

D.T1.2.7

PP 3 VŠE - Behavioural change concept
towards stronger engagement of descendants
to take over family business

1st Version
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2. Objectives

2.1. General objective of the document

The objective of this document is to summarize behavioural change concepts and approaches towards stronger engagement of descendants to take over family business, and to prepare for O.T2.3 Pilot action in South Bohemia region

2.2. Specific objective of the document

Suggestion of methods on how to counterbalance low interest of young family members to take over the business instead of pursuing career through the employment outside of the family business.



3. Intra-family succession process

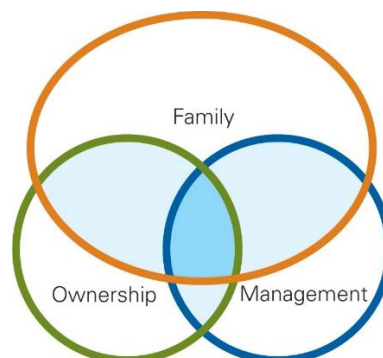
Family businesses around the world consider it as equally important to ensure company prosperity and family cohesion. According to a survey of the Association of Small and Medium-Sized Enterprises (Specifics of family business. May 2017. <http://amsp.cz/48-pruzkum-specifika-rodinneho-podnikani/>) 70 % of business owners target family transfer when considering the business succession. However, succession is often referred as an intergenerational challenge, since it is a long and difficult process. Succession is a change in business and a change in family relationships. People's leaders will be exchanged, and leadership styles will change. This creates a feeling of change throughout the community. Each member of the community accepts and accepts changes in a different way.

3.1. Challenges to intra-family succession process

According to KPMG Family Business Succession Managing the All-Important Family Component Report, family business owners indicated four major challenges, from which were three directly connected to other family members and the succession process (*Resolving conflicts among family members who are in the business, Formulating a succession plan, Developing a retirement and estate plan*¹).

The basic starting point for a successful company transfer to new generations is a management of so-called "family component". In other words, it is the ability to be aware of and to master the specifics of family businesses. Benefits of a family business vary according to the composition and size of the family or the given developmental phase (i.e., first, second or third generation) and can include loyalty, maintaining tradition, and a unique "stockpile" of workforce with compatible shared values and a high level of loyalty. In the case of risks, the first three places include factors such as intergenerational conflicts of values and goals, personal conflicts and different expectations. In the case of the category of risks, Moreover, factors considered family business benefits can quickly become a negative one in the dysfunctional situation that can lead to irreversible damage not only to family relationships but also to a range of business activities.

Traditionally, family business has been depicted by the Three Circle Model, which illustrates the interaction/impact of the family, management, and ownership components of the family business. The family business succession model in this section further expands on the Three Circle Model by focusing on the all-important family component during the succession process. It outlines management and ownership succession activities that involve family members with the goal of enabling family members to make informed decisions about their individual and collective futures in the family business.



Source: KPMG Enterprise, 2016. *Family Business Succession Managing the All-Important Family Component: Who says the family business won't make it to the next generation?*
Available at: <https://assets.kpmg.com/content/dam/kpmg/pdf/2015/07/3468-succession.pdf>

¹ Mass Mutual Financial Group, Raymond Institute, Survey Results



On the basis of a simple Three Circle model, there was a model, or a proven process set up for all the processes of successful planning, management and final implementation of the family business handover to the next generation.



The KPMG Enterprise Centre for Family Business

Source: KPMG Enterprise, 2016. *Family Business Succession Managing the All-Important Family Component: Who says the family business won't make it to the next generation?*
Available at: <https://assets.kpmg.com/content/dam/kpmg/pdf/2015/07/3468-succession.pdf>

This model well illustrates the processes and activities that need to be taken to ensure the smooth transfer of family businesses. From the point of view of the needs of our project, namely point 1.2.7 - the preparation of the concept of behavioral changes towards a stronger involvement of the offspring to take over the family business, it is possible to use the set of family business rules, which gives an example of what type of policy successful family businesses implemented, applied and transferred to the next generation.

The implementation of these rules largely addresses the issue of contractual arrangements for relationships between family members, including potential successors. The rules are able to set the responsibilities and competencies of designated members, in addition to the culture and values shared in family business. The rules, if widely respected by family members, can become a basic document governing family business, including solutions to corporate succession.

