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Slovak Enterpreneurs and Family Businesses Survey

Private sector in Slovakia in 2014

For the second time, PwC in cooperation with Ing. Monika Krošláková, PhD. from the University of Economics in Bratislava and daily newspaper Hospodárske noviny has prepared an up-to-date picture of conducting business in Slovakia.

Contents

Foreword

Without any doubt, individual entrepreneurs and family firms are a dynamic and stable sector of the Slovak economy. Even though they too were hit by the economic downturn, it was a valuable lessson and the firms that have survived came out of it stronger, more resilient and self-confident.

Everywhere in the world, individual private businesses have their own specifics. Themes like trust, loyalty, financing and succession often resonate within. Decision making differs greatly when your own money is at stake.

Last year we conducted our first survey among family firms in Slovakia and the reason was simple: they are part of the Slovak economy in which we are interested and, since free enterpreneurship has been existing in Slovakia for only slightly more than 20 years, the family business is practically an unexplored area. This year, we have also included individual entrepreneurs in our survey. Many themes that have arisen from the survey last year relate to them directly, too.

PwC has already been conducting a similar global survey for several years. However, the situation in the US or Germany is different from that in Slovakia. Some Western firms have already been witnessing the fourth generation change in the family business and most firms in Slovakia are only preparing for the first generational replacement. Despite this, or maybe because of it, the findings of our Global Family Business Survey are interesting and can also be instructive. Therefore, in this report you will find major global survey findings in addition to the findings of the survey performed in Slovakia.

If we are to summarise our survey among individual owners and family firms in Slovakia into a single message, it would be: entrepreneurs and family firms have been a living and substantial part of the economy. However, they must recognise their unique challenges, learn how to respond to them and overcome them successfully.

We would like to thank all owners who participated in our survey and who shared their experiences and views wih us.

Alica Pavúková
Partner
PwC Slovakia

Rado Krátky
Senior Manager
PwC Slovakia

Monika Krošláková
University of Economics
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Marcela Šimková
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Department of
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The unique features of the private business

As we have already mentioned in the foreword, private business has its own unique qualities that distinguish it significantly from other types of businesses. We asked entrepreneurs how they perceive the most significant differences and unique challenges their firms face.

As many as 63% of respondents have univocally designated greater involvement and personal interest in the growth of the firm. This is natural, since their own money is at stake.

The second ranking (53%) belongs to a simpler decision making process which helps owners address changes more flexibly compared to, let us say,their multinational competitors, which means they are better able to make use of the gaps in the market.

The third, most often reported unique feature (27%), is a more intense linkage between life and work. However, even though it is at everyone's discretion whether to view this quality as positive or negative, it presents the risk that potential challenges or conflicts at work may be carried over into personal life or vice versa.

It should also be noted that entrepreneurs believe that they feel higher commitment to their employees and the firm as such. Based on this stronger feeling of responsibility, they exert more effort than other companies to maintaing staffing levels in the firm even in difficult times. This fact is reflected in the higher level of loyalty and commitment of the people they employ.

63%

of respondents see the uniqueness of private business particularly in higher personal commitment

53%

of respondents believe that they are more flexible in decision-making

30%

of family firms do their business on the basis of trust and unity

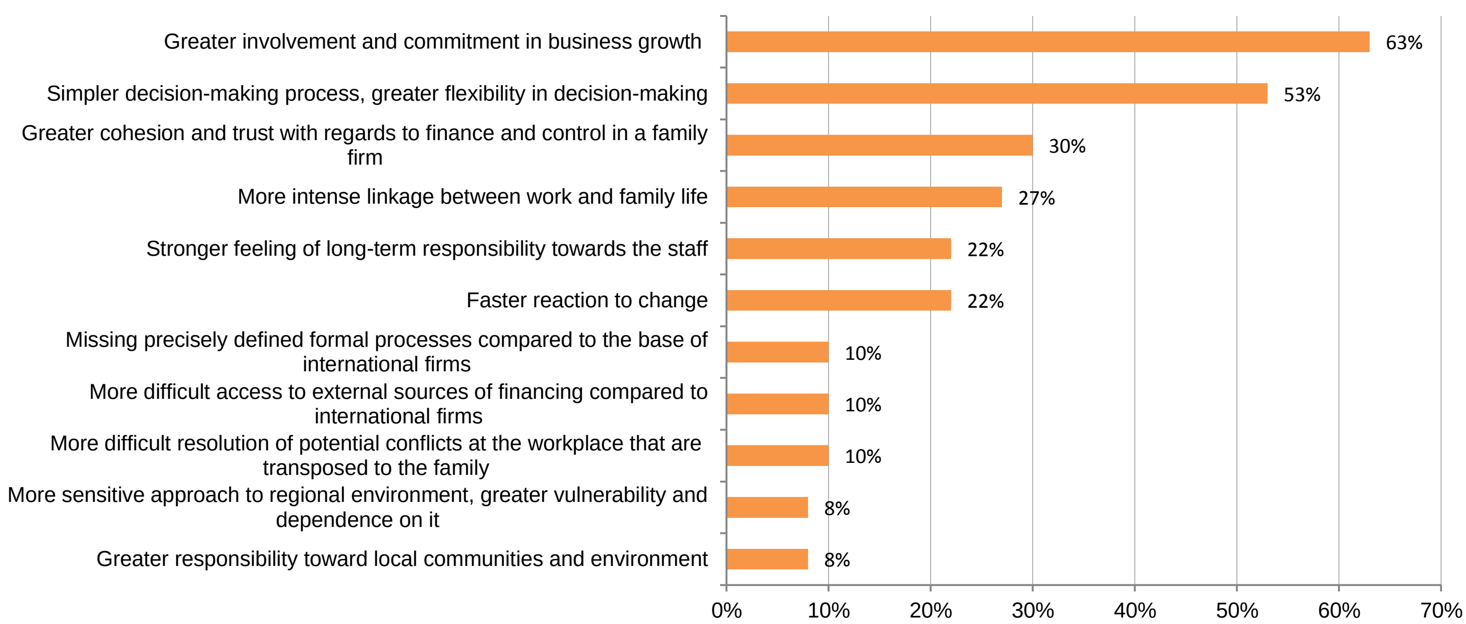
Natural qualities of family firms include greater cohesion and a more personal approach to the business that is based on trust (30%). Family businesses embrace the power of culture and values that are reflected in mutual trust in the area of finance and control. However, the trust in a family firm can be undermined by conflict arising from either professional or personal reasons which can result in disputes about future strategy and business direction, personal performance and remuneration of the family members, etc. Consequences can be temporary and minimal, but also devastating and can bring a firm, which could othervise operate as a sound business, to its knees.

"When a firm achieves a certain size, it is required, if not inevitable, that its owners focus intentively on strategic decisions. It is more appropriate if issues relating to operations are conveyed to professional management.

I believe that there are many areas where indiviual owners and the corporate sector can learn from each other. However I am convinced that there are many areas where entrepreneurs could do without the others' help in order to have greater control over their own fortune. Either by adopting some of the professional processes and also by being more active in seeking and acquiring the assistance they need. We must create a more constructive and positive environment in which businesses can interact, create networks and innovate."

Alica Pavúková
Partner, PwC

What, in your opinion, distingushes Slovak firms in private ownership from other types of businesses? The respondents could identify three areas.



