THE TARGETED STRATEGIES GROUP

WHEN IT COMES TO BUSINESS SUCCESSION, THE SOFT STUFF IS HARD

July 2021

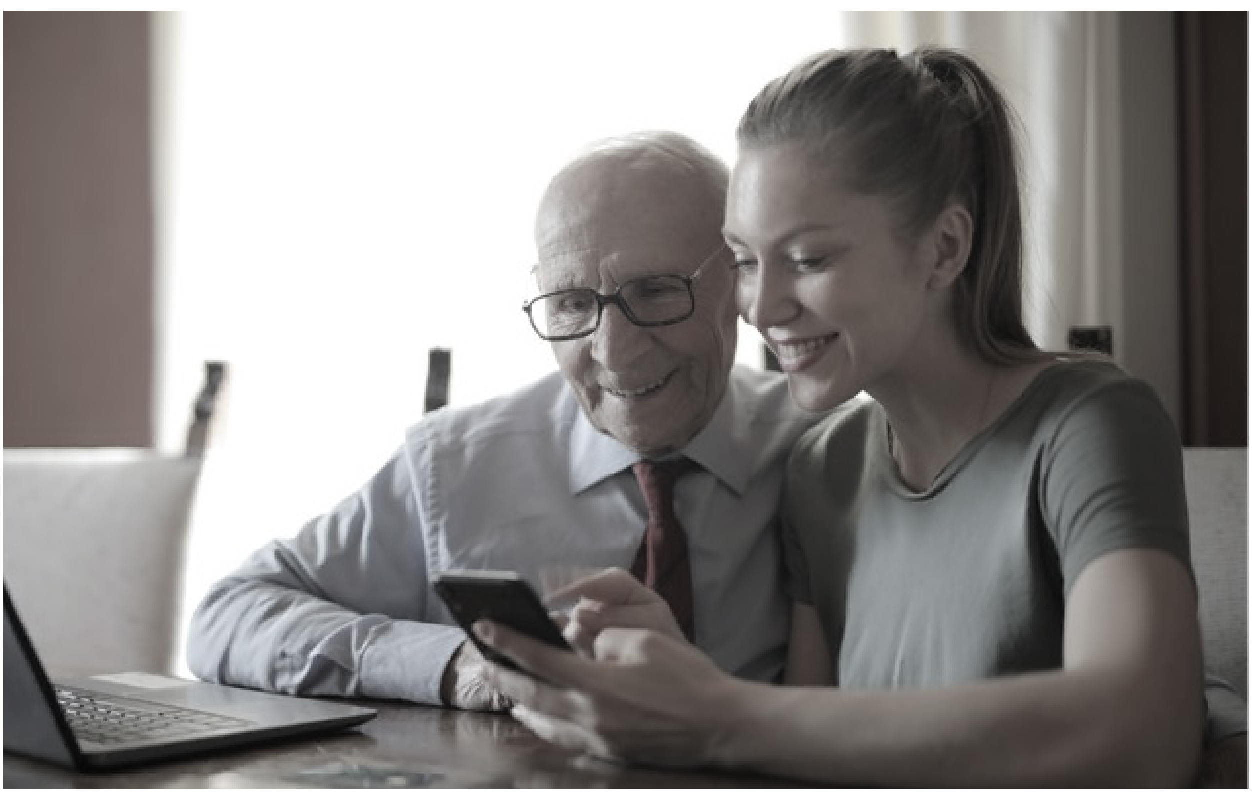
SUCCESSION PLANNING IS A WEAK SPOT FOR FAMILY BUSINESS

Few topics in the business world are discussed more frequently or with more sense of frustration than succession planning. Although countless studies and articles stress the importance of creating robust plans for transferring power and ownership, the number who act on this information stays stubbornly low.

Nowhere is this more true than among family-owned businesses, which create half of Canada's private-sector GDP and generate 7 million jobs.[1]

- As of 2019, **only 33% of North American family businesses had any kind of succession plan for transferring power when the current head retires or dies.**[2] Further, most of those plans were largely lip service to the idea: **only 18% of them**[3] **were clearly documented** and up to date.

- In 2020, after the COVID pandemic hit, the number of family businesses claiming to have a formalized succession plan rose to 30%.[4] Despite the impressive rise, this still means that **fewer than one-third of family-owned businesses** have a clearly planned process for transferring power when the time comes.



- **Seventy percent of family businesses last only one generation**, with 30% making it to the end of the second generation and 12% through the third. Only 3% of family businesses survive to the fourth generation and beyond.[5]

- The so-called three-generation rule, which states that a business family will go from shirtsleeves to shirtsleeves in three generations, remains a significant reality. One major study of over 3,000 families found that **70% of wealth is squandered when it is passed from the first generation to the second, and 90% by the time it is passed from the second to the third**[6]—a stark confirmation of the saying, "First generation makes it, second generation spends it, third generation loses it."

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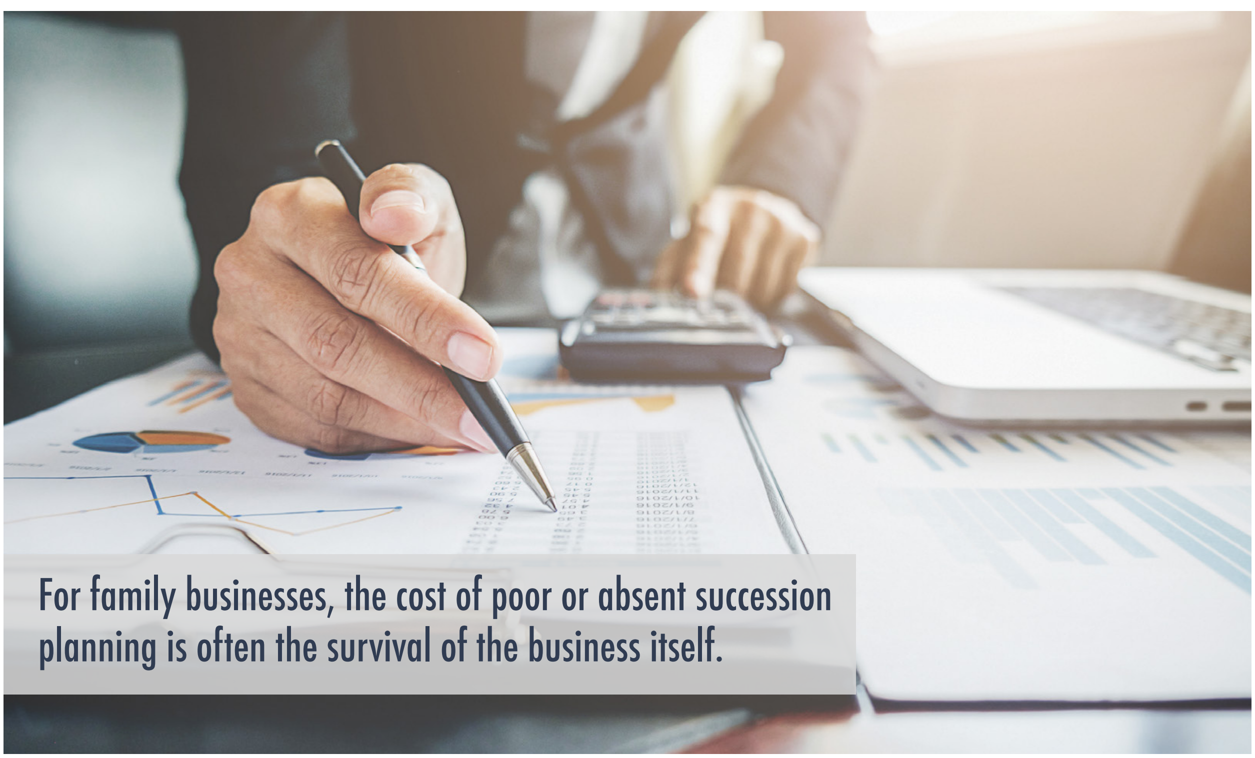
These figures are dismaying in themselves, especially given how well-known the negatives of poor succession planning are. "More worryingly," as the authors of PwC's 2016 Family Business Report note, "[the] figure has not risen significantly in recent years."[7]