The Family Partnership Agreement included in Appendix A is based on the original version of the English version created by KPMG, with the author making adjustments to make the rules generally applicable in the European environment. At the same time, the author draws attention to the need to verify the rules, for example in the form of a notarial record, in order to increase their binding nature.

3.2. Most important factors influencing intra-family succession process

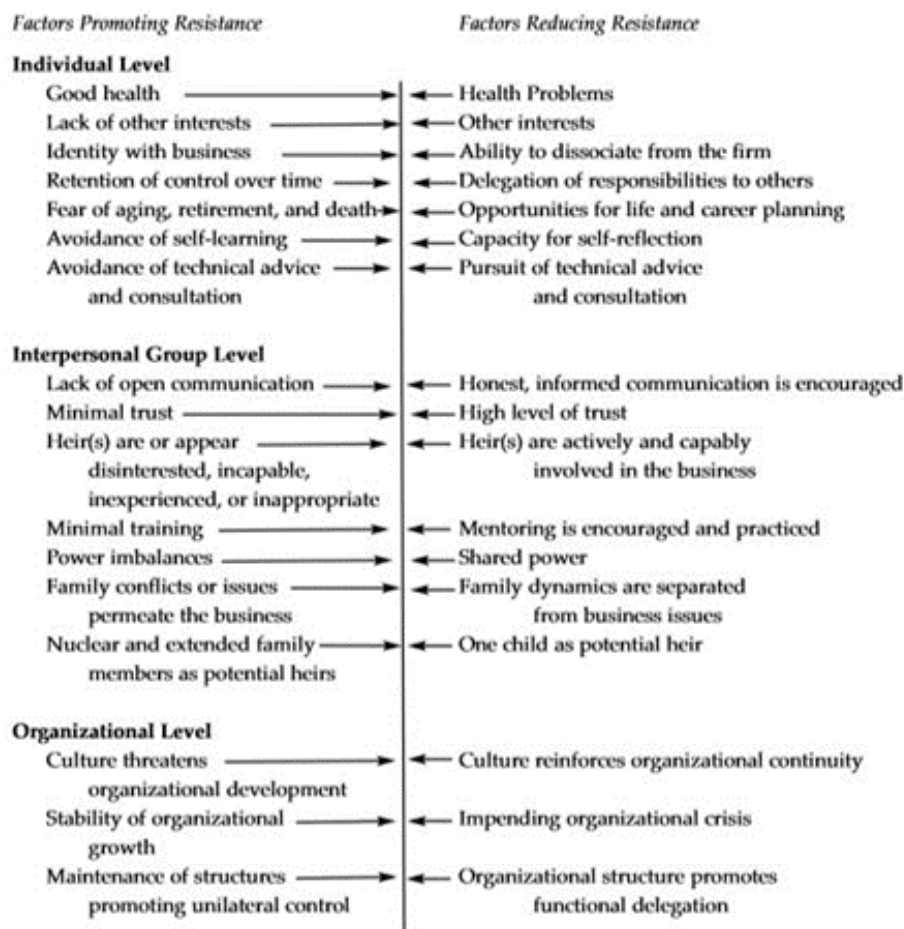
Lockamy III et al. (2016) identified four groups of factors impeding intra-family succession.

Variable	Construct
Family-comprised Board of Directors (BOD)	Governance factor
Incumbent is CEO and Chairman of the BOD	Governance factor
Informal succession plan	Context factor
Financial performance decline	Context factor
Successor will be selected using identical criteria from previous successions	Process factor
Successor lacks work experience in the family business	Process factor



Successor lacks relationships with major customers	Process factor
Successor lacks relationships with major suppliers	Process factor
Conflicts between successor and non-family members	Individual/relationship factor
Rivalry among the children (potential successors)	Individual/relationship factor
Family members dissatisfied with successor's commitment to the business	Individual/relationship factor
Non-family members dissatisfied with the successor's commitment to the business	Individual/relationship factor
Incumbent is dissatisfied with the successor's commitment to the business	Individual/relationship factor
Successor is not motivated to run the business	Individual/relationship factor
Successor lacks commitment to the business	Individual/relationship factor
Successor has conflicts with family members (other than the incumbent)	Individual/relationship factor
Successor lacks the decision making skills needed to run the business	Individual/relationship factor
Successor lacks the interpersonal skills needed to run the business	Individual/relationship factor
Family members question the successors' integrity	Individual/relationship factor
Family members lack trust in the successor	Individual/relationship factor
Successor is not seen as a legitimate leader by family members	Individual/relationship factor
Non-family members question the successors' integrity	Individual/relationship factor
Family members do not work well together as a team	Individual/relationship factor

Similarly, according to Whatley (2011), there are several types of factors influencing resistance to succession in the family business, among which the individual and interpersonal level (also between the owners and successors) plays an important role.