Private business in 2014 and the outlook for next year

In general, we can say that private business is in good shape in Slovakia. Slightly more than half of our survey participants (53%) reported that their revenues increased on a year-by-year basis (2013 vs. 2012) and almost one quarter of them confirmed that their revenues did not change, ie. they were stable.

Next year's expectations are also optimistic: 35% of respondents believe that their revenues will grow and 31% expect slight growth.

This positive trend is backed by the fact that as many as 44% of owners plan to recruit new staff in the next 12 months and 51% of them will maintain their staff number without significant changes. Only 3% of entrepreneurs reported thay they plan to reduce their headcount next year.

53%

of entrepreneurs recorded a year-by-year growth of revenues

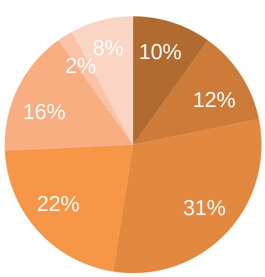
66%

of entrepreneurs expect that the revenues of their firms will grow next year

44%

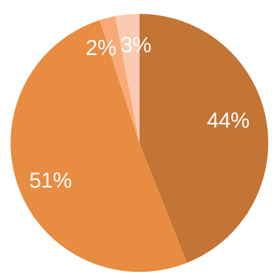
of firms plan to hire new staff

How did your revenues change in 2013 compared to 2012?



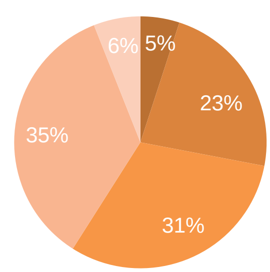
- Increased significantly (by more than 30%)
- Increased (between 15% and 30%)
- Increased slightly (up to 15%)
- Did not change (+/- 5%)
- Reduced slightly (by 15% and less)
- Reduced (between 15% and 30%)
- Reduced significantly (by more than 30%)

Do you plan to recruit new staff in the next 12 months?



- Yes
- No, I do not plan to change the headcount
- No, we plan to reduce the staff number
- Not sure for the moment

Do you expect revenue growth in the next 12 months?



- Not at all
- Not much
- Yes, a little
- Definitely
- Not sure for the moment

The above findings confirm what has already been reported in the foreword: entrepreneurs and family firms constitute a living and substatntial part of our economy. At this point, it should be mentioned that the participants of our survey are firms that have been long established on the Slovak market – more than half of them have been existing in Slovakia for more than 15 years, one- quarter of them employ more than 50 people, and more than a quarter achieved annual turnover in excess of 5 million Euros.

Global trends: stability and perspective

Family firms throughout the world are prosperious. Last year, 65% of them recorded growth and 70% expected stable growth in the next five years. At the same time, these figures are similar to those resulting from our 2012 Global Family Business Survey – which reflects the stability and prospects of the sector.

15% of family firms globally plan to expand relatively aggressively during the next five years, whilst the most ambitious firms are in China (57%), Middle East (40%), India (40%). Not surprisingly, these include firms that will consider a sale or entering the stock exchange (22% globally).

Source: PwC Global Family Business Survey 2014

How do entrepreneurs plan to safeguard growth?

Entrepreneurs and owners of Slovak firms are seeking, relatively speaking, more conservative ways to safeguard the growth of their businesses. One-fourth of them intend to increase their share in the home market, one-fourth will innovate their existing products and services, and another fourth do not even plan to make any changes in their business model. Alternatives, such as cross-border expansion, strategic partnerships or joining forces, are considered only marginally.

They appear to be even more conservative with regards to financing future growth. Two types of sources prevail: bank loans or own finance (either directly in the firm or from private accounts).

Only a small percentage of Slovak entrepreneurs see an entry into private or risk capital as an option.

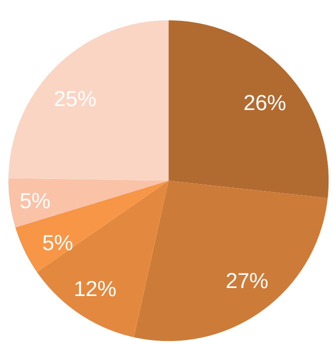
Almost no one is considering offering shares on the stock exchange.

”Primarily, entrepreneurs plan to use their own sources to finance growth, since they have learnt from the crisis that a reliable source of funds can be found inside the firm. Firms that plan to borrow funds will use banks. They are avoiding using alternative forms of financing.

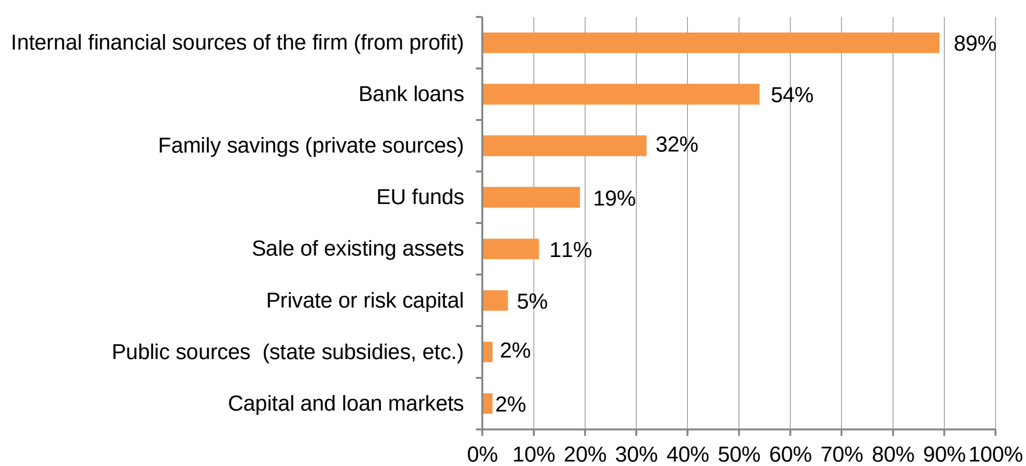
However, I believe that private equity or strategic partnerships are also an appropriate option to be considered by Slovak business owners when considering growth financing. If cooperation terms are set properly, then the common concern about loss of control will no longer be reasonable.“

Alica Pavúková
Partner, PwC

How do you plan to safeguard the growth of your firm in the next 12 months?



How and from what sources do you intend to finance the further growth of your firm? The respondents could identify all relevant options.

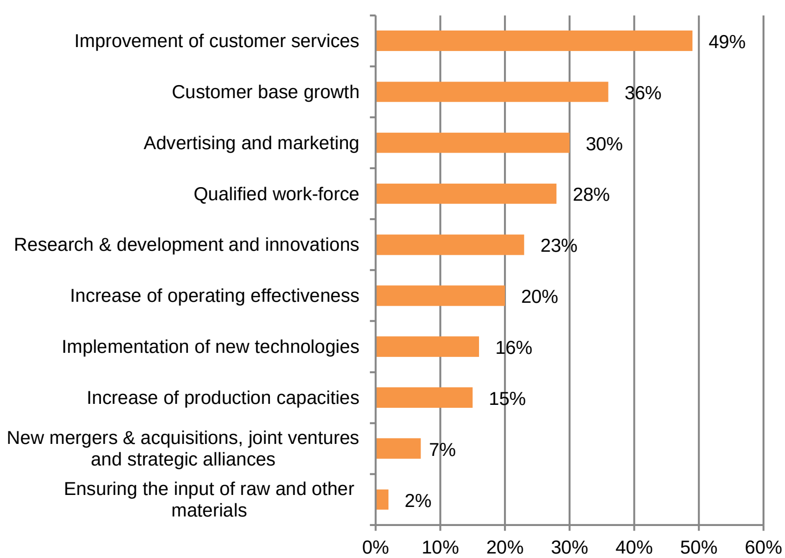


We also asked our respondents where they would direct their investments next year. They intend to spend the majority of funds on improving services to customers. Almost half of the respondents marked this option. Significant investment will be made into ensuring the growth of their customer base and advertising. 28% of respondents plan to invest in skilled staff.

