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SUCCESSION: THE KEY TO COMPANY SURVIVAL

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I. INTRODUCTION[1]

For many years there has been serious concern about the state of family businesses. Such concern is expressed in both the purely scientific-economic sphere and also in relation not only to the actual situations of families themselves and their businesses but also to the wider environment of the economy itself.

In general terms, and viewed from the standpoint of business institutions, the key points of concern are the same as those that preoccupy all those other institutions intent upon long-term survival - that is to say:

- Firstly, survival - or, to reverse the terms, a reduction in the death toll of businesses. The latter is enormous and

[1] Lecture given at the International Symposium *"Anthropology and Inheritance"* held in the Faculty of Humanities, University of La Coruña, Spain on 4 and 5 November 1998.

particularly so in family firms. The disappearance of such a business creates a real human drama in its effect on the individuals themselves, but it also brings with it the wastage of all those resources and all that potential that could be used to help resolve the many problems within our society.

- The problems of "*succession*" and "*inheritance*" are one of the main causes of business failure. This is not limited only to family firms, in which succession is determined by the wishes of certain family members. Succession affects all businesses. The survival of any company depends upon the capability of individuals to manage it and there are two key elements in such management:

  - The capacity of its managers to adapt the business to rapidly changing circumstances;

  - The problem of ensuring management "*succession*" - that is, having available those individuals who can take on the role of directing and managing the business.

- "*Succession*" is, therefore, of key importance both in large companies and in family firms. There are, however, significant differences between the problems it causes in the former and in the latter.

- Yet another basic question is that of the growth and development of a business. Any institution which neither grows nor develops will have serious difficulties in adapting itself to changing circumstances and, above all, in ensuring that "*succession*" takes place in an effective way. The company which does not grow, dies - such is the consequence of an inability to adapt to change. The search for those factors which will encourage growth is, without any doubt, the key to the success of an institution.

These are the underlying conditions that guarantee the survival of businesses. A key point is that the continuity of institutions depends upon their ability to guarantee "*succession*" in an on-going and permanent way - or, to use another term, to ensure the "*inheritance*", the passing on, of both acquired knowledge and the availability and utilisation of capability and potential. It is not solely the "*inheritance of property and wealth*", of fixed and financial assets - however important these may be: It is also the "*inheritance of knowledge and understanding*" - factors which determine the way in which a business is planned and managed.

II. BUSINESS REALITIES: THE PROBLEMS OF "SUCCESSION" (Inheritance)

In a highly industrially developed country like Germany it is estimated that there exist at the present time 365,000 companies with no "*succession*". That is to say, there is no clear "*succession*" within the echelons of management and for this reason the "*inheritance*" may well be lost. And in a country like Germany such "*inheritance*" affects more than 4.5 million jobs. Furthermore, such companies are of key importance in terms of the economic competitiveness of the country. To a large extent this is today a generational problem of the highest importance.

SMALL & MEDIUM BUSINESS IN GERMANY:
THE DYNAMICS OF CHANGE

☑ Family businesses	1,5 mill. companies
☑ Companies affected by generational changes	68.000 companies
☑ Until the year 2000 will affect	400.000 companies
☑ Situations of difficult "inheritance"	80.000 companies
☑ Affects	4.000.000 jobs

Figure 1: The dynamics of change in family businesses

The dynamic of adaptation within companies is, without doubt, one of the fundamental factors in ensuring business growth. And it is of even greater importance when it manifests itself more acutely during the processes of generational change.

If the significance of these businesses within the economy as a whole is taken into consideration, then it can be noted from Figure 2 that family businesses account for 85% of the GDP - that is, of wealth creation in the country - while non-family businesses contribute only 15%.

BUSINESSES AND THE ECONOMY

Family businesses	85% of GDP
Non-family businesses	15% of GDP

Figure 2: Family businesses and the economy

Similar figures apply to employment creation, a factor of great economic, social and political significance. Family businesses create 80% of the jobs, while non-family businesses create only 20%.

