Succession Issues in Small and Medium Enterprises in Japan:

Study to Establish a Family Business Center at Rikkyo University

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This thesis deals with the creation of an academic program to assist SMEs (Small and Medium Enterprises), and especially family businesses, in coping with succession issues. In Japan, 99% of businesses are SMEs. They employ 54,185,000 workers\(^1\) and account for about 30% of the economy\(^2\). In the past 20 years, there has been a general decline in their survival from one generation to the next. It is believed that this severely impacts the economy and is wasteful of human resources and experience. The Japanese government has programs to assist SMEs, but these are not overly effective.

This thesis focuses on the narrower area of how to best assist viable companies in dealing with succession from one generation to the next. At present, many such companies close through the lack of finding a suitable successor. If such SMEs could better deal with the issue, the survival rate of SMEs may improve, as the new generation introduces new business concepts. Several US and European universities have Family Business Centers (FBC) to assist companies in dealing with human, financial, legal, and other matters. These were studied, and together with a survey of family businesses in the Ikebukuro area of Tokyo, a program concept was developed to create an FBC at Rikkyo University.

Keywords: SMEs, Family Business, Succession Issues, Family Business Center (FBC)

1. Thesis Hypothesis

The hypothesis of this research is that a university-affiliated FBC would be a great benefit to SMEs, to the university, and ultimately to the country. To this end, a study of existing programs in the US and elsewhere was conducted. In addition, a survey was made of family businesses in the Ikebukuro area of Tokyo as to their needs and possible support of such a program.

2. Thesis Overview

1) The Current Situation of Succession in SMEs in Japan

The Japanese CEOs of SMEs have no custom to write a will for his or her family. Recently, this became a hot issue, because the remaining family, whose father or mother passed away without writing will, has problems how they should treat both the tax and business. Some lawyers say that the father or mother, the CEO, did not write a will, because there was no problem in the family and/or business. During the research of this thesis, the actual situation was found to be completely different. Every family business is struggling with the issue of succession, especially when the death of the CEO is unexpected. In an interview with one Successor, who should
succeed in the position of CEO, there was still a dispute as to how the property should be divided.

(2) Academic Programs to Assist SMEs with Succession Issues

In the US and in some other countries, an important success factor for business families is a commitment to the education and personal development of family members. Many successful families believe that a knowledgeable and well-informed family group is an asset that contributes to the family's effectiveness and ability to work together. Some families hold regular educational activities as part of their family meetings. Other families attend business seminars that highlight such topics. Each year, family business seminars are offered at over 80 colleges and universities to help hundreds of families understand and work on family business issues, especially in the U.S. In many families, educational efforts are begun before the family member is involved in decision-making or planning.

(3) Potential for a Family Business Center at Rikkyo University

In the U.S., since the 1990's, FBCs were established as part of some local universities in order to support local SMEs. Scholars and business people study about SME problems together. They hold seminars, conferences, discussions, and competitions of family business plans, utilizing the university's faculty and facility. Results from my questionnaire and interviews with CEOs and Successors, SMEs need support by university from the academic side and also practical business side. The Rikkyo University has a nice facility and eligible faculty to use, and would be a very reliable organization to set up an FBC, perhaps in the Business School. It would be desirable to set up a curriculum of "Family Business" for undergraduate school students, and also at the Graduate School in Rikkyo. In order to check the possibility whether Rikkyo University could establish an organization for supporting SMEs, I picked 649 family business enterprises and dispatched questionnaires to both incumbent CEOs and Successors. According to the responses from 90 CEOs, 33 Successors, and interviews including telephone interviews with 5 families (separate contact with the CEO and one Successor) it was found that they have common characteristic issues in family business, especially that of succession. I am in the affirmative to establish an FBC in Rikkyo University to support them. It would be a differentiation among Japanese MBA Schools and social contribution service to SMEs in Japan.

It would be good to set up a new academic program in Rikkyo University with an organization that will mainly handle the succession issue in SMEs. The reasons are (1) the Faculty of Rikkyo University is suitable to cover succession issues in SMEs, perhaps in the Business Design Department which can coordinate staff in the business and other disciplines, (2) Undergraduate and graduate students' parents often run a family business, and the students are the future CEOs, and (3) local CEOs around Ikebukuro wish to tie up with the eligible University for their stable management. Like many American universities have already done, Rikkyo can create a good
business relationship with SMEs.