20% of business owners will invest in increasing operational effectiveness. They recognise that optimising operations is crucial in order to face the competition successfully.

Almost one-quarter of respondents reported that they would invest in innovations and 16% see opportunities in new technologies. Our experience and similar surveys show that organisations all over the world are investing in technologies these days. Digital progress is unstoppable and it concerns all players in all markets. It is, therefore, necessary to keep pace with it. Eventually new technologies affect the ways of how operational effectiveness is increased and customer services improved, since customer preferences are also affected significantly by technological progress and the digital revolution.

What are the priority areas into which you intend to invest in the next 12 months? Respondents were asked to identify not more than three areas.



”In today’s complex business environment, planning business growth during the process of ownership and management transfer between generations brings many challenges. Family firms must face never-ending organisational decisions whilst planning the transfers of management and ownership which are driven by the cycles of family life. These issues are not exceptional nor do they relate only to family firms.They rather relate to foreseeable changes occurring in both family and business growth.“

Monika Krošláková
Family Business Expert
University of Economics in Bratislava

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Internal and external challenges

As our findings clearly show, owners of Slovak firms are a vigorous group of very ambitious entrepreneurs, many of whom lead successful firms. However, some barriers exist that must be overcome if the business is to achieve its full potential and meet its growth plans. Some of them are very specific and relate to the business model, on the other hand some include more general challenges that can put the firm in a diffcult situation.

We asked owners to identify top issues or challenges that will affect their firms in the next 12 months. Based on their responses, we divided the challenges into two groups: internal, the management of which is primarily in the owners‘ hands, and external, which are caused by the environment and the market to which firms must adapt and which cannot be easily influenced.

Internally, the top priority will be ensuring profitability and liquidity of customers. This will be followed by the opportunity to finance further growth. In the context of the usual ways that Slovak firms finance their growth (see chart on page 8), these are considered natural priorities.

45%

of respondents identified ensuring profitability of the business as their priority

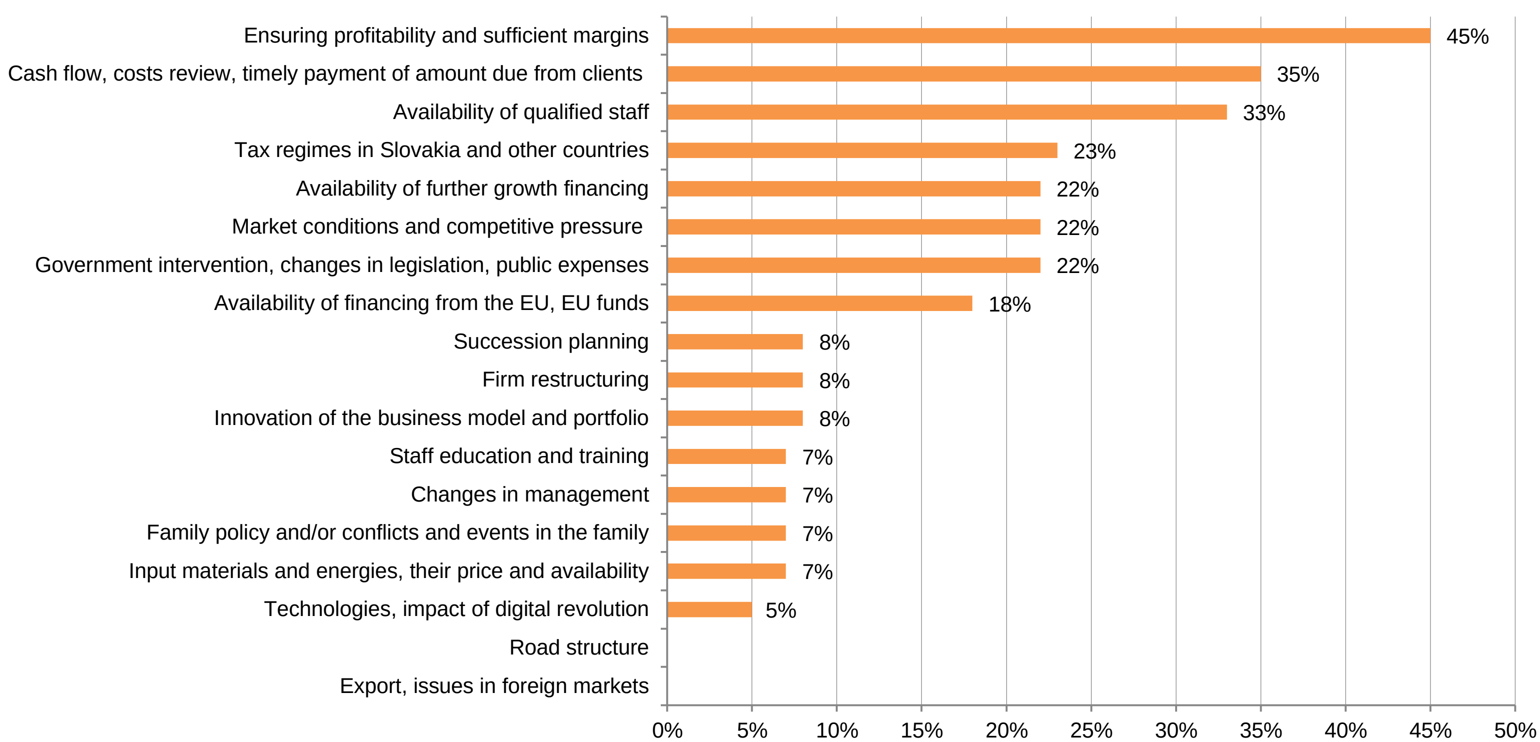
33%

are concerned about the availability of a skilled workforce

23%

view tax regimes as a challenge

What do you believe will be the major challenges or issues that will affect your firm in the next 12 months? Respondents could identify not more than three areas.



With regard to the external environment, Slovak firms are most concerned about the availability of skilled staff. It is difficult for entrepreneurs to compete in the market with international corporations that are offering strutured career growth. If viewed globally, the situation is similar. As stated by one of the respondents of the PwC Global Survey: "it is difficult to employ skilled managers in a family firm as they do not see the opportunity for career growth there."

Other external factors that owners believe will have significant impact on their business are tax regimes - both local and foreign - market conditions, competitive pressure and legislative changes.

Among factors that entrepreneurs are almost unconcerned about are technologies and the impact of the digital revolution – only 5% of respondents consider them a challenge. Nor do they appear in the top rankings for investment or for ensuring growth. However, we believe that entrepreneurs should show a greater interest in the digital revolution as it offers many opportunities. In order that Slovak firms can use them fully, it is essential that they understand the commercial potential of digital platforms.

Global trends: technologies will have priority

Technological development is one of the top global trends that will change the way of doing business worldwide.