BUSINESSES AND EMPLOYMENT CREATION	
Family businesses	80%
Non-family businesses	20%

Figure 3: Employment creation in family businesses

The business structure in Spain presents even greater contrasts. In the Spanish economy 90% of business activity is in the hands of family firms and only 10% rests with non-family companies. The significance of this, shown in Figure 4, is very clear.

SPANISH BUSINESS STRUCTURE	
Family businesses	90%
Non-family businesses	10%

Figure 4: Spanish business structure

Looking more closely at Spain, one particular characteristic of this social, economic and human reality is that 65% of family businesses do not survive beyond the first generation. In other words, there exist very serious problems of "*succession*" or "*inheritance*", for in only 35% of the cases does the company remain in family hands.

Even worse, only 12% of family businesses survive until the third generation. The problem is, in consequence, centred on a failure to resolve questions of "*inheritance*" and "*succession*".

FAMILY BUSINESSES AND SUCCESSION

1st generation: liquidated/sold off	65%
2nd generation: remain within the family	35%
3rd generation: survive	12%

Figure 5: Family businesses and succession

Consequently, it can be reasonably claimed that 80% of all family businesses have a lifespan of less than five years and that only 20% survive longer than this. From an economic point of view and in terms of ensuring the efficiency of economic, business and social processes, this is totally inadequate.

DEATH TOLL OF FAMILY BUSINESSES	
Life less than 5 years	80%
Life greater than 5 years	20%

Figure 6: Death toll of family businesses

During recent years a predominant concern has been the search for a kind of "*contractual-moral*" solution, now defined as "*family protocols*". These are contractual agreements between family members which are intended to anticipate - and prevent - possible conflicts.

Figure 7 illustrates more precisely this attempt to resolve as effectively as possible any conflicts that arise between business activities and family interests by establishing a style of "*management*" that balances the requirements of the enterprise against the expectations of the owners.

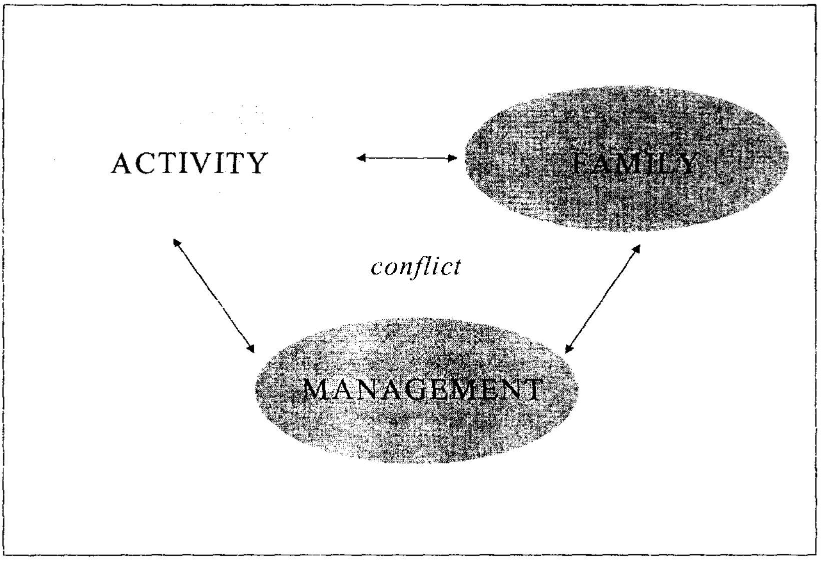

Figure 7: Conflict between business activities and family interests

It can therefore be said that the problems of "*succession*" and "*inheritance*" are centred on the relationship between the family and its business activity. However, the real root of the problem when it comes to actually resolving this conflict lies in how to organise and develop the management of these types of companies.

This key problem of "*property/ownership succession*" and management cannot be effectively addressed unless the following specific situations facing all business economies are taken into account:

- Firstly, all economic and social processes are in a state of permanent change. For this reason, the kind of management needed is one capable of adapting its activities to new situations in a way that is both rapid and flexible.

- "*Management succession*" occurs more frequently than "*ownership succession*".

- A constant process of adaptation with costs kept to a minimum is required - an achievement dependent upon the skills of the management.

- It also always involves the implementation of a cultural change, addressing precisely those different value systems which lead either to conflict or to its resolution.

