The Trusted Advisor

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The Challenge of Generational Succession

Entrepreneurial challenges in handing over the baton

by Felix B. Waldeier

This year, as every year, more than 20,000 family businesses in Germany are looking for a CEO-successor. Ideally, the successor should come from their own offspring, although this is not always possible – or in some cases can go impressively wrong. According to estimates by the Institut für Mittelstandsforschung (IfM), on average only 10-15% of companies surveyed survive to the third generation. And these empirical values are not forecast to improve in the face of demographic change. Accordingly, there are numerous family entrepreneurs who are looking to external managers to succeed them due to a lack of their own junior staff – or who even wind up having to sell their company.

Apart from the demographic aspects of the problem, however, serious intra-family conflicts are often the cause of unsuccessful – or even non-existent – company successions. In this context, it would certainly be exaggerated to speak of a general taboo on this subject. But as a rule, Germany prefers to sing the devotional song of praise to family businesses, which are successful in the world markets as small, innovative, cost-conscious and agile players with great advantages such as speed, decisiveness and adaptability. And, of course, it is precisely these advantages and special virtues specific to small and medium-sized enterprises that give rise to major competitive advantages – and often outstanding world market leaders.

Unfortunately, however, it is also true that these advantages can quickly turn into disadvantages if the patriarchs lack their own calibration and self-reflection, and if they cannot let go themselves. In our experience, anyone who thinks that the problems that large family-owned companies like Oetker, Schlecker, Merckle or Oppenheim are faced with every month in a variety of business magazines are exciting, possibly inglorious, but also extreme exceptions is unfortunately mistaken. They are perhaps the tip of the iceberg, but less spectacular problems do proliferate in smaller or less prominent family businesses as well. And certainly, there are also several family feuds that have been spared by the research of journalists (and by luck and chance). Quite a few of these conflicts are directly related to succession issues.

But what exactly are the causes of these problems around company succession? In many cases, the next generation simply has different future plans for themselves or the company than their parents. In other cases, potential successors (apparently or actually) do not have sufficient entrepreneurial qualifications to take over the business. And still far too often the handover is delayed, missed or even revoked as an essential part of the entrepreneur's performance. In our consulting activities, we have already witnessed tragic human conflicts in family businesses, in which, for example, the senior family member unexpectedly came back at the age of 78, after he had already handed over the company (but not the majority of the shares) eight years before to hundreds of guests with a symbolic key and tears in his eyes to his son, who was no longer so young. In the meantime, he had probably noticed that things could get boring in Tuscany at some point – and that the son would probably not be able to do lead the business without his help and guidance. Not infrequently, strongly emotional power struggles for succession, shares or influence between or within generations and family tribes wear down those involved. This can quickly lead to disagreements between the shareholders, and in the worst case can even lead to the break-up of the company.

What should family entrepreneurs be advised to do? Even if, of course, recommendations always have to take the individual context of the company into account, it can certainly be stated: A successful succession must be planned with sufficient advance notice and comprehensively prepared with all parties involved. Most succession situations arise purely for biological reasons due to age – and are therefore actually predictable. Sometimes, however, fate also strikes, and a succession must be organised at very short notice, e.g. for reasons of illness. Unfortunately, it is precisely these emergency plans that the majority of the affected companies and families do not have in their drawers. And in such cases, is there no advisory board that already bears responsibility or at least is "activated" at short notice?

Successful handovers are often planned eight to ten years or more in advance, because ideally, the senior and successor should run the company together for several more years. Ideally, there is a well-thought-out, structured and objectified decision-making process that leads to a regulated succession solution from the perspective of all stakeholders. Should there be family-internal options for succession, these candidates must be handled very carefully in the development. Education is the foundation, grooming occurs afterwards with work experience. In the case of several candidates from different family / shareholder strains, one should, of course, ultimately the best candidate should win – the "thickness of the blood" should not be decisive. The question of whether and which candidate in a family is best suited to lead the company or to accompany it as an active partner is one of the hardest to make. Many families have broken apart over such a decision. Apparent non-suitability or obvious outstanding aptitude are still relatively easy to judge – even for fathers. But it becomes extremely difficult when it is necessary to distinguish between "still suitable" and "just not suitable". Even successors can indeed grow into larger functions and develop, but "entrepreneur genes" are unfortunately rarely inherited. An external moderator, be it the chairman of the advisory board or an independent consultant, can play an important role in such decisions, providing some objectivity, and attempting to moderate or resolve alleged family conflicts.

