption.

Most firms assume that the very fact of being a family business provides channels of free and open communication to allow disruptive issues to emerge and be diffused. However, effective mechanisms for communication inside the family firm seldom exist, despite being the first best protection against conflict. Small firms are often thought of as autocracies. However, academics Monder Ram and Sue Holliday suggest that family firms tend to be based on "negotiated paternalism" in which all the family members have some sort of stake in decision

making, even if only a passive one (Keep it in the Family: Small firms and family culture, Small Firms Research and Policy Conference 1992). This style tends to create hidden agendas, covering a series of potentially sensitive family issues that might generate conflict.

The roots of strife often lie at least as much in psychology and emotional baggage as in real issues of strategy or management. Family relationships are fixed before business ones. The origins of a dispute may thus be totally irrational, nothing more than "mum loved you more", but are nonetheless critical to the feuding parties. Roger and Donald Saunders ran parts of a family hotel chain against each other and entered a bidding war over the Boston Lennox Hotel. Both were willing to pay a huge premium to deny the other. Commentators suggest that the death of the former's wife removed a restraining influence and set brother at brother.

Conflict prevention - the family council

So how can the potential for conflict best be minimized or actual conflicts resolved ? Of course, the family have 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 for Christmas or birthdays.

- As the place to generate a shared vision and guide and discuss its development.

If this is to be effective, all family members must know that this is the place where they are on neutral territory and can be and are expected to speak their mind. The family should be defined in the broadest sense, as those who work in or just have shares in the business, as well as those who manage it. The business's 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 owned by a married couple, might find taking a formal approach to establishing a council wrong 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 has the objective of building agreement, not imposing edicts. All family members need to 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. A forum should never allow for attacks on family members or the laying of 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 forum must discuss change, after all the firm is where many family members will spend the rest of their lives. Individual objectives also change 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 aired. 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 hurt pride after finding out on the grape vine.

Setting up a Council

If the business does not have a family council, there are 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.

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, perhaps not the business's leader	
Do not be too informal – there is serious business to consider	
Use subgroups - mixing the membership of the Council together to 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. This is a written statement of values and objectives with regard to the business, containing:

- The objectives of the business
- The family business or business, which happens to be a family, philosophy
- Remuneration and equity ownership polices
- 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.

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 have begun to emerge and the best means to resolution. There are 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 business is the client. The accountant or other adviser's allegiance cannot be to any one individual or group	
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	
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 to them	

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 structures in place that channel the dispute, perhaps through a forum. Equally, the outsider, or a group of professionals representing various interests, may be given the task of finding the answer without access to any family governance structures.

Working Out A Solution

There is no one right way, but the following process certainly makes sense as a starting point.

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.

⇓

- **Brainstorming**

All of this data and interpretation needs to be brainstormed 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 MD'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 what ? 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, only 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 procedure 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 begged to be allowed to leave the firm to teach. 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.

Succession planning process chart

Recognise the time-scale for change -- take independent advice

What is the family's attitude to the business ?

- How far is strategy influenced by family issues and values ?
- Must the firm stay in the family; is selling the business an option if it yields the best return ?
- How will new family members be admitted or promoted ?
- How does the firm view outsiders and will they be able to compete for promotion on an equal basis ?

Before the plan is written, review the business to take into account everything about the firm which might shape its development

- Formal knowledge about structures and contacts and the workings of the firm
- Informal information: what everyone has in their head but never bothered to write down;
- Workings of family relationships
- The employees: their skills, abilities, roles and attitudes
- The retiring generation; what they want, how they can get in the way, what they can still give

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 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 create a final 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 of family and employees standing four squares behind a succession plan. The moment the king abdicates every rule of the family relationship may disappear in a struggle for control, wealth and family attention.

The advising accountant or the wise business owner needs to be able to put a succession plan in place to avoid conflict, with structures for resolution and damage limitation where discord occurs. The succession process is one of the events most likely to require in-depth outside help. For both the adviser and the business's owners, the most important lesson to learn is that succession is a process, not an event. The business is looking for transition to a future, not for the flicking of a switch. 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, others may be needed to contribute. No one individual can have a complete understanding of such a complex animal as a family business. The process can and should take many years. The action of passing the baton from one leader to another is the least part of the succession process. 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 if the evaluation of the succession options points to a sale of the business. Rather a realisation that the business has outgrown the family and it is to be hoped that the firm can be preserved under new ownership.

