Risk during business succession planning & generational risk profiles

Learning materials for family businesses

Module no. 8

SUFABU

SUCCESSION IN FAMILY BUSINESSES

Erasmus+

In this module you will learn

- What is risk?
- How this applies to a succession process
- How to identify and manage risk
- How to consider risk profiles between generations
- What could go wrong, what to do about it and how likely it is

Introduction

Risk is an issue that you will have to both understand and deal with during any family business succession process.

But what is a risk? The Association of Project Managers provides a definition:

"Risk - an uncertain event or condition that, if it occurs, has a positive or negative effect on one or more project objectives."

To summarise, a risk is something that *could* happen which, if it *does* happen, could have an effect on *something*.

As you go through a succession process, this could be the riskiest process your business has encountered recently.

You should be aware that the risks of the process are large and high, and could seriously damage the business if things go wrong.

Hence, we develop risk analyses and try and both identify potential risks, and develop plans in case the risks actually occur.

Considering Risk

Take a few minutes to think about potential risks that could occur during your own family business succession process?

What do you think could go wrong, and how would you fix things if they did go wrong?

Succession Risks

We would suggest there are two separate areas of risk that you need to consider whenever you are contemplating a family business succession process.

Firstly, there are risks within the process itself – things can go wrong and ensuring you are prepared for such risks, can greatly increase your chances of a positive, successful succession.

Secondly, you need to consider the risk profiles of both yourself as the current incumbent, and your successor. Each individual looks at risk differently, and any differences should also be considered in both the succession process, and the succession choice.

- *Creating a risk analysis document for the succession process, along with mitigation steps, can increase the chances of a successful succession taking place*

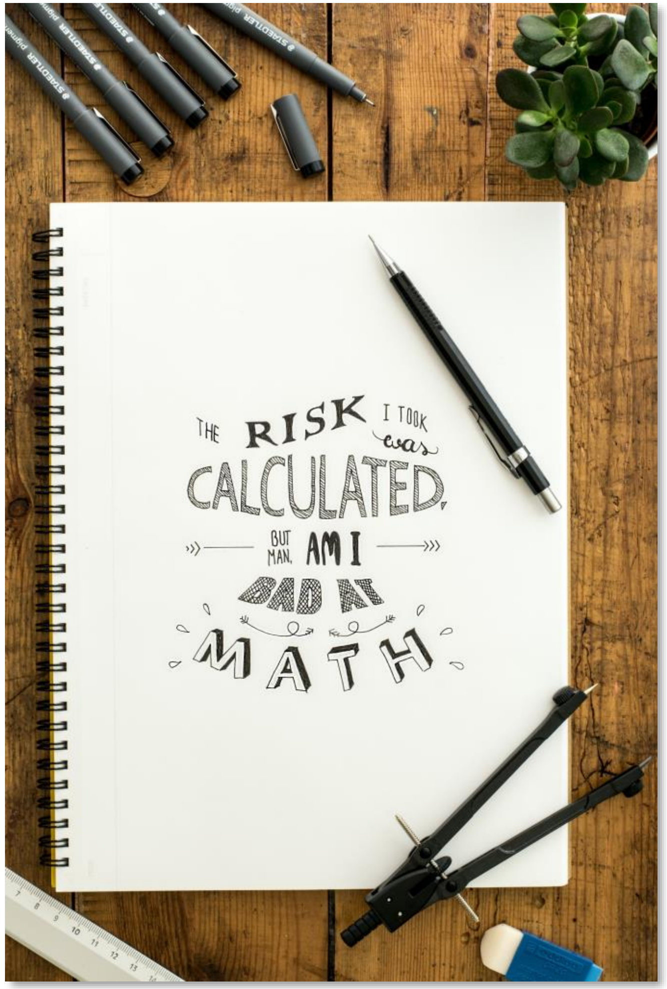
- *Considering the different individual risk profiles of both the incumbent and the future successor can highlight any potential issues post-succession.*

Risk Analysis

The key to controlling risks is to identify risk from the outset. Making use of the whole family as well as the business management team to help identify risks, will allow for mitigating action to be considered to nullify and/or reduce the risks being faced.

Develop a list of potential risks as well as how you can fix those risks or avoid them happening. Then for each risk, try and identify what the probability of that risk occurring is, along with the impact to the business and process should the risk occur. We would recommend you score these out of 5 where a probability of 4 is equal to 80% probability, and an impact of 4 is equal to an extremely large impact.

Use the probability and impact to identify how you should approach the risk using the table on the next page



“Risk analysis is a tool that enables organisations to identify, evaluate and prioritise risk with the aim of reducing the impact of risks on the overall project and organisational outputs.”

Risk Analysis

Impact

Probability

	1	2	3	4	5
1	1	2	3	4	5
2	2	4	6	8	10
3	3	6	9	12	15
4	4	8	12	16	20
5	5	10	15	20	25

<4	Add to risk analysis and risk list to keep track of and add mitigation. Not concerning.
5-8	Track and add mitigation.
9-14	Track and add strong mitigation. Assign resources towards mitigation in case it is triggered.
15-19	Track closely and add strong mitigation which is resourced. Ensure stakeholders are aware of possible risk.
20>	Major risk. Track closely and add strongest mitigation using as many resources as required. Consider other options to remove risk. Ensure stakeholders fully aware. Will require time, resources and budget to mitigate efficiently.