(4) Local and Social Effects of a Family Business Center

1) Local Effect

Support by an FBC can have a positive on SMEs and the local area. For instance, during this study, I had contact with a CEOs group in Ikebukuro North Shopping Center. They would like to re-develop and re-organize their shopping area. They won budgetary support for renovation for their area by the Toshima Ward Office. The East side of Ikebukuro shopping area is well-developed, and there are several new projects to make it much more active. On the other hand, the West side of Ikebukuro, where the North Shopping Center is, has a big problem with tenant shops. Some worsen the environment and atmosphere. Shop owners said that if people do not come to the North Shopping Center, their children are not encouraged taking over the business. In this case, the FBC can propose a drastic idea to them, if they really want to change their area. The reason why one CEO contacted me was the CEOs group wanted to tie-up with Rikkyo. Rikkyo is a symbol of the West side of Ikebukuro, and they are the graduates of Rikkyo University. Prof. Yoshiki SHIMAZU took care of this project in the first step. But continuous support is necessary, and the CEOs want it too. Rikkyo faculty has experience in a case similar to Prof. SHIMAZU's, but in another area of Tokyo. These examples show that the University can help in local development and that there is demand and support for such help by the local SMEs.

2) Social Effect

An FBC no only can assist individual SMEs, but also provide support for a stronger business foundation. Even if they could clear the succession issue with professionals, they must still face competition in their industry and even from other SMEs. An FBC can help in M&A and in changing the category of an SME's business, if they wish. So SMEs need to be independent enterprises that have specialties. It is necessary for them to progress into growth areas, but this is a challenge. New technology provides the opportunity to move into a new area, while the old one is declining. SMEs have to make the effort to try to change their business style in time to take advantage of the opportunities and combat the threats. Is it possible to do this by themselves? An FBC could provide a wide range of advice and support, including tie-ups among SMEs. But not all SMEs can succeed or survive. In such cases, the FBC can lead them to close the business "nicely", i.e. FBC could advise for the exit of business to reduce financial and social damage. It is hoped this would reduce the number of bankruptcies by making earlier and better-informed decisions. This would reduce the potential for the forfeiture of the personal property of the CEO and could be a positive approach for saving people who mortgaged their properties for business.
3. Issues

(1) Small Business Issue

The founder CEOs often have an idea of what they expect to happen when they die or retire, but it is never communicated in an appropriate manner. It is only in their head. They often delay discussing the issues related to naming their successor because of their own inability to relinquish control.

For any scale of companies, “Only-one product” or “Number-one skill” would be a very important factor to survive, especially for SMEs. A local company, which has strong ties with local people, or the company, which has a long history and tradition, can be sold, even if the management of the company becomes difficult. That will help to take a risk of management, but the company does not have any skills, they would have hard time, because of depression or competition with big companies.

If the incumbent CEO feels that his or her company has no bright future, it might be irresponsible that the CEO transfer the company to the future Successor. First of all, CEO has to read the future market where the company belongs. If there seems to be a difficult future, the CEO has to check the opportunity of business conversion. Whoever succeeds the business or if the company will be sold, the CEO has to think of management improvement, or future competitive power. If the conclusion is negative, the CEO should consider the choices of non-succession or dissolution. Just after the CEO finds out the possibility of improvement of company value, then the CEO should decide who will be the Successor. If the Successor has no ability or energy to realize the business plan, the CEO has to think about the transfer of the business to outside people.

(2) Succession Issue

When a company fails in succession, most of the reasons are as follows. The first case is the failure to choose a Successor. This happens most often in SMEs. It is the intention of the owner CEO that his son is the successor or at least a family member is the successor. In this case, it is necessary that there be preparation and education of the future CEO. The second case is in the failure of succession timing. It is important to transfer the business while the incumbent CEO is still powerful and healthy. CEOs often think that the company is equal to themselves, so they do not want to transfer the management. Even so, good governance must be set up, in order to have continuous growth and development of the company. The third case is the misunderstanding of company value. The actual company valuation by in-house people, including the incumbent CEO, and outside people is different. It is important for the incumbent CEO to tell the correct company value to a Successor, which is a part of business succession. If the company value is lower than their estimate, there may be a succession failure. The fourth case is due to inadequate time for preparation and risk management. In case the incumbent CEO leaves the company because of unexpected accident, illness, or death, the next CEO cannot be prepared to
be a new CEO. It is the same for an aging CEO. Unfortunately, these kinds of risk
management are not well known in SMEs.

