

## SUCCESSION TRANSITION IN FAMILY BUSINESSES

Tomáš Novák – Jiří Dobrylovský – Petr Adámek

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### Abstract

Transferring ownership of a family business is a very important step. In addition to the economic context, decision-making about economic management also has its emotional aspect. The lifelong building of a family business is often confronted with the reality in the form of the life plans of the next generation. The difference between plans and reality can lead to conflict in the family, but also in relation to long-term business partners. The aim of this study was to analyse the process of transferring or selling a family business to the next generation, focusing on the basic component of the strategic succession plan and to create a proposal for the process of selling a specific family business. Based on the so-called Round Table Discussions, a diagram of the family business sale process and a draft sales plan were created. This diagram addresses all possible issues that may arise in connection with the transfer of ownership.

**Key words:** Family business, controlled succession, strategic succession plan

**JEL Code:** M12, D22, G32

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### Introduction

The article summarizes the results obtained during investigation of problems connected with transition of running and ownership of a family business down to the next generation, which means succession of a family business from the founding father to the son.

Looking at the global economy clearly dominated by joint-stock companies with much dispersed ownership, it might seem that traditional family businesses don't have a place in modern entrepreneurship anymore. But that is a mistake! Many of the big companies, being joint-stock companies these days, were originally set up as family businesses. The best example is a car factory Ford. One could argue that the form of a joint-stock company is more advantageous for many reasons. It is said to be particularly advantageous from the view of increasing the capital and therefore even the company Ford gradually transformed into a joint-stock company. That is obviously true. However, first, each starting company must grow up into a certain size to be attractive for investors. This is not easy at all and can take several

generations of steady building up a business (Cennamo, 2012). Family businesses, no matter of which legal form (trade companies, but often also eg. “father and sons, Ltd.”, where the father keeps the dominant share and thus maintains decisive control over the company), are being set up even these days. Moreover, as family businesses are not bound by a lot of various administrative restrictions (Servus, 2018) typical for joint stock companies, they can solve different problems more operationally and thanks to this they might be more flexible and at least hypothetically more competitive. (Letonja, 2016). Nevertheless, only few of them manage to grow into the size, or to gain such a market share to implement its transformation into a joint-stock company successfully.

This article is based on a research study and submits empirically made conclusions about a common reason why newly founded family businesses only seldom manage that magic transformation from a partner company into a joint-stock company. For the first insight, the reason for this unfavourable entrepreneurial development might be seen in the fact that succession of a family business to the next generation is not only a purely rational economic and managerial decision, but it also involves an emotional element. (Zellweger, 2013).

## **1 Methodology of the research**

The issue of family business succession belongs to main topics of professional literature in the field of family business (Chua et al., 2003). It is a crucial moment in the life of a family business, when from an economic view the family business is transferred from the “founding father” to a new succeeding generation and its participation in the previous economic activity. The relevant literature claims that only 30% of family businesses successfully survive into the second generation and only 15% into the third generation (Kellermanns et Eddleston (2004), or (Casillas, 2011).

Thus, one can assume that a high rate of failure can be expected during succession of family businesses to a new generation of owners. This failure is worth a research particularly in relation to the specifics of Czech industry, respectively its share on the GDP generation and its history. Based on the accessible data from the Ministry of Industry and Trade of the Czech Republic (MPO ČR), the age category of entrepreneurs 56+ accounts for 30% of all entrepreneurs in the Czech Republic. (see Tab. 1).

**Tab. 1: Number of natural persons doing business in the Czech Republic broken down by age structure**

Age	Entrepreneurs absolute	Entrepreneurs in %
group 56-60	200,651	9.78
group 61-65	175,177	8.54
group 66-70	126,538	6.17
group 71-75	73,107	3.56
group 76-80	28,720	1.4
group 81-85	9,202	0.45
group >85	4,044	0.20
Stated groups total	617,440	30.10
Total regardless the age	2,051,614	100

Source: <https://www.mpo.cz/cz/podnikani/zivnostenske-podnikani/statisticke-udaje-o-podnikatelich/pocty-podnikajicich-fyzickych-osob-a-zivnostenskych-opravneni-dle-vekove-struktury--225459/>

The issue of passing down family businesses is hot in the Czech Republic, as many of them are currently in the phase, when their owners are deciding whether and how to pass their business down to the next generation. (Servus, 2018). Creation of a successful model of succession for specific conditions of the Czech Republic where the entrepreneurial tradition was disrupted by nationalization of traditional Czech family businesses (Machek, 2017), has a potential to bring new theoretical and in practice applicable knowledge.

