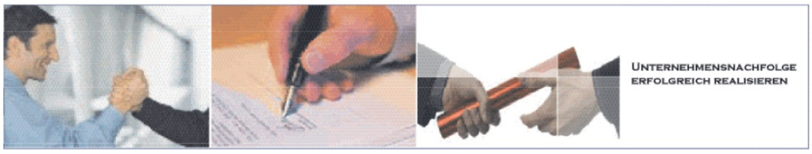

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Work Stage
Case Studies and procedures

Succession planning in SMEs Ensuring continuity

Management Summary

According to a Dun & Bradstreet's analysis, a total of 93,009 SMEs in Switzerland have a succession problem as of April 2022. This is shown by the analysis of the age of the owners (sole proprietors) or shareholders (companies) or board members (stock corporations) entered in the commercial register. With a total of 614,247 companies analyzed, this results in a relative share of 15.1 percent of companies with a succession problem. Micro and small companies with 1-49 employees are particularly affected.

Among medium-sized companies with 50-249 employees, only 7.9 percent are facing an open succession. A look at the individual sectors reveals major differences. The greatest succession problem exists in the printing and publishing industry (23.2%), in architectural offices (18.9%) and in business and tax consulting and repair services (both 18.4%).

Dear reader

Considering an acquisition or the sale of a company or of a part of a company is a most complex thing. A lot of questions have to be answered and to be certain to do the right decisions in the different phases of such an M&A process. experience and specific know how is needed. Apart from the big multinationals who have their internal specialists for such activities, usually management or owners do not have this expertise. Therefore for them it is absolutely vital to work with an external consultant who knows what steps have to be taken in what form, to make sure, that the commercial, the legal and the market issues are treated in a professional way.
The following article shows in an example the procedure of a company sale and the contributions of an external consultant.
For further information please do not hesitate to contact me.

With my best regards.

Werner Fassbind, Managing Partner

Succession planning: ensuring continuity

There are various options for company succession: Succession within the family, a management buyout / management buyin, retaining the financial commitment while relinquishing entrepreneurial responsibility, a sale or an IPO.

Different scenarios

If no suitable successor can be found within the family, the founding shareholder is forced to sell the company. Possible buyers include the existing management (management buyout, so-called MBO), a new management (management buy-in), potential investors (strategic investors or financial investors) or the public in the context of an IPO.

Pure MBOs are rather rare. More often, the previous owners look for a financially strong partner (private equity houses or venture capital investors) who is willing to take a stake in the company. Such a participation has strategic or financial backgrounds. While the strategic investor often uses synergies between his own and the acquired company and may only partially need the acquired management, the financial investor is dependent on the existing management remaining in the company and assuming entrepreneurial responsibility. Furthermore, the strategic investor usually pursues a long-term goal with the takeover and wants to integrate the company within his group. In contrast, the financial investor usually takes over a company with the aim of selling it at a later date at a profit, often by listing it on the stock exchange in the medium or long term. One of the best-known examples of a succession arrangement that was concluded with an IPO is that of the Geberit Group. In this case, a leveraged buyout (LBO) combined with an MBO was carried out as part of the succession plan, and in June 1999 the Geberit Group was successfully listed in the traditional segment of the Swiss stock exchange.

With every generational change, management should also be considered as a potential successor. In all those cases where the manager has proven entrepreneurial skills, has sufficient financial resources and is prepared to bear the entrepreneurial risk, a management buyout (MBO) can ensure the continuation of the company. The prerequisites for a successful MBO are a positive assessment of the company's future and an economically justifiable sales price.

Having to sell the business to a third party, possibly a competitor, is one of the most difficult decisions for a family business owner. Scarce capital resources, for example as a result of high settlements in the event of the division of an estate or divorce, can make it difficult for the next generation to continue the business. This is because investments in new developments or the development of foreign markets are indispensable for securing the company's existence.
For a company of suboptimal size that can hardly make progress on its own and could develop better in a larger group of companies, the search for a suitable partner is recommended.