III. THE PRINCIPAL CHARACTERISTICS DETERMINING THE ECONOMIC-SOCIAL FRAMEWORK IN PROCESSES OF SUCCESSION

This situation produces two kinds of problems:

- Firstly, the problem of implementing *technical and economic changes* in those activities falling within the power of the family.

- Secondly, the problem of an adaptation within management that leads to the creation of values responsive to demands made by the processes of change.

At the present time radical changes are taking place within the context of an increasing globalisation of the economy and the need for business entities to work together in networks. Basically, the requirement is for increasing decentralisation, and such a process brings with it a new approach to the management of business activities. This means a strongly decentralised management; whereas the traditional nature of family businesses, in their early generations, has always emphasised centralised control. Membership of a network and the capacity to decentralise, together with the dynamic derived from such a network, demand divisions of labour in a state of permanent change. Consequently, and ever increasingly, the burdens and responsibilities of family companies are being shifted from "*ownership*" to "*management*".

The approach of "*protocols*" - that is to say, the "*contractual-moral*" solution - may be centred on how specific formal aspects are regulated; both those that correspond to ownership/property rights and those relating to the way in which the power of the family has an effect on management. All kinds of protocols exist, but one aspect none of them can avoid is the reality of the new kind of economic activity within the context of a permanent change in business procedures.

The dominant values resulting from globalisation of the economy are:

- A permanent intensification of *competitiveness*. With this comes permanent change in the division of labour and the integration of the individual family business within a network of relationships requiring a dynamic approach towards opportunities and risk-taking. Family businesses, if they have such a kind of management at their disposal, offer flexibility and a rapid capacity to adapt. However, if such management, supported by the family, does not exist, then a business will soon find itself in serious difficulty.

- The second key value of globalisation is *co-operation*, with the strategic aim of achieving economies of scale, economic efficiency, differentiated economies and strategic capabilities.

- *Self-responsibility*, which implies decentralisation, is without doubt one of the vital elements in the "*family-management*" relationship, differentiating as it does the "*ownership*" role of the family from the management structure.

- "*Security*" is, of course, a key element in all economic and social processes; but it is of even greater importance in the procedures of family businesses and their patterns of "*succession*". Any company which operates with a dynamic of change requires a *culture of stability*. Family protocols are intended to create such a *culture of stability*, so guaranteeing continuity of ownership and power within a dynamic of change but, at the same time, imposing a culture of competence from the point of view of the operational dynamic.

It can be said that this new paradigm of economic and social activity, upon which the whole question of "*succession*" and "*inheritance*" must be centred, depends predominantly upon the availability of effective management. This means a capacity to manage people throughout the processes of change and, as such, involves cultural changes in both real and intangible assets.

Management capability is an intangible asset closely linked also to "*inheritance*" - but inheritance in the wider sense of the term rather than its more restricted association with "*ownership and property*".

"*Ownership and property*", and therefore "*inheritance of real assets*", are becoming ever less significant as "*management capability*" becomes increasingly important. It will be difficult, therefore, for family protocols to succeed in establishing in any predictable way criteria sufficient to resolve all possible situations.

"*Succession*" in a company is fundamentally intangible and is shared by both ownership and management. "*Inheritance*", on the other hand, is without doubt more property related. However, it is "*succession*" which has at its core a set of inherited values: the accumulated experience of the company, which is its "*legacy*".

IV. TRANSFORMATION PROCESSES IN FAMILY BUSINESSES

The characteristics defining a family business in terms of its continuity are those which guarantee the "*intangible aspect of inheritance*": that is, the management. It is notable, as can be seen in Figure 8, that successful businesses are those

CHARACTERISTICS OF CONTINUITY IN FAMILY BUSINESSES

- ☑ It is an ongoing process
- ☑ Successful businesses are those which transfer the management responsibilities to managers from outside the family
- ☑ Management succession is thus made independent of family succession (inheritance)
- ☑ The periods in the change of management in the business are reduced
- ☑ More frequent changes in management ensure continuity
- ☑ In order to ensure continuity in the business:
    - facilitate transfers of ownership and management
    - use resources from both within and outside the company

Figure 8: Characteristics of continuity in family businesses

which have transferred the management responsibilities to staff recruited from outside the family: "*outside managers*". This clearly brings with it certain difficulties and co-ordination problems. It is basically a question of making "*management succession*" independent of "*family succession*" and so differentiating the inherited "*real assets*" from the "*intangible assets*", although both are of course closely linked.

