Information Booklet

Business Management

7

Succession Plan

for SMEs

SMEDA

NBDP

National Business Development Program for SMEs

Introduction

Small and Medium Enterprises Development Authority (SMEDA) works under the Ministry of Industries and Production, Government of Pakistan and was established in 1998 with the objective to propel economic growth through development of SMEs. SMEDA serves as an SME strategy-advisory body for the Government of Pakistan and facilitates partners in meeting their SME development agendas.

SMEDA envisions growth of a globally competitive SME sector (in Pakistan), through creating an enabling environment and support services for increase in the national economy. SMEDA strives to achieve this vision by providing assistance in employment generation and value addition to the national income, through development of the SME Sector, by helping increase the number, scale and competitiveness of SMEs.

National Business Development Program for SMEs (NBDP) is a project of SMEDA which intends to provide hands-on support services to SMEs. The aim of this business development support provided by NBDP is to advance new businesses and improve efficiencies in existing SME value chains to empower them to contend in global market. NBDP expects to facilitate around 314,000 SME beneficiaries over the period of five years.

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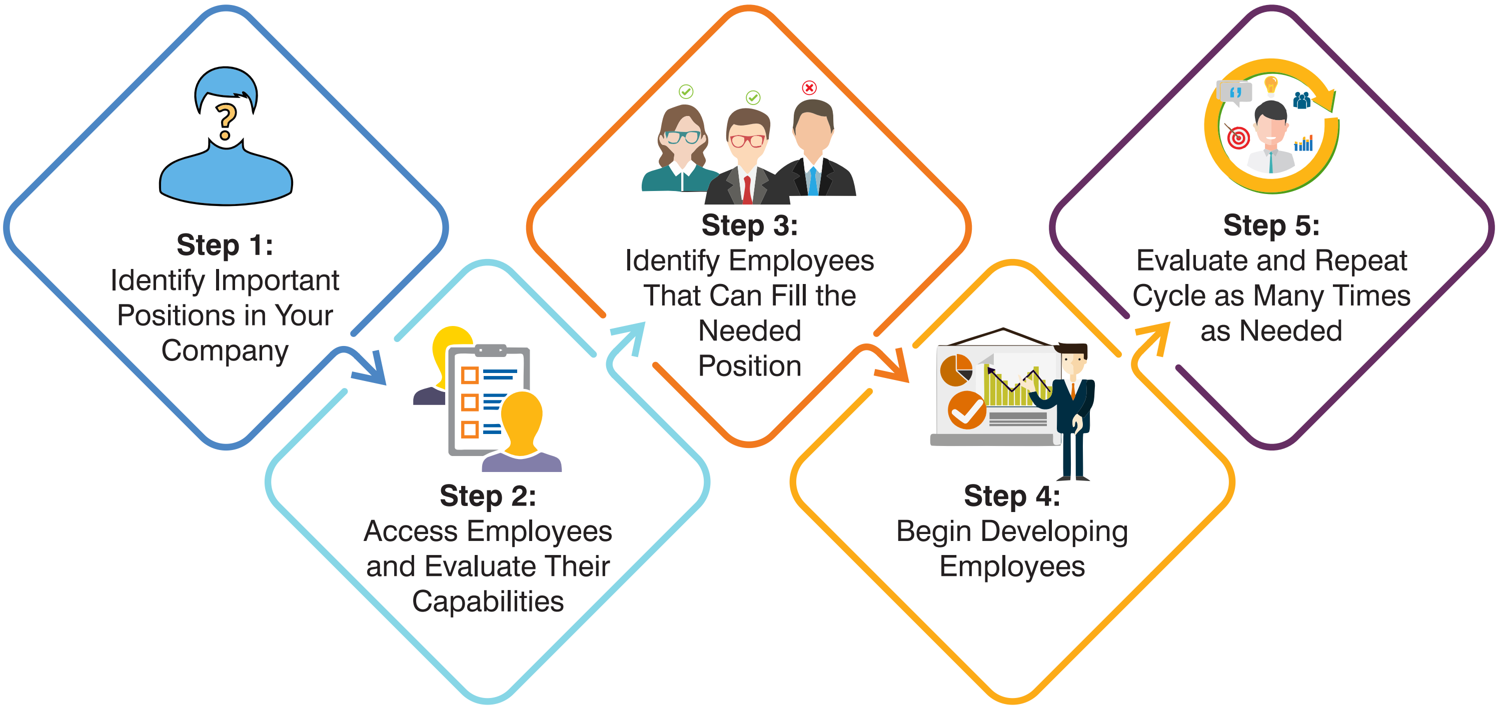
Objective

- To provide information about business succession planning to ensure smooth transition process for the successor with less possibilities of disruption to operations.