72% of respondents understand that they must adapt to the changes of the digital age both internally and externally, so that they can leverage its potential and prevent competitors from overtaking them. 43% also acknowledge that in order to manage this challenge successfully, they will have to hire external staff. This poses the question of whether other firms fully understand the complexity and scope of this technological challenge...

Also this year, innovations remain substantial for family firms globally – 64% of respondents cited this. Even though innovations were identified as the highest priority, our experience shows that family firms are not biased in favour of change. Despite the fact that they concordantly say that higher flexibility is their strength, not much evidence of this can be found worldwide.

Source: PwC Global Family Business Survey 2014

"I believe that taxes will remain challenging for entrepreneurs – especially as they extend their activites across the Slovak borders.

Following and adapting to continuous change in tax regulations is very time and energy consuming. Effective tax planning as part of a firm's strategic management can help enterpreneurs better identify and use available sources that can be used for business development or for other purposes."

Rado Krátky
Senior Manager, PwC

Doing business internationally

Long-term growth and profitability depends on managing breaking points successfully. The first breaking point is the moment when a firm achieves a certain size and can proceed only if significant change is implemented. This can involve a new opportunity offered by the local market, or the implementation or introduction of a new product. However, the most frequent breaking point is the moment when the firm starts exporting its products or services.

Half of the survey participants confirmed that they were involved in export. For almost half of them, export constitutes more than half of their income, and for 21% more than 20% of income.

The majority of Slovak firms export to the Czech Republic (75% of respondents), Germany (36%), and other neighbouring countries. This is also true for the the next five years‘ projections; export destinations do not change dramatically.

49%

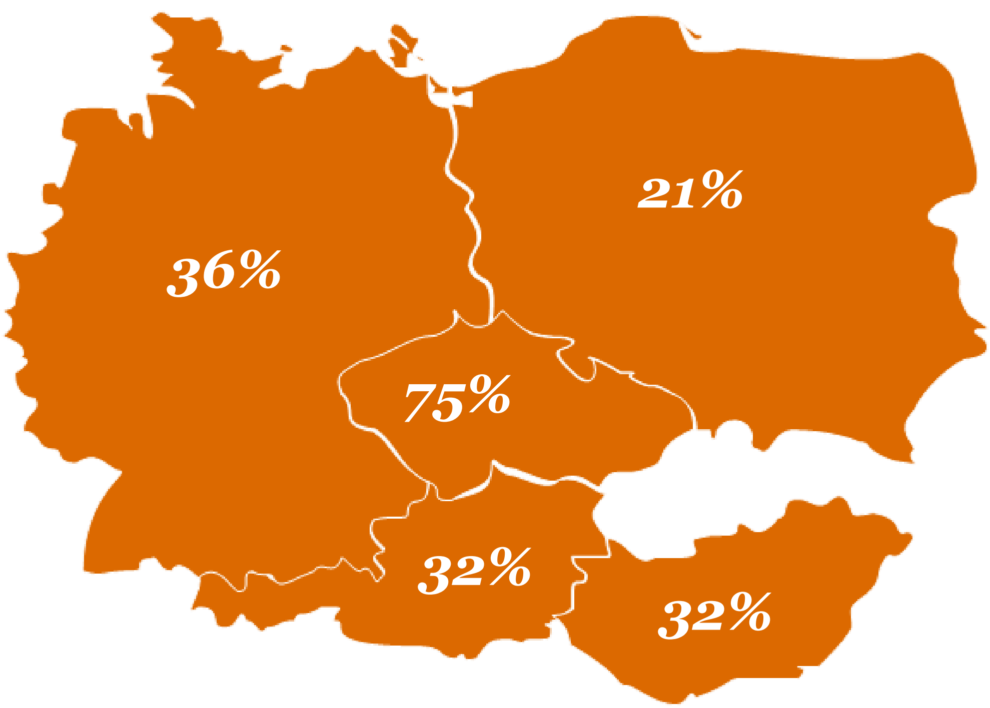
of Slovak firms are involved in export

25%

of entrepreneurs consider tax regimes and joining new markets to be an obstacle

17%

of owners do not have sufficient funds to start exporting

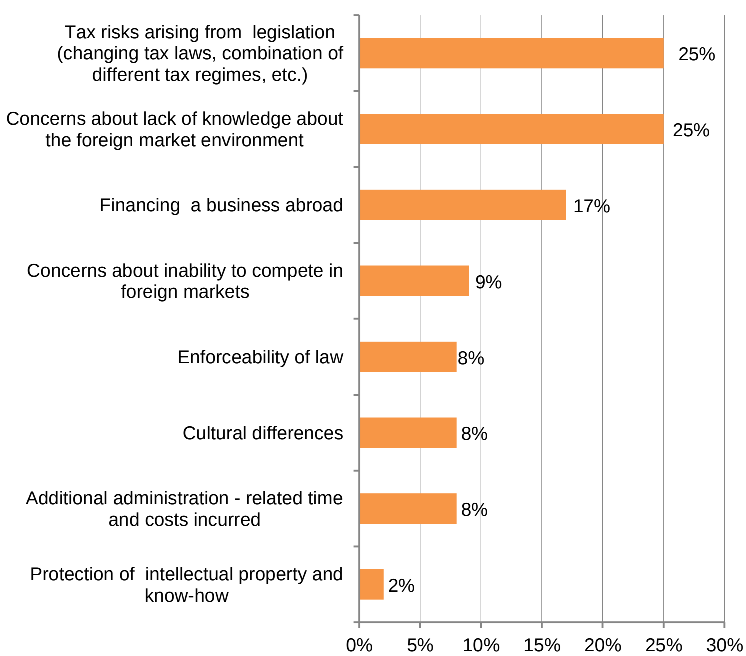


Half of respondents reported that they do not export to foreign markets at all. In the survey, we sought to find out the reasons for this. Almost one-third of enterpreneurs stated that their products and/or services are designated solely for the Slovak market. However, one-fourth noted that they do not have sufficient capacities, such as time or finance.

Expansion into other countries brings specific challenges including managing the supply chain and production, and building the customer base and developing the structure. Moreover, owners must tackle a new culture in the workplace which has a significant impact on the way people are managed, and - last but not least – deal with the new financial and tax laws.

When we asked the respondents to identify one area they consider to be a major obstacle in doing their business globally, the following three areas were most frequently identified: tax risks arising from legislation, concern about lack of knowledge of the foreign market business environment, and business financing in other countries.

What, in your opinion, is the major obstacle in doing business internationally? The respondents could identify one area.



"We have learnt from our experience that when expanding into other countries, it is almost impossible to find a universal long-term solution, e.g. a holding or business structure that would be functionable for all. This is caused by the continuous development of legislations and their interpretation, which in the best case, only responds to new ways of doing business. However on the other hand, these changes offer opportunities for business improvements.

In any case, it becomes evident that the effect of decisions made based on incorrect information about taxes can be devastating."

Rado Krátky
Senior Manager, PwC

Exports to neighbouring countries dominates also globally

68% of family businesses worldwide are involved in export, and the revenues of international business constitute about one-quarter of their turnover. Three-quarters of respondents plan to start exporting or expand their exports in the next five years and they expect that exports will constitute more than one-third of their revenues. This relates particularly to businesses in the East European region, BRIC countries (Brazil, Russia, India and China) and MINT countries (Mexico, Indonesia, Nigeria and Turkey).