An important benefit of the conducted research is the interconnection between the theory and the acquired realistic findings about functioning of particular businesses in the field of basic elements of a strategic succession plan. Qualitative research, a group interview method, and a method of so-called „round tables“ were used to learn more about the issue of running the succession strategy in the practice of family businesses. This method is studied in professional literature by e.g., Kotler et Keller (2013), or Eger et Javorská (2005). Under the leadership of a moderator, the owners of family businesses discuss their experience in running a succession strategy with the successors in the family business. The aim of this method is to get information how the discussion participants implement the given issue for running of their business. Then the discussed conclusions and experience are generalized.

Another method of qualitative research used is a case study. The method investigates a feature selected in advance, in this case running of a succession strategy in particular businesses. The aim of case studies is primarily descriptive, which means they try to describe the case in its complexity and to describe the relationships in their integrity. The basic idea of

a case study is an assumption that a detailed examination of one case opens an opportunity to understand other similar cases much better. (Hendl, 2005).

## 2 The course of investigation

An analysis of accessible primary and secondary sources connected with a final synthesis was carried out. Internal data are from own sources of the authors and external data represent the outputs of a qualitative research carried out through questionnaires (n = 200, quota sampling). The results can be generalized only for this control sample. Businesses quoted in Tab. 2 represent a selected sample with a permission to be published. These businesses operate in the industry, in general in the B2B market. With a more detailed insight in the history, these businesses have the same characteristics, as they all were set up in the 1990s, their founding fathers belong to the age category of 56+, and the question of succession is very current to maintain the continuation of their family business.

**Tab. 2: Examined businesses**

Number	Name of the business	IČ:	Annual turnover 2019
1	ARMATURY Novák s.r.o.	07524676	CZK 41 mil.
2	Ferostav a.s.	63078937	CZK 69 mil.
3	EMERS-ČR s.r.o.	47539470	CZK 18 mil.
4	PolyComp ENERGO s.r.o.	27156699	CZK 38 mil.
5	Liberecké Kotelárny Hölder s.r.o.	43225381	CZK 60 mil.

Source: own analysis made by the authors

The research study was focused on family companies with experience in passing the control over the company down to the next generation. The research set is based on the sample of addressed companies with a recent experience in the process of controlled succession and examines current social issues in context of economic development in recent years. In total, 200 questionnaires were sent off by emails to business owners or business executive managers. The authors received 166 questionnaires (83%) back. The sample was gained from the database of AMSP organisations. It contains in total 12 questions divided into two groups, some of them being closed questions (with the possibility of only one answer), and other questions suggested a choice from more answers.

The choice of family businesses was intentionally focused on the companies having experience with passing the family business down to the next generation: companies where the process of succession planning as a complex approach is completed (companies EMERS-

ČR s.r.o. and Ferostav a.s.), companies where succession transfer is in progress (ARMATURY Novák s.r.o. and PolyComp ENERGO s.r.o.) and the company Liberecké Kotelárny Hölder s.r.o., where there is no succession transfer, because the company is heading for sale, see table 3. Regarding the related legislature and due to confidential character of the data, the research contains the age of the founding fathers and their sons from the successive generation, but it does not contain their first and family names.

**Tab. 3: Original and successive generations in the examined companies**

Number	Name of the company	Founding father	Successive generation
1	ARMATURY Novák s.r.o.	Active, 56 years	Active, 33 years
2	Ferostav a.s.	Non-active	Active, 41 years
3	EMERS-ČR s.r.o.	Non-active	Active, 38 years
4	PolyComp ENERGO s.r.o.	Active, 64 years	Active, 36 and 34 years
5	Liberecké Kotelárny Hölder s.r.o.	Active, 62 years	Non-active

Source: Author's own information processing

Individual businesses were assessed in relation to their strategic succession plan with the aim to suggest a solution for individual businesses in the form of a feasible scenario of a future succession of the family business to the next generation.

### 3 Results

The discussion at round tables resulted in formulation of questions which founding fathers and the next generation should answer before starting the transition of a family business.

#### Questions for a founding father:

- Have you thought about whether you will participate in running the business after passing it down?
- Have you selected your successor?
- Have you passed your abilities and skills on to the next generation?
- Have you passed your contacts on to the next generation?
- Do you know the value of your business?
- Do you wish to participate in economic results of your business after you pass the business on the next generation?

#### Questions for the succeeding generation:

- Do you wish to take over your family business?

- Are you familiar with the life “style” of your parents?
- Have you seen through at least one crisis in the life of the family business?
- Do you know the value of your family business?
- Are your family relations clearly sorted out?
- Are you prepared for a failure?

