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SUCCESSION IN FAMILY BUSINESSES

FAMILY BUSINESS SUCCESSION STORIES

EXIT

7

INTRODUCTION TO THE THEME

There are several external exit options in addition to the prototypical intra-family succession. As one can see on the bottom right of Figure 1, these options include sale which can be to a new management, a financial investor or a strategic buyer. There can also be a transfer of control to the firms' employees, referred to as management buyout (MOB) in the figure. A partly exit is also an option by either selling part of the company to a co-owner or by listing the company on the stock exchange.

In the figure below, Thomas Zellweger divides between succession in ownership and succession of leadership. On both axes, the alternatives are family, combination and external. For the exit option, the external alternative is the outcome both of ownership and leadership succession. Within the exit option there can be a partial exit through partnership, merger or initial public offering (IPO), or a full exit with sale and liquidation. With a partial exit it is important to update shareholder agreements and other governing documents to reflect the new ownership situation and ensure that the family's intentions are secured in future ownerships. There are examples of partial exits that after some years ends up being a full exit for the family.

<table>
<tr><th></th><th colspan="4">Leadership</th></tr>
<tr><th rowspan="4">Ownership</th><th></th><th>Family</th><th>Combination</th><th>External</th></tr>
<tr><th>Family</th><td>Family succession</td><td>Mixed Management</td><td>External management</td></tr>
<tr><th>Combination</th><td>Partner, Private Equity, publicly listing, merge</td><td>Mixed management and ownership</td><td>Financial investment</td></tr>
<tr><th>External</th><td colspan="2">Ongoing family involvement after ownership succession</td><td>Exit (Sale, MOB, liquidation, sell listed shares,)</td></tr>
</table>

Source: Zellweger, 2017

Various circumstances can influence the decision to exit the family business. Some family business owners may question whether they are the best owners for the business. Others may have the perception that the company has grown too big for their ownership, and that change is necessary to further develop and grow the business The senior generation might think handing over the business to the next generation is too complicated and would rather sell the company and transfer the profits. In other instances, the next generation might not be willing or capable to take over the ownership of an operational company.

Challenges and opportunities with the succession option to exit ownership and leadership

Exit option	Opportunities	Challenges
Transfer to employees (MBO)	• Continuation of the firm with management that shares the values and vision with the incumbent owner • Stability for stakeholders (customers, employees, local community) • Management well informed, no information asymmetry on state of the company	• To finance the transfer, often only feasible through with seller financing as seller loan • Limited possibilities to maximize the sales price (loyalty discount to managers, financed from company's cash flow) • Role conflict; during the negotiation the managers are involved on both seller and buyer side, after the transfer risk of old owner will not let go
Sales to financial or strategic buyer	• Many potential buyers • Higher sales price due to opportunity to maximize price • Opportunities to invest in new venture with the capital from the sale	• Loss of entrepreneurial legacy • Confidentiality and privacy issues in sales process • Publicity and eventual threats to family reputation • May have negative for stakeholders (employees, customers, suppliers, local community)
Sale to co-owner	• Can enable simplification of ownership structure "pruning the family three" • Synergies with other assets owned, network, competence brought in by the co-owner • Continuation of family legacy	• Financing, does co-owner have the fund to pay • Valuation of the company • Find the right partner - lack of common values and time perspective can make it challenges to align future strategic direction
Initial public offering (IPO)	• Access to capital for growth • Exit opportunities for family "pruning the family three" • Tradability of shares also for remaining family shareholders	• Administrative cost of listing as well as additional reporting requirements • Public exposure of firm and family • Analyst pressure on short term performance • Loss of family culture • Family can lose controlling power if sufficient shareholder agreements are not in place • Dilution of family control of the family cannot participate in future capital expansions
Liquidation	• Orderly closing of firm, especially if not performing	• Loss of firm • Loss of identity and pride for the owner/s • Negative consequences for stakeholders (employees, customer, suppliers, local community)

Source: Zellweger, 2017

To exit the family business can be a very difficult decision. It is important that the family communicates well throughout the process, to ensure agreement and alignment among owners, potential future owners and the extended family. A complicating factor can be the question of who should be involved in the decision making process. Is an exit a decision for the senior generation, the succeeding generation or is it a joint decision? In some scenarios the senior generation had started to sell assets assuming that the next generation were not interested in taking over, while they actually were interested.