Good communications are essential, even then ensuring successful succession is difficult to get entirely right. Breaking through family chemistry to find ways of looking at emotions and personal ambitions with detachment is contrary to the usual mixture of family and commerce. However, experience suggests that the firms that can communicate and plan 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.

ANNEX 1

SELECTIVE EXAMPLES: TABLE SUMMARIZING THE TAX BURDEN ON THE SALE OF SMES (PERCENTAGE OF THE CAPITAL GAIN)

(Extract from the 1999 edition of the FEE Survey on the Fiscal Treatment of the Transfer of SMEs)

I. Facts:

* *A (60 years old) sells in 1999*
  a) his enterprise
  b) his interest in a partnership
  c) shares in a limited liability company/corporation
  to B.

* *Price of disposal : 5 Mill. euro*
* *Book value of the business/interest/shares : 2 Mill. euro*
* *Acquisition cost of the business/interest/shares : 3,5 Mill. euro*

II. Tax burden *(percentage of the capital gain)*

Sale *Country*	*a) of a business*	*Y[1]*	*Z[1]*	*b) of interest in a partnership*	*Y[1]*	*Z[1]*	*c) of shares in a limited liability company/ corporation*	*Y[1]*	*Z[1]*	*Update 1999*
Austria	*24,9%*	*X*		*24,9%*	*X*		*24,9%*		*X*	*Yes*
Belgium	*18%*/ 36%***	*X*		*18%/36%*		*X*	*18%*		*X*	*No*
Denmark	*53,8%*/59,8%***	*X*		*53,8%*/59,8%***	*X*		*29,3%/39,3%****		*X*	*Yes*
Finland	*28-59%**	*X*		*28%*		*X*	*28%*		*X*	*Yes*
France	*56,5%/ 38,6% **	*X*		*56,26%/20,9% ***	*X*		*20,9% ****		*X*	*Yes*
Germany	*51%**	*X*		*51%**	*X*		*51%**		*X*	*Yes*
Greece	*20%*	*X*		*20%*	*X*		*-*		*X*	*No*
Ireland	*40%*		*X*	*40%*		*X*	*27%, 40%*		*X*	*No*
Italy	*45,5%/18,5% **	*X*		*27%/12,5% ***		*X*	*27%/12,5% ***		*X*	*Yes*
Luxembourg	*23,419%*	*X*		*23,419%*	*X*		*22,796%*		*X*	*Yes*
Netherlands	*44,68% **	*X*		*44,68% **	*X*		*25%*		*X*	*Yes*
Portugal	*40%*		*X*	*10%*		*X*	*10%*		*X*	*Yes*
Spain	*20%*	*X*		*20%*	*X*		*20%*			*Yes*
Sweden	*56%*	*X*		*30% **		*X*	*30-56% ***		*X*	*Yes*
UK	*0**		*X*	*0**		*X*	*0**		*X*	*Yes*

Notes: [1] *Capital gains arising from the sale of a business/partnership interest/shares are calculated as the difference between:*
Y: *price of disposal and book value of the business/partnership interest/shares*
Z: *price of disposal and acquisition cost of the business/partnership interest/shares*

NOTES CONCERNING THE TABLE (BY COUNTRY)

Belgium

* *In the case that the seller completely stops his activities and that the goodwill does not exceed the average taxable profit of the years 1992/1995.*

** *In the case that the seller does not stop completely his activities or the goodwill exceeds the average taxable profit of the years 1992/1995.*

Denmark

* *Equipment*

** *Inventory and goodwill*

*** *Unquoted shares. The rate depends on the years of ownership. If the shares have been owned for 25 years prior to 1998 the rate is 29,3%. With ownership for fewer years the rate increases up to 39,3%.*

Special rules apply for family succession, without immediate tax.