The following table 4 summarizes the activities during passing a family business on to the next generation. It was used as a basic material for starting the round tables. The number in columns “the business undertakes the activity” and “the business doesn’t undertake the activity” correspond to the numbers of investigated businesses in tables 2 and 3.

**Tab. 4: Strategic succession plan of the investigated businesses**

Strategic succession plan	The business undertakes the activity	The business doesn’t undertake the activity
Development of talents	4	1,2,3,5
Monitoring and increasing business productivity	1,2,3,4,5	
Business evaluation	4,5	1,2,3
Business funding	1,2,3,4,5	
Business sale	2,5	1,3,4
Preparation for unexpected life situations		1,2,3,4,5
Trusts, foundations and other structures of ownership		1,2,3,4,5
Management and running of a business	1,2,3,4,5	
Maintenance of personal and family wealth	1,2,3,4,5	

Source: Author’s own information processing based on so-called round tables

If there is no harmony in ideas and visions of the parties (founding fathers and next generations) in this basic phase, it is appropriate to ask a key question “to sell or not to sell the family business”? Should the answer be “yes”, it is necessary to start thinking about selling the business or selling the business through so-called MBO. Settling of this issue should certainly be started well in advance.

The discussion at the round tables resulted in a list of the following problems which are recommended to be solved before starting the process of business sale:

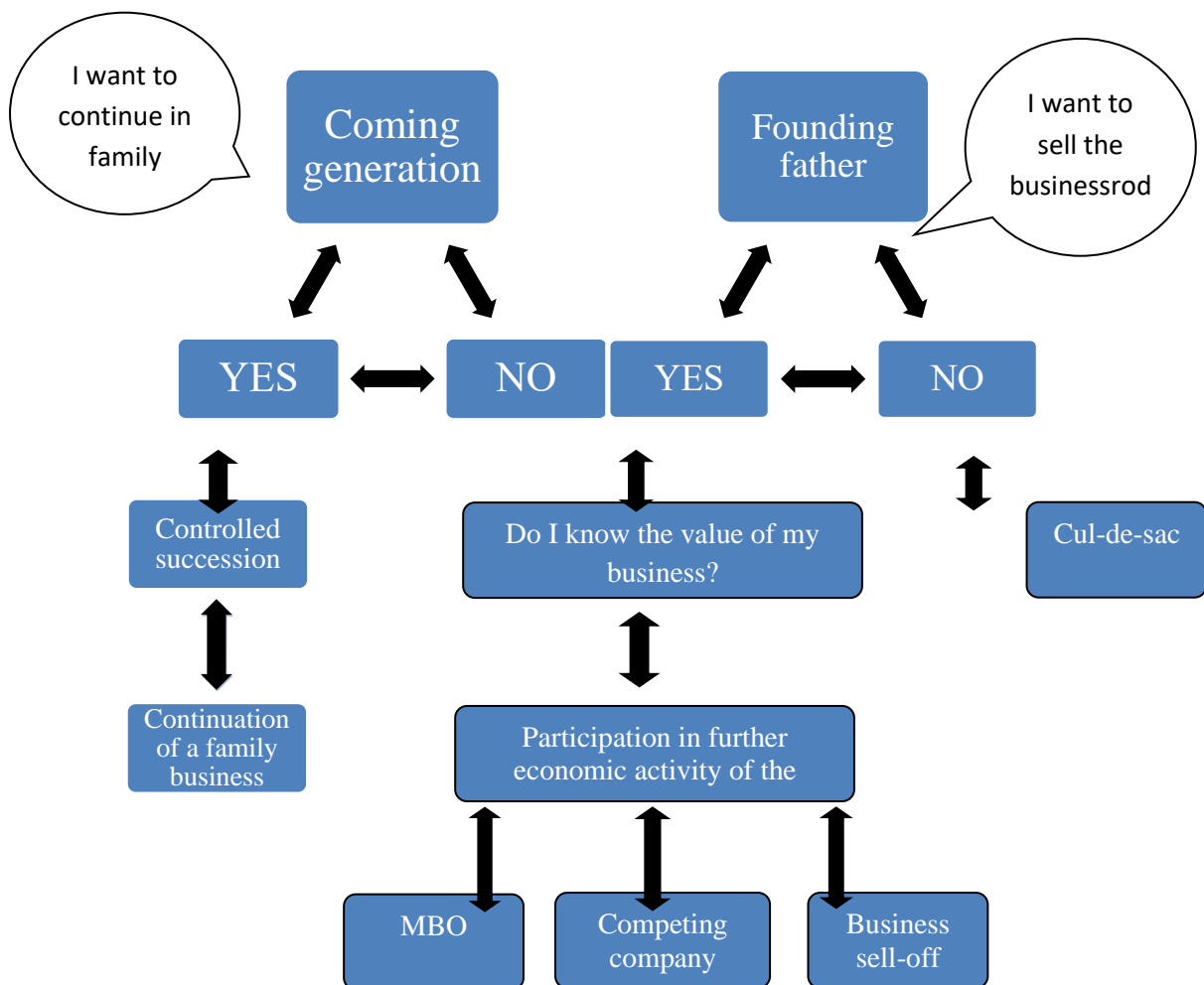
**Recommendations before the sale of the business:**

