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Journal of Eastern Europe Research in Business & Economics

Vol. 2012 (2012), Article ID 421949, 54 minipages.
DOI:10.5171/2012.421949
www.ibimapublishing.com

Succession Planning and Generational Transition: The Greatest Challenges for Family-owned Businesses

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Abstract

The purpose of the article is to describe problems connected with succession and generational transition in family-owned businesses. The author examines how family-owned businesses can be characterized along with the general position of family companies in the economy. The strengths of the article are that the author completes theoretical findings with real examples of family-owned businesses and case studies. He also makes use of the latest findings of a dissertation thesis focused on succession problems in small and medium-sized family enterprises. The solving of the question of succession in family businesses has been identified as the greatest problem and a proposal for solving this dilemma is analysed in detail in the article. The solving of the problem of succession is an interdisciplinary theme on the border between management and sociology. Family companies share numerous problems with non-family companies; however, family businesses differ from other kinds of businesses in that they have to come to terms with a generational transition in the leadership of the family business.

Keywords: Succession Planning, Generational Transition, Family-owned Business, Small and Medium-sized Enterprises.

Introduction

Family-owned businesses hold a particularly significant position in mature world economies and are a signal of a healthy market economy. Family businesses are undoubtedly a special kind of companies which greatly differs from non-family businesses and are marked by specific aspects and needs. Family businesses face the specific problem of succession and generation exchange. According to Carlock and Ward (2001), all businesses, family-owned or otherwise, find it difficult to continue for a long term. In their book they presented the evolution of the Fortune 500 List as an example, where, since 1955, only 77 companies have remained independent. More than 80 % have been sold or acquired or witnessed their sales slide significantly in the past 45 years.

Family businesses in the Czech Republic do not have a long-term tradition. The Czech Republic was established in 1993 after the dissolution of Czechoslovakia, when the Czech Republic and Slovakia became separated states. Most of today's successful Czech family businesses such as Kanzelsberger (1990), Grund (1990), GiTy (1990), Ravak (1991), Ryor (1991) were founded in the 1990s and are actually dealing with succession and first generational transition.

One of the oldest Czech companies and currently one of the world leaders in production and distribution of first-rate stationery for artists, schools and offices is KOH-I-NOOR HARDTMUTH a.s., a member of the KOH-I-NOOR holding a.s. Group which was founded by Josef Hardtmuth in 1790 in Vienna. The production of graphite leads was relocated to České Budějovice, however, in

1848 (KOH-I-NOOR HARDTMUTH a.s., 2012). The development and position of family businesses was as similar in Czechoslovakia as in other European countries up to World War II. After the war, private businesses in Czechoslovakia were nationalized and became state companies.

After the company was left with only the factory in České Budějovice, the rest was lost. 1945 meant the escape of the owners abroad, leaving the factory behind and finally the nationalization. The change of regime in Czechoslovakia also brought about the beginning of dispute over the trademark. The lawsuits initially appeared positive for the company at the beginning but later on everything changed. The dispute over the trademarks resulted in an agreement with the original owners and resulted in a contract for joint venture in 1966. The socialist company gained a subsidiary company in capitalist Austria. After the privatization, the entire company was left with only the factory in České Budějovice. Problems with export appeared as a result of the changes in conditions. The year 1994 signified a complete turnover in the corporate policy. In 2 years time the dispute over the trademark came to an end and the stock company with a clear portfolio of ownership began to move upwards. The export has risen to 3 quarters of the sales once again and the company became the largest producer in Central and Eastern Europe. (KOH-I-NOOR holding a.s, 2012) In the 1990s, the majority of the state companies were privatized generally without transparent conditions. Many of them became family-owned large companies. It is difficult to consider them family businesses, however, because they were not created and built by a family. (Poledna, Polednová, 2008). The current owner and director of KOH-I-NOOR holding a.s, is Vlastimil Bříza with his two sons David Bříza and Vlastimil Bříza Junior, their wives also working there. Since the privatization of the company and the interruption of the family tradition, this company with one of the oldest traditions has only first and second generation family members working together.

It is very difficult to classify the concrete way in which family companies contribute to the development of the economy in the Czech Republic, because the Czech Statistical Office and additional state institutions do not categorize family businesses as a specific category of business and do not monitor them in any fashion (Hnátek, 2012).