The incumbent CEO and the Successor are very busy, so there is a lack of family
discussion. It is out of date to think that the words between father and child are
unnecessary and that the Successor will see and learn how his or her father is
working. Having the same information and exchanging opinions are necessary,
because they are a family. Succession is not only "property" (hardware) but also
"property plus idea" (software). It is the old myth that succession is going well if
the company can clear the problems of tax and law. If the CEO forgets to transfer
the management idea, the company may fail in the next generation. In SME
business, sometimes banks or business partners believe in the CEO personally, and not
in the company's achievement. If the Successor misunderstands this, banks could stop
lending money or the business partners would not wait for a late payment.
Successors are made by skill and education. Parents overvalue or undervalue their
children's ability. The Successor should be evaluated by themselves, not just because
they are a blood relative. Proper education to be a Successor is the great project for
the CEO.

4. Investigation: Summary of Ten Academic Programs

✦ Organization: They are mainly a sub-organization of local college or university.
They are often called "Family Business Center" or "Family Business Institute"
e.etc.

✦ Curriculum: Most of the FBCs hold an annual big conference. Many CEOs or
Successors with their family join the conference. The main curriculum at the
conference is the lectures by University Professors and discussions between CEOs.
Usually, the FBC holds a breakfast meeting for CEOs for discussions or case
studies. Another curriculum is a competition of family business plans. This is
also once a year. A top rated plan is introduced on the website or the bulletin
of the organization.

✦ Finance: Some organizations have a membership fee or annual fee from SMEs.
Others are set up only by donation from cooperating companies, such as banks,
security companies, etc. However, depending on the curriculum, attendees have to
pay the attendance fees for the seminars or accommodations.

5. Investigation Results of Questionnaire Respondents

(1) Succession Issues

85 percent of the CEOs decided on particular Successors, because they are their
children. In the Successor's side, 76 percent recognized that they were appointed to be
the Successor, because they are children of the CEOs. Of Successors, 33 percent
decided to accept the role to support the family business. From the interviews, it is
natural that in their daily and private conversations in the family, they often talked
about the business ever since they were small children. 21 percent of Successors
responded that succeeding business is their responsibility to employees and customers. 53 percent of CEOs wanted to transfer the business to the next generation while they are in their 60's. While, 16 percent wanted to stay in the company into their 70's. At age of 40's, 46 percent of Successors wanted to succeed the business, while under 40, it was 21 percent. This meant that Successors preferred the earlier retirement age of CEO compared with the CEO’s responses.

After retirement, 39 percent of CEOs want to stay in their company as Chairman or an Advisor. According to the interviews, they were worried about the company even after they retire, and it is the CEO’s duty to assist their Successors. Most of the incumbent CEOs had the same experience when they succeeded to the position of CEO from their parents. So it is natural to them to do the same thing for their children. There was no CEO to be a business angel for entrepreneurs.

The same things were expected by the Successors’ side. 61 percent of Successors wanted the CEOs to become the company’s Chairman or Advisor. On the other hand, 27 percent of the Successors wanted the CEO to enjoy their free time for the rest of their lives.

Figure 2: Question to CEOs. Do you think that there are some problems in your company for succession? (Response all that applies.)
For the succession issues, 16 percent of CEOs were worried about the management skill of their Successors. 15 percent of CEOs felt that their business belonged to the declining industries, and 14 percent of CEOs replied that the motivation of employees were low. The questionnaire results from Successors showed that 19 percent were worried about their skill as CEOs, matching the responses by CEOs. 15 percent replied that there were no eligible younger employees in the company and 14 percent responded that the motivation of the employees were low. These are the common problems in SMEs.

(2) Academic Programs

26 CEOs were interested in a Successors' education program, 18 CEOs were interested in a second life after retirement. This kind of seminars would be the competitive program, when Rikkyo holds the seminars. 13 Successors were interested in the primary factor of success in business, but Successors interests were spread on every area.

