



Information Overload

Issue 27, November 2004

Welcome:

Welcome to this months issue of Information Overload. First of all I would like to take this opportunity to welcome all our new subscribers, thank you for joining us, we hope you enjoy reading.

This months edition of Information Overload looks at the topic of Succession Planning. If you have ever wondered what will happen to your business, or the business you work for should the unthinkable happen, then this topic should interest you. As always, if you would like to see us cover any other topics, we would love to hear from you. Just send an e-mail to training@iea.com.au.

Have a great week.

Lorraine Bradshaw
Marketing & Training Coordinator

In this Issue we will be looking at:

- What is Succession Planning?
- When Disaster Strikes;
- Small Businesses; Big Issues;
- Why should I be concerned with Succession Planning?
- It's not just about money;
- Poor Hiring Decisions can be Costly;
- A Thought to Ponder.

What is Succession Planning?

In business terms, succession planning is a structured means of training family members or employees who will carry on business activity and fill vital positions within a company should the primary owner become incapacitated and unable to work, or dies.

Imagine that your company or organisation is a small country. Who takes over the running of the country should the leader/ president/ monarch/ dictator no longer hold the office? And what will happen if they don't? First of all there will be a period of uncertainty, this will be intensified if a nominated successor has not been agreed upon, with power struggles, civil war and anarchy likely, all of which is likely to cause untold suffering for those people who are having to live through it.

Thankfully in most cases, a desire to ensure a continuity of operations at all times has meant that most offices have some formalized order of succession. In republics with fixed term elections, the vice-president usually succeeds the national president. In the event that neither person is able to serve, then the Speaker of the House usually takes over. In the United States, the next in line is the President Pro Tempore of the United States Senate followed by the Secretary of State.

In the case of hereditary monarchies, the successor to the throne is through the bloodline. For instance most people are aware of who will take over the British throne when Queen Elizabeth dies or vacates the throne. If however, Prince Charles should die before his mother, then it will be his first-born son who will take over the ruling of the British Monarchy.

Whilst there will be a period of uncertainty as the successor takes his or her place at the helm, we all know that the "country" will continue to run. Unfortunately most organisations do not have the same approach to their continued existence, and it is not unusual for the business to fail once the primary owner and driver of the business is no longer at the helm.

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When Disaster Strikes

September 11 is perhaps the most vivid example of what can happen when disasters happen, and a company's fortunes can change in a heartbeat. Bond-trading firm Cantor Fitzgerald lost about 700 of its 1,000 World Trade Center workers, including many top executives. Whilst disaster planning can assist an organisation overcome incidents, with backup strategies for information, mirror sites and alternative locations to work from, it is a little harder to replace the intimate knowledge and details a person holds in his or her own memory.

An executive interviewed in the *Los Angeles Times* expressed how overwhelming it is to face a future without a company's established leadership. Jimmy Dunne, a principal at investment banking firm Sandler O'Neill & Partners, was away from the office when the World Trade Center was attacked. Chief executive Herman Sandler and investment banking chief Christopher Quackenbush died in the building's collapse. Dunne suddenly found himself in charge. The problem was that he alone could not duplicate the strengths that each partner had brought to the firm.

The fact that different people bring different skills to the table isn't lost on experts. "Typically, the CEO of a company has a certain set of skills that leads to success," Monson says. "But the same person might not be so strong in other areas, and so might depend on others to fill in the gaps." A succession plan can help an organization identify its needs -- as well as those of individual managers and executives -- and ensure that it is hiring and training to fit an overall master plan. A plan can also help employees gain experience in diverse areas so that they're ready for an assignment when an opening occurs.

As reported in
<http://www.workforce.com/section/00/feature/22/97/54/>

Small Businesses: Big Issues

A business is generally regarded as small if it has the following characteristics:

- It is independently owned and operated;
- It is closely controlled by owners/managers who also contribute most, if not all, the operating capital;
- The principal decision-making functions rest with the owners/managers; and

- They employ less than 20 people.
- Non-employing businesses** are those that are sole proprietorships or partnerships, and do not have any employees.

Micro businesses are those that employ less than five people and include those classed as non-employing businesses.

According to the Australian Bureau of Statistics, the number of small businesses in WA is continuing to climb. In June 2003 there were 139,500 small businesses registered in WA, an increase of 2.8% over the previous 2 years. Of which:

- 62% of which are non – employing businesses (owner operated);
- 54% of small business operators are aged between 30 and 50;
- Approximately 100,000 small businesses are operated from home; and
- One third of all small businesses are operated by women. (Source ABS Cat. No.8127.0)

Thankfully not every organisation is going to suffer the devastating loss of life brought about by terrorism, however small businesses are perhaps more vulnerable to loss through injury, illness or death as the following illustrates.

"Michael is 55 years old, married to Wendy with two children. He is in partnership with his friend Peter. Peter is 32 years old and recently married. Together they run a successful machine parts business. Peter specialises in sales while Michael has the technical expertise. Through 7 years of hard work, endeavour and frugal drawings the business is now worth \$1.4 million.

Tragically, Michael suffers a stroke and can't continue working. Months pass and the business starts losing money. Peter can't afford to hire someone to replace Michael, as he is still drawing a salary out of the company. Peter wants to buy out Michael's interest in the business but they can't agree on what the business is worth. In any event, Peter is unsure on how to fund the purchase as all of his personal property is already held by the bank to secure the business debt.

Later that month Michael dies leaving all his assets (including his interest in the company) to his wife. Michael's funeral is still two days away but Peter is already in trouble.

