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FAMILY BUSINESS

Key Issues

Denise Kenyon-Rouvinez and John L. Ward

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To Amy and Eliot
To Jeffrey and Julie

To the many business families who have the courage to be different and who enrich the world of business.

To the many of them who have over the years shared their hopes, concerns, fears and dreams with us, opening their hearts and trusting us. The learning we seek to share in this book comes from them.

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The cartoons on pages 2, 18, 32, 46, and 60 are by GABS.

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Authors' note

In order to provide an overview to the field of family business, this book is intended to be short, written in a simple manner and accessible to all.

It is designed specifically for families who are reading about family business for the first time, but will also serve as a refresher and a guide to families who are already much more knowledgeable.

We hope you will enjoy reading it and we offer you our best wishes for your continued success.

Denise Kenyon-Rouvinez
John L. Ward

Acknowledgments

We wish to thank Joe Astrachan, Randel Carlock, John Davis, Miguel Angel Gallo, Annelie Karlsson Stider, and Sabine Klein for their contributions to this book. Their deep knowledge of family businesses and their collaborative spirit form the core of the book. We would also like to thank them for generously devoting all royalties to the creation of a new award for best practice in grooming the next generation for the family business.

Wanda Ferragamo, André Hoffmann, Thierry Lombard, and Karl-Friedrich Scheufele have each contributed their personal experiences in such a powerful way that they will touch the hearts of those who read this book, as they have touched us while writing it.

We would like to express our deep gratitude to Lombard Odier Darier Hentsch & Cie, who conceived the idea for the book and have sponsored it throughout; and in particular to Nicole Favre for her unfailing support and encouragement. Without them this book would not exist.

Jane and Craig Aronoff of the Family Business Consulting Group stepped in early in the project and took on the challenging task of editing the first manuscript. Their devotion to the field of family business, their comments and their guidance were instrumental in ensuring that the book saw the light of day.

We also thank the teams at Palgrave Macmillan, Stephen Rutt and his staff, and at Curran Publishing Services, Susan Curran and her staff. Their support and expertise were invaluable.

And a special thanks to GABS, who produced the original cartoons for this book, for bringing a smile to our lips – and, we hope, to yours.

Foreword by Wanda Ferragamo

There are many family companies in Italy and they represent a notable and important contribution to the country's economy.

It is exciting and interesting to know many of these. Almost all represent houses that are special and unique, growing from strong and healthy roots. From that derives the force and energy by which successor generations may continue to grow and evolve.

In general, family businesses are loyal to the principles and the ideals of the founder, who was more often than not a self-made person. The beautiful thing about this is that in the reality of the family business, even when the founder is no longer present, there remains an enduring sense of respect for what he/she succeeded in achieving.

In fact, Salvatore used to tell me about his dreams concerning the future of the company. He hoped that the family could remain united, working together in the same family company. He wanted them to create the Ferragamo house, not only producing shoes, but also R.T.W., bags, other accessories, and silk. I am proud that we could realize all his dreams.

There are some secrets though to keeping the family together. The secret is that I have been fair with all of them, about their property, their salary and having each head different departments. In this way, they are united as a company but with different responsibilities.

Nowadays, it is still as was dreamt: brothers and sisters, our children, working together in harmony. I feel my task today is to form the next generation: my grandchildren may or may not join the Ferragamo Company, but they should learn the principles that can be applied in any company or position.

These are the basic, fundamental principles that have helped my own children succeed: loyalty, honesty, and the ability to motivate those around them. These are principles on which anyone can build their future.

I wish all the young people of the world could be educated to understand that achievement and maintenance of one's success is a worthwhile exercise.

The faith and ideals that feed the heart of this family are hard to deter, even when there is bitterness or delusion, or when one feels unappreciated. Sometimes one feels discouraged, ready to give up, to turn the business over to younger people who are eager to move their projects forward. With the motivation to assure that family business values will not be forgotten or discarded – and with a good night of rest – one returns to the challenge revitalized and stronger than ever.