FOR FAMILY BUSINESSES, SUCCESSION EQUALS SURVIVAL

All types of businesses have low rates of succession planning, and all types suffer the consequences. Among publicly listed companies, only 54% say they are actively developing successors for their top C-suite executives, and 40% say they don't have a single viable successor should their CEO unexpectedly exit.[8] These companies pay the cost in efficiency, reputation, and money. Succession-failure events such as forced CEO turnover at large public companies have been calculated to cost $112 billion in forgone market value the year before and after the transition—far more than if the transition had been planned.[9]

For family businesses, though, the cost of poor or absent succession planning is often even higher: the survival of the business itself. The reason for this is that succession lies at the heart of what a family business is.

While there are multiple definitions of the term "family business",[10] almost all of them centre on the inter-generational, intra-family transfer of power. Leading family-business authority John L. Ward, for example, defines it as a business "that will be passed on for the family's next generation to manage and control."[11] Similarly, professional-services firm KPMG lists among its qualifying criteria that "the family maintains control through a family member in a senior leadership position" and has "a clear intent to pass this ownership/control to the next generation."[12]



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The idea that succession is at the core of what it means to be a family business is borne out by the intentions and practices of business owners themselves. For instance, in 2019, 62% of family-business leaders responding to a major global survey said they intended to pass the business to the next generation. In 2021, spurred by the global COVID-19 pandemic,[13] the number of leaders who named keeping the business in the family as a top priority had risen to 65%, from 61% in 2018.[14]

Considering this premium on keeping the business in the family, one might expect family-business owners to be highly motivated to plan for succession. In fact, though, most of them put succession on the back burner. When asked why, they cite lack of time, know-how, and resources for help in carrying out planning, as well as discomfort with the idea.[15] It is no wonder that most experts consider succession planning one of the biggest existential threats in the family-business realm. The authors of the 2016 PwC Family Business Survey call transfer of power "the fault-line" in the family-business model, and add, "There's no point in having detailed plans for business continuity if the single most significant risk to this is not addressed."[16]

The disconnect between most entrepreneurs' desire for long-term success and their reluctance to carry out this non-optional step in achieving it has led frustrated experts to look for the source of succession planning's credibility gap. Many have come to believe that the root causes lie in psychological factors, rather than the realm of business governance.

There is widespread agreement that, as one researcher put it, "the major causes of financial failure have more to do with psychological patterns in the family than with legal, financial or business planning."[17] Among the psychological factors at play are the mentality of the owner/CEO, difficult family dynamics, sibling conflict, poor communication, lack of trust, and psychological unpreparedness on the part of potential successors.

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- The mentality of the owner/CEO
- Difficult family dynamics
- Sibling conflict
- Poor communication
- Lack of trust
- Psychological unpreparedness on the part of potential successors

SUCCESSFUL FAMILY-BUSINESS SUCCESSION STARTS AT THE TOP

Although many factors go into determining the character, attitude, and psychology of the family-business owner are only part of what determines the success or failure of a succession plan, most of the time the owner is the starting point. If he or she is unwilling to put time, thought, and resources into developing a strong, formalized succession plan, others involved with the business can do little about the matter. The incumbent's willingness and initiative toward transferring power is therefore necessary to the creation of a strong plan, even if it is not enough, in itself, to ensure that it succeeds. Research shows, in fact, that the owner's attitude and involvement are key predictors of a plan's success.

It follows, then, that understanding the mindset of the owner is an important first step in understanding how to reach an effective succession plan. Further, since the main problem with succession plans is the absence or weakness of such plans, it makes sense to focus on assessing what psychological obstacles the business owner may be experiencing or creating that keep him or her from engaging in the succession-planning process.

COMMON OWNER/FOUNDER CHALLENGES THAT NEED TO BE ADDRESSED FOR A SUCCESSFUL SUCCESSION

Overall, many of the psychological dynamics within the owner that hamper good succession planning fall under the general heading of resistance to the idea and/or the action. Family-business advisor Keith Baldwin calls the successful owner mindset “the psychology of relinquishment,”[18] and advises that any planning process start with an assessment of the incumbent’s psychology in order to keep psychological factors from “torpedoing” the process.

The psychological factors that make an entrepreneur resist planning for a transfer of power can be external, internal, or both. External factors known to increase resistance include lack of interested or seemingly capable successors, organizational structures that promote unilateral control, and pervasive family conflict.[19]

Some points of resistance on the owner’s part can be well founded; for instance, a successor may genuinely be unlikely to run the company well. However, other factors are both internal and, while understandable, are not grounded in objective reality. As one article put it, thoughts and discussions about transferring power are freighted by the fact that they “often take place against a backdrop of issues most people would rather not talk about: aging, mortality, expectations, and even family secrets that might suddenly come out of the closet.”[20]

Thoughts and discussions about transferring power often take place against a backdrop of issues most people would rather not talk about, such as aging, mortality, and family secrets.

Challenge #1: Delay and Avoidance

The main way that entrepreneurs express their resistance to transferring power is simply by putting it off indefinitely. The lack of an established timetable for beginning the planning process allows owners to stall indefinitely.