Methodology and Objectives

This article emerged a detailed review of current scientific literature and is based on the latest academic developments. The author of the article made use of a doctoral dissertation (Hollerbach, 2011b) which thoroughly describes the situation of family firms in Germany and has been the source of invaluable secondary data and resources which would have otherwise been extremely difficult to obtain through additional research. Hollerbach (2011b) rightly argues in his doctoral dissertation that future research should not focus on the facts and figures of generational exchange, but should be more focused on the human beings involved in the processes who are influencing the process with their personalities and their decisions in each unique situation. This issue is an interdisciplinary one and combines within itself elements of management and sociology. The author consequently made primary use of tools and approaches from empirical observation and qualitative research.

The primary goal of the research is to draw attention to problems concerning succession and the seeking out of an appropriate successor. A secondary goal of the article is to indicate what losses might arise when and if the succession problems are not dealt with in family firms and respective organisations which might lead to the termination of family firms along with the loss of know-how, work positions and weakening of national economies. The strengths of this article are that the author also completes the theoretical findings with actual examples of family businesses and case studies.

Characteristics of Family Businesses

According to Leach (2011), it has only been in the past 30 years that we have begun to study and understand two fundamental ideas: that family businesses differ in a variety of critically important ways from non-family businesses and that business families function quite differently from non-business families. As the title itself indicates, the term family business combines family and business. This linkage is not all that simple despite it being quite easy to identify the terms. Carlock and Ward (2001) state that, those families which equalize family and business systems create a positive environment where the family thrives and business performs. Hollerbach (2011b) states that a family business does not merely consist of a family and business since ownership actually has an extremely important role here. For this reason, family businesses are labelled as family-owned businesses. Family business, as with other kinds of companies, face an entire range of difficulties in connection with doing business, as well as having to come to terms with specific problems involving, for example, succession. Family businesses also, however, have certain benefits and positives. Family businesses generally make the entrepreneurial community healthier. The positive image of the company which has been built need to be maintained and therefore caring about the high quality of products and services is paramount. Family businesses are also reliable business partners. The positive effect of family businesses on the labour market is that they provide jobs for family members belonging to risk groups on the labour market such as fresh graduates, single mothers, people without working experience, etc. (Hollerbach, 2011b).

Family business does not exist in the Czech Republic as an individual category and is part of general entrepreneurship which does not distinguish ownership characteristics. The strength of a family business is in its genuine characteristics. A high sense of social feeling, an emphasis on quality, tradition and motivation based on business ownership are all important differences that make family business qualitatively distinct. This represents a high value for the economy (Poledna, Polednová, 2008). Family firms are important, not only because they make an essential contribution to the economy, but also because of the long-term stability they bring, the specific commitment they show to local communities, the responsibility they feel as owners and the values they stand for. These are precious factors against the backdrop of the current financial crisis (European Commission, 2009). One of the most important advantages of a family business is the loyalty of the employees towards the company and the family. It can be stated that the surroundings and the climate within a family company is different than a public company. (Hollerbach, 2011b)

The Position of Family Firms in the Economy

Due to the fact that family businesses in the Czech economy are manifested in various forms, it is extremely difficult to precisely define and label them. In all probability, the greatest amount of family firms is in the form of self-employed persons and limited liability companies. (Hnátek, 2012) Family Firm Institute states (2012) that 80 % out of 95 % of all companies in the Czech Republic can be classified as family firms. Hollerbach (2011a) argues that more than 94 % of all German companies can be classified as family businesses, thereby completely dominating the German economy. In terms of employment, family firms employ more than 59 % of all German employees and family firms contribute more than half of the domestic gross production. Family businesses make up more than 60 % of all European companies, encompassing a vast range of firms of different sizes and from different sectors. Most small and medium-sized enterprises (SMEs), especially micro and small enterprises, are family businesses and a large majority of family companies are SMEs (European Commission, 2009).

Specifics of Family Businesses

In comparison with non-family companies which are only focused on creating profit and satisfying the needs of interest groups or individuals, family firms have certain specific features. Family businesses are marked by a close link amongst the family and combine property ownership of the company and an influence on its management.