A family business succession is a complex process and it is important to be aware of the opportunities and challenges when considering the exit options.

List of stories:

7.1 Liquidation

CATEGORIZATION

Nationality:	**Norway**	Succession option:	**Exit**
Company size headcount:	**<10**	Company size turnover:	**<€2m**
Generation:	**1st to 2nd generation**	Industry:	**Construction**
Interviewed:	**2nd generation**	Anonymous:	**Yes**

SUCCESSION STORY

This case is based on an interview with the oldest son of the entrepreneur of a construction company that was founded in 1974. The entrepreneur had two sons; the younger son chose to follow in their father's footsteps, whereas the older son chose a career path outside of the family firm. The family agreed that the younger son did a good job, and that he should therefore carry on the company. In theory, this sounds like a good precondition for a successful succession of ownership to the next generation.

However, the family struggled with communication and the father failed to sufficiently carry out the succession of the company. The youngest son who had started working in the company in 1995, felt like he could never do good enough. Their father was from a generation where praise was under communicated, and he delivered criticism in a very unproductive manner. After twelve years in the company the youngest son was drained. As a bystander, the older son was able to share insightful reflections, whilst still maintaining somewhat of an objective perspective. He attempted to help their father through the process and encouraged him to give up some of the control, and let the youngest son take over the leadership. Even though the father agreed, he struggled to put his words into action.

This eventually resulted in the younger son resigning from their fathers' company in 2006, and founding his own company within the same industry. Due to the fact that he was so skilled and well liked, many customers chose to work with him rather than their father. From this point the sons' company thrived, whereas their father's company was in decline. After a few years their father realized that he had no other choice but to liquidate his company. This was both an emotional and economic defeat, and it affected the entire family dynamic. In the years following the liquidation the communication between the father and the youngest son was limited, and sadly their relationship was never mended. In our interview, the oldest son shares that pride seems to have been the source of the father's reluctance to give up control of the company.

He kindly shared with us a reflection he has done concerning pride:

“Pride, as we learn in Shakespeare’s Macbeth, is a tragic flaw. Pride may come in the form of greed, jealousy, revenge, lie, and more. It also may come in the form of willful ignorance, and biased opinions. People do very bad things because of many reasons, all of which are linked to pride.”

– 2^{nd} generation

Undoubtedly, both father and son would have been better off had they been able to come to an agreement, and had the father been willing to step aside and let his son take over the control.

REFLECTION QUESTIONS

- Do you let your pride come in the way of good communication?
- If you work together with family members, are you acknowledging their contribution to the firm?
- Often, we tend to only highlight negative things or areas of improvement and forget to give feedback on the positive performance. No one likes to be taken for granted – not even family members.

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7.2 Next generation sell the company

CATEGORIZATION

Nationality:	**Denmark**	Succession option:	**Exit**
Company size headcount:	**<250**	Company size turnover:	**<€10m**
Generation:	**1st to 2nd generation**	Industry:	**Manufacturing**
Interviewed:	**2nd generation**	Anonymous:	**Yes**

SUCCESSION STORY

The CEO of a Danish engineering company bought the company in 1990 after working there since 1965 (management buyout). His four children had summer jobs during school breaks at the company, creating an emotional relationship with the business despite not growing up as next generation owners. The new owner invited the four children to take an active role in the company. In 2003 the father transferred shares of the company to his four children, each receiving 15%. The transfer of shares was required to be included in each child's prenuptial agreement which created friction with the in-laws. The oldest son was identified as the potential successor after the father and took over as CEO in 2007 when the father became chairman of the board.

The oldest brother took over a robust company with a decent turnover. He identified growth opportunities in eastern and central Europe and took some risky business decisions to grow internationally. He also identified potential improvement within the supply chain, among others to replace various components. One of the sisters was at this point responsible for sales for one of the offices abroad and started to see issues in the quality of their products. With quality problems and conflicts among the siblings, the father made his son, the CEO, redundant in 2011. The rest of the family and management team realized that the company was in worse shape than the ousted son had reported and the company was close to bankruptcy. The business had been managed irresponsibly and the communication between the siblings was poor.