Succession planning in SMEs

The topicality of business succession in medium-sized enterprises is due to several factors:

1. Age-related retreat of the founding generation of the booming 60s and 70s.
2. Economic difficulties caused by the long recession have further eroded the entrepreneurs' will to continue.
3. The regulation of succession is reflected in the rating criteria of the banks, which thus take into account the sustainable, personal will to continue.

Regardless of the legal form chosen, there are a number of special characteristics that must be taken into account in the case of medium-sized companies. Very often, they are very substantial companies that were committed to traditional security thinking and still have very high reserves today. The network of relationships and the formal and informal organisational structure are in many cases geared to their patron. In the event of a short-term departure, the entrepreneur leaves behind a large vacuum that can only rarely be filled with a suitable successor within a reasonable period of time. It must also be taken into account that the entrepreneur has invested a considerable part of his life energy in his company and therefore in most cases wants to ensure an independent continuation of "his" company.

The objectives of the entrepreneur open up or limit the selection of a suitable successor quite considerably: it is often conflicting objectives, such as ensuring entrepreneurial continuity, achieving a maximum severance payment, guaranteeing influence for life. that complicate the search for a successor.

Before searching for a suitable successor, the entrepreneur must be clear about this conflict of objectives. Negotiations should only be started when a well-founded price range is available and the transitional period for structural adjustments, in which the entrepreneur still wants to and can exert significant influence, is foreseeable.

Successor does not necessarily mean offspring. The goal of entrepreneurial continuity can very often be better met by a management buyout (MBO) outside the entrepreneurial family than by a takeover within the family Of course, successful family dynasties over generations are phenomena that particularly fascinate us. But this cannot be the yardstick for a successful succession plan.

lution. In principle, the search should take place within and outside the family and the company. The same entrepreneurial criteria should be applied to the successors as in the case of a management selection, but with the addition of financial potency.
Management buy-in.

Recently, advisors have registered an increasing number of enquiries from capable entrepreneurs in their 40s who are interested in a management buy-in after a successful career as a manager. However, the available capital and the external financing granted are rarely sufficient to satisfy the sometimes too high price expectations of the sellers. If the purchase price exceeds the net asset value of the company, this added value (goodwill) should be amortised by the sustainably achievable profit after three to five years. Otherwise, the financial risk does not appear foreseeable and is therefore not recommended. The management buy-out has two major advantages with regard to "external" succession planning. The existing management can assess the business risks well and is better able to carry out the integration after the takeover with the familiar faces. In many cases, however, the necessary small change is lacking, or the required entrepreneurial personalities are not even available due to a strictly patriarchal entrepreneurial culture.
If ensuring business continuity is the top priority, the severance payment must be appropriate due to the considerations described above. In most cases, this results in a reduction of the theoretically possible purchase price to a sustainable or financeable basis. This MBO- or MBI- racket can also take the form of long-term financing aid. However, these often contradict the premise of a complete replacement of the entrepreneur and his influence on the business activity.

Various scenarios are conceivable when maximising the sales price:

1. Sale to competitor,
2. Sale to investor group (industry solutions),
3. IPO (depending on size),
4. Sale of individual parts of the business ("spin-off"),
5. Liquidation in the event of an unsatisfactory earnings situation in the future.

A careful analysis and selection of potential buyers as well as their targeted approach is an important prerequisite for the successful sale of the company. In addition, the sales process should not take longer than six to nine months from the decision to completion (exclusivity, uncertainty among partners and employees, avoidance of indiscretions and rumours).

Do not miss the ideal time

The ideal time for succession planning is often missed. The lack of a strategic objective prevents the timely orientation of the company structure and culture towards succession. Under time pressure, the but find suitable successors only in very few cases. The following measures provide sustainable support for the succession process:

- Set strategic goals regarding succession at an early stage. Changes in the company organisation and corporate culture as well as tax planning measures take time.
- Avoiding heavy, substantial companies makes it easier to finance an external and internal succession plan and considerably increases the tradability of a company (despite tax consequences, appropriate salary and possibly dividend payments).
- Divide larger companies into autonomous divisions with responsibility for results (takeover of responsibility by management, possibility of spin-off and MBO).
- No fixation of the successors on the family.
- Do not expect too high a price - find out the price range before starting negotiations with the company valuation.
- Postpone strategic business decisions with high investment and financial requirements so that the framework conditions can be chosen by the new generation itself / avoidance of constraints increases rapid identification and integration of the new management.
- Involvement of an experienced advisor to circumvent the stumbling blocks in the succession process (not a routine process for the entrepreneur) and to critically assess the key decisions with the possibility of accessing a local, regional, national and international network for the search for a successor or buyer.