The difficulty of dealing with generational transition and succession planning has been identified as the major problem threatening the existence of family firms. This specific problem endangers all family firms directly in terms of their existence and has therefore been identified as key. In the majority of cases, the owner is also an entrepreneur with the company actually being a reflection of his or her personality and vision. Keřkovský (2002) states that each business is founded and exists in order to serve a certain purpose. This purpose, also referred to as a mission, corresponds with the actual visions of the founders of the company. It is specifically the founder who decides what will be the subject of the business, who will be the customers for the business, what needs and what products or services the business will provide. Missions and visions should be written down on paper and be clearly formulated so as to express the basic strategic aims of the management and be understandable for all employees in the company. Leach (2011) claims that typically, it is the founder who articulates the mission they see for the business, but these values – sometimes called lived rather than espoused values – transmit down through succeeding generations, often without the family even recognizing that this is occurring. During periods of challenge and transition their business is supported by the belief in a set of shared values, but where there is no relevant vision to unite the family, opportunities for conflict can arise. The family's value system may need to be reinterpreted and revitalized by succeeding generations. Each new generation of the Rockefeller clan, for example, re-examines the family's core ideals and values, redefining and renewing them as is felt appropriate to help reinvigorate the sense of connection between family members and the organizational mission. Some company's visions and mission statements are written very briefly and in general such as for example the vision of Sabancı Holding: "Creating sustainable advantage through differentiation" and their mission is: "Managing a competitive strategic portfolio with sustainable growth potential to create value for all of our stakeholders" (Sabancı Holding, 2012). Koç Holding (2012) states their visions and value more broadly: "We are aiming to be the best through customer-focused work strategies, attaching due importance to human resources; knowing that development is born through creating resources; internalizing business ethics and honestly as sine qua non; and understanding that adding power to our country gives us power in return." The most impressive leader, visionary and entrepreneur who practically built the city of Zlín and transformed his visions into reality was Tomáš Baťa, founder of the current Bata Shoe Organization. Tomáš Baťa viewed his business and entrepreneurship as a public service.

The business is actually a reflection of its founder. It should be viewed as a living organism which is not only learning but also making mistakes. Family businesses should therefore not be viewed as merely anonymous organisations, but instead as concrete persons and human stories should be sought out within them. In contrast to hired managers, a family manager puts their own name at risk and primarily their property. A poor decision on the part of the manager will have a direct influence on both their personal and family financial situation.

The Close Link between the Entrepreneur and the Business

As has previously been stated, family businesses often bear the name of their founder who fulfils his visions and dreams through the company. Through his or her activities, the entrepreneur risks the good name of the family and makes commitments in a certain fashion. A typical problem of family companies is paternalism where the company founder concentrates power, permanently monitors other participating family members and resists passing leading positions to relatives (Poledna, Polednová, 2008). Hollerbach (2011b), in contrast, states that the founder / owner of the family business is a kind of role model and their personality has a significant influence on the structure and quality of the human interactions within the company. It has been demonstrated within certain sociological studies that the identification and allegiance of employees increases with the degree of personal interaction each employee has with the founder / owner of the family business.

According to Hnátek (2012), it need be understood that a family business is made up of two linked parts; the family and the business. These, at first glance, incongruous elements have to be in complete harmony in order to ensure the functioning of the family business. The basis of the family is the emotional and feelings perspective, harmony and communication in the inward direction. Non-family businesses, in contrast, are based on concrete results, rational facts and substantiated information. A company also has to be open to its business partners, customers and therefore the communication is more focused outwardly. The task of the family is mutual encouragement, assistance, tolerance and upbringing. Non-family companies, in contrast, value competitiveness, rivalry, obtaining profits and focus more on developing personal skills as opposed to upbringing.

Founder / owners of family business have a much more intense relationship with their company. Their strategic decisions are based more on long-term considerations than that of non-family businesses. The reason for this being the fact that the company is the economic base for the family and the latter has the major influence. Non-family business owners usually have less power to have influence, first of all because of the smaller amount of shares and second, because they have higher information costs. Thus, employed managers have more influence. Naturally, the latter have more interest in short-term profit maximizing. The ideal scenario is that the owner family has received the company from the preceding generation and has an interest in handing it over to the following generation in the best possible state (European Commission, 2009).