The problem of stalling is a major one everywhere in the world, but it is especially acute in Canada and the U.S.:

- **While only 27% of family-business leaders globally plan to wait until they are older than 70 to retire, this percentage increases to 40% in North America**, meaning that transfer of power is significantly more delayed in Canada and the U.S. than in other parts of the world.[21]
- In North America, 15% of family-business leaders belong to the Silent Generation (those born between 1925 and 1945), more than double the global average of 7%. This means that an extraordinary number of leaders on this continent are hanging onto power well into their 70s, 80s, and even 90s. As the authors of the STEP 2019 Global Family Business Survey remark, these figures indicate that "in those firms, a change at the top is urgent."[22]
- North America also has **the world's lowest level of female business leaders, at only 7%** (compared to, for example, Central Asia, where the figure is 43%).[23] This matters because female leaders tend to retire younger, make decisions about succession earlier, and have less autocratic leadership styles, a trait associated with a greater likelihood of implementing a succession plan. [24]With so few women heading family firms in Canada and the U.S., **this region has not seen the beneficial change in attitude to succession-planning that female leadership can bring about.**

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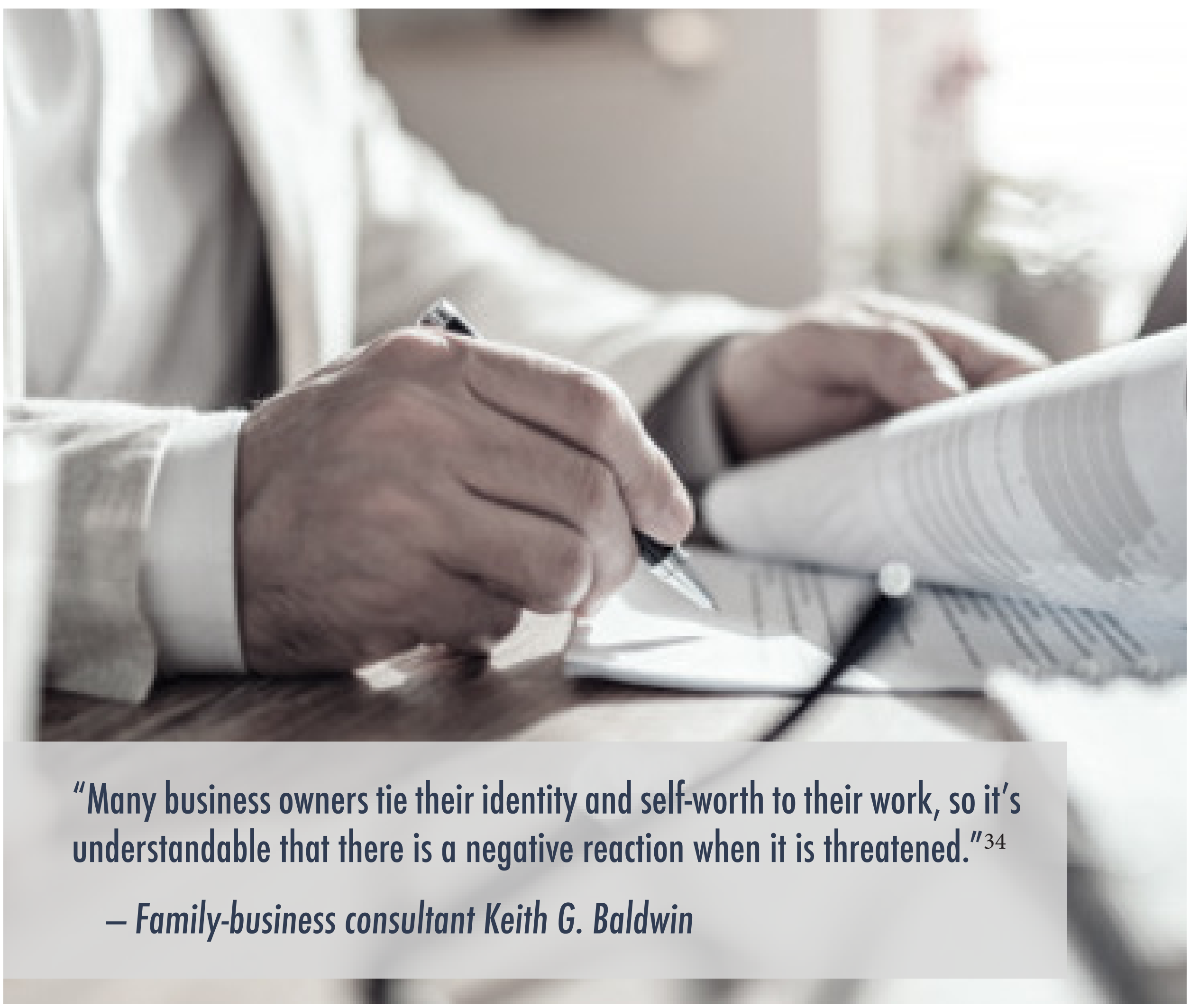
One of the most obvious aspects to succession planning is coming to grips with giving up control of the business. Thinking about handing over the reins of a family business involves a combination of things many people naturally resist, including change and retirement. These natural tendencies are amplified by an owner's frequently intense relationship and identification with his or her business. Researchers overwhelmingly agree that the main psychological source of delay is a desire to avoid the implications of a succession plan.

THREE IMPLICATIONS IN PARTICULAR PRESENT PSYCHOLOGICAL HURDLES:

- **Loss of identity and status.** Scholars and financial experts like note that most entrepreneurs' identity and sense of status are closely intertwined with their business. This is especially true if the owner is also the founder; however, we should not underestimate the degree to which next-generation owners can identify with businesses that they may have reshaped, built up, or even saved from insolvency. Organizational-change expert and psychoanalyst Manfred Kets de Vries' foundational research in this area attributes the family-business owner's resistance to succession to his or her identity being wrapped up in the firm and hence an inability to dissociate from it.[25] Organizational psychologist Ivan Lansberg similarly theorizes that the founder fears losing control and is concerned that retiring from the firm will mean a demotion in his or her role within the family. Loss of identity and power in the firm may also mean loss of stature in the community.[26]