However, even though it is probable that the share of export revenues will increase, only a few firms expect that they will increase the number of their export targets substantially. The majority of firms seek to remain on the markets of their neighbouring countries, or where the same language is used or a similar culture prevails. This indicates that family firms worldwide either lack the capabilities or courage to penetrate into completely new territories. Obviously, in order to overcome this barrier many of them would have to hire external staff, from outside the family. However, this situation may result in them losing potential sources of growth.

Source: PwC Global Family Business Survey 2014

Family business in Slovakia

In our survey, we have specifically focused on the profile of family firms in Slovakia. In more than half of the firms, management and ownership is held within the family. Almost one-third of family firms confirmed that some management members are employees of the firm, and in 15% of family firms interests are also held by individuals other than family members. Following from the above, family business in Slovakia is mostly conducted within the family. None of the respondents stated that even though they own the firm, they do not have a family member in top management.

Most often, up to five family members work at the firm – the percentage of owners who stated that they employ two to five family members was about 90%. The insight into the number of generations that actively work in the firm has also been interesting. 62% of family firms employ two generations, and 28% employ one generation. The occurrence of three generations in a family business has been rare so far.

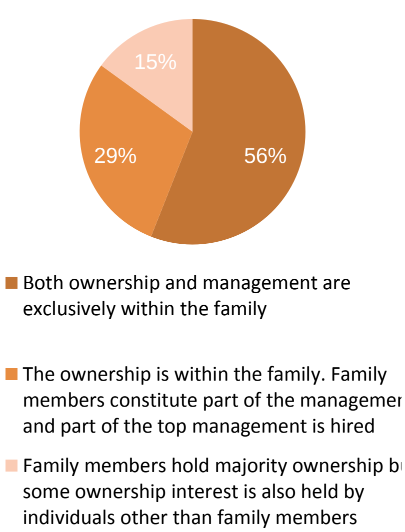
The situation of family businesses in the world, particularly in the US and Germany, is different. Some Western firms already see the fourth generation replacement. Since private business in Slovakia has only a little more than a 20-year history, family firms have undergone only one generation replacement at most, or the retirement of their founder is only just expected.

”The uniqueness of a family business rests in the interaction between business and family rather than in the distinctiveness of related legislation. Family firms are known for their special internal atmosphere where a strict business climate meets with a profound family relationship. Since in a family business several generations of a family work together, it is difficult to distinguish and separate relationships between family members that are often professional at work and informal and emotional outside work.

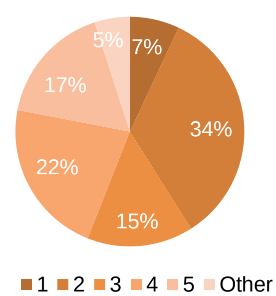
The success of family firms internationally is measured by the number of generations that have handed the business over, rather than by the achieved profit. From this point of view, the objective of a family business is not immediate profit but its continuous existence.“

Monika Krošláková
Expert in Family Business
University of Economics in Bratislava

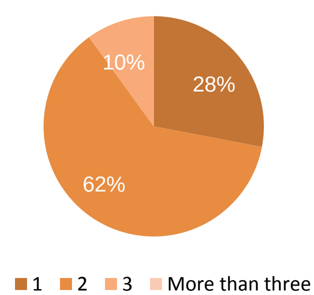
How is the ownership and management of your family firm structured?



How many family members work with you in your family firm?



How many generations are currently working in your family firm?



Professionalising a family business

The strength and weakness of a family business model rests in the name, "family" itself. Working with relatives can lead to a much larger degree of trust and commitment, but on the other hand, also to strain and open conflicts. Reasons for a conflict vary – from professional to personal, from arguments about future strategy and direction of the firm, to arguments relating to personal performance and remuneration of individual family members. Consequences can be temporary and minimal, or disastrous and can bring the business, that could otherwise be healthy, to its knees. Individual family members seek to distinguish the heart from the brain, and achieve success in the family firm as well as satisfaction in their private lives.

Since a family business involves personal emotions in addition to entrepreneurial spirit, professionalising a family business is much more difficult and key decisions are often postponed as they cause many problems that are difficult to solve. However, nothing can be postponed forever and with the passage of time the risk a family firm faces in relation to management challenges, increases.

Professionalising a family business means introducing rules and procedures into how and to what extent the firm interacts with the family as such. In other countries it is common practice for a family business to introduce a formalised infrastructure of decision making and formal communication channels to supplement the informal ones. Their justifiability can be seen particularly in difficult situations or conflicts. This is done for the sake of the protection of family interests, and it ensures the survival of the business.

It is difficult for a family business anywhere in the world to take daring steps and get involved in new risks, as this may divert the business from its comfort zone. So what does business professionalisation mean to family firms? It is above all, the structure and discipline oriented into a clear vision and the ability to innovate better, diversify more effectively, export more and grow more quickly. Simply said, it is setting up a business so as to achieve two basic objectives: long-term sustainability of the company and the improvement of profitability.

Global trends: owning a firm, however not managing it, is "in"

Understanding the difference between ownership and managment is becoming increasingly important globally, and it seems that the trend only to own a business is increasing. The number of family firms in the world that intend to pass the ownership, but not the management, onto the next generation increased to 32% in 2014 (from 25% in 2012). And the closer the moment of succession, the more owners actively consider this opportunity. Even though they would be happy if the next generation took over the business, they acknowledge that an employed management can substitute for one - or even two - generations, or the firm need not return to family management at all.

Professionalising family businesses is often reflected in hiring external managers to manage the firm. Often it is the right decision, particularly if the firm achieves a certain critical size, the handling of which could be difficult for the firm.

Source: PwC Global Family Business Survey 2014

Changes in the ownership structure

The finding that owners of Slovak firms prefer ensuring growth in a rather conservative way, has been confirmed in their answers to the question whether they are planning to implement changes in the ownership structure for the purpose of growth financing. Almost all respondents (98%) stated that they have not considered this option at all.

The longer-term view of changes in the ownership structure is a little more varied. 18% of respondents plan changes in the five-year term.

We also asked respondents to look further into the future and report what they think they would do with their business. Assignment within the family dominated the options they considered. However, almost one-third of owners will leave ownership in the family, but will hire management to manage it.

From other options that included change of owner, the most popular ones were merger with another firm, sale to investors, or sale of the business to another firm (15% each option).

Only 2% of owners would consider sale of the business to management (management buy-out; MBO) and initial public offering (IPO).

18%

of owners plan changes in the ownership structure within five years

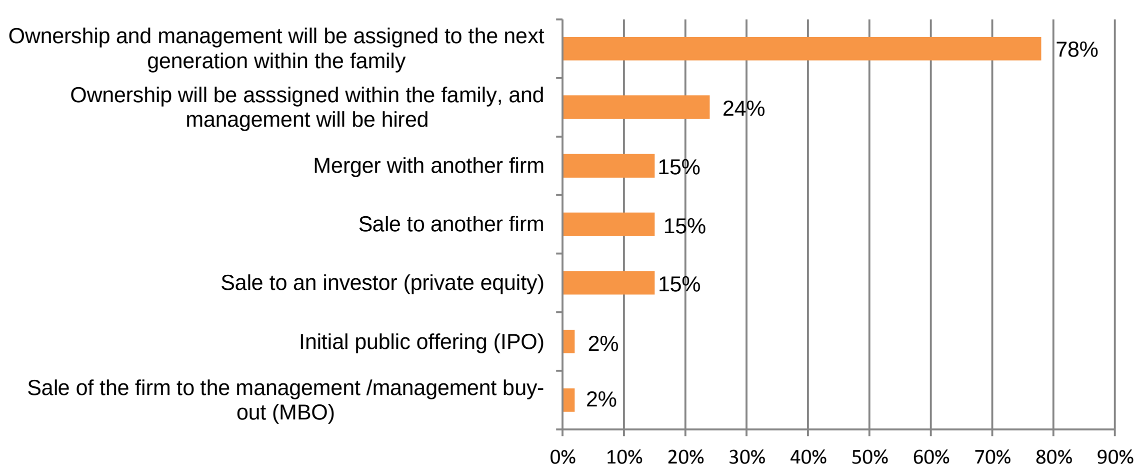
78%

of Slovak firms will be assigned and managed within the family

15%

of family business owners would consider the sale of the business to another firm or PE investor

If you look further into the future, what do you think you will do with your firm?
Respondents could mark all relevant options.