The Generational Transition and Succession in Family Businesses

One of the most important strategic tasks in a family business is to transfer the business to the next generation. Transfers of businesses (enterprises) in the Czech Republic have specific features arising from the extremely short modern history of private enterprise (Poledna, Polednová, 2008). Hnátek (2012) has pointed out that this involves an extremely complicated, long-term process. Inability to manage this process can lead to a decrease in the effectiveness of the family business and even eventually to bankruptcy. This will have the effect of decreasing work positions and a worsened state of the entire economy. Experience from the Czech Republic confirms that potential small and medium-sized enterprises are much more interested in setting up a new business rather than taking over an already existing one (Poledna, Polednová, 2008).

Succession is not a one-time event, but consists of a lengthy process which should be smooth, natural and primarily thought-out. A family business is based on completely different foundations than pure rational decisions and financial results for the owner, with the emotional perspective also playing a major role. This fact also has an influence on decision-making in connection with planned succession. If this phenomenon is to be truly understood, departing entrepreneurs and their successors need to be viewed as human personalities with all those basic qualities and needs and not as machines behaving in line with managerial handbooks.

There is unfortunately very little experience with generational transition in the Czech Republic since actual family businesses only came into being after the year 1989. Only now companies are beginning to come to terms with this crucial problem since current entrepreneurs / owners are beginning to think over whether their children will be able to take over and manage the business in the future.

According to Hollerbach (2011a), generational transition in family companies is one of the greatest challenges for the German economy since it is actually based on family business. Hollerbach (2011b) additionally names in his dissertation several problems which would come about in Germany if this generational transition is not successfully managed:

a) The loss of a special family business culture

b) The loss of special know-how and knowledge

c) The loss of more than 30 % of all jobs provided within Germany

d) The loss of almost 50 % of the Gross Domestic Product (GDP) and therefore the insolvency of Germany

The Gross Domestic Product in Germany is not only important for Germany itself, but furthermore for the Czech Republic and the entire European Union (Hollerbach, 2011b).

The Life Span of Family Businesses

The Czech Republic unfortunately does not have family firms which have been owned and managed by one family over several generations. There is therefore no experience with succession and generational transition. At present the first Czech family firms are beginning to encounter this situation whereby they have to deal with the problem of succession. The first small and medium-sized companies are beginning to move from the hands of the founders into the hands of their children, thus the businesses began to be managed by a second generation. The rest of the world has much more experience with family businesses and with generational transition. The situation, however, is not all that conducive and generational transition is an extremely demanding process. The Family Firm Institute (2012) states on its web pages that only 30 % of all American family firms survive the transition from the first generation to the second and only 12 % of these companies survive to management by the third generation and only 3 % of family firms are consequently managed by the the fourth generation.

The unsuccessful managing of generational transition in family businesses has led to an inalterable loss of knowledge. This particularly concerns business experience in managing a company. It is practically impossible to record these experiences on an external memory and they are tied up with concrete persons. This knowledge can only be passed on through interaction between the actual entrepreneur and his or her successor. If and when the successor is not interested in becoming involved in business activities and the management of the family business, this knowledge is impossible to pass along. Practical experience also indicates that the entrepreneurs / owners themselves do not think about who will run their company in the future and do not prepare their children sufficiently for responsibility for the future management of the company. It is therefore logical that if the future successor does not build up a relationship to the business in time, he or she will never be able to manage it in the future. Current owners and managers of family firms are submerged in the operative managing of the company and consequently do not have a plan as to what will happen to the business in the future and as to who will be capable of running it.

The Need to Find an Appropriate Potential Successor

The actual need for succession and the search for an appropriate successor arises from the needs of the business and the family of the managing company. Hollerbach (2011b) states that businesses should be prepared for a case of emergency as more than 50 % of all succession takes place suddenly due to an unforeseen emergency, such as the death or sickness of the actual entrepreneur or owner. If we do not take into account, however, this relatively frequent occurrence where a family business loses its owner and the initial entrepreneur as a result of an unexpected death or serious health problems, there is still a need to seek out a potential successor. It is extremely important that the company be prepared far ahead of time for this situation prior to it actually occurring. Thus, succession planning and generational transition is particularly important in a timely fashion.

Rothwell (2010) in his book understands succession planning as identifying critical management positions, starting at the levels of project manager and supervisor and extending up to the highest position in the organization. Succession planning also describes management positions as providing maximum flexibility in lateral management moves and ensuring that as individuals achieve greater seniority, their management skills will broaden and become more generalized in relation to the total organizational objectives rather than purely departmental objectives. He also mentions that succession planning should not stand alone. It should be paired with succession management, which assumes that a more dynamic business environment in the capacity building of talent should occur in actual time.