Finland

**Sale of a business*

The income generated from the sale is taxed in the hands of the entrepreneur divided into earned income (progressive rate max 59 %) and capital income (flat rate 28 %). The amount of capital is based on the net assets of the enterprise and 18 % of the net assets is seen as capital income.

Sale of shares in a limited liability

Plus stamp duty of 1,6%.

France

* *Plus registration duties up to 11.4 %*

In the case of sale of a business the fiscal treatment differs depending of the length of time during which the assets have been owned (less or more than two years). If less than two years capital gains are subject to income tax rate schedule (56,9% in the example).

** *Plus registration duties up to 4.80 %.*

The fiscal treatment differs depending of professional practice or not:
- professional practice: if the interest has been owned for less than two years: income tax schedule up to 54% + CSG (2,4%) + RDS (0,5%); if not: 20,9%;
- no professional practice: 20,9%.

*** *Plus registration duties up to:*

4.80 % (limited liability company);
1% with a maximum amount of 20 000 F (corporation).

Germany

* *In certain circumstances it could be less.*

The fiscal charge on capital gains is five times the difference between the tax on the income without capital gain and the tax on the income plus one fifth on the capital gain.

Italy

* *Sale of a business*

The different fiscal treatment is related to the option offered to the tax payer to elect - instead that for the ordinary taxation (45,5%) - for the tax rate applicable to his average net income in the last two fiscal years preceding the disposal.

** *Sale of interest in a partnership*

If the participation is a qualified one (more then 25% of share capital or more than 20% of vote right) he tax rate is 27%, otherwise the tax rate is 12,5%.

In a quoted listed company the participation is qualified when exceeds 5% of share capital or 2% of right vote.

*** *Sale of shares in a limited liability company/corporation*

If the participation is a qualified one (more then 25% of share capital or more than 20% of vote right) he tax rate is 27%, otherwise the tax rate is 12,5%.

In a quoted listed company the participation is qualified when exceeds 5% of share capital or 2% of right vote.

Netherlands

* *The taxation can be deferred as a result of legal methods to avoid such high rates.*

Sweden

* *Certain anti-abuse rules apply preventing high-taxed business income (56%) from being transformed into low-taxed capital income (30%).*

** *A gain from the transfer of such shares may partly be considered as income from business.*

United Kingdom

**The UK exempts from capital gains tax virtually all business disposals on retirement and exempts from inheritance tax (100% business property relief and 100 % agricultural property relief).*

However, the retirement relief is being phased out and replaced by a relief which will depend upon the length of ownership of the relevant asset.

ANNEX 2

SELECTIVE EXAMPLES: TABLE SUMMARIZING THE TAX BURDEN ON THE TRANSFER OF SMES WITHOUT CONSIDERATION

(Extract from the 1999 edition of the FEE Survey on the Fiscal Treatment of the Transfer of SMEs)

I. Facts

- *The ownership of an enterprise/interest in a partnership/shares in a limited liability company (corporation) in transferred:*

  a) by donation
  b) mortis causa

  from A (60 years old) to his son C in 1999.

- *Tax base (allowances not yet considered): 5 Mill.euro*

***II. Gift/Inheritance tax burden** (percentage of the tax base)*

Transfer country	*a) by donation*	*b) mortis causa*	*Update 1999*
Austria	*15%*	*5%*	*Yes*
Belgium	*28.65%*	*28.64%*	*No*
Denmark	*15%*	*15%*	*Yes*
Finland	*16%*	*16%*	*Yes*
France	*23,37%*	*35,96%*	*Yes*
Germany	*10,03%*	*10,03%*	*Yes*
Greece	*1,35%*	*1,35%*	*No*
Ireland	*6%*	*8%*	*No*
Italy	*23,5%*	*23,5%*	*Yes*
Luxembourg	*0*	*0*	*Yes*
*The Netherlands**	*25,95%*	*25,95%*	*Yes*
Spain	*32,59%*	*0,8%*	*Yes*
Sweden	*30%*	*30%*	*Yes*
*The United Kingdom***	*0*	*0*	*Yes*

* Excl. 3750 euro tax free

** These rates apply only where the assets in question are classified as business assets.

Further reading

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