In addition to considerations of protection and provision, financial and legal aspects of succession should not be neglected. Depending on the current company valuation, a potential successor may have to expect significant transaction costs (taxes, costs for (legal) advice, etc.). In addition, it makes sense to develop a long-term family strategy at an early stage, which reconciles the interests of family and shareholder responsibility and forms a framework for successfully transferring the company to the next generation. Company values and objectives, but also requirements for a successor, should be written down in a family and corporate constitution.

In the end, the difficult process of generation succession remains one of the key challenges that entrepreneurs should consider as a high priority, personal task. The timely initiation of the process, the comprehensive involvement of all participants, open communication as well as the use of external support and advice can have a very positive influence on a successful generation succession.

Actively Managing Succession

The role of supervisory bodies in succession planning for CEOs

by Dr. Christian Bühring-Uhle

Each year, roughly 10-15% of CEOs are replaced, which corresponds to an average retention period of no more than seven to eight years. Although this is not only an exceptionally important, but also an inevitable task, most companies are not prepared for it. In the United States, shareholders can force the Board of Directors to create a succession plan by litigation; yet a survey in the US revealed that in 50% of companies the Board of Directors was not prepared to appoint a successor in case of need. In 40% of companies it was stated that there was not a single suitable internal successor. This does not appear to be too much of a concern, as time spent on succession issues averages just two hours a year. One of the most important tasks of the supervisory body (be it the Supervisory Board or the Advisory Board) is to ensure that the company is managed in the best possible way, i.e. that the person at the top meets the current – and in particular the future – requirements for the management of the company to the fullest extent possible.

This means that the supervisory body must not only coach and supervise the man or woman at the top of the company and know when it is time for a change at the top. But also, that the supervisory body must in particular ensure and take precautions that any change at the top, whether regular or unforeseen, will lead to the optimal appointment for the future of the company. This responsibility for the sustainability of the company is perhaps the most important task of the supervisory body. In particular, the Chairman of the Supervisory Board has a special role and responsibility here. Unfortunately, the reality is all too often different, because especially when dealing with succession situations, serious mistakes can be observed time and again – sometimes with fatal consequences for the company.

Of course, we also know positive examples from our practice. For example, more than a year before the CEO's earliest possible departure, the Chairman of the Board of Directors of a larger, listed company asked us for a proposal to accompany his successor. However, we are also aware of many cases in which CEO successions were simply not prepared and planned for, particularly in the SME sector. Quite often, even the most significant medium-sized companies have no supervisory body at all and thus no one to help the long-serving chairman realise that a real "entrepreneurial achievement" is only complete once the handover has been successfully completed.

In order to do justice to this issue, it should be borne in mind that this is not a one-off event, but a continuous process that has a strategic component on the one hand and is an important cornerstone of the risk management function incumbent on the supervisory body on the other. It is generally assumed that, all else being equal, and especially in larger organisations, an internal succession is superior to external solutions, partly because an internal successor knows the company (and its market, competitors, etc.) better and can be systematically prepared for the CEO role. And indeed, at least in larger companies, succession is often solved internally.

The hoped-for advantages of an orderly handover can only be realised in a reasonably reliable manner if continuous work is carried out over many years to ensure that as many suitable candidates as possible are groomed and available. A really suitable candidate for the top position does not grow by him- or herself, especially since the new task will often require completely different skills and personality traits than the qualities that the internal top performers have relied on so far.

However, due to their size and the available organizational and financial resources, many small and medium-sized companies are unable to keep succession candidates in the company. This applies not only to CEO candidates, but frequently to all management functions.