What is the value of your firm?

Whether or not owners plan succession or the sale of their business, our survey has shown that the majority of them want to know the value of their business. However, not all of them actually know it.

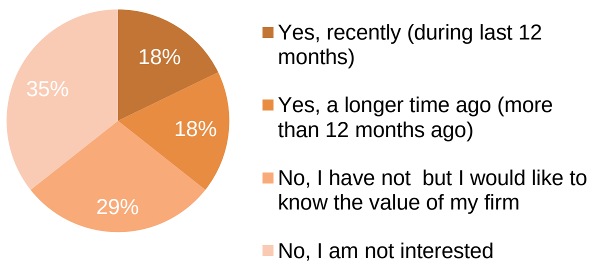
36% of respondents know the value of their firm – they have either had it valued in the last 12 months or some time in the past. 29% of Slovak owners have not had their firm valued, but wish to do so.

"If an owner wants to hand over or sell his business, he should also know its value. There are several methods of assessing the value of a business – from the present value through the expected value of future cash flows, to the results of a valuation or transaction of a business of a similar type or size.

Consulting on the valuation with a reliable third party is a reasonable option, as the owner's emotional links to the firm often prevent him from an objective evaluation of the business and may, therefore, directly affect the attractiveness and value of the business for potential buyers."

Alex Šrank
Partner, PwC

Do you know the value of your firm? Has its valuation been assessed?



Opportunities for raising further capital and/or succession

Succession within the family

The most common approach applied in Slovakia is handing the family business over to the next generation. For the existing owner, this means the requirement of a systematic and early involvement of family members in the business, providing them with the required information and knowledge, often guiding them through all areas of the business and, last but not least, gradually passing powers onto them.

The successful handover of a family business between generations is usually connected withconcerted ongoing efforts on both sides, and the necessity to pass on the older generation‘s knowledge and trust in other family members and business partners. The owner must also be really willing to make the change. His personal inclusion is crucial as is his support of his successor’s actions.

Secondary factors include issues like formal agreements in case of sickness, death, divorce or any disagreements within the family. These must be established so as not to threaten the business. The study of the American Institute of Family Firms shows that only 30% of firms will survive after they are handed over to the second generation, 12% in the third generation and only 3% of firms will get behind the fourth or further generation.

Entry of a strategic investor

Strategic investors buy businesses in order to supplement their capabilities in an appropriate way, penetrate into the market, or gain a competitive advantage. Ideally, both firms should be compatible from the point of view of corporate culture.

The transferred company should be free of any complicated relationships and structures, such as unrelated activities, real estate property, etc. It is also a flaw if in its operational issues the firm is extremely dependent on its owner. Usually, a significant requirement is that management and owner remain in the firm over a period of 1 – 3 years, so as to safeguard the continuity of the business and the transfer of know-how.

Management Buy-Out

Recently, the management buy-out has become more popular in relation to available financing and the growing experience of similar transactions. It is often connected with the entry of another investor, most often financial, who will provide the funds required for the purchase of the business, which may not be available to management or which are not available in the required amount.

It is particularly the management’s ability to finance the purchase that often appears to be one of the issues. Another one is an agreement on the fair value, when management, particularly if the MBO is prepared a long time in advance, can be in conflict of interests. In extreme cases, they can seek to under-estimate the business and act so as to achieve the lowest possible price upon the purchase. The involvement of a financial investor or a competitive offer may reduce this risk.

Initial Public Offering

An initial public offering was particularly popular at the time of the capital market boom prior to 2008, and also in relation to the development of regional stock exchanges, in particular the Warsaw Stock Exchange. Firms usually raise new capital for development in this way.

An IPO is an elegant option for gradually leaving the company and still remaining in touch with it. However, this is achieved by the requirement to become more open to investors and the public and to demonstrate more structured activities.

Preparation for the IPO itself takes at least six months. And on top of that, several years are needed to establish functions, particularly for those companies whose processes are not set precisely.

Sale to financial investor

The reason owners sometimes have a negative attitude towards the sale of their business to a financial investor, often rests in the misunderstanding of the financial investors‘ objectives and the owners‘ concern about the loss of their firm’s identity. However, financial investors in particular are critically dependent on the management of the company and it is in their interest that the firm is doing well and that those people manage it further. The financial investor can then assist in potential expansion, mergers with other businesses within the sector, and can provide the financing.

Merger with another business

The advantage of a merger is that usually there is no need for external financing in this type of transaction. Friendly alliances are quite interesting tools for the organic growth of a business. However, the complexity of the transaction and the potential challenges of further coexistence discourage some firms from taking this step.

If the transaction is performed through the exchange of shares, it is rather an easy step. However, if businesses are merged through their contribution to a new business, the complexity rests in setting mutual relationships within the new business. Therefore, initially a thorough stock count is required to be performed in both businesses, and an agreement made on their future operation, profit distribution, etc. Nor is it easy to determine the share of the merged businesses in the new firm, particularly if one of the firms contributes know-how or capabilities of the management in addition to tangible assets. It is also worth getting prepared for the situation that the merger may not be functional. Entering into a „prenuptial agreement“ that will address the way of leaving the joint entity is also worth considering.

Succession planning and family involvement

The issue of succession or ensuring the operation of a business after its owner - who is often also the CEO - ceases to be active in the operation of the firm, is a complex one, and very sensitive and personal for the owners.

What should be taken into account when an owner considers retiring from the firm? Obviously, he should know the answers to the following questions:

- What is necessary in order to ensure the growth of my firm in the following decades?
- Who is the best person to make it happen?
- When is the most appropriate time to take final strategic, legal, management and tax actions relating to retirement from the firm?
- What is the actual value of my life's work?
- To what extent do I intend to keep control over the management of the firm after I leave?
- How can my family members most benefit from what I have built?
- How can I avoid potential disputes within the family?
- Which option is most favourable from the point view of taxes and legislation?

Answers to these questions require that you have clear vision of the future strategic direction of the firm. Whatever your decision will be, it should be based on your personal and business priorities so as to match your needs best.

"Every owner of a business will sometime ask himself – what will the firm be when I leave? Even though it is not typical for enterpreneurs to think in this way, circumstances will force it.

It is not easy to answer the question, who will take over the management of your firm when you decide to leave? Succession should be a process and not a one-off event. The choice you have may be discouraging. The decisions you make will affect the future of your entire firm, your customers and employees. Whether or not your objective is to keep the business in the family, or to sell it to someone in management or a third party, it will be crucial that you thoroughly consider all alternatives and their consequences and prepare a succession plan. Without the plan, you risk the future of your firm that you have built through hard work."