Written by Author

Figure 3: Question to CEOs. What Seminars are you interested in? (Response all that applies.)

Written by Author

Figure 4: Question to Successors. What Seminars are you interested in? (Response all that applies.)
I found that the expectations of CEOs and Successors of Rikkyo University are not only to give them the chance to attend seminars, but also in setting up a kind of support organization for SMEs. 28 CEOs expect exchange of information at gatherings where Rikkyo takes an initiative, instead of only practical seminars. 25 CEOs had an interest in a lecture by professionals or panel discussion, and 19 CEOs are interested in individual consultation. These results seem to support the 15 percent of CEOs who feel that their businesses belong to a declining industry. 14 Successors had an interest in information exchange gatherings, 9 want to have advice from psychologists and professors about personality and communication issues. As to the subject of individual or group consultation, 16 percent of CEOs requested marketing, 15 percent about sales and another 15 percent was about strategy, while Successors’ interests were broad. It seems that both CEOs and Successors expect to have broad information and individual consultation supported by Rikkyo.

Figure 5: Question to both CEOs and Successors. What subjects are you interested in Rikkyo seminars. (Response one or two.)
Thinking about Rikkyo faculty and facilities for the seminars, the results were very satisfactory. 45 CEOs would request a Business Administrator including university professors. 21 CEOs preferred a psychologist including university professors. 26 CEOs want to hear success stories from other CEOs who got over the succession problem. 13 Successors requested CPA/Accountant, another 13 Successors preferred CEO who got over succession problem.

Concerning the attendance fees of seminar, both CEOs and Successors preferred less expensive ones. Targeted fees could not be found from the questionnaire results. However, the fee schedules of FBCs in the US can be a guideline.

6. Conclusion

(1) Exit Issue of Family Businesses
Some companies may not be able to continue their business, because of declining industry or no innovation of technology of their products. This is the Exit issue of a business. Even if the FBC encourages those companies, they have no way to continue or expand the business easily. In that case, they have to think about closing. Unfortunately, information of a negative attitude, such as closing a company could not be found. FBCs must give effective advice for exiting to companies. This concept must be covered at an FBC in Rikkyo University. While selling a company is very popular in the U.S., there is no idea about it by Japanese SMEs. This can be found from the questionnaire result. Selling firms must be covered, too.

(2) Following US and European Examples
Each country has its unique history of SMEs and experience in solving problems. A great deal can be learned from their approach in dealing with problems and in “localizing” them to Japan, when suitable. In the U.S., SMEs are evaluated as the countervailing power of monopolies. In U.K., SMEs are expected to have the role of a “seedbed function” for revitalization of the economy. In Germany, it is not necessary to support SMEs in any special manner, if the problem is only the size of the enterprises compared to big companies. In Japan, SMEs are evaluated for their contribution, because SMEs are necessary for the economic development in Japan, especially for competitive export. This thesis does not present an historical analysis leading to current situations in SMEs that is the necessary and worthwhile research of other studies. It starts with the simple understanding of SMEs and the role of government support. It then deals with the recent situation that post-World War II and newer SMEs must find successors for the founders and CEOs. Succession issues are not discussed in Japan deeply, except with regard to taxes. Succession is rather new in SMEs, and there are many cases of failure to understand the human issues resulting in failure. Using the models and examples of successes and failures of FBCs in other countries, we can accelerate the introduction of a program in Japan. It could be the prompt and proper method to solve succession issues in SMEs.
(3) Need for a Program and Chance for Its Success at Rikkyo

Judging from the questionnaire results and interviews, SMEs need a place that provides a multiple of services to support them: information, education or private consultation, discussions, etc. The optimal place is at a University. The kinds of programs that may be used include public and private meetings, and may also include “tools” which smooth difficult communication issues. While the development of Information Technology tools may be useful in financial and tax analysis, the human problems cannot be solved with IT. Succession also greatly involves inter-personal relations, which is strongly emphasized in the personal and business culture in Japan. This is one aspect which will influence the use of any concept study in US and UK programs. In case Rikkyo University establishes an FBC, graduates who form a private study group can come back to the university and help the undergraduate and graduate students’ education, too. I am sure that is of great benefit to the SMEs and to Rikkyo University. It can be what differentiates Rikkyo, especially the MBA School, from other schools.

[Notes]
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