A supervisory body can only fulfil its task if it actively manages the issue of succession and devotes a substantial part of its time and attention to the future, ideally the greater part of it, instead of remaining preoccupied with the status quo and familiar faces. Nor can the supervisory body leave this task to the current job holder. If the long-time CEO attracts a "crown prince" according to his own taste, and possibly changes to the top of the supervisory body even after handing over the staff (which is still frequently observed today), then it should come as no surprise that at some point the company is no longer able to cope with changing conditions. In addition, there is the danger that the former chairman will then morph into a "back-seat driver" and steer the fate of the company from the supervisory board. In these cases, our experience is that when a strong successor to the CEO senses such a constellation, he usually doesn't even come aboard. The other danger is that a not-so-strong predecessor (occasionally to be seen in family businesses) will immediately look for someone 'tame' – or someone even weaker than himself.

A few practical recommendations for owners and supervisors:

- It is advisable to discuss in detail, document, and update at regular intervals the requirement criteria, the process for regulating succession and the "talent pool" of short- and medium-term candidates. The bar should be set high, especially with regard to the competencies required for the top position. Developing these suitability and experience criteria is as important as it is challenging.

- The current CEO plays a particularly important role in building up the candidate pool but must not monopolise the process. And the members of the supervisory board must also get to know these people and develop their own "connection" to them.

- Even if the size of the company allows working systematically on internal succession planning, it is often advantageous to include external candidates in the recruitment process as well. This not only widens the selection and increases the prospects for "fresh blood", but also because an internal successor who has prevailed against external candidates will have better "credibility" when tackling his new task. But there is also a danger – that internal candidates could be demotivated. Such a two-pronged approach must therefore be carefully managed and moderated and requires a great deal of experience and tact.
- Of course, good succession management requires a high degree of confidentiality. In practice, this is more often disregarded than one would think. Increased vigilance, especially on the part of the chairman of the supervisory board, is indispensable.

- Particularly in the case of external appointments, care must be taken to ensure that the new hire at the top is smoothly integrated into the new position (and possibly the organisation).

- Last but not least, there must be a (concrete!) contingency and interim plan if the CEO "fails" unexpectedly and on short notice (for whatever reason).

If these recommendations are heeded it is quite possible that crises can become opportunities, because one thing is clear: the only constant in life – also in the life of companies – is change.

A little more than just gut feeling…

Competence-based assessment and evaluation of successors and managers

by Andreas von Specht

The entrepreneur owner of a medium-sized business sat opposite us and was somewhat perplexed. He had recently spent almost three hours, again, with a candidate for the management of his business. It had been a very nice, pleasant conversation – and the candidate had left a solid and dynamic impression throughout. The entrepreneur finally ended the interview and thought to himself: “Basically, I’m just as smart now as I was before. Is this really the man I want to entrust with the second most important function in my company? How exactly am I supposed to determine whether he really can do that or whether he is just a well-trained candidate?” The candidate was nice and sociable – but of course he knows for himself that this alone is not enough. But what are the objective criteria by which he should judge an outstanding executive? What central questions would he still have to ask in the next interview in order to arrive at a more in-depth assessment? And how can he actually tell whether the candidate also has the potential one day to become his own successor as head of the entire company?

We encounter these questions more frequently. In honest moments they are also asked openly – and sometimes you notice rather intuitively that even experienced company managers are pondering this question. This is especially true of entrepreneurs who frequently make internal personnel decisions, but relatively seldom recruit executives from the market.

Many decision-makers go into such conversations having acquired many years of experience, a good portion of common sense and a pronounced gut feeling. This is good and right, after all, one has to find out whether, for example, a successor candidate fits into the special cultural network of one’s own company. However, purely intuitive evaluations are frequently strongly distorted, and the evaluator risks falling into one of several traps. A few perceptual distortions as examples: the so-called ‘halo effect’: how the evaluation of a candidate is generalized on basis of a very positive impression in a specific situation afterwards. This effect also works exactly the opposite way when a critical first impression pulls the whole assessment down at a later time (the ‘horn effect’). Or there is the ‘hierarchy effect’: in the evaluator’s mind, in which candidates with higher hierarchical standing are automatically judged better – according to the concept of “Once a Board member, always a Board member”. Many evaluators can be overly influenced by the very first impression, which then colours the entire evaluation. The list of possible distortions of perception is longer still. Imagine an aspirant for a partner position in a conservative private bank, who enters the room with white tennis socks under too short suit trousers. Will an assessor be able to get over this initial visual perception later in the conversation?