The poor relationships within the family created huge tension and when the bank took a pledge in their shares, the idea of selling the company became appealing. The family initiated a turn around to get the company in better shape for sale. Although challenging, they managed to turn the results from negative to positive, while being able to repay intercompany loans from the operational company to their real estate company.

"If we had managed to utilize our combined strengths among the four siblings, we would have been a strong ownership team. With conflicts in the family and high financial risk, the burden of ownership became too much for the family. The best solution for the future of the business was to find new owners."

– 2nd generation owner

In 2018, seven years after the eldest son was fired as CEO and a demanding turn around was initiated, the company was sold to one of their competitors. The new owners kept the name, the management team, and employers. The former owner felt they had found a suitable new home for their company and was content with the price.

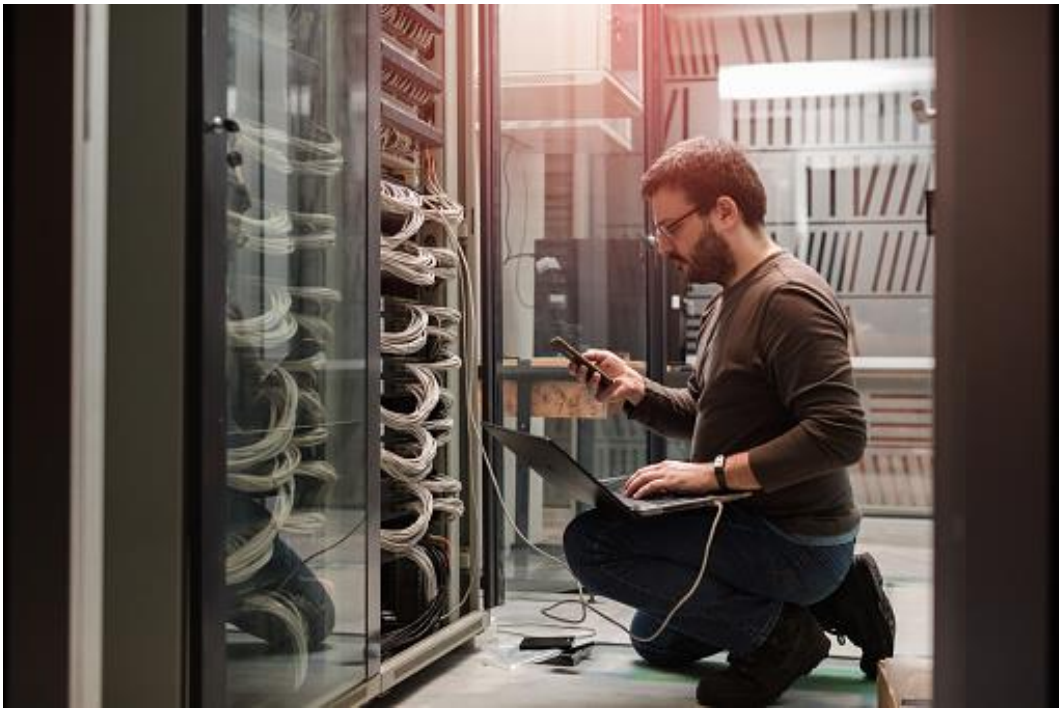
In retrospect, what would the family have done differently?
First, a family must have distinct role descriptions when working for and in a family business. The management consisted mainly of family members and without clear guidelines or role descriptions in their contracts of employment. This created issues further on with accountability and target responsibility. There was initially neither clear instructions to the chairman of the board.

Secondly, it is important to maintain a clear distinction between business and private life. Disagreements at work were often brought up during family dinners and it was difficult to have a professional work relationship without getting emotional.

Thirdly, to maintain a strong ownership, it is important to accept each other's differences, know each other's strengths and weaknesses and take advantage of every family member's good qualities to build a strong team. This could have enabled more effective use of resources and improved collaboration.

Also, the owner's values are often an important asset for a family business. In this case, the father's values and management style were discontinued by the son. It became evident that the father's value was fundamental to the business culture, and the other siblings were more aligned with the father's values that the eldest son.

Finally, to carry out a successful transition and succession of a family business, it is important to create a clear strategy to identify the necessary steps well in advance and be explicit in the way it should be implemented.