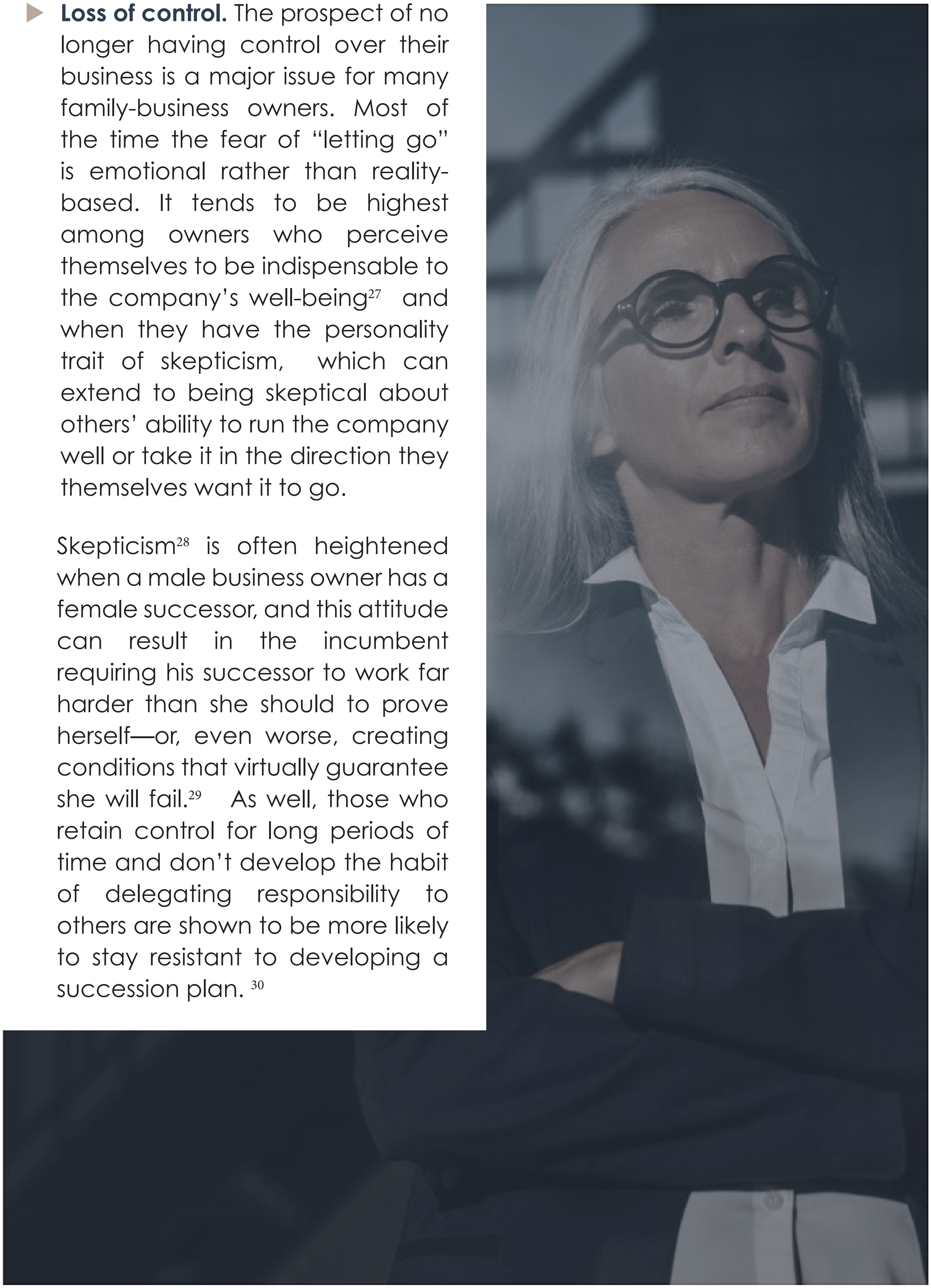


"Many business owners tie their identity and self-worth to their work, so it's understandable that there is a negative reaction when it is threatened."[34]

– Family-business consultant Keith G. Baldwin

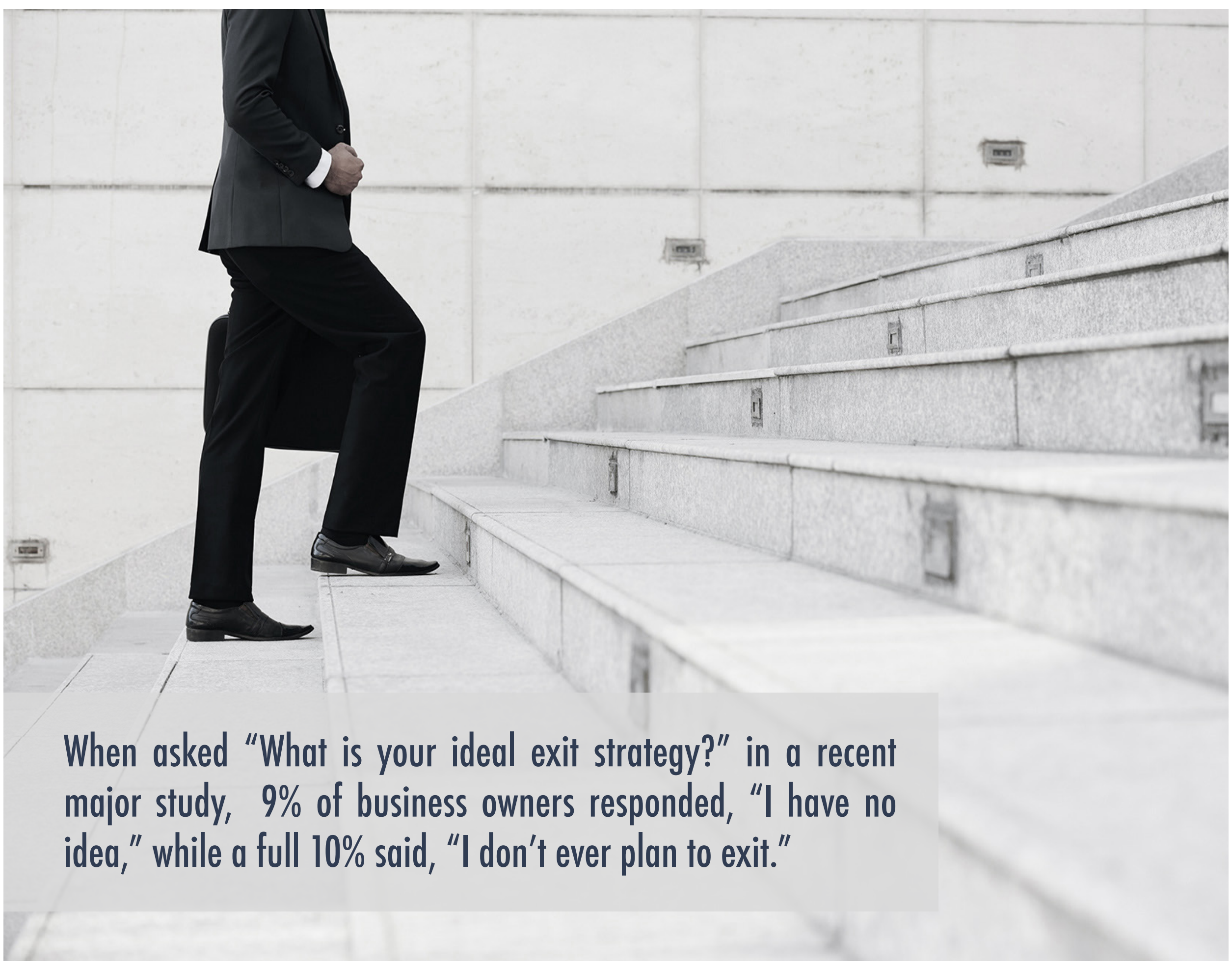
- **Loss of control.** The prospect of no longer having control over their business is a major issue for many family-business owners. Most of the time the fear of "letting go" is emotional rather than reality-based. It tends to be highest among owners who perceive themselves to be indispensable to the company's well-being[27] and when they have the personality trait of skepticism, which can extend to being skeptical about others' ability to run the company well or take it in the direction they themselves want it to go.

Skepticism[28] is often heightened when a male business owner has a female successor, and this attitude can result in the incumbent requiring his successor to work far harder than she should to prove herself—or, even worse, creating conditions that virtually guarantee she will fail.[29] As well, those who retain control for long periods of time and don't develop the habit of delegating responsibility to others are shown to be more likely to stay resistant to developing a succession plan. [30]



- **Mortality.** Few people want to face their own death, and business owners are no exception. The very notion of succession highlights the fact that one is aging (or at least going to age), perhaps facing incapacity, and certainly facing death. Researchers at the Harvard Business Review note, "For the founder, giving up the company is like signing his own death warrant."[31] This theory is supported by business-owners' responses to the question "What is your ideal exit strategy?" in a recent major study. While nine percent responded, "I have no idea," a full 10% said, "I don't ever plan to exit."[32] Unless they are counting on the business dying before they do or they have somehow found the key to immortality, "never exiting" is not an option.