- To plan the sale of the business at least 2 years in advance,
- To pay attention to financial results of the business,

- Stocktaking of stock and assets, indicating the value of the business,
- To require lump sum sale or instalment sale,
- To answer the question how the sale of the business will influence my family life.

The discussions at the round tables, questions answered by founding fathers and the coming generation, and the recommendations what to do before the sale of the business resulted in the creation of a new flow chart showing alternatives for the future continuation of the family business:

**Fig. 1: Alternatives of future development of a family business**



Source: Author's own information processing based on round tables

## Conclusions

The chart of future family business development assumes, that the business sale is considered by the founding father. The idea of the given procedure is to offer step-by-step guidelines

from the social and economic view. The social view reflects the results of the round tables (see the questions for founding fathers and questions for the coming generation). The economic view reflects the awareness of family business sale impacts, which means whether the financial means gained from the sale will be used as annuity, or as a source of capital for business activities of the coming generation, or they will be divided among the members of the family.

The logic sequence of the chart is clear: the founding father on the one side and the coming generation on the other side both ask the same question whether to sell the business or to continue in running the family business. Apart from other issues, the chart solves a particular situation when the coming generation doesn't want to continue in the running of the business and the founding father is decided to sell the business.

The key issue of the figure regarding the findings at the round tables is the area linking the founding father with the coming generation through questions "Do I know the value of the business?" and "My participation in future economic activity of the business?" Intentionally, there isn't any Yes/No option, as the discussion at the round tables showed that neither party in the figure flow chart) had an idea about the value of the business, respectively about a particular sum at which they would be willing to sell the business at the given time. At the same time, the founding father cannot answer the question of lump sum sale or participation in further economic activity. Hence it is clear that at this point of the figure, evaluation of the business must be undertaken not only in relation to the real estate and movables of the family business, but also in relation to supplier and customer relations, know-how of the family business, personnel audit and other parts of the business which bring a competitive advantage (in case of a family business, competitive advantage in the form of abilities or skills of the founding father is expected).

The last part of the figure is a question of participation in further economic activity of the family business, which means whether the aim is a lump sum sale or instalment sale of the business and the ensuing way of the sale. The discussions showed three expected ways of the sale – MBO, competing company and business sell-off. The use of the MBO principle for the sale of a business is known, however, the idea to address competing companies is the second key point of the round table discussions.

The premise results from the assumption that a family business knows its competitors (often other family businesses) as they act in the same specific industries. Knowledge of the competition is understood as an opportunity to choose and address a prospective buyer of the business. The issue of business sell-off in the chart represents the phase when the business is



not able to find a potential prospective buyer and the only possibility is to direct the business to the sale of real estate and movables. Founding fathers emphasize the negative perception of the word “business sell-off” as this form is unacceptable from their point of view. To get a complete figure, ensuing phases in case of continuing of the coming generation or in case the founding father can't make any decision are also given in form of a cul-de-sac.

From those 5 investigated businesses, only the company Liberecké Kotlářny Hölter s.r.o. is seriously considering the sale. At these days, the coming generation is not participating in the running of the family business and so the current management is thinking about the sale. Long lasting activities of the business in the field of investment construction of boiler rooms and boiler plants, boilers, heat exchange stations, steam pipelines and gas pipelines enable the company to look for a prospective buyer among the current competitors or to transfer the running of the company through MBO.

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### Contact

Tomáš Novák

University of Economics and Management

Nárožní 2600/9A, 158 00 Praha 5

tomas.novak1@infovsem.cz

Jiří Dobrylovský

University of Economics and Management

Nárožní 2600/9A, 158 00 Praha 5

jiri.dobrylovsky@vsem.cz

Petr Adámek

Prague University of Economics and Business

Nám. W. Churchilla 1938/4, 130 67 Praha 3

adamek@vse.cz