REFLECTION QUESTIONS

- Do you bring business discussions into the family dinners in your family? If yes, can you be the one to initiate family meetings?

7.3 Creating a family investment company for the Scott family after exit

CATEGORIZATION

Nationality:	**UK**	Succession option:	**Exit**
Company size headcount:	**<250**	Company size turnover:	**<€50m**
Generation:	**4th of 5th generation**	Industry:	**Financial and Insurance Activities**
Interviewed:	**4th generation Alex Scott**	Anonymous:	**No**

SUCCESSION STORY

Applerigg was formed as a holding company for the various family businesses of the Scott family. Built on the foundations of a financial services group founded in 1903, the group of organizations within the Applerigg umbrella include investment advisory services, fund administration services, wealth management as well as a social enterprise developing responsible leadership for the Next Generation of owners and entrepreneurs in family businesses.

The family has an interesting past, with Sir James Scott founding The Provincial Insurance Company back in 1903. The company expanded and in the 1920's they secured economist John Maynard Keynes to the Board. Continued global expansion followed with branches around the world and an employee count over 2000, whilst retaining the business within the family. Provincial Insurance Company was sold by the family in the mid-90s and other ventures under the Applerigg holding were created to both continue the family business in their areas of expertise, and to provide wealth management for the family in general. With Applerigg the Scott family have a joint family investment company to cater for a portfolio of companies where acquiring new companies and exiting existing is a part of the portfolio management.

> ***"Like people, businesses have finite lives. Family business ownership permits greater endurance as generational transfer injects a new lease of life or a change in direction. In some cases, the legacy of the family continues to make a positive impact that extends beyond the lifespan of the original firm."***
>
> – Alex Scott, 4th generation

When the 4th generation owner, Alex Scott founded Applerigg after selling the core business, the ownership of the company was split amongst 80 different shareholders, and as his father (the third generation leader of Provincial Insurance) had informed him earlier in life that he 'had no choice' but to join the family business, Alex decided at an early stage to create an environment within the family business where the next generation actually wants to join the business, and not be forced or coerced into it.

This would be the 5th Generation of family succession, and there were over 30 family members within this generation could possibly join. Alex spoke to the family members early on and was pretty clear in stating that someone needs to step up from the next generation and then left the subject of leadership succession for a few years to give members of the next generation the opportunity to come forward and indeed, 'step up'.

One next generation cousin did come forward and step up, and received the recommendation and backing of the board, as well as the backing of the family members. At this point, it is worthwhile noting that throughout the lifetime of the family business, all the way back to Provincial Insurance, the governance of the companies was such that there was a majority of non-family, non-executive directors on the Board, and it was a Board made up of such, that approved the next generation successor.

The successor themselves had an interesting past. With an existing profession and with two start-ups and successful exits behind them, they held all the attributes that both the Board and the family members were looking for. The successor was appointed in June 2020 ensuring the family business would survive into the 5th Generation which is highly unusual.

The previous generation Alex, is now making a clean break and indeed does not wish to be part of the Board as he firmly believes the next generation successor can provide their own new ideas to help expand and improve the business, without the scepter of their predecessor watching from the wings in a position of authority.

"Our goal is to nurture valuable and enduring businesses, drawing on our heritage and values whilst mindful of the responsibility to reinvent and innovate to be fit and relevant for the future."

– 4th and 5th generation owners Scott family

REFLECTION QUESTIONS

- What can you accomplish together if you decide to invest together as a family after an exit?

7.4 Partly exit in M&M Production – Smart Wrap

CATEGORIZATION

Nationality:	**Romania**	Succession option:	**Mixed management and ownership**
Company size headcount:	**<250**	Company size turnover:	**<€10m**
Generation:	**1st to 2nd generation**	Industry:	**Manufacturing**
Interviewed:	**1st generation Melinda Muresan**	Anonymous:	**No**

SUCCESSION STORY

Ms Muresan founded M&M Romania 36 years ago. Upon the company's founding, Ms Muresan gave 10% of the company's shares to her colleague, a business partner who she already had joint ventures with prior to establishing M&M. Her business partner remains a shareholder and worked in the company until 2012, when her husband took over from her and became CEO of the company.

