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The dangers of not initiating succession planning early

By: PROF. ENRIQUE M. SORIANO III

ACCOUNTING for more than 96 percent of enterprises in the Asean, SMEs that are made up mostly of small family business firms are a significant engine of growth in the region. Although perceived as small, their combined contribution to the economy has a great impact.

It is also a fact that most family businesses have a very short life span beyond their founder's stage and that some 95 percent of family businesses do not survive the third generation of ownership.

In the Philippines, most businesses are small and family-owned. Challenges for SMEs in the Philippines include a lack of research and development, inadequate access to technology, and financing.

This article will focus on intellectual capital management as well as the lack of or inadequate knowledge perspective prevailing in small family businesses. In today's Information Age economy, knowledge—not natural resources, machinery, or financial capital--has become the most important factor in business activity.

Intellectual capital is a result of empirical research

Without being too academic, intellectual capital or IC is the combined value of its people (human capital), the value inherent in its relationships (relational capital), and everything that is left when the people go home (structural capital), of which intellectual property is but one sub-component. The term became widely used in academia in an attempt to account for the value of intangible assets on company's balance sheets.

A second branch that has survived in academia and was largely adopted in large corporations was focused on the recycling of knowledge via knowledge management.

According to Karl-Erik Sveiby in his article "Intellectual Capital and Knowledge Management", a term is best defined by its use, and therefore it is probably still correct to regard IC and knowledge Management (KM) as twins–-two branches of the same tree. Both Skandia and Ernst & Young emphasize the static properties of knowledge, that is: inventions, ideas, computer programs, patents, etc., as IC.

Correlation to family-owned enterprises

Measuring the real value and the total performance of intellectual capital's components is a critical part in running a company in the knowledge economy and Information Age. Understanding the intellectual capital in an enterprise allows leveraging of its intellectual assets. For a corporation, the result will optimize its stock price.

In my family business book, "Kite Runner Column" (Article No. 7), I enumerated several reasons why most family-owned businesses fail and what to do about it. One of the reasons is failure to develop a succession plan. Few people find it hard to come to terms with their own mortality and it may be difficult for an entrepreneur to recognize the time when he/she is no longer the best person to run the company. The third generation has not been adequately trained to take over, thus, resulting in failure to continue the business. And this is where the knowledge management perspective comes into play.

Challenges confronting family business owners

Early succession planning ensures the continuity of management, goodwill, operations efficiency and retention of clients in the event of the owner's departure.

The owner-manager represents the central source of competencies and capabilities in the family firm and sometimes, he retains these assets to his dying day, not knowing why and how to pass them on to the next generation. Another major challenge is in choosing a successor who will chart the future overall direction of the business as well as the highly emotional process of succession. IC plays a role in explaining the competitive advantage of the family business and the successful or unsuccessful family business succession.

One of the surrounding issues involved in the business succession process is the transfer of tacit knowledge embedded in the owner-manager's mind to the successor. Small firms tend to be loosely coupled, founder-centered and with a low development of operative systems. As a consequence, the organization is not capable to retain and to develop knowledge independently from the owner-manager presence, and might not be able to support the succession process.

Under this scenario, the business struggles to survive and loses its momentum to transition to the next stage of the family business cycle. Inevitably, when the owner dies or loses power by reason of health, the business succumbs to internal dynamics and the pressures of the external environment.

Therefore, it is imperative that succession planning, when initiated way in advance, can be considered a capstone and legacy project for the senior generation leader.

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