Source: Whatley (2011)



3.3. Family business owners' vs successors' perspective

Facilitating the transfer process is possible through long-term planning and management. A very important factor that can help to overcome the differences in the way the goal is directed is the confidence that it can handle the assigned function (Rydvalová and all, 2015). Trust is an important tool in reducing the reluctance to take over the business.

Servus (2016) encourages the business owner to ask questions in the first instance about the future fate of their business, which should include the following:

- What is my vision about the future of the business? Do I want to keep my business in / I want to sell it? Why?
- How do I see myself? How do colleagues / family / partners evaluate me (etc.)?
- What (my) properties helped me build a successful business?
- What are the values or principles on which I built a business?
- What do I want to influence management / management after "handover"?
- Am I prepared to assist and support the successor? How do I want to be active for the business (and family) after handover?
- What do I want to do after the handover?
- How do I imagine my financial security after the business transfer (how secure)?
- How do I imagine the successor? Will I be able to accept it and pass it on?

It is possible to identify this question proposal. Perhaps it would be appropriate to give the same set of questions to successors and ask him how he thinks his father (mother) will answer. The result of the comparison might be to remove some misunderstandings that the successors actually mean, and the fact is different. Perhaps it would help to put that important trust in the continuation of the handover process and more open talks.

Servus (2016) draws attention to another important landmark. It is only possible to start the transfer process when it is quite obvious that the owner of the company is internally convinced that really transferring the business wants a family successor.

It is advisable to publish and communicate with other members of the family (Familylegacia 2013, <http://www.familybusinessunit.cz/sluzby/mezigeneracni-predani/>) as a suitable means of realizing the establishment of a family constitution and to establish firm rules, which can be revoked at any time. These rules must be binding on all family members. A well-established family constitution can make it possible to create a fair process of decision-making that affects all family members. It can effectively help the family stay together. One of the essential elements of a family constitution should be the formulation of vision and mission. It should contain a wording on what principles family values are built upon. At the same time, the family constitution should include a list of the powers and responsibilities of individual family members. It should include a list of members of the family council.

A well-functioning family council is next to the family constitution another important factor in the success of keeping family businesses together. The Family Constitution should state what matters at least the family council must decide (it could also become a mediator in solving family conflicts).

From the analysis of available resources, it is clear that within the framework of the concept of a stronger involvement of offspring in the transfer of family businesses, it is necessary to start at the transferor, i.e. the owner of the company:

Particularly important factors for success were:



- Creating a sense of trust in the successor that the owner believes him to manage the company.
- The owner must be convinced internally and make the neighborhood clear that he wants to pass the business.
- Existence of a family constitution (the internal conviction about the transfer of the company becomes a necessary change of this constitution and thus also by a written declaration in a family document).
- Existence of a family council.
- Use of coaching for succession and leadership (i.e. <http://www.familybusinessunit.cz/sluzby/mezigeneracni-predani/>)