Alica Pavúková
Partner, PwC

Global trends: succession planning is worthwile

Succession is a breaking point for all family firms worldwide. Only 16% of family firms have a succession plan in place. Too many firms either do not plan succession at all or they manage it rather as a personal issue between two individuals than as a process that requires equal discipline and objectiveness, just as any other aspect of the business decision-making process. The result is an increasing tension and family conflicts that can lead to the extinction of the whole firm. As said by one of our respondents: "Family firms usually fail for family reasons."

A plan that is not written is not a plan, but only an idea. This is a point that family businesses should handle with equal commitment and energy as they deal with professionalisation or other aspects of a business. Succession will always be an emotional issue and this is another reason why it should be approched professionally, rather than personally.

Source: PwC Global Family Firm Survey, 2014

Regardless of the form it takes, succession is rarely easy and has often been a conflict both within the family and the management.

Owners who plan to retain ownership and management within the family are concerned about the new generation being able to withstand the pressure it will have to face. Some of them have to deal with situations where family members are reluctant to take over the management of the firm.

”I do not have any concerns, just the contrary; the new generationcan will be an asset.“

Respondent of the survey

“So far, I do not have any experience, but around me I can see the successors‘ lack of interest in continuing the family business. This is true particularly for smaller family businesses. Children are demanding with regards to their job position and function and do not want to stay in a small family firm, especially when they have studied abroad.“

Respondent of the survey

“I am afraid that young people will not be interested in what we seek to sustain.“

Respondent of the survey

“Family firms almost always destroy family relationships. The distribution of power and money will never be fair and similarly neither will be the succession – who and why just him? So we are sceptical about this issue.“

Respondent of the survey

“Succession is about trust, regardless of whether we have a family or any other type of business in mind. I can see possible risks in a family business in conflicts about the management of the firm and the potential effect on family bonds.“

Respondent of the survey

Views and opinion of an expert in family business

One of the major factors that affect the continuity of a family business upon its transition from one generation to another, is whether or not succession is planned. Planned succession safeguards the harmonic transfer of the family business from one generation to the other. Members of a family business often have mixed feelings about succession planning; these are natural concerns about the change in functioning of an already proven business cycle.

In economically developed countries, “family business“ is a synonym of quality, prestige, and proven stability of the firm, acknowledged proudly by the whole family. You will obviously spend all your time in the family firm you own and will seek to build it for your children. This works differently when you are part of a large corporation and need too achieve immediate results in order to receive a good appraisal at the end of the year. Moreover, if you give your name to your firm, which is common for a fimily firm, you care about it differently than about an anonymous corporation where other firms also hold ownership.

Of course, a family firm cannot always and at any cost rely only on the potential of the family. If a situation not yet experienced occurs, such as penetration across the border, it is worth contracting an expert for a period of time.

A real shift of generations in a family firm occurs approximately after 20 – 25 years. In Slovakia. this means right now - 25 years after its transition to a market economy. In other countries, it is common for an entrepreneur who achieves the age of 55 to pass a proven firm to his son and spend time travelling or playing golf. In our country, the founder would work in the firm until he is seventy and even if he has a successor in the firm, he would be concerned about passing the firm onto him. The reason may rest in concerns about the property or in a feeling of irreplaceability.

The founder should realise that by handing over management of the firm he will not lose his ownership interest and can still participate in all investment and strategic decisions. Another specific is that our enterpreneurs are hard workers. It is important that successors are prepared, but there is lack of awarness of this. Selecting an appropriate successor and deciding from several children, is not easy. Often it is necessary to employ a professional manager, eg. until the descendent reaches adequate age, education or experience.

Ing. Monika Krošláková, PhD.

Monika is employed at the Department of Services and Tourism of the Faculty of Trade of the University of Economics in Bratislava. In her pedagogical, research & development and publication activities, she has focused on family business. She is the supervisor for Family Business as an academic subject, and author and co-author of several publications dealing with this issue. She participated in preparing the Act on Family Business in Slovakia in 2013. Monika has also participated as a lecturer at scientific and technical conferences on themes covering family business, as well as in projects and research works relating to it. At the University of Economics, she is involved in the following subjects: Business, Business Services and Marketing. Monika is a member of the Public Relations Board of the Institute for the Support and Development of Education, Science and Research (IPVR) and a co-owner of the following family firms: Novplasta, s.r.o. and Pro Tennis Academy s.r.o.

"We have been managers and owners of the firm for over 20 years and we see that the number of individuals who would be willing and be able to manage it, is shrinking. It is preferable to be employed, receive a guaranteed salary, even if a lower one, but free of any risk. At the same time, the number of those who are interested in working in the service sector under the conditions prevailng in Slovakia, is falling. We see there is a risk that our firm will cease to exist when we retire."

Respondent of the survey

"If an owner tackles the issue of succession early and if he has capable and committed successors in the family then the process runs naturally: generational conflicts, different approaches, educational differences, different relationships within the existing firm."

Respondent of the survey

"An interesting question, I have not dealt with it yet. Probably, I should..."

Respondent of the survey

The findings of the survey show that many family businesses do not have a succession plan in place at all. Moreover, many families do not even have a probable successor. As succession is a prolonged and complex process of transferring management of the firm to the next generation and the time spent on the process depends on the type of family and business, we recommend that a clearly formulated succession plan consisting of four phases is prepared:

Launching the process – this is a period during which children learn about the family business. Children 'meet with' the business on a daily basis, and get acquainted with its value and the culture ruling there. Parents believe that their children will decide to work in the family business.

Phase two is a process where the successor is selected from the children. Owners can select several criteria based on age, gender, qualifications, capabilities. It is difficult for a parent to select one child to become his/her successor. Most often selection is made based on age - the eldest child. However, the eldest child is not always best suited or does not have the appropriate qualifications to manage the family business. In selecting an appropriate successor, it is essential that the issue is not viewed emotionally.

Phase three includes training, which is a difficult process. Parents often come to realise that training their own child for a job position is more difficult than they expected and planned. Therefore, an alternative solution would be gaining work experience outside the family firm, eg. at a competitor. Another way of training a potential successor is training by objectives (TBO). Within this concept, the owner- parent, manager and potential successor work together so as to reveal the potential successor's capabilities. In order that the successor be evaluated objectively, he should have actual responsibility for certain tasks. His involvement in the day-to-day operation of the firm would be an appropriate way to assess and improve his capabilities.