Essentially each family business will sooner or later have to solve the problem of succession. The business will thus find itself in a situation where the founder or long-term manager– who was the highest authority, a visionary, a strategist and a stable certainty for everyone often for decades– will have to leave their post. This will bring uncertainty to the company as well as impatient expectations. It is therefore important that the business already be clear as to who will naturally replace the current manager when they leave.

Hollerbach (2011b) in his dissertation names the systematic requirements for a successful succession:

a) An economically profitable company which generates a certain profit.

b) A professional analyzed and calculated realistic price for the company.

c) An exact generation transition planning schedule for the realization of the examination matching and optimization of the existing contracts or a clear settlement in the event of the entrepreneur's death.

d) A taxation specialist should develop an optimal tax solution and long-term strategy plan.

e) A professional realization.

f) A qualified and potential successor.

g) Since life does not end when the entrepreneur leaves the company, his or her life has to be financed with a sufficient pension supplied for the support of the entrepreneur.

h) Respect for the individual solutions and heritage of the predecessor.

The concept of succession begins with a certain key moment when the entrepreneur has decided for some reason that a successor should take their place. According to Hollerbach (2011b), the reasons for succession planning are varied with the most frequent being the age of the entrepreneur.

The Personal Characteristics of the Potential Successor in a Family Business

The founder and owner of a family business has several roles, amongst the most important of which is the role of manager. The manager's activities should be apparent on all levels of interaction between people, in particular in the area of work productivity and the success of the business. The success of their actual work will also be resonate in the success of the company. A manager should understand people, view them as varied and also be able to negotiate with them, create motivation, be an example and have the power of an informal authority. One of the managerial roles also consists of being a leader. This role assumes a certain charisma and strength of character. Managers in a family business face more pressure as they are viewed as leaders of the family with the business representing the source of finances for the family. The performance and success of the company consequently rises and falls with the family which owns the business and which has the decisive influence in the company. The potential successor and family manager should be first and foremost a leader.

The Profile of an Ideal Successor

At present, when managing a business has become a complete activity with major demands placed on it, it is extremely difficult for a successor to fulfill the ideal profile. The future successor should, however, be as close as possible (Koráb, Hanzelková Mihalisko, 2008). If and when the successor has certain weak points, he or she should attempt to eliminate them through education. Practical experience outside the family company is consequently extremely important from this perspective.

Hollerbach (2011b) in her thesis presented examples from her own experience, when she describes how she and her brother returned home after finishing international studies of management abroad. During their studies they took the opportunity to work for other companies and gain experience outside their parent's companies. Her brother came home after a seven-year trip to America and began a good job in an external company. It was important for him as the son of the owner-manager to prove himself outside. He proved success and upon leaving his interim company, they did not want to let him go. This provided him with self-confidence. Later, both of them began to work in the company of their father on the lowest levels. They did every single possible job necessary for the daily life of the company, continaully keeping in mind that they had to be able to fulfill all the given tasks not with the aim of being the best in everything, but in order to know what each single task entails.

The future successor should also know the business well and respect its culture. The successor should become acclimatized with the business to the greatest extent possible in case they finds themselves in direct contact with various work positions and responsibilities. There should not be any exceptions for the successor and they should be able to carry out all possible work tasks just like any other employee who holds the position. The placement of the future successor into the working process in a family business leads to the creation of relationships between the actual entrepreneur and the successor. This interaction leads to transferral of invaluable knowledge and experience.

An Internal Potential Successor

Founders / owners of family business have the possibility to train their own management personnel and form them practically from their birth. The upbringing serves to form their personality, their approach to work and their essential character values.