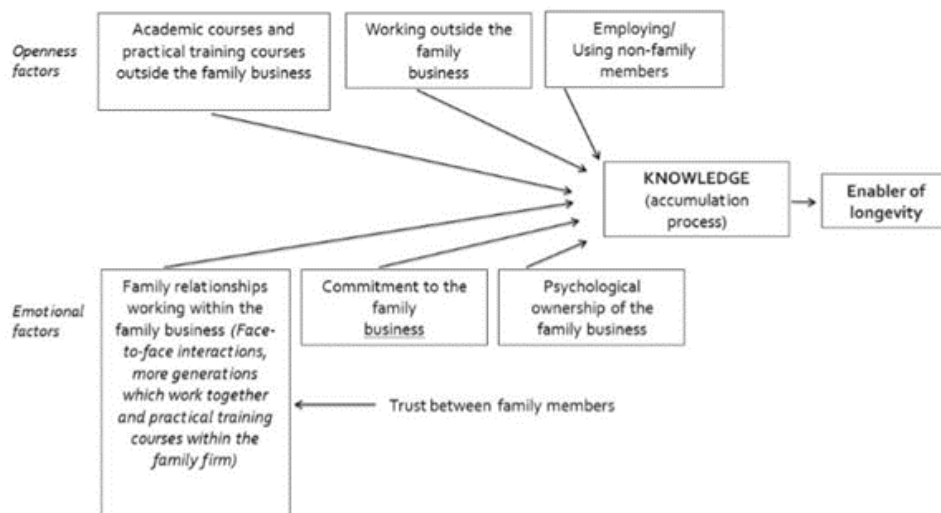
The young generation is forced to accept the fact that change is part of the development of the company. If the successor wants to master the takeover of the company, it is necessary to manage the change management and communication with it. Many processes in the company will be other than the past owner and it does not have to mean that worse because the young ones want to have others.

The takeover would facilitate a clear and clear definition of what a successor can expect from a company and what the company expects from it, and that the successor takes the takeover of the company as an opportunity, not as a duty. To manage the emotions management of your own and other stakeholders. Uncontrolled emotions can affect the quality of communication and, of course, the result. Tolerance and respect for another approach that goes towards the same goal. Getting experience away from a family business will make it easier to take responsibility in a family business.

Particularly important factors for success were:

- Defining what a successor can expect from a company and what the company expects from it.
- Manage change management and communication with it.
- Manage emotion management.
- Tolerance and respect for another procedure.
- Getting experience in another company.

Moreover, the process of preparation of family member successors to take over the family business may lead to other benefits, i.e. knowledge accumulation



Source Chirico (2008)



3.4. Five steps for efficient overhaul of the family businesses by next generations

According to PWC 2016 Family Business Survey five main steps have to be taken to smooth and successful overhaul family businesses to the younger generations. Steps are as follows:

1. Plan ahead

The only most important success factor for taking over a business is a good plan. It starts with detailed career planning and the development of next generations, so they can gain a wide range of experience and get the right skills. If possible, find ways to work outside your home market and outside your family business. This will help build their credibility if they eventually decide to return to a family business.

2. Family business as an opportunity, not a burden

Research shows that most respondents are willing to take over a family business. Some respondents are looking forward to it. However, there is a predominant concern that taking over the company could become a burden. The young generation must be able to freely choose their own future.

3. Chance to build something of their own

Research has shown interesting insights - 54% of respondents are afraid to take over a family business because they can't build their own success story. The older generation should allow the next generation to build their own businesses, which can work as a complement to the main family business. Everything must be set within the family business rules.

4. Understand where and when to let go

Most respondents in the research said they would welcome the support of their parents (or other family seniors) as part of the process of exaggeration. At the same time, the question of the need to create a border between this support (eg in the form of mentoring) and an unreasonable interference with the management of the firm. You need to set the role exactly.

5. The importance of the older generation for managing relationships in the family

Conflicts and misunderstandings are very dangerous for family businesses. From the PWC research, there has been a great concern among younger generations that their entry into family businesses will ruin family relationships. In this case, older generations must play the role of moderators and be the celestial element of the family.

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5. Appendix 1 - Family Partnership Agreement

I. Objective

The goal of these Family Business Rules (hereinafter referred to as the "Rules") is to create a business environment that will respect the relationships, values and traditions of our family while setting clear responsibilities and competencies of individual family members involved in the business. By committing to adherence to agreed rules and policies, and honestly observing them, we will reduce the chances that we will have to deal with a conflict that could damage our personal relationships and business relationships, and thus our family business.

The rules below were approved by our family council on and were presented to a wider family at one of our family business meetings held on ...

II. Family business meeting

The purpose of our "family business meetings" is to provide a formal communication forum for family members who are active in the family business. The main items of the meeting agenda are family business problems, family issues that affect business, and all issues that affect the relationship between active family members. Family business meetings should not replace regular management meetings. The goal is to enable members of active families to have a better understanding of each other and to better understand why the family business works as it works. The meetings will also discuss topics such as personal and business values, succession principles, succession care, family rewards, and family expectations.