Furthermore, the periods of time in the changes of management are reduced even more. Even within a single family generation possessing a clearly defined "*property and ownership inheritance*" various changes in management occur, so a fundamental problem is that lack of continuity is more frequent in management than in ownership.

To guarantee the continuity of a business, succession in terms of "*real assets inheritance*" (property and ownership) must be made compatible with "*intangible succession*" (management). Any discrepancy between these, whether due to economic or generational realities, is either complicated or simplified according to whether the two processes of change coincide or not.

MEASURES TO ENSURE CONTINUITY

☑ Professionalisation of the management of family businesses
  - *Only 10% have internal training programmes compared to 50% of large companies*
  - *Both in-house and outsourced training programmes*

☑ Ensure continuity in the business by regulating inheritance
  - *Only 1/5 of firms have such regulation*

☑ Ensure continuity in the business through marriage contracts
  - *Only 40% have such contracts*

☑ Assure continuity through outside recruitment of managerial staff

☑ Assure continuity by establishing advisory boards

Figure 9: Measures to ensure succession in family businesses

It is clear that there are various factors affecting this problem of "*succession*" and "*inheritance*":

- Firstly, there are direct factors. These are the measures that must be taken to ensure the continuity of the business - what is inherited both in terms of property and also other less tangible assets.

- Secondly, taxation. The enormous tax burdens imposed in all European countries contribute very significantly to producing a lack of continuity and in disrupting the process of succession. The failure of the taxation system to clearly differentiate between situations of individual tax liability and those affecting the business institution is a key problem that must be resolved as quickly as possible.

- There also exist a series of indirect factors. These, as a consequence of the continuity or discontinuity of inheritance, either encourage growth or make it difficult for the business to remain in the hands of the family.

- We shall concentrate here on the direct factors - those measures which correspond to the actual situation of the inheritance and to the continuity of the business enterprise.

Only 20% of businesses regulate the continuity of the firm by an "*inheritance regulation*" or by "*protocols*" of various types. In these a legal and contractual framework strengthens those procedures that guarantee the inheritance. In terms of "*marital unions*" only 40% of businesses have regulations affecting the continuity of the firm and procedures that ensure its continuity.

A fundamental factor which ensures the continuity of a business is, however, the "*professionalization of the* *management*" in family firms. It is here where the greatest difficulties occur, as demonstrated in Spain and in countries like Germany. There exist problems in the professionalization of managers, particularly at the top levels, of large family firms, and also problems of integration in the context of "*ownership and property inheritance*". To this can be added the fact that only 10% of small family firms have in-house training programmes as compared with 50% of large non-family businesses.

A fundamental step to guarantee continuity of "*inheritance*" is, without doubt, to ensure the availability of managerial staff by the setting up of boards, administrative or advisory, and by establishing foundations, etc.

It should be pointed out that success depends upon the extent to which managers identify themselves with the business in order to ensure its continuity and so maintain the "*ownership and property inheritance*" within the family. The latter is only one of the interest groups and must therefore recognise the existence of other groups which have a direct effect on the development of the business.

There is a very specific statement to illustrate this fact: when "*the family firm dies*" and is replaced by just "*the* *company*", so reflecting its breadth of activity, it is then that continuity is guaranteed.

In order to achieve continuity three steps should be considered:

- It is advisable to create a board, the members of which are those with an interest in ensuring the strategic continuity of the business. Such boards are not executive organs but do determine overall executive behaviour. They act, in a socio-economic manner, as a bridge between the "*ownership dimension*" of the family and the "*business dimension*". Such an interface between ownership and business offers a fundamental guarantee to the company. They frequently take the form of foundations.