In order for the succession-planning process to start, the entrepreneur needs to, in the words of one expert, "somehow consciously face and make the decision that, even though they will die, the company will live."[33] Similar figures for future-planning among the general population support the idea that fear of mortality is a powerful driver behind delaying plans that imply aging and death.



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Challenge #2: Excessive Optimism

Optimism is an inherent human trait.[35] The strong tendency to think that things will be better for oneself than the information objectively suggests it will—in other words, "It might be true, but it doesn't apply to me"—exists in people of all ages, cultures, nations, and personality types. It is thought to be a survival trait, and it is generally a positive one.

However, when it comes to the psychology of the family-business owner in relation to starting a succession plan, optimism can be another expression of denial and another justification for delay. For instance, even though most family businesses worldwide do not have a formal succession plan, and even though the high failure rate of succession is a well-known fact, 45% of global family-business leaders surveyed in 2019 said that the likelihood of the family business staying in family members' hands in the future was "very high."[36]

Further, a noteworthy 80% expressed either "high" or "medium" confidence that the next CEO would be a family member[37]—a percentage more than double that of those who said they had any kind of succession plan in place. Meanwhile, a major study of family-business CEO attitudes found that "the critical and urgent need" to develop the family-governance systems needed for strong succession planning is "often lost on the family CEO"—and single biggest reason for this was that "CEOs of family businesses perceive both the enterprise and the family much more favorably than do the rest of the family and nonfamily managers."[38]

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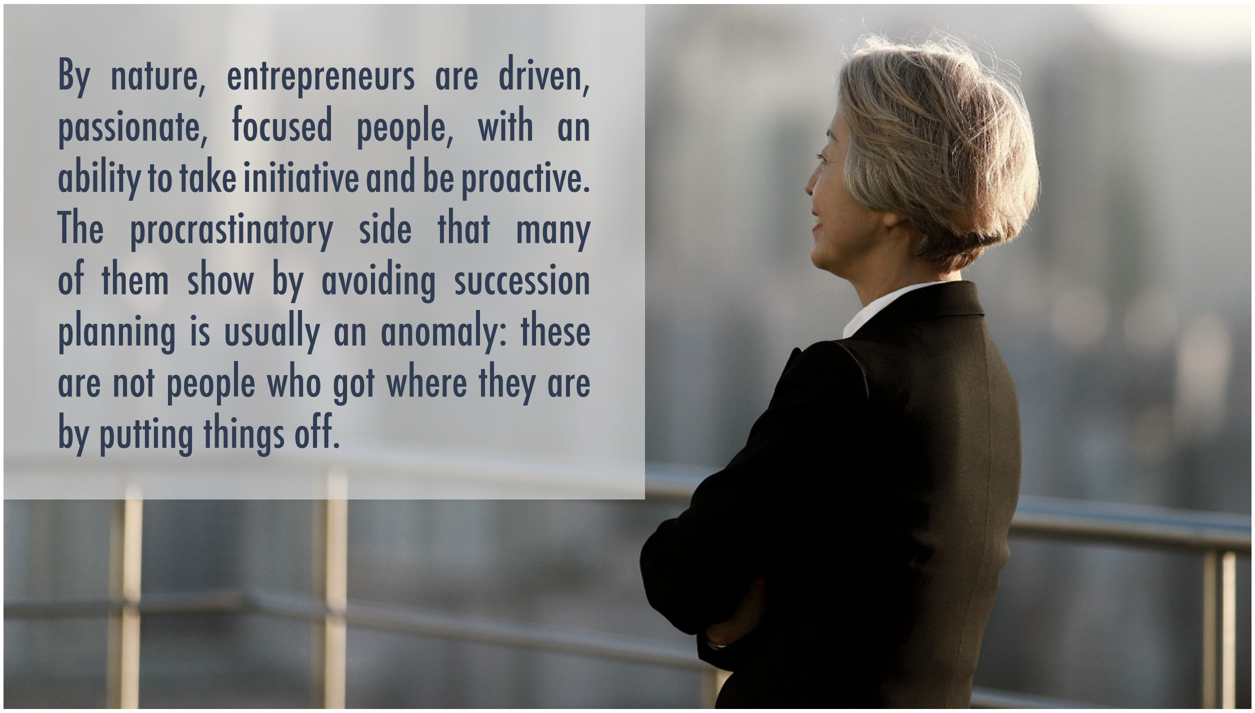
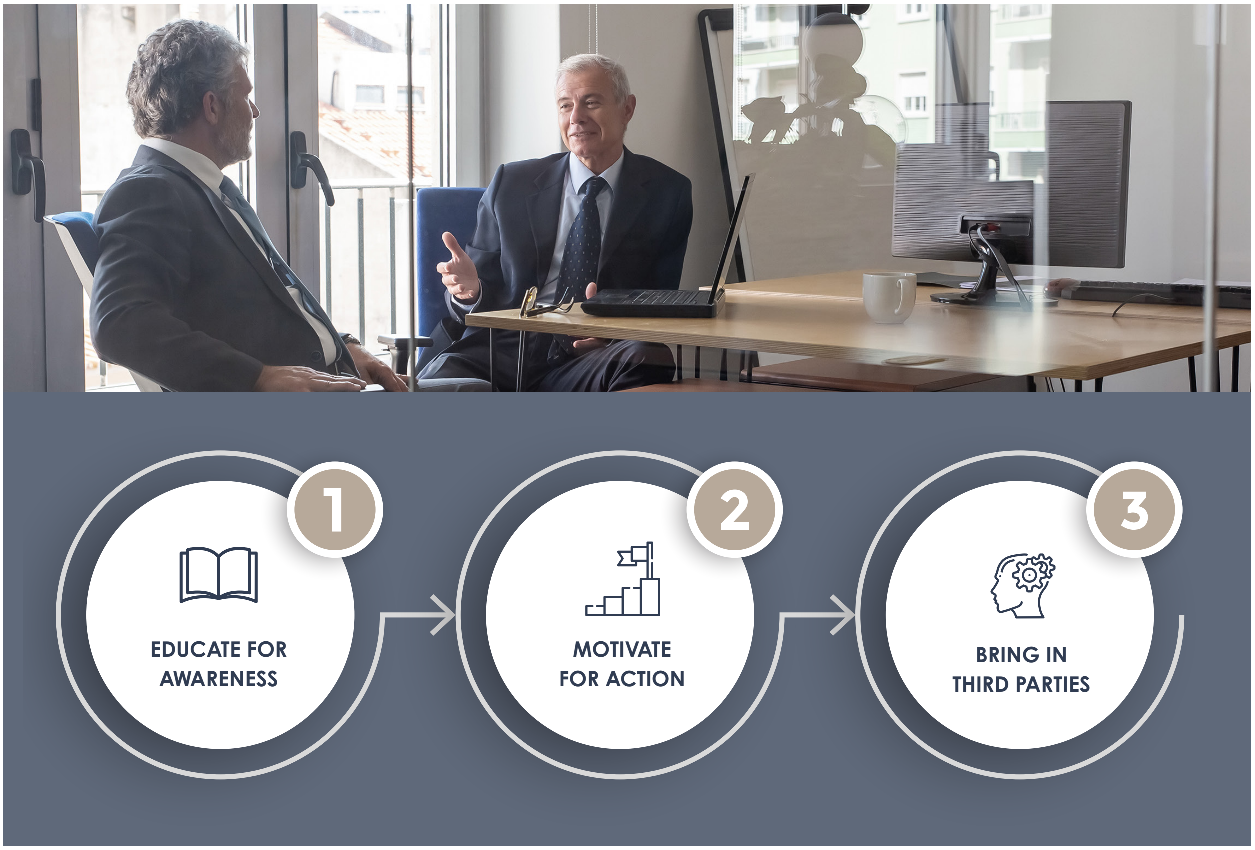