The result of our family business meetings is the following set of family business rules that are supposed to lead to our day-to-day activities in family business. Family business rules and all their changes will be presented to wider family members for information and feedback at one of our family council meetings.

The family business meetings are chaired by the highest active member of the family and will be held at least quarterly, or more frequently.

III. Family council meetings

The purpose of our "family council meetings" is to provide a formal communication platform for wider family members to be informed about the overall activities of the family business. The aim of these sessions is to provide members of a wider family with a preview of the overall functioning and status of the family business. Families will also address issues such as employee and family opportunities for family members, heritage principles, corporate philanthropy, community activities, and family management. Because active family members are working under our Family Business Rules, they will be submitted for information and feedback.

A family council presides over an active family member with the help of an inactive family member. The family council meets once a year or more often, if necessary, and has a formal agenda.

IV. Basic family rules

a) Employment of family members

Owners of a family business would like to support and support the involvement of family members in a family business. Family members are encouraged to consider employment opportunities in a family business as well as their share of ownership. Possibilities of ownership are available only to family members who are active (full-time) in senior positions.

Owners recognize the importance of ensuring that businesses conduct and manage individuals with the appropriate skills and a sufficient degree of loyalty to the family business. In other words, the family business is not here to support the family (or the employment of their members), but family business can offer career opportunities to family members where there is a good agreement on the skills the business



requires with what family members can offer. Owners of a family business are fundamentally opposed to situations where artifacts are artificially created or released for family members without sufficient capabilities. For this reason owners will support the following principles apply to the employment of family members:

- Employing family members in a family business will be based on the opportunities available and on the appropriate adaptation of candidate's skills with employment opportunities. The account will also be taken of the compatibility of personalities (especially at the level of ownership) in assessing the employment and potential property of family members.
- Employing family members in a family business will be based on the opportunities available and on the appropriate adaptation of candidate's skills with employment opportunities. The account will also be taken of the compatibility of personalities (especially at the level of ownership) in assessing the employment and potential property of family members.
- Before the offer is made to a family member for a full-time or part-time job, the offer must be approved by all owners.
- Executives are expected to have the following qualifications:
 - Higher education (or equivalent)
 - three to five years of relevant work experience from a non-family business
- Wages will be rewarded by family members on the basis of fair market conditions.
- All new members of the family will be subject to a six-month probationary period.

b) Family members as company owners

Owners recognize and support the concept that active senior members of the family are brought into the company's property ranks after demonstrating their abilities, skills, and willingness to honor family responsibilities. New family members need to be approved by existing owners.

Family members seeking to be family owned should have three to five years of family business experience as a manager.

When a family member can be considered as a successor to a succession or transfer to owners, the company carries out the so-called "freeze", which means that the present value of the company will be determined and then divided among the existing owners in proportion to their ownership (ie 1/2 if there are two same owners) in the form of shares.

c) Employment of family members

Employing spouses and partners of active family members in a family business is a very delicate and sensitive issue. It is best to resolve this issue and agree on how to deal effectively with it before a situation or requirement arises. The following guidelines are intended to reduce the potential conflict that may arise when wives/spouses are employed, or life partners and partners.

- Due to the dynamics of family business, we do not support the employment of wives or spouses or family members active in family businesses. However, if a situation arises where it would be appropriate to employ a spouse of an active family member, the employment principles contained in policy (a) above should apply.
- Employing spouses or partners of inactive family members will be treated in the same way as employing any of the family members referred to in rule a).

d) Remuneration of management members



The remuneration for executive positions should be proportionate and representative in the family business. It is to be expected that inadequate rewards (whether high or low) will lead to conflicts both in the family and throughout the enterprise. In an attempt to minimize these conflicts, such a financial rating of executives will be supported, respecting the standard market remuneration for that position in the sector.

e) Termination strategy

The shareholders' agreement will ensure a fair and adequate exit strategy from the family business. The terms of the exit strategy will be clearly defined. If there is no shareholder agreement, the terms and conditions of the exit strategy will be submitted and approved at a family business meeting and referred to the legal council for future use.

f) Retirement strategy

Led by an effort to encourage a proper transfer of leadership and ownership of the family business to new generations, we propose a mandatory retirement age at the age of 65, unless other owners declare otherwise.

g) Small shareholders

The family company is committed to informing all shareholders of their roles, responsibilities and expectations. Small shareholders will be kept informed about ownership issues, including regular business results.

h) Conflict solving

The goal of conflict resolution policy is to provide family members (active and inactive) with a platform to discuss and resolve family-related conflicts. The nature of the family business is such that family affairs will have an impact on business and business affairs that affect the family. The family conflict, which will not be resolved, will negatively affect family relationships, which will negatively affect the family business.