Risk Analysis

You should consider conducting a risk analysis with your stakeholders on a regular basis, and updating any documentation, as and when required.

Risk	Prob	Impact	Profile	Mitigation	Responsible
What is the risk?	/5	/5	P*I	How to address	Who
Existing customers may not want to deal with the successor due to them not being familiar with them	3	3	9	Prior to full succession, ensure successor is introduced to all major customers to make them familiar with them	AB
Family members and shareholders may attempt to veto my choice of successor	3	5	15	Ensure all stakeholders are involved in the identification process for the successor	CD
Existing long-serving staff may not accept a new owner/manager, especially one younger than them	3	4	12	Plan for successor to work across all areas of the business in the 18 months prior to succession	EF
Changes may require amendment of governance standards and documentation	2	3	6	Work with legal expert to amend documents if required and ensure Board are aware of potential	GH
Change in ownership may affect ‘goodwill’ of company and lead to reduced revenue	2	3	6	Ensure all key customers are introduced to successor prior to succession (1 year + beforehand) and build relationship	AB
Succession process and/or potential successor may fall foul of new legal requirements for Directors and owners	3	5	15	Carry out full due diligence with successor alongside company law expert to ensure compliance	AB
Current incumbent may decide to setup a business to act as competitor to family business	2	5	10	Ensure current incumbent signs a non-compete agreement as part of succession process	IJ

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Risk Process

> *You track risks in your usual day-to-day business processes; you should track risks of your business succession processes to increase the chance of your success.*

Risk Analysis - Exercise

Create a risk analysis for your succession process. Feel free to start it yourself before asking for feedback from your family and other senior members of the business. How may additional risks did they consider over and above yours? Did they agree with your probability and impact assessments.

Now, during your next family business meeting, carry out a workshop with all relevant stakeholders to try and define a full and encompassing risk analysis, complete with mitigation strategies for the succession process you are about to go through.

Risk Analysis – Heat Map

Impact

Probability	1	2	3	4	5
1					
2			2		1
3			1	1	2
4					
5					

NOTE: This heat map is based on the risk analysis on the previous page.

Another helpful exercise could be to create a heat map of your succession risks. When you have completed your risk analysis, plot on the table how many risks are in each particular segment (ie. on the table we have 2 risks with an impact of 5 and probability of 3).

This heat map gives an overall view of the general 'risk' of your process based on your analysis and the assumptions made during that analysis.

Keep it updated for a constant risk heat map throughout the process.

Risk Profile

Are you a risk taker or risk averse?

What about any successor? Are they the same as you?

If you have different attitudes towards risk, you may need to consider how this could affect the business after the succession takes place.

Risk averse can

- Think about short term concerns
- Have a fear of failure
- Work with smaller budgets
- Have a culture of routine and control
- Be apprehensive
- Be complacent

Less risk averse can

- Think about long-term concerns
- See opportunities others cannot
- Have a culture of creativity and innovation
- Be confident
- Continually seek learning and growth

Risk Profiles

The table below shows a typical risk profile for an investor. Consider this as a basis for reviewing the risk profiles of the current and potential future owner/manager. Bear in mind that equity investing is most risky in the table below, and debt financing the safest (in theory!)

Risk Profile	Notes	Equity Preference	Debt Preference
Very Low	Looking for security of capital invested, small risks and low returns	<10%	>90%
Low	Willing to take small risks for decent returns over medium and long term	<30%	>70%
Average	Aiming for larger returns over medium to long term, and will accept reasonably modest levels of risk	50%	50%
High	Looking to maximise returns over medium to long term and will also accept a high and large risk	>70%	<30%
Very High	Will take very large risks in order to secure and maximise returns over the long term	>90%	<10%

Risk Profile - Exercise

Consider how risk averse you are and compare this against your potential successors. If there is a difference, give some thought to how those differences would impact on the business.

For example, if your successor would take more risks than you, would that potentially put the long term viability of the business at risk, or could it allow the business to increase it's growth very quickly?

Discuss any risk profile differences at your family meetings.

Learning Recap

- *As you start planning the succession process, ensure you develop a complete and thorough risk analysis with both the family and business managers, to try and envisage all possible events that could cause issues.*
- *Ensure that you keep your risk analysis updated and accurate throughout the process, ensuring your mitigation and contingency plans are also still valid.*
- *When considering a potential successor, determine how the family would like the business to move forwards as you will need to align this with the risk profile of the potential successor.*
- *Bear in mind that your risk profile may be very different to that of your successor, especially if this is a Generation 1 to Generation 2 succession.*

What do I need to do?

Risk Analysis

- Spend time creating a list of all the possible risks that could occur during the succession process
- Develop this list alongside the family and non-family employees of the business
- Create your risk analysis based on these risks, complete with probability, impact, mitigation and contingency

Risk Profiling

- Work with your board, family and non-family employees to identify your general risk profile
- Determine if your successor should have a similar risk profile or be more-risky or more risk-averse (business risk)
- Identify risk profiles for potential successors and use this and the future business risk to help decide a successor

Consideration

- Remember that your succession process could be the most risky project your business has been involved in for some time – give it, and your risk appraisal, the time and attention to detail that it both deserves and requires
- Any differences in risk profile between the current and the potential future business leader or owner could have dramatic (both good and bad) effects on the long-term nature of the business.

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