All of these psychological barriers to planning for a transfer of power are natural and understandable. Many people who aren't business owners show a similar resistance to future-planning tasks such as making a will[39] or purchasing life insurance.[40] Meanwhile, the lifelong worker who refuses to consider retiring is not only a well-known stereotype but, at this point, a significant economic problem.[41] Add to that the key personality traits that make entrepreneurs successful and driven but that make it particularly hard for them to step back — such as a belief that the "locus of control" resides within rather than outside them[42] — and it's easy to understand the paradox of entrepreneurs wanting long-term success and legacy[43] while being unwilling to do the planning they need to achieve these things.

Because of its roots in deep human psychology, the problem of resistance to succession planning will not easily be overcome. That said, entrepreneurs have psychological assets, as well as liabilities, when it comes to changing their mindset about this issue. By nature, entrepreneurs are driven, passionate, focused people, with an ability to take initiative and be proactive. The procrastinatory side that many of them show by avoiding succession planning is usually an anomaly: these are not people who got where they are by putting things off.

The most effective approach, then, is to tap into and capitalize on their extraordinary traits, as well as the fact that the business itself provides a professional structure through which some of these personal matters can be channelled.

THREE STEPS TOWARD OVERCOMING PSYCHOLOGICAL RESISTANCE



EDUCATE FOR AWARENESS

Most entrepreneurs are intellectually aware that planning for succession is of fundamental importance to the long-term survival of their business. A 2015 survey by The Boston Consulting Group saw family business leaders ranking succession second among “important subjects” that were on their mind; in the number-one spot was the related issue of reaching agreement among family members on crucial topics.[44] Clearly, then, judging by the chronically low rates of succession planning, simply knowing is not enough. However, this is not to say that education cannot be an effective path to overcoming resistance to planning. There simply needs to be more of it, and it needs to extend beyond a blizzard of warnings and dire statistics. Family business owners need to educate themselves, or be educated, in a way that convinces them that a formalized plan for transitioning their business to someone else is non-optional if they want to achieve longevity for their business, harmony for their family, and a lasting legacy for themselves.

One way to start down the path of fuller awareness is to make education a core value of the business, so that the entrepreneur actively seeks to learn all he or she can about how to achieve goals such as long-term success and their desired legacy. Family-business guru John L. Ward considers an investment in self-education a vital part and natural outcome of "respecting the challenge" that perpetuating a family business presents.

> Those who are successful at multi-generational family-business continuity appreciate what is facing them and try to learn what they can about it. Many, many family business owners have taken a significant amount of time away from work to visit other family businesses and learn from them.[63]
>
> *– John L. Ward, Perpetuating the Family Business*

With such a mindset, a leader and his or her family will read about and observe situations where success, ongoing struggle, or catastrophic failure hinged on the strength or weakness of a business's succession plan. When the positive and negative consequences of planning or failing to plan become real, even at second-hand, the business owner is more likely to take steps despite feeling some emotional resistance.

A related form of deeper education is peer-to-peer coaching, where family-business owners meet to talk to each other about their experiences, goals, skills, and perhaps even hopes and fears. Many family-business owners have an understandable aversion to talking to outsiders, feeling that non-entrepreneurs may not appreciate the particular challenges of their situation and the emotions that come along with it. The sense of shared reality that comes with talking to others who are simultaneously managing business and family issues can provide a great deal of support for business owners, helping them feel more secure, less threatened, and more capable of handling the emotionally freighted matter of planning to hand the business over to someone else.

One expert believes that business owners' main difficulty in letting go is the feeling that "as long as they had control of the business, they had control of the family."[45] However, through professional and peer-to-peer coaching, they become more secure and less controlling of both the family and the business.

MOTIVATE FOR ACTION

In succession planning, like all areas of future planning, low motivation is an inherent problem. The psychological factors that hold the business owner back from engaging in planning are real, immediate, and felt at a gut level, while many of the reasons to act are abstract, distant, and only intellectually understood. Studies back this up. They show that when the fear of aging and death are combined with good health, family-business owners are more resistant to starting a succession plan.[46] When they experience "trigger" events such as sudden illness, spousal death, or other stark reminders that death is inevitable, they are often prompted into action.[47]