- Secondly, care must be taken to ensure that management staff are not selected solely from within the family. On the contrary, it is necessary to look for those individuals who are most competent according to the management requirements of the company. One great disadvantage of the family business is that it does not have easy access to the "*managerial job market*", unlike large companies.

The situation above occurs constantly and is perhaps one of the most significant problems affecting "succession" in family businesses. As has been stated earlier, the act of "succession" occurs much more frequently in management than it does in ownership and the situation becomes more acute when succession of both ownership and management occurs at the same time.

A further measure to ensure continuity in the family firm is for the managers also to have shares in the capital of the company. In this way they see themselves to be more closely involved in the economic activity and for the management the family firm then constitutes a mixed market of labour and capital. This is the way forward adopted to a large extent by banks.

One great problem in ensuring continuity in family firms is difficulty or delay in identifying business crises in good time. For various reasons, particularly those related to the family, there is delay in recognising that a crisis exists or possible solutions are ignored. This results from an evaluation of the situation based on considerations other than the economic-social health of the business and for family reasons the situation has to be overcome without generating a crisis in the business activity and within the family. One of the most important aspects is, without doubt, the separation of the business crisis from that financial crisis which may occur within the family group.

Furthermore, as previously mentioned, the State is, without doubt, the principal "*partner*" in a family business at the time of influencing the pattern of inheritance and taking decisions. In certain countries inheritance tax is as high as 80%.

V. KEY POINTS OF INHERITANCE FOR THE SUCCESS OF FAMILY BUSINESSES

As already stated, family businesses and virtually all small and medium size companies are crucial to the success of an economy and they provide it with a way of achieving greater efficiency in employment creation. Experience shows that there are three elements necessary for such businesses to be successful:

- Firstly, *strong management* - that is, a firmly-rooted decision-taking capability which sets *ambitious objectives*. This requires strong personalities to lead the company and resist any weakening of it through family influence..

- The success of family businesses, as with all small and medium size companies, depends basically on their capacity to be constantly *innovative*. They engage in a continuous process of change, thanks to the flexibility given by their size and their proximity to capital and to the market.

- Such businesses must rely upon their own particular strengths. A family business is created for a very specific purpose; its funding is based on self-financing and on its own technological capabilities; it is, in consequence, much closer to the actual realities of technical-economic and financial processes.

- The staff of a family business must be very carefully selected and also well motivated. In reconciling the various interests groups within the firm, they must be made to feel strong identification with the concerns of the family. Such a company structure is very specifically one of *stakeholders*.

- Success depends upon proximity to the customer - precisely the strong point of a family business. Customer proximity requires a strongly front-line management, far removed from those *staff-centred* structures typical of large companies - it is, therefore, of fundamental importance.

- A global orientation is essential - which is to say that a family firm should not be just a "local" business; its competitive advantages must be “globalised”. The idea of globalisation puts strong pressure on family enterprises to operate world-wide, but to restrict their activities to those fields in which they have important competitive advantages.

The type of management in a family business naturally differs significantly from the management of a large company, with all the great advantages available to it. Succession in the former is only viable if there is an effective resolution of problems related to both ownership and property succession and also management succession.

Consequently, the success of a family business depends upon a strategy of adaptation, by both sides, to procedures laid down within the framework of governing guidelines - that is, the protocols. The choice of management should be decided with a view to bringing together both activity and protocol, family and management. It is in this middle ground where the success or failure of family succession - and, therefore, the disposal of the inheritance - is decided.

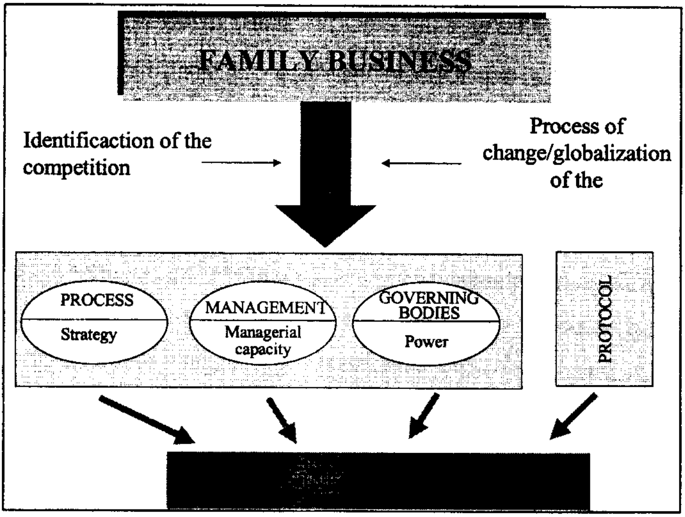

Figure 10. The corporate structure of a family business

Business policy should be centred on:

- Firstly, the leadership of its own products. Every family firm has its own particular character. Its "legacy" clearly consists of all those services and products initiated and developed by the founder, and with which the firm is associated. It is difficult to conceive of a particular family business evolving in such a way as to completely change its corporate identity.

- Secondly, while family businesses must operate globally at a world-wide level, they should still concentrate on those particular basic competencies they are able to offer.

- Thirdly, the identification of a family business (and any small and medium size company) with specific and specialised products, rather than any dilution of what it has to offer, is another basic characteristic of the general nature of all these types of enterprise.

- Pioneering work in both products and techniques constitutes a particular strength, for it is this which has made such companies successful leaders in many areas.

- Proximity to the customer and the personal treatment that can be given to customers by the "family" are both, without doubt, strong points in maintaining customer loyalty. They also ensure close contact with the requirements of the latter and with the market.

- Another key point is the development of the specific kind of business culture which motivates staff and integrates them in the project. In some cases this occurs during the time of the founder. Such a culture is clearly very important in binding staff to the company. However, it can, at the same time, cause professional difficulties in the assimilation of managerial staff and also in their integration into this type of culture. An integrating style of management, strongly orientated towards human resources, is fundamental in ensuring the success of these types of enterprises.

VI. CONCLUSIONS

The family business has an important role to play in modern economies, characterised as they are by sharp labour divisions. The success or failure of such economies and the social stability and development of a country depend upon the success or failure of family firms. Their contributions are strongly diversified with a wide spread of risks for the economy and they have a commanding presence at the forefront of development of many activities.

The influence of the family business in all western economies, particularly in Europe, is particularly important. However, the survival risks are also very high, as is evidenced by the continuing death toll for various reasons. There is no "market" for family firms.

As part of the processes of family businesses, the problem of "*inheritance*" affects two closely linked areas: "*ownership and property succession*" and "*management* *succession*" in the field of business activity. Such acts of succession do not usually occur both at the same time.

In the first stage of the creation of a family business, given that it has survived the first five years and so consolidated its existence, there is of necessity a loss or reduction of "ownership power" and a significant growth in "management". This loss of "ownership" power is increasingly reflected in regulation through "*family protocols*", which control the procedures affecting the interdependence between the ownership and the business activity. In reality this represents the appointment and development of management staff.

One significant problem is that States, in their fiscal policies, appear to be unable to adopt a clearer vision of the role of family enterprises. The State values above all the ownership aspect, as if this were the only factor determining the success of the business. The existing strong tax sanctions clearly have a very negative effect upon survival capability and the continuity of a business.

A family firm has very particular characteristics, both in the services it offers, relationships with customers and in all aspects of the way in which such a business is managed. For this reason, for those firms which offer outstanding service and have proved their capability to survive through their activities, it is essential to define how interface institutions that will ensure this survival can be established. Such institutions may be foundations or controlling bodies operating between the ownership and the business activity. On the one hand, the dynamic of management must be sufficient and, on the other, the family nature of the firm must be maintained; for it is the latter, at least during the pioneering days of the enterprise, which gives the firm its own particular character. The statement that with the passage of time the family firm "dies" and the "company" is born and grows, in terms of economic activity, is both important and realistic.

In its first stage the family business starts with the pioneer who generates that basic element, vital to its survival. It then grows and with growth comes the need for new types of management, and it is these which require regulation of the relationships between the "*ownership and property inheritance*" and the "*business legacy*". The latter should be understood as the capability to provide services and products; it involves millions of jobs and a efficient utilisation of resources. And at the same time its effect is felt on the dynamic of the economy and on the appropriate maintenance of an open society.