With these agreements all being informal, the process to make them formal and legally binding was started recently, officializing the roles and ownership stakes inside the business.

The succession within the business has not yet taken place and there is not a set time frame for the business to be transferred, however it is currently being planned.

Ms Muresan is currently planning the process so that when she decides that it is time for her to move on from the business, there will be a formal process and structure in place in order to ensure the survival and the continuation of the company and its important values. Ms Muresan wants to ready these plans so that in the future, she can start to move away from the running of the company and start to find more time for herself so that she can gradually retire from the business.

Her daughter does not have an interest in going into the family business as she is largely creative and does not feel the correct fit for a production-based company and therefore there are not yet internal structures set up for her to take over the business. Ms Muresan is still open to leaving the door open for her daughter to be part of the business or in the future for grandchildren who may be interested to play a role.

smart wrap

smart as our clients

Currently, Ms Muresan is the only family member to work within the business, however she hopes that one day her daughter, or her future partner, will join the business. At the moment, her daughter is not interested in being a board member or involved with the business, however she is young so this may change over time. .

Following her recent succession planning, Ms Muresan and the CEO are planning to create a board of shareholders within the company which will then develop a good level of management over the next 2 years. The hope is that the board members and managers can take on more responsibility than they currently have.

Hopefully one of the managers will prove their potential and become the new CEO, however Ms Muresan is not afraid to bring in an external CEO again. Once this process has been finalized over the next 2 years, Ms Muresan and her business partner hope to be able to decide what to do next, however they are leaving all options open for this, including family succession.

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7.5 Partly exit Anchovy Inc

CATEGORIZATION

Nationality:	**Malta**	Succession option:	**Partly exit**
Company size headcount:	**<50**	Company size turnover:	**<€2m**
Generation:	**1st to 2nd generation**	Industry:	**Other services and activities**
Interviewed:	**1st generation Zachary Borg**	Anonymous:	**No**

SUCCESSION STORY

Anchovy Inc was founded by brothers Zak and Benji Borg in Malta back in 2013, after they spotted a gap in the market in Malta for a data-driven digital marketing agency, at a time where Malta lacked a real marketing firm.

Following rapid expansion, Anchovy decided to increase their reach from Malta to overseas, so in 2017 the company was listed on the Malta Stock Exchange. Soon after this, a bond was issued for €1 million. These funds have been used in a drive to take the agency international with the acquisition of external expert talent, investing in new start-up ventures and allowing the company to set up an affiliate arm of operations.

This process was a natural progression for the brothers due to the rapid expansion of the business, and the process went smoothly. The company developed six new assets including their flagship sites Alpha Sports Betting and Bite My Coin adding a consistent revenue stream, as well as further trust and value to the ANCHOVY brand. They also expanded their ventures line-up to include Fetch It, remaining true to the start-up mindset and innovating in sectors which are still in their infancy.

Their rapid growth came as a combination of hard work, business acumen and smart financial decisions that have allowed the company to expand in different ways. The business is still rapidly expanding with just under 50 employees and counting. There has been an expansion of the services offered by Anchovy, with the company now sharing their work and the work of others on the Island of Malta with a series of podcasts.

Anchovy now boasts offices across the world, in Malta, Amsterdam, Riyad and Dubai with 4 new partners across these different offices. The company is committed to transparent and responsible corporate governance, aiming to maximize the value of the company.

In order to assure compliance with these key values, the company has its own Board of Directors involved in the governance of the company. This board features the 2 founding brothers and 3 non-executive directors from outside of the family who regularly meet to ensure the smooth running of the business.

The board meetings are accompanied by shareholder meetings across the year and then internal meetings for the running of each of the branches with their relative management team and partner.

Following the listing of the company and partly exit of the founders in 2017, the Borg brothers still both work full time for the company from their office in Malta.

The process was extremely successful for the brother and the business as it has enabled them to expand their in-house expertise and services with the attraction of new talent from across the world. This new expertise has enabled the business to grow and develop into new areas and provide new knowledge and opportunities for the founders and their clients.

Benji & Zag Borg, brothers and founders of Anchovy Inc

REFLECTION QUESTIONS

- Can partly exit by listing the company enable you to reach your ambitions of the company?