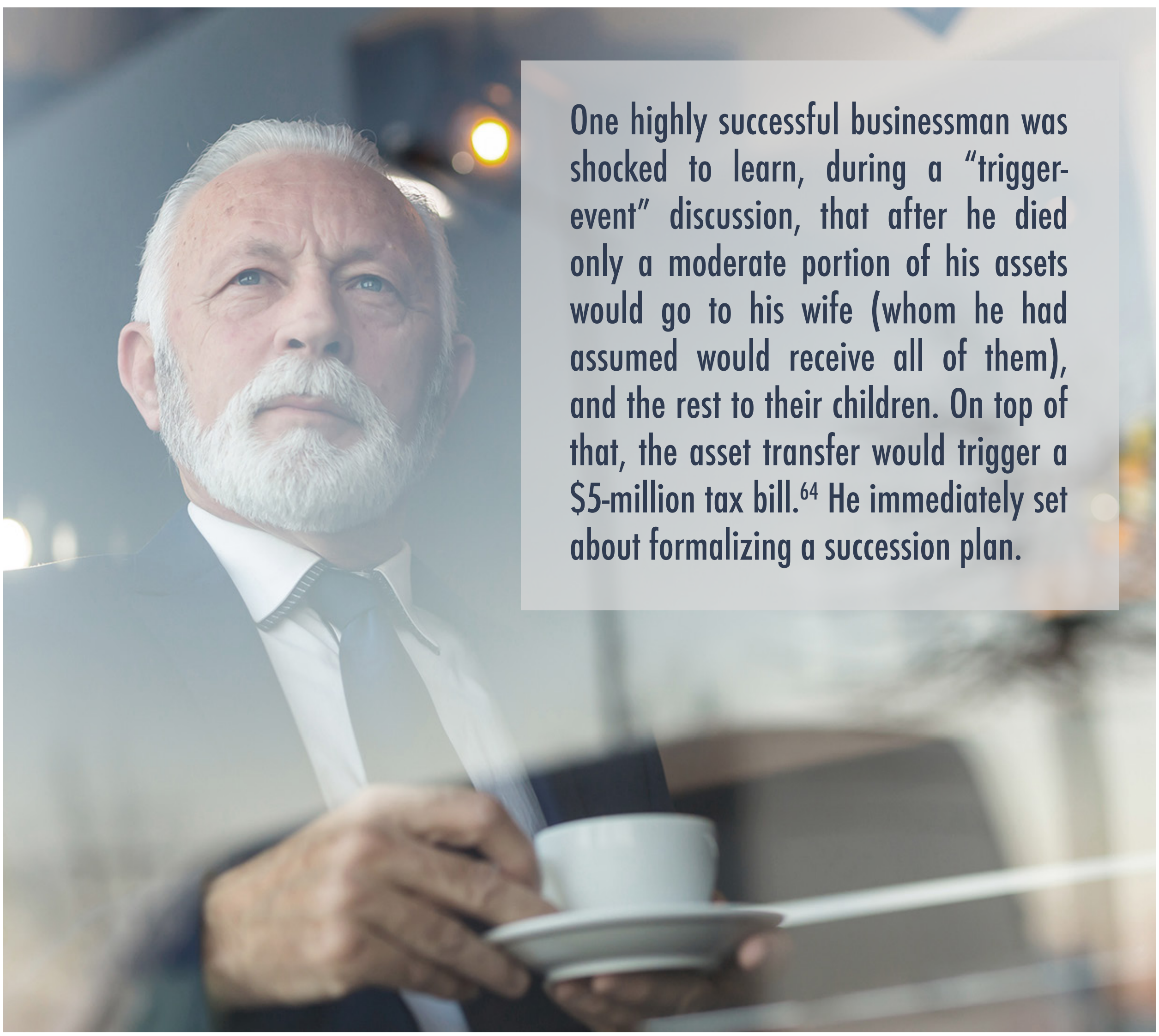
Of course, waiting for an actual trigger event to happen before starting to plan is an ineffective strategy. For one, it probably won't happen: far more people don't get hit by a bus (even metaphorically) than do. For two, crisis-based planning is advisable only for emergency plans; it is the opposite of the long-term, systematic succession planning that will lead a business and family to thrive over many generations. And in the case of many types of trigger events, by the time they happen, it's too late.

This is not to say, however, that trigger conversations can't take place and be highly effective at overcoming psychological resistance to future-planning. These are discussions, led by a family-business advisor or even as part of a family assembly, where the owner explores future hypotheticals such as,

- **Who will lead the business when I'm gone?,**
- **What taxes will my death incur for my spouse?,**
- **What are my goals for the business into the next 20 years, and what traits does the next leader need to have in order to achieve those goals?"**

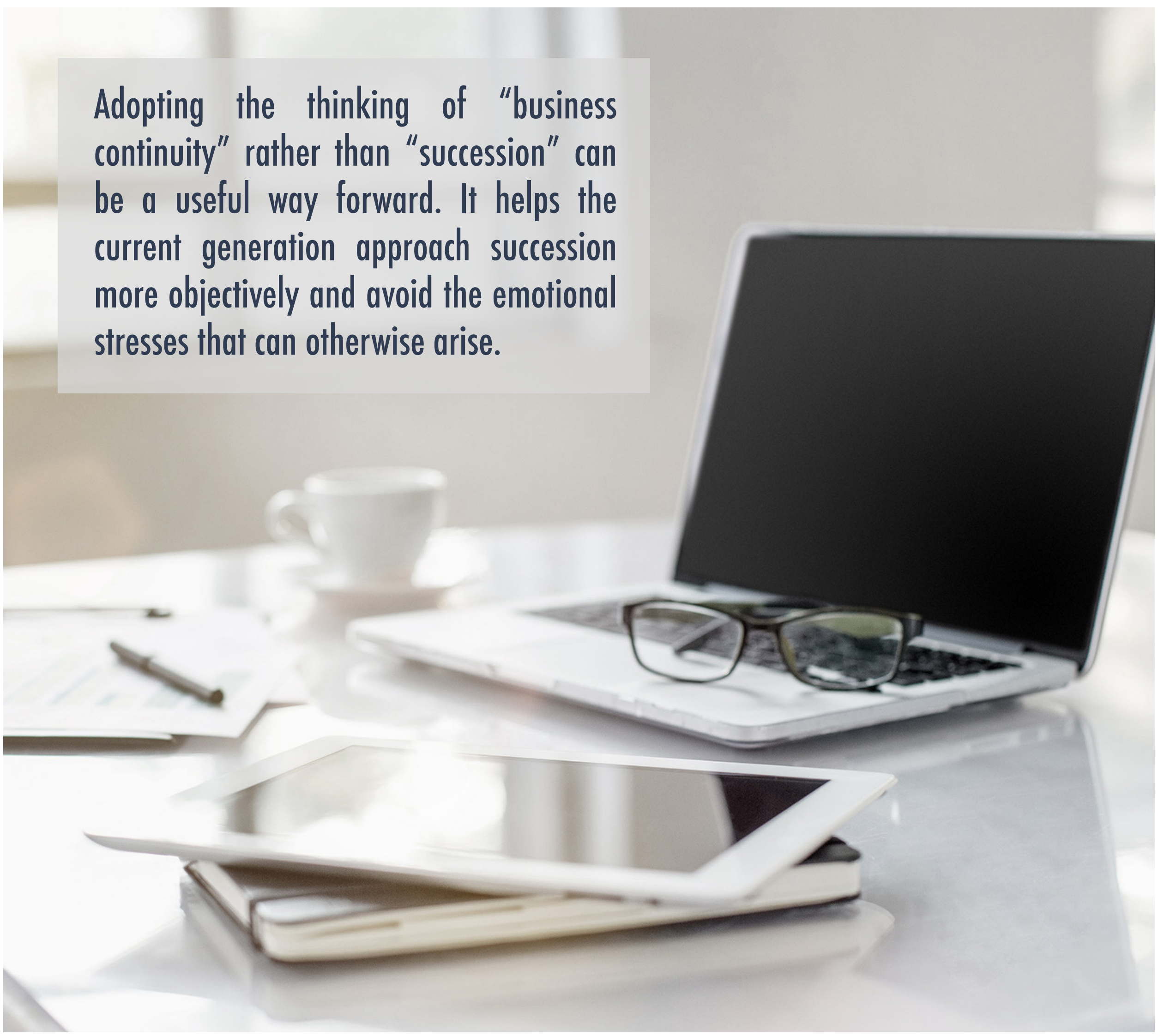
One consulting business recommends asking both "What if you get hit by a bus?" types of questions and "What if no one gets hit by a bus?" to ensure that the planning has a long-term component.[48] Trigger conversations can also help leaders figure out starting points and get a better handle on the complexities of succession planning, which is a very large and often poorly understood process.

These questions will often awaken the family-business owner to the consequences of leaving his or her business without a plan, and act as motivation. For instance, one highly successful businessman was shocked to learn, through these kinds of "trigger-event" discussions, that on his death, only a moderate portion of his assets would go to his wife—whom he had assumed would receive all of them—and the rest to their children. Moreover, this transfer of his assets to the children would trigger a $5-million tax bill. He immediately set about formalizing a succession plan.