The last phase includes generational transition itself. The entrepreneur, founder, retires and his position is taken over by the successor, most often one of his descendants. The founder is no longer involved in daily processes, however, he may participate as a consultant in larger or strategic investment decisions. *

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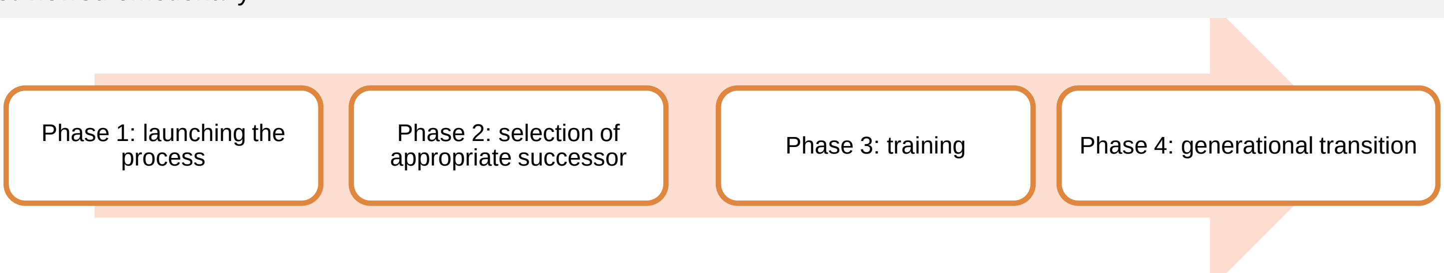
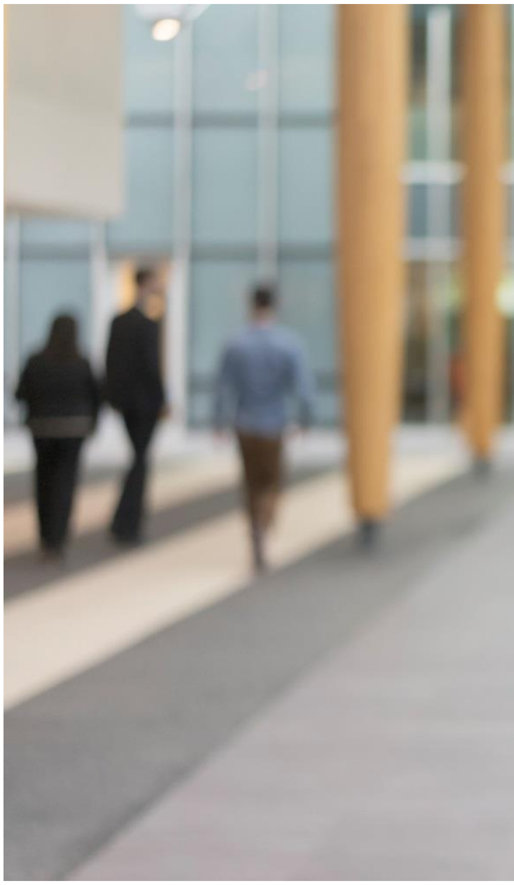


Employing professional management

Employing professional managers can solve many business issues that entrepreneurs face, and bridge the skills or experience gaps. However, it brings several inherent challenges that are not always clear initially.

There is distinction between owning a business and ”only“ managing it and for many founders it is difficult to leave the firm. Of course, the same is true when a business is passed onto a successor. However, a conflict of approaches is more probable when there is a skilled manager with strong views that may differ from the owner’s. Firms that hire external top management must learn how to „manage their managers" and achieve the most from them. From time to time, an owner must use his influence and position in the firm in order to protect firm‘s culture and values.

Managers in firms owned by individuals should understand and appreciate the extremely different environment they are joining and adjust their work style and habits accordingly. In some instances, employing an independent manager can be the only way to acquire precious skills and technical knowledge, but it may often be difficult to find the right people.



“When ensuring succession in the management of the firm, family relationships or bonds will not be determining it, but it will be a standard tender, in other words, the selection of the best candidate according to set criteria.“

Respondent of the survey

Global trends:

As far as skills are concerned, professionalisation of a business is often expressed through hiring external managers to manage the business. Often this decision is actually correct, particularly when a firm achieves a certain breaking point. At the same time, this can be a difficult moment for the firm. When external managers are brought into a firm – especially in top positions – the dynamics of the firm will inevitably change, since different interests are introduced into the equation.

It is a challenge for a family firm to manage this transition and understand that if a business is to be successful, the approach of family members to the business should also change. They must accept the partial loss of control and increased demands on formalised discipline, which may not be easy, particularly with strong personalities as is often the case with entrepreneurs.

Source: PwC Global Family Business Survey, 2014

"We will have to assure ourselves whether my successers are sufficiently prepared. I would not call it concern though. I believe that they will manage the firm as well as we have been till now."

Respondent of the survey

"Our family firm does not have a biological successor from among the family. So the only possibility is to run the firm as long as possible and then sell it. In this case, the situation becomes easier and concerns about succession are beyond us."

Respondent of the survey

"We are concerned about crumbling the shares and controlling votes."

Respondent of the survey

"Our kids imagine themselves outside Slovakia..."

Respondent of the survey

"Succession can be a source of problems. It should be prepared in advance which will reduce the risks."

Respondent of the survey

"I see succession happening in ten years.Within the family, I am not sure about the successor's interest as the majority of the young are abroad and it is not yet clear whether or not they will return. And as far as succession outside the family or a sale is concerned, this clearly means a decrease in process control, the potential reduction of responsibility for the future of existing and future staff, and uncertainty about the new management being able to (of course with a slight actual modification) maintain the high level of culture we have been building for over 40 years."

Respondent of the survey

About the survey

Slovak Enterpreneurs and Family Businesses Survey, 2014

The survey has been performed by PwC in cooperation with Ing. Monika Krošláková, PhD. from the University of Economics in Bratislava and daily newspaper, Hospodárske noviny. Owners of family firms provided their responses through an on-line questionnaire from 8 September 2014 to 15 October 2014. 77 owners participated in the survey (28 individual owners and 49 owners of family firms), 67% men and 33% women, from several sectors.
Age of respondents: 33%: 45 – 54 years, 28%: 35 – 44 years, 19%: 55 – 64 years, 6%: under 25 years, 4% over 65 years.

Period of conducting business in Slovakia: 53%: over fifteen years, 21%: from five to nine years, 19%: from ten to fourteen years, 6%: less than five years.

Revenues: 51%: less than EUR 500 thousand, 16%: EUR 500 thousand – 1 million, 14%: EUR 5 – 15 million, 8%: EUR 2 – 5 million, 6%: EUR 15 – 50 million, 4%: EUR 1 – 2 million, 2%: more than EUR 50 million.

www.pwc.com/sk/private-owners

PwC Global Family Business Survey

The seventh year that the Global Family Business Survey has been conducted by PwC on a regular basis. This year, 2,378 structured telephone and on-line interviews were performed with key representatives of family businesses in more than 40 countries worldwide between 29 April 2014 and 29 September 2014. The turnover of participating firms amounts from more than USD 5 million to more than USD 1 billion.The interviews were conducted in local language by native speakers and tended to average between 20 and 35 minutes. The results have been analysed by Jigsaw Research.

Family firms from more than 40 countries and regions participated in the survey: Australia, New Yealand, U.S.A., Canada, Brazil, Mexico, Peru, South Africa, Nigeria, Kenya, India, Singapour, Indonesia, Malaysia, Taiwan, Hong Kong, China, Middle East (Jordan, Saudi Arabia, Oman, United Arab Emirates), Russia, Turkey, Great Britain, Germany, Italy, Spain, Ireland, Sweden, Austria, Switzerland, Belgium, the Netherlands, Denmark, Malta, CEE countries (Bulgaria, Hungary, Latvia, Poland, Romania, Slovakia).

www.pwc.com/familybusinesssurvey

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Hospodárske noviny, daily newspaper

The economical daily newspaper, Hospodárske noviny (HN), issued by ECOPRESS, publisher of economic and technical press, is the most read economic periodical in the Slovak market. In HN, readers can find the latest information about national and foreign economy development, particular sectors in which they are involved; the paper also offers insights into the Slovak and global policy. HN contains two sections, one of which is exclusively news reporting and the other one, titled HN+, is devoted to the economy, analyses, services and news reporting. The paper is thus a reliable primary source of information with a strong economic competence. www.hnonline.sk

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