This is why we have to do what we must do. When the company grows, we must convey these values to new managers and make them understand that the path is not a short-term journey, rather a voyage, long and sometimes with little sustenance. Our hope and objective is to transmit into the future and the new generation the enduring importance of faith, belief in ideals, and of course, dreams.

Wanda Ferragamo
Chairwoman, Salvatore Ferragamo SpA
Florence, Italy

Foreword by Thierry Lombard

All children who, like me, were raised in a family with a business knew even in the cradle that family businesses are neither businesses nor families like any other. But just how are they different? It is difficult to say, just like people who know a language without having had to learn its grammar.

My first instinct would be to say that handing down, focusing on the long term and measuring time in generations are all part of my definition of family business. When my partners and I agreed to take over the running of our firm – succeeding a father, uncle, or other family member – none of us felt as though we had "inherited" something that would be ours. Instead, it was more a feeling that an orchard planted by our ancestors was being left in our care and that our sole mission was to cultivate it and see that it bore fruit.

My second instinct would be to say that, perhaps more than others, family businesses are deemed to have a "human face." No doubt that is because their very existence is linked as much to a long line of men and women as to a specific product or service. That expression "have a human face" should be taken literally: I believe that, compared with other businesses, family businesses provide a truer reflection of the values of their founders and of the people who pass them on from generation to generation.

But those are only my instincts. Family businesses are slow to reveal their true selves, even to those who are the most directly involved. That is why this book is so necessary. For the past few years, family businesses have been arousing the interest of researchers the world over, inciting them to discover just what makes them so different from other businesses, including such unexpected areas as corporate governance, compensation policy, resolution of conflicts and last, but not least, performance.

This book provides a synopsis of the findings of that research by the best international specialists in the field. General readers will find that the book contains the first systematic portrait of a family business, that entity which is so familiar but of which so little is known. Readers who already have insider experience of the issue will certainly identify with many chapters, but they will doubtless discover themselves too, just like during a scan or session on an analyst's couch. This book will help to provide a way of better understanding what family businesses are and will thus help them to remain true to the tradition of flourishing family businesses.

Thierry Lombard
Sixth generation of Lombard Odier Darier Hentsch & Cie, Bankers in Geneva since 1796

Foreword by André Hoffmann

Taking responsibility, respecting boundaries

Here we have a real contradiction. In the media there is ever-growing criticism of large public companies, where salaried management is in sole charge of all decisions and shareholders are kept on the sidelines. At the same time, however, these same media keep an extremely close eye on companies in which families have minority or majority holdings, or are even the sole shareholders, and they are quick to denounce any actual or suspected breaches of good corporate governance. Against this initially confusing background, the question to be asked is: are family companies a good thing or not? Is a company that is quoted on the stock exchange, in which one or more families have a majority holding, an ideal situation or an anachronism?

The requirements of good corporate governance have increased sharply – and, in my view, quite rightly – over the last few years, and there can be no doubt that these have placed particular demands on family-dominated companies. Shareholders with majority holdings, or even minority shareholders who are in a particularly influential position, must always act in the full awareness of their special responsibilities for the company as a whole, its operational management and its employees, and also for the other shareholders. This responsibility is not always an easy one to bear, especially in difficult economic times, and it presupposes that everyone involved will stick closely to the rules laid down for running the company. If someone understands the role of principal or majority shareholder to mean that (s)he is able to gain as many advantages as (s)he can for him or herself, in the long run (s)he will fail. Equally unlikely to succeed is an attempt by a family business member to avoid personal responsibilities and to be interested only in getting the maximum dividend.

A good family shareholder brings commitment with judgment, a working relationship without undue assertiveness, and a level of interest in the company that still leaves sufficient freedom of action to the people who are in charge of operations. This means that the family members who are actively involved need to have the necessary training and in-depth knowledge to enable them to play an active role – on the management board, for example. This is what really matters: playing an active role that makes a real contribution to the company.

Today, especially, when many companies are in danger of losing their independence and are at the mercy of mergers and major takeovers, a stable family majority with a long-