Planned Succession Involves Several Steps And Begins When The Founder Or Current Manager Encourages Their Children To Become Part Of The Business. They Are Encouraged To Be Interested In How The Business Functions And In Eventually Taking On A Leadership Position In The Family Business. The Entrepreneur Can Achieve This Through Informing Family Members About The Activities Of The Company, Demonstrating The Positive Attributes Of The Business And Emphasizing The Psychological, Emotional And Economic Benefits Arising From Life In The Family Business. If The Owner Instills The Desire Of Continuing In The Family Business In Their Children, It Will Consequently Make Sense To Begin To Plan Succession (Koráb, Hanzelková, Mihalisko, 2008). Hollerbach (2011a) States That The Established Unwritten Rule, Which Has Existed For Hundreds Of Years, Whereby The First-Born Son Automatically Becomes The Successor Has Changed In The 21st Century. At Present All Of The Children Regardless Of Their Gender Are Considered Potential Successors. This Approach Consequently Expands The Circle Of Potential Successors. Regarding Internal Succession By A Family Member, It Is Important To Take A Look At The Entire Family, The Possible Family Successor(S) And The Relationships Within The Family. All Members Are Involved In The Business In Both Direct And Indirect Ways. The Relationship With Non-Family Members Involved In The Business Is Another Important Influencing Factor On The Succession: The Surroundings Of The Company With All Its Employees, External

Partners, Clients And Customers Cannot Be Overseen In This Process. (Hollerbach, 2011b)

An External Potential Successor

Hollerbach (2011a) states that if the predecessor does not have children or if they for various reasons are not interested in being involved in the family business, they will have to seek out a suitable successor from the wider family circle and also look around for possible external successors. According to Hollerbach (2011b), the missing or unsuccessful succession can be explained by the lack of interest of the next generation, younger people and youths. These young people are not always interested in succession in the family business or in leading the same life as their parents. A solution to this problem cannot be made without the help and active influence of the legal administrative. The major task of the legal administrative is to provide the best possible surroundings for potential successors.

The choice of a suitable successor for a family business from external sources would seem to be much easier as there is an almost unlimited choice of candidates and fairly demanding requirements can be placed on the potential successor in managing the company. An externally hired manager, however, does not have a direct ownership relationship with the family business and this might result in a decrease in motivation and performance when carrying out the function. A family business must therefore work at developing a sense of work satisfaction among their employees who should be aware that the owners of the business appreciate their work and that they are not less valuable only because they are not members of the family. Each business relies on employees who should be the first customers of the business so as to be proud of the company in which they work. Members of the owner family of the business should achieve a sense of security, certainty of a future vision and stability among their employees which will not be influenced by the generational transition from the actual entrepreneur to the successor.

Conclusions

Generational transition and generational succession rank among the most important tasks which family firms have to come to terms with. Generational transition is a long process which has to be planned and thought out ahead of time. In light of the fact that family firms are a natural part of each healthy economy, the inability to manage these changes will lead to the termination of family firms and to a consequent weakening of the economic situation. This will of course have a negative impact on employment, a decrease in the gross domestic product and also bring about changes to the social climate of the market. This will also lead to inalterable losses of knowledge which are linked with concrete persons. The transference of this knowledge is only possible through direct interaction and business experience. Family firms exist in numerous forms in the Czech Republic and make up the basis for the Czech economy. The largest amount of family firms are in all probability self-employed persons or limited liability companies. There is practically no experience unfortunately with generational transition in the Czech Republic in light of the fact that independent private family businesses only began to emerge after the year 1989. Current entrepreneurs / owners have begun to think about whether their children will be able to take over and manage their company in the future.

Family business managers have the possibility to train their own successor from the family. It involves several steps and begins when the founder or family manager encourages their children to become part of the business. He can achieve this through informing family members about the activities of the company, demonstrating the positive attributes of the business. In contrast, the choice of a suitable successor for a family business from external sources would seem to be much easier. Entrepreneurs have an almost unlimited choice of candidates and fairly demanding requirements can be placed on the potential successor in managing the company. An externally hired manager, however, does not have a direct ownership relationship with the family business and this might result in a decrease in motivation and performance when carrying out the function.

However, specialized researchers, advisory firms and legislators all need to be interested in the succession planning and generational transition in order for all of these problems involving family firms to be solved properly.

Acknowledgment

The author would like to acknowledge his supervisor doc. Ing. František Lipták, DrSc for invaluable advice, encouragement, assistance, kindness and guidance. The author is also thankful to the Internal Grant Agency of FaME TBU No. IGA/FaME/2012010

(Research on approaches to planning succession in small and medium-sized companies / Výzkum přístupů k plánování nástupnictví v malých a středních rodinných podnicích) for the financial support to carry out this research.

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