LEARNING POINTS

Voluntarily ownership and leadership
Creation of an environment whereby the next generation actually WANTS to join the family business. This prevents the successor to feel like they have no other choice but to join the family business.

Early involvement of next generation
For larger families with many potential successors within the next generation, opening up the opportunity early to provide potential successors with time to consider whether they want to 'step up' can be beneficial. It is imperative that planning for any succession is carried out early – maybe even 5-10 years in advance. Enough time is required to identify potential successors and integrate them (if required) into the business prior to succession whilst addressing any skills shortages.

External help
The risk of liquidation in the story 7.1 could have been reduced if the family had employed an external advisor in the form of an auditor or a lawyer. It can be easier for an outsider to initiate uncomfortable conversations and keep the dialogue professional.

Make the succession process easy
In some cases, talking about succession to the next generation and actually carrying it out can seem like a huge task. It can be helpful to present pre written documents to transfer the shares, where all the senior generation has to do is to sign the documents.

Clear boundaries
It is important to distinguish between one's role in the business and one's role in the family. If possible, try not to let disagreement in the workplace damage family relationships. A way to combat this could be to create an environment where open communication is encouraged, where there is room for conversations about intentions and expectations.

Respect generational differences
Generational differences may cause disagreements in a family business setting. It is important to try to understand each other's needs and be emphatic. The senior generation may need a gradual transition of responsibilities, as it can be very difficult to give up control if one's identity is strongly tied with that of the company. The younger generation may need to be appreciated and acknowledged by gaining autonomous responsibilities.

Be prepared
One key learning point from the story 7.4 was that you can never be too prepared for the succession process. This is especially the case as you can never predict when the succession process will be necessary, therefore it is better to be prepared rather than caught out. For Ms Muresan, this is not just financially but also in terms of values in the business which have made it what it has been today.

Do not be afraid to take risks
For the company in story 7.5, the risk of expansion and taking a gamble in areas in their infancy was key to their success. The opportunities it can present are endless.

ACTIONS TO CONSIDER

Exercise to align expectations
Initiate a family meeting with the purpose of aligning expectations. The following is an example of how to do such an exercise. Distribute three simple questions prior to the meeting with a request all participants to reflect on these questions.

1. What are my expectations for myself when it comes to my role in the family business?
2. What expectation do I have to the other family members?
3. What expectations do I think they have of me?

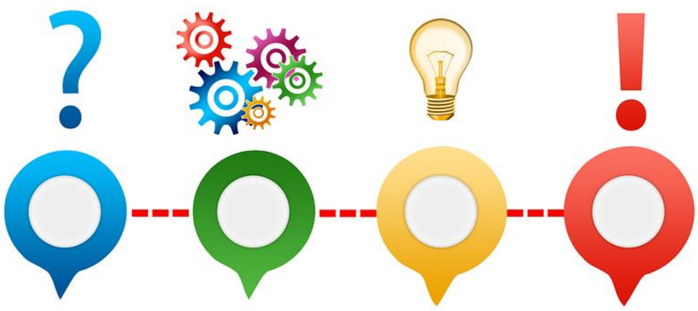
It is important to clarify expectations in order to avoid misunderstandings, avoid spending energy and frustration on delivering on expectations you think others have to you or respond to expectations you don't intend to deliver on.

External advisors
Appoint legal advisor or auditor to provide a structure for transferring the company.

Ms Muresan from story 7.4 added that bringing in an external advisor to guide her through the process was extremely useful and really made her think about what to do to make the transition run as easily and smoothly as possible. It gave an external perspective to the process and removed emotions and personal views from it.

Transitioning from the top
Leaders or owners looking for a succession to take place in the future, should consider their other interests to ensure that when they do withdraw from the company, they have something to do with all their extra time! To avoid the situation described in story 7.1, which lead to liquidation of the company. An action to consider is to develop a personal continuity plan in order to create a personal path forward where their can use their passion and capacity to benefit themselves, the family business and possibly the community through new endeavors, can ease the process of let go of the current role.

Speak to other families in similar situations
Ms Muresan from story 7.4 would recommend speaking to families in similar situations who have been through a succession process, so that they are able to learn from their expertise. Search your network, industry association or family business network for relevant stories to learn from.



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