To help reconcile business and family, it is recommended to implement the conflict resolution process set out in the following points:

- the conflict is solved officially within the family council,
- the conflict is moderated by a family member - chairman of the anti-conflict council,
- if necessary, work with an external moderator,
- the conflict must be resolved, the outcome is the conclusion.

i) Pre-marriage contracts

The purpose of pre-marital contracts is to protect the ownership or control of a family business so that in the event of a marriage breakdown the ownership structure is inappropriately altered, compromised or compromised. Therefore, the owners approve the following principles.

- A condition of ownership in a family business is that the owner is required to have a pre-marriage contract written in the form agreed by a corporate lawyer.
- Every member of the family who is about to join the family business is asked to write a pre-marriage contract before marriage.

j) Separation of owners property

One of the most important conditions of ownership is the need to separate corporate and private property. It is necessary to ensure that this issue is resolved through some kind of trust funds or other acceptable legal measures. The corporate property must be strictly separated from the individual property.

k) Personal leave and short-term holidays



Due to the fact that in family companies, family members often do not "turn off" business matters after working time, or this is intertwined with the time that should be dedicated to the family, it is necessary to set clear rules for situations where members of families free from work.

Sabbatical leave:

- Long-term leave (Sabbaticals) are intended for longer-term release from a family business. An application for work-related exemption is due to continuing education, health reasons or other special circumstances (eg personality crisis).
- Long-term release may be requested by a family member who has been in the family business for more than three years.
- After returning, a member of the family should be offered the same or comparable position within the family business.
- Long-term holidays are unpaid unless the owners stipulate otherwise.
- Approval of all owners is required.

Holidays:

- Holidays are intended for a short-term period (ie weeks to months) so that family members can face short-term illnesses or personal problems.
- Freelance hours are usually paid.
- The claim is based on a case-by-case assessment, the approval of which is required by all owners.

l) Business loans to family members and purchasing of goods/services from family members

The purpose of this policy is to apply consistency in financial transactions to family members who are not in ordinary business. In a family business, you can meet requests from active and inactive family members for personal loans. Similarly, the company may encounter the issue of buying goods/services from a family member who is involved in another business. If these situations are not addressed, they can cause a long-term conflict between the owners and the family.

All applications for loans for personal business or other financial transactions with family members must be approved by unanimous vote of the owners and written conditions of the transaction must be set. These conditions include, for example, the following items:

- The entire amount of the loan, commitment or other financial transaction
- Specify to whom the amount is lent
- Proposed payment plan and all related interest
- What happens in case of default?
- Whether the loans have to be insured?

m) Philanthropy

The goal of this policy is to maximize the charitable contributions of the family business to the surrounding community, thereby maintaining the company's reputation.

- The family business will create a charity donation strategy that will be reviewed and approved by all owners. The strategy will address the following issues;
- Which charity we want to support and why.
- How much we're ready to donate each year.



- In whose name the funds will be provided (family business, individuals).

n) Public Relations

Owners have to make a decision on who will represent the company in the media and communicate with the public on behalf of the family business. In other words, all requests for written or oral comments by the media or the general public, public appearances and all other public relations activities will only be directed and settled by designated representatives of the company.

o) Conflict of interests

It is a fundamental requirement for every family member employed in a family business to make sure he is not in the center of interest. Any family member who is not confident about his / her potential conflict of interest needs to submit the parameters of his / her situation to the family council.

For example, a family member of a family member employed in a family business might be in a position of conflict of interest if he or she engages directly or indirectly in their own business activities without the consent of other owners.

Every family member who is employed in a family business may not engage in any other active activity without the unanimous consent of the owners.

V. Changes to Rules

Changes in family business rules require a majority vote of active owners. Any changes will be introduced to a wider family at the next family meeting.