Another way to increase the motivation quotient is to reframe the question of succession into the positive: not "What will happen when you're gone?", but "What kind of legacy do you want to leave? What plans can we put in place to maximize your chances of realizing this legacy?" This taps into the natural passion and drive that most entrepreneurs possess, and helps them see themselves as stewards of the family business—a self-perception that has been shown to lead to far more success[49] than when they view themselves as "monarchs" whose role is defined by power and control.

The authors of the 2016 PwC Global Family Business Survey comment, "In our experience adopting the thinking and terminology of 'business continuity' rather than 'succession' can itself be a useful way forward: if the current generation sees succession in these terms it can help them approach it more objectively, and avoid the emotional stresses that can otherwise arise."[50]



BRING IN THIRD PARTIES

Advisors and specialists can help a business owner understand why succession is important and motivate them to start planning. They can also help to facilitate the process. This is a way of "professionalizing" family governance in order to maximize the business element of the family-business system and minimize the psychological aspects that are creating resistance. As the 2021 PwC Family Business Report notes, "A professional approach strips emotion and personal bias, common stumbling blocks for families, out of decisions."[51] The goal here is both the bring a set of balancing perspectives into the process and, in a manner of speaking, to get the CEO/owner out of his or her own way. Family-business owners usually have exceptional traits and talents that have allowed the business to thrive; when the prospect of transferring power is moved out of the realm of personal emotion and into the executive realm, those talents can be brought to bear, and a strong succession plan can be viewed as another significant accomplishment instead of a harbinger of loss and negative change.

Just as importantly, when the process of planning for succession is integrated into the governance system, it becomes just that: a process. Evidence shows that a succession plan that truly works is one that is ongoing, clearly communicated, fully discussed, and frequently revisited. Transfers of power that are treated as a discrete event or a private plan usually fall into the high percentage of plans that fail. In an ideal situation, the psychological process of acquiring and then relinquishing power and control within the family business happens in a smooth, gradual way. The incumbent moves from sole operator to "monarch," then to a less all-powerful role as an overseer and delegator, and finally to a "consultant" who is largely disengaged. At the same time, the successor progresses from a minimal role to that of a helper, then a manager, and finally the chief decision-maker.[52] A management structure and system that facilitates and encourages this twin psychological process is an important component of success in the eventual transfer of power.

A succession plan that truly works is one that is ongoing, fully discussed, and frequently revisited. Treating succession as a discrete event or a private plan is likely to put it in the high percentage of power transfers that fail.

Third parties who can be of use in helping the succession-planning process overcome psychological hurdles include:

- **Independent board members.** Researchers have found a strong correlation between board independence and effective continuity planning.[53] Some advisors even counsel going so far as to take the entire family out of the succession equation by taking them out of the business-operations side of things and creating a family trust, which allows them to continue to act together as a family while reducing conflict.[54] Another move is to **make sure that the owner/CEO and Chair of the Board of Directors are not the same person. Not only is this a general principle of good business governance,[55] but it also allows the board to make succession planning a matter of routine by listing it as a standing item on the strategic agenda.** It also allows the board to discuss the matter of succession during a CEO-free portion of each board meeting, which should be run by the board's top outside director.[56]

- **Family-business advisors.** Transferring power is a complex matter, and many family-business owners say they delay planning simply because they aren't sure how to go about it. Sitting down with specialists who can discuss specific components of succession planning can remove the overwhelm and fear of the unknown for family-business owners, as well as helping them feel more in control of the process. Specialists include:
    - **Financial advisors.** These experts can offer the family-business owner advice on a wide range of issues concerning the financial aspects of succession planning, once he or she has taken that first step of asking for help. A Certified Financial Planner (CFP) is a qualified investment professional who can provide guidance on how to maximize assets and meet long-term financial objectives during the transfer of power. A life insurance advisor can help business owners protect and preserve their net worth using life insurance solutions. Working together, a team of financial specialists can collaborate on the best way to optimize intergenerational wealth and legacy for successful families and entrepreneurs.

- **Lawyers.** Lawyers can help the owner negotiate the legal components of the succession plan, as well as draft documents and agreements.
- **Accountants.** Accountants work with the family-business owner to reduce taxes payable both during their lifetime and at their death. They also offer advice on the tax implications of a succession plan.
- **Chartered Business Evaluator (CBV).** One of the most common sources of family conflict as a transfer of power enters the picture is the question of how much the business is worth. Like succession planning, business evaluation is an area where denial and delay often prevail, so for a family-business owner to ask for an evaluation can be an important step in breaking through psychological barriers. A designated CBV specialist can provide an objective outside opinion that can reduce emotional tension within the family and help the eventual transfer of power seem more real to the incumbent.

Sitting down with specialists to discuss specific elements of succession planning can remove the sense of overwhelm and fear of the unknown for family-business owners. It also helps them feel more in control of the process.

- **Family business therapists and coaches.** Family-business coaching has gained acceptance in the business world since the early 2000s,[57] and many coaching seminars and sessions focus on helping owners "truly let go of the business" and transition the firm to the next generation.[58] Business therapists, as experts in both business and psychology, can be immensely helpful to owners struggling with the idea of handing over the reins. Offering someone to talk to, confide in, and trust can ease the owner's fears and significantly lower resistance to succession planning.[59] It does this partly by increasing the owner's self-awareness, the starting-point to all other therapeutic approaches.

Business therapists report being called in mostly for emergency situations,[60] but as their presence becomes more familiar and their value to the business more evident, owners may increasingly find it acceptable to invest the money and effort.

Both therapists and coaches have received extra training in issues specific to family business, including intra-family wealth transfer, family conflict resolution, communication styles, and emotional intelligence. They can be invaluable as trusted but objective third parties, bringing in an outside perspective in order to moderate emotion-based thinking. As importantly, any one advisor can serve as the starting point for a trusted network of advisers and experts, who can develop long-term relationships of trust and counsel with the business owner, helping to allay his/her fears about letting go of control.

A BRIGHTER FUTURE FOR SUCCESSION

Clearly there is no quick fix for the psychological obstacles to succession planning. Still, there is cause for hope even in the face of historically low planning rates. As a growing number of financial advisors become aware of both the importance of a strong succession plan and the fact that the main causes of delay lie with "soft" issues within the psychological and relational realm, they can take more effective approaches to educating and working with entrepreneurs.

In this, they will be helped by the demographic sea-change currently underway. The enormous Baby Boomer cohort has reached retirement age, triggering the biggest transfer of power and wealth that the modern world has seen with Canadians alone set to receive $750 billion in transferred wealth between 2016 and 2026.[61] While this makes the matter of succession planning all the more urgent in the immediate term, it also means that more and more businesses are being led by Millennial and Gen X members, who show less need for control and a greater willingness to relinquish control over the business (in fact, a remarkable 78% of Millennials intend to retire before their 50th birthday, in contrast to 4% of Baby Boomers[62]).

Taken together, these trends could move the dial on family-business succession planning, creating conditions where many more businesses and families do the planning needed to thrive over many generations.

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