Succession problems often end up with the consultants. The selection of suitable successors is then very small due to the problematic business conditions. For this reason, the question of succession should be a permanent item on the agenda of the strategic planning process.
Family internal succession
Where the owner's own sons or daughters are available as successors for the management of the company, it is self-evident that this will be realised in most cases. In practice, however, it is often the case that handing over the management to one's own descendants is even more difficult for the retiring generation than handing it over to a third party. There are various reasons and ways of dealing with these difficulties.

Reason: Lack of emotional distance

The relationship between parent and son or parent and daughter is naturally completely different from the relationship with strangers. But it is precisely here that the

Difficulty. The distinction between paternal/maternal advice and interference in the autonomy of the descendants is more difficult to make. Also, the threshold on the part of parents to "interfere" with their own children is lower than with regard to strangers. On the other hand, a remark by the father or mother is perceived by the children themselves as "telling them off" much more quickly than if it comes from a stranger.

Recommended behaviour

Parents in particular should be aware that, especially at the beginning of the new leadership situation, restraint is very important. They must be able to accept that their son or daughter does things differently than they did. It must also be possible to make mistakes, if they do not endanger the existence of the company.

Pioneer entrepreneurs who have built up the company from the ground up must be aware that the detailed knowledge of everything that runs and exists in the company is not available to the successors, that they therefore base their decisions and activities on a different informa- tion and thus in many cases also come to different - also correct - decisions or solutions.

Sons or daughters are advised not always to put their parents' statements on a gold scale and also to understand that giving up one's own leadership is not always easy. After all, the experience and knowledge of the predecessors, if listened to openly, can also be very helpful.

Lack of acceptance

From the employees' point of view, it is clear that the son or daughter is taking over because of their family background, which does not necessarily mean that they are also seen as having the skills to run the company. In many cases, this leads to the new generation's performance being viewed with much more critical eyes than would be the case with non-family members.

Recommended behaviour

Especially in the first phase of taking over the leadership function, communication with all employees is very important. This is the only way to create the necessary basis of trust. Communicating one's own decisions and intentions is especially important when innovations are introduced.

Furthermore, one should be aware that mistakes are a no- mal phenomenon and can therefore also be openly admitted. Admitting one's own mistakes is the best proof that one is sure of what one is doing.

Culture change

A change of generation is not only a change of management, but practically always also a change of ideas about the management of the company, i.e. a change in the corporate culture. This is often difficult to comprehend, especially for long-serving employees, especially if the company has worked successfully up to now. Many of the things introduced by the new management are met with resistance and in many cases to the transfiguration of the former situation. Complaints by older employees to the former boss are therefore frequent.

Recommended behaviour

Any new leadership must be aware that corporate cultures cannot be changed overnight. The prerequisite for a successful cultural change is a clear vision of the future of the company. If you succeed not only in developing this vision, but also in convincingly communicating it to your employees, you will also succeed in achieving the necessary changes.

New ideas about leadership must always be tested for their contribution to the sustainable development of the company. If they stand up to this test, they can also be communicated convincingly and meet with acceptance, even among initially sceptical employees.

For the outgoing generation, while it is flattering to hear that everything was better under their leadership, their successors will only support them if they make it clear that they have full confidence in their leadership. This does not mean that one cannot also admit that one would have done certain things differently, but at the same time make it clear that there are different paths to success.

Werner Fassbind

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Several years of experience in management functions and in board of directors and advisory mandates

Editor and author of various specialist publications.

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