Judgments are therefore extremely prone to errors. Insofar also a first recommendation reads to take itself with very important evaluations from other humans sufficiently time. It happens frequently that decision-makers decide already after ten minutes that a high-level candidate unfortunately does not fit. Even more astonishing, however, is the alleged ability to decide after a half-hour discussion: Yes, that's a fit! We, as consultants specialised in the assessment and evaluation of executives and entrepreneurial successors, cannot do that at any rate.

We recommend that our clients set the bar as high as possible for the desired "fit". This does not imply searching for the famous needle in a haystack or a "unicorn". But a decision-maker should be clear in his mind beforehand, both when evaluating the performance of his own management personnel and when recruiting externally, which criteria he would later like to apply. When we once asked a raw materials trader in Hamburg what the most important criteria for him for the external search for his successor was, he told us: "Of course, he has to be able to show a little bit of something – but above all he should not steal, if possible". Above all, assessors need methods that reduce the susceptibility to errors previously shown. Competence-based interviews are one such method, and we are convinced that they are the best method to have been developed over the last 20 years.

Competences are reliably measurable for the trained assessor and represent a good indicator of present and future work performance. Some companies have developed very complex competency models with 30 or 50 individual competencies. However, it is already possible to very precisely assess senior managers with roughly 8-10 core competencies. These core competencies can be divided into entrepreneurial and social competencies.

There is hardly any selection process for an entrepreneur succession in which the demand on candidates, above all to be very "entrepreneurial", is not explicitly formulated. But what exactly does that mean? When is someone entrepreneurial? And when are they more likely not? The most important entrepreneurial skills are certainly consistent result orientation, strategic thinking and change management, including the ability to take reasonable risks. Of course, professional competence and market knowledge are also required, but an entrepreneur certainly cannot do without high levels of the first three core competences. This describes the "hard side" of the coin; additional social skills must be examined, i.e. the "soft side". Important social skills are in particular leadership skills, employee development and team orientation, but also, for example, the important quality of customer orientation. And imagine a manager who operates globally in many markets, but who unfortunately is not "cross-cultural" – and in Asia, for example, "like a German tank", he flattens everything. Strategic foresight or the ability to change is quickly neutralized.

In the final selection, but above all in the weighting of individual competencies, it also depends on the specific company situation and position. In the assessment, the competencies are not rated on an absolute basis, but scaled on a relative basis. Each individual competence can be divided into different "activation levels". If a competence is not particularly pronounced (i.e. the pronunciation is in the lower range), a manager is more reactive. Then terms such as "he understands", "he tries", or "he tries to avoid mistakes" appear more frequently in the assessment. Managers who show very high levels of a particular competence are "pro-active" in this area. Then they are not only "understood" and no longer "applied", but "developed". Not only "tries", also no longer only "actually achieved", but "surpassed". Managers with such high competence characteristics can usually also inspire, lead and motivate others to peak performance. In a competence-based interview, behaviour in the past is examined in order to obtain an indicator for future behaviour. The "what" plays less of a decisive role than the "how". So not only the "What did you do?" is questioned, but also the "How did you proceed?", "How did you achieve the result?" or "What exactly did the result look like?".

At the end of a competence-based assessment, there should also be a comprehensive reference process. No one can give as authentic information about a candidate's team behaviour as former team members; or assess how direct leadership felt like former employees. Above all, however, former superiors or chairmen of advisory boards should have their say when it comes to the question of whether a candidate, for example a subsidiary, has really developed sustainably. But beware: the process of obtaining references also needs to be practised. According to surveys, 90% of all reference providers undertake to make a positive assessment before a reference interview.

So, can the medium-sized entrepreneur, who finds it so difficult to assess his potential successor, still be helped? We believe so. As in other life situations, a good mixture is important: A technically sound, competence-based interview process, backed up by comprehensive reference statements – and in the end also a dash of intuition and gut feeling.

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