Table of Contents

a Introduction to Succession Planning

Succession planning is a strategy for passing on leadership roles to an employee or a group of employees. Also, referred to as the replacement planning, it ensures businesses continue to run smoothly in the event of a business owner or senior management member moving on to new opportunities, retiring or passing away.



Succession Planning Process

b Significance and Importance of Succession Planning to Business Success and Growth

How can succession planning help the business?

1. It signals the business's long-term future by protecting it from the trouble that unwelcome departures can create.
2. It assures clients and customers and helps preserve their confidence in the business because they know that it will continue to provide products and/or services without interruption.
3. It helps focus people's attention on the competencies they need to do an excellent job.
4. It puts more focus on developing talent from within the business. Employees will know that with targeted education, training and coaching, they could move into key positions. This boosts overall motivation, morale and satisfaction of employees.

How to Develop a Succession Plan?

Determine the Plan Type

Determine the concerns stimulating the development of the succession plan. Clarifying the reason for developing a succession plan will help construct a plan that truly meets the business needs.

Put a Succession-Planning Team Together

Find the right balance of people to participate in the succession-planning process. Select people who are process-oriented, effective communicators, knowledgeable about job competencies and competency development, and connected throughout the business in ways that will help garner support for the plan.

Identify the Main Factors that will Influence the Plan

Anticipate factors that may influence the success of the succession plan e.g. changing trends occurring in the marketplace that will require new competencies in key positions.

Link Succession Plan to The Overall Strategic Plan

The overall business strategic plan tells both - customers and employees alike - what the business is all about, where it's going and how it will get there. If the succession plan is out of sync with the overall strategic plan, the succession plan will not work.

Identify Sources for Successor Candidates

After identifying the competencies required, determine how and where can the right candidates be found. The two major sources are internal and external candidates. External sources include employment agencies, internet job boards, professional association websites, colleges and universities, job fairs etc.

Shape Action Plans

The succession plan needs to be translated into concrete action plans with measurable goals, specified timelines and people accountable for taking various actions or applying required processes. The implementation of the plan needs to be continuously monitored by the succession planning team, evaluated on an ongoing basis and adjusted for unexpected events in order to ensure its success.

Rights & Obligations of Owner:

In business succession, new people or owner(s) join the business and the business owner avail several rights and privileges in exchange of the investment in business, but business owner is also responsible for meeting certain obligations. The following rights and responsibilities apply to all owners whether the business is a corporation governed by bylaws or a limited liability company with an operating agreement:

Rights

A Voice:

All owners can and should attend shareholder meetings and vote on major business decisions such as incurring substantial debt, merging with another business, electing directors, or selling business assets.

Protections:

If a majority owner sells his/her stake in the business, the minority owner will have the right to join the transaction to sell his/her stake in the business on the same terms (if the bylaws or buy/sell agreement create that right.) This protects the minority owner from owning shares in a business that is now owned by someone they may not know.

Transparency:

Every shareholder has the right to inspect the list of shareholders and the most fundamental of its books and records. Sharing all the financial information might be a challenge for senior owner who is bringing in new owners for the first time.

Share of Profits:

Profits should be distributed in proportion to shares of ownership. As an example, an owner who has taken out a loan to purchase 5% of the business should receive a full 5% of the distributed profits. New owners do not have to wait until the purchase price is fully paid, their right to the profit distributions accrues right away.

Obligations

Profit/Loss Focus:

Owners do need to pay careful attention to the profit/loss of the business which is a responsibility shared by all owners whether they are a majority or minority owner. By embracing this focus, new owners often bring new ideas to the table and try to improve business operations in key areas such as: management of staff, technology, marketing and client facing issues in order to improve profitability.

Consensus & Consideration:

For sole proprietors, all the decisions about how to run the business fall to a single person. Once other owners are part of the mix, however, founding owners are no longer making decisions that only suit his or her interests. Each owner should consider the voices and opinions of the other owners for all business decisions including (but certainly not limited to) making adjustments to the marketing plan, deciding how to recruit and reward new talent or investing in new technology.

Time Commitment:

The obligations of owners may extend beyond an 8-hour day. Because owners are working on the business as well as in it, the responsibilities of managing the business are added to day-to-day operational responsibilities. This doesn't mean owners will always work 16-hour days but it may mean an additional evening or weekend in the office every so often - whatever it takes to grow the business and get the job done.

Rights

Share Appreciation:

As the business grows, so should the value of its shares. Equity should build over time so assuming business growth, the seller should receive the appreciated value rather than the amount originally paid for the shares.

Tax Treatment:

As stock goes up in value over time, the appreciation is not taxed as it occurs. Rather, the appreciation is considered capital gains and is taxed only when the stock is sold. If the stock is held for at least a year, the gain should be taxed as long-term capital gains, a more favorable rate than the tax on ordinary income.

Obligations

Financial Risk:

Along with the right to receive the profits and the stock appreciation, an owner is also taking a risk. The value of the business could go down due to market changes, loss of clients, increased expenses or the loss of a key employee. Keen management is needed to handle such challenges and to regain the business's profitability as quickly as possible.

Legal Considerations:

A succession plan should be a dated, signed and stamped legal-proof folder. The succession plan should address these six legal issues.

The Name of the Successor:

While succession plans usually cover retirement, divorce and death, there are some extraordinary situations like natural disasters and kidnappings that should never be ignored. Having a successor's name attached to the document ensures that an incompetent person will never take over the business.

Distribution of Property:

If some of the business property is registered in the previous owner's name, then this should be addressed immediately. Property distribution is critical because one business owner may want the property to stay in the business. And another business owner may wish to have the property given to family or to themselves for retirement.

Business Structure:

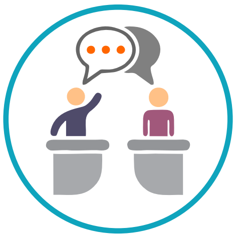
No succession plan is a one-size-fits-all template; each business structure requires its own plan. In case of partnerships and sole traders, the managers and owners can receive succession decisions fairly freely; the presence of a board of directors makes things a little complex.

Taxation Issues:

Unfinished business, debts and outstanding taxes should be resolved before succession occurs. Ignoring them means that the successor will inherit debts they had nothing to do with – especially in the case of partnership and sole trader businesses. Financial management should be thoroughly addressed in the succession planning documentation

Planning of Benefits:

Planning for succession is not only critical in case of an emergency but also in case the management or owner decides to retire. The major decision in this scenario is whether a manager or owner will go on receiving benefits even after they leave the business and what will these be. This is the moment a retirement package is drawn up.



Employment Issues:

Employees are also affected in case of a succession. They have the choice of either following the management or leaving the business altogether, should a partner leave. It is important that you guarantee employee loyalty and protection

How to Ensure Smooth Transition Process for the Successor?

1. Familiarize the successor with the business. Arrange a tour of the new office and introduce him or her to other employees working for the business.

2. Provide the successor with an orientation that covers business policies and procedures, as well as business-specific passwords, acronyms and the operation of business phones, computers, copiers and printers.

3. Help the successor feel more at home by introducing him or her to department heads and other key people across the business. Encourage social interactions such as having lunches that include the successor and business staff with whom he or she will be working. The more welcome a successor feels, the smoother the transition will be.

4. Before the transition takes place, prepare the employees who will be interacting with the successor. Use departmental meetings to provide employees with full information about the successor and his or her forthcoming roles and responsibilities in the business set up.

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If possible, allow the successor, particularly if he or she is entering a top leadership positions, to shadow the person being replaced. This will familiarize the successor with the daily details of his/her new jobs, the issues and problems that typically come up and the knowledge needed to effectively carry out the job.

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Provide the successor with as full a debriefing as possible regarding the ins and outs of his or her new position. Depending upon the position itself, this debriefing should include information on business operations, accounting and financial data, new product development and the strategic plan.

C Identifying Potential Leaders

Sometimes the next leader of the business is hidden within the ranks of the current employees. Businesses must look at the consistent performers as a talent pool for advancement. The following nine-box grid helps evaluate employees' current and potential levels of service to the business. It plots whether the employees are "below, meeting or exceeding" expectations and determines their individual growth potential.

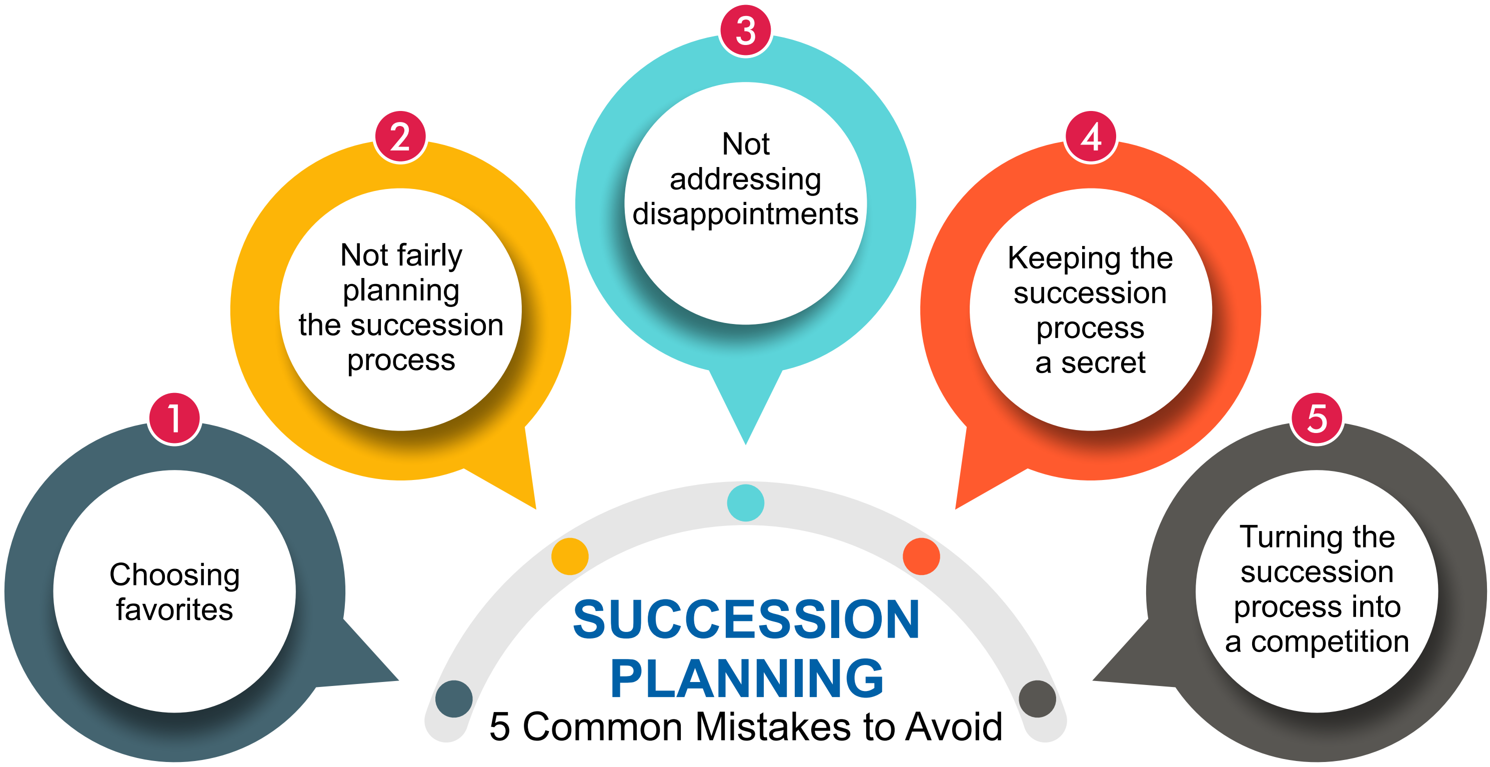
Conducting a thorough performance review can help identify potential leaders who can take on the role of successor. Employees who are consistently accomplishing more than others may have what it takes to move up the ladder. Performance review can help identify which employees are seeking growth or leadership opportunities on their career path. These employees should be considered for future leadership.

X-AXIS (PERFORMANCE)

Y-AXIS (POTENTIAL)

	Under Performance	Effective Performance	Outstanding Performance
High Potential	**Box 5** Seasoned professional capable of expended role but may be experiencing problems that require coaching and mentoring.	**Box 2** Does extremely well at current job with potential to do more. Give stretch assignments to help prepare for next level.	**Box 1** Consistently performs well in a variety of assignments; superstar employee. Big picture thinker, problem solver; self motivated.
Medium Potential	**Box 8** With coaching, could progress within level; focus on stretch goals for this employee.	**Box 6** May be considered for job enlargement at the same level, but may need coaching in several areas, including people management.	**Box 3** Current role may still provide opportunity for growth/development; focused on tactical; focus should be on helping improve strategic thinking.
Low Potential	**Box 9** Consider reassignment, reclassification to a lower level or exit from the organization.	**Box 7** Effective performer, but may have reached career potential; try to coach employee on becoming more innovative with focus on lateral thinking.	**Box 4** Experienced high performer but has reached limit of career potential; Still a valuable employee and can be encouraged to develop communications and delegation skills.

d Common Succession Planning Mistakes to Avoid



e Contingency Risk Management

Businesses should anticipate unplanned events. Contingency planning is an integral part of any business planning. The level of contingency planning conducted is dependent on the amount of risk an owner is willing to accept or ignore.

Some of the basic components of a contingency plan include:

1. **Leadership Succession:** It is not always feasible for small businesses to have adequate leadership ready to take over if the owner is unable to lead but as businesses grow, management layers typically deepen. Grooming a broad management team that can eventually function autonomously mitigates operational risk and increases the value of the business. Key employees can be compensated appropriately and engaged. Some owners even provide key leadership employees with small share incentives to plant the seeds of succession.

2. **Updated Will & Estate Planning:** An owner's will and estate plan should be up to date and consistent with the business succession plan. If the owner were to pass away prematurely without proper planning and communication, there could be a dispute between the children on who steps into the leadership position.

3. **Life Insurance for Liquidity Protection:** Death is usually a tax-triggering event and could put a family in the position of an untimely sale of assets to fund taxes. Life insurance protects against this and also ensures that shareholders and estates do not awkwardly continue jointly owning the business. One could also consider estate freeze planning to limit the owner's taxes at death, the subject of another article entirely.

4

Shareholders' Agreement: This agreement governs the business relationship between shareholders. Three key areas that the agreement should cover are:

Voting and other control provisions	Buy and sell options between shareholders	The entry of new shareholders, including children, into the business.

5

Disability Planning: It's important to create a management team that is aware of the critical functions of the business and who can effectively cover the owner's responsibilities if the owner is incapacitated. It is also important to have an updated Power of Attorney and appropriate disability and critical illness insurance coverage.

6

Diversification: Many business owners have most of their wealth tied up in just one asset – their business. Unexpected economic or industry downturns can dramatically impact the owner's wealth and future lifestyle. During good times when the business is growing and is profitable, consider "taking some money off the table" and diversify into other non-business assets (i.e. marketable securities, real estate, life insurance, etc.). Owners should openly discuss these risks and contingencies to be properly prepared.

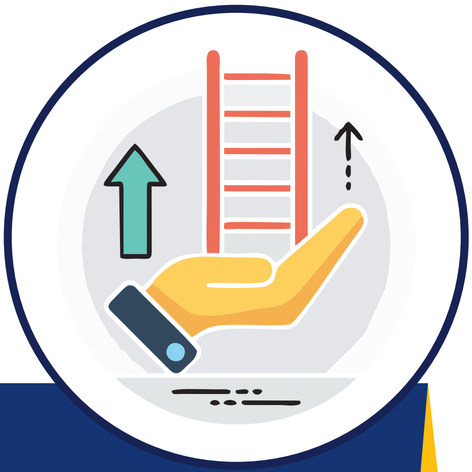
f Succession Planning Checklist

- ☐ Set a clear vision and strategy for the business by creating a formla 3-5 year business plan
- ☐ Bench marking business performance year over year
- ☐ Regularly communicate business's vision and strategy
- ☐ Standardize customer experience and systematize processes and workflow
- ☐ Clearly define processes for business governance and decision making by designing and executing the right business structure
- ☐ Align human capital practices with the business plan

How to align human capital practices with the business plan?

- Recruit proactively for key positions - not reactively
- Establish competitive compensation plans
- Provide regular employee performance feedback
- Focus on employee development and career paths by formalized training and educational programs

Conclusion



Succession planning is a process that ensures a business is prepared for future success and growth. Succession planning is required to identify potential leaders from within the staff members as it helps the business to run smoothly in case the senior leadership is changed or replaced. It is important for SMEs that a good succession plan is in place as it not only helps to secure long-term future of the organization but it also focuses on developing talent from within the business.

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