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- *The company* borrowed money to purchase a warehouse. In addition, they have a bank overdraft. Both debts are guaranteed by Michael and Peter. The bank manager is on the phone - Michael's death has triggered an automatic default of both debts (as is the case in almost all loans and mortgages in Australia). The bank manager needs payment or to renegotiate the loan: "Will Wendy (Michael's wife) guarantee the loan?".
- The firm has lost one of its biggest assets - Michael's technical knowledge. Peter must immediately find someone who can fill that role.

The problem is exacerbated by the fact that Wendy can't help run the business because she doesn't have the technical expertise, and her children need her more than ever now that their father has gone. - Wendy's once good relationship with Peter is souring over the dispute as to what is going to happen to the business and her husband's usual salary.

Peter is eventually able to re-finance the two loans at a higher interest rate. He manages to employ Rod, who has the necessary technical knowledge. Peter has to pay Rod \$80,000 a year. Errors made before Rod started result in the loss of the firm's best client.

Peter is forced to take on further debt to keep the business afloat. In desperation, he tries to sell his share of the business. The offers are only a fraction of what the business was worth before Michael suffered the stroke. Grimly, Peter decides to struggle on.

The company folds less than 12 months later. Peter is bankrupt and loses his family home."

<http://www.taxlawyers.com.au/Manuals/Succession.htm>

Why should I plan for business succession?

Business euthanasia is quite common in small businesses. Less than 30% of business owners aged 51 to 60 have a written Business Succession Plan, and more than 70% have no plan at all. For those people over the age of 60, half do not have a written plan for the orderly or disorderly transfer of their businesses. It has been said that only a third of family businesses continue into the second generation and less than a sixth (16%) survive

to the third generation.
<http://www.taxlawyers.com.au/Manuals/Succession.htm>

Having a business succession plan means you:

1. Give your business every chance of survival when you are gone or suffer a long-term illness or accident;
2. Ensure your family and yourself receive the true value of your interest in the business;
3. Allow for an orderly transition of ownership to the remaining partners, family members, or key employees - rather than suffer a fire sale;
4. Provide a ready market for your business interests;
5. Retain key employees

A **Business Succession Plan** considers the best way to:

- Structure your affairs to reduce unnecessary Capital Gains Tax, Income Tax and Stamp Duty for you, your family and your remaining partners;
- Fund the transfer of your interest in the business to your outgoing partner;
- Trigger the events to allow the succession to take place, for example your business partner:
 - gets a nasty and undignified divorce
 - goes broke
 - dies
 - goes to jail
 - becomes of unsound mind
 - suffers a total and permanent disability
 - suffers a trauma event, like a heart attack or a stroke and can't get back to meaningful work
 - turns 60 and wants to retire

<http://www.taxlawyers.com.au/Manuals/Succession.htm>

It's not just about money

The reason succession planning is not high on the agenda is because it is not easy to do. Mapping out the success of a business means having the right financial plan and insurance just in case something happens. It also means knowing who is going to take over the key positions.

To begin with, it is essential to know which employees have the particular skills and competencies required to assume positions higher on the corporate ladder, what talents will be required in the future, and how best to

train employees for management positions, or whether a company will need to hire talent from the outside. It is sad to say that mentoring and on the job training is a vital component often overlooked by organisations.

In the past, developing and promoting talent was a fairly simple proposition. The CEO or board of directors simply decided who would be slotted into a senior management position - a decision usually based on hunches, instincts, and intuition. If the CEO or president died or became seriously ill, the number two person almost always assumed the top post. In most instances, the person next in line knew ahead of time that the company was grooming him or her for the job. This follows the linear progression used by most countries as discussed previously.

But having a well-designed succession planning system allows HR and senior management to adapt more quickly to rapidly changing business conditions -- including new roles and responsibilities for executives, as well as coping with the after effects of disasters.

Yet many organizations lag behind when it comes to implementing an effective succession plan. "They engage in replacement planning. They ask managers to fill out forms and suggest who should be promoted," says William C. Byham, CEO of consulting firm Development Dimensions International and author of [Grow Your Own Leaders](#) (DDI Press, 2001). Even worse, many businesses don't bother to use the list they have, thus alienating workers further."

Byham says that identifying top talent is usually the easy part. (Although tools such as psychometric testing may be able to assist with the process). It is providing people with the skills and knowledge necessary to become leaders that presents a challenge. In order to develop future leaders, it's essential to inform the brightest and the best that they're in an "acceleration pool" and move them around within an organization to gain expertise and experience. "The fact that they're considered for future leadership can prove to be a huge motivation," he says.

Poor Hiring Decisions can be Costly

According to a recent news report failed management transitions are costing Australian companies dearly. It is estimated that almost 40% of managers fail within the first 18 months of being taken on. Companies employing managers on an annual salary of \$120,000 can expect to incur an average cost of \$780,000 to cover the failed management transitions. Costs include recruiting and preparation, compensating the manager and maintaining them in the job, severance pay, mistakes, failures, missed opportunities and business disruption. It is also estimated that it takes approximately 6.2 months before a manager in a new role adds value to a company, as they are spending all their time and resources to learn their new role, rather than doing the job they were hired to do.

Failed Managers Hurt Business. Human Resources Issue 68, 2 November 2004 p11

A Thought to Ponder:

"One of the symptoms of an approaching nervous breakdown is the belief that one's work is terribly important."

Bertrand Russell (1872-1970)

Your comments and suggestions on the subject of this newsletter are most welcome. Or if you would like to see other issues covered in future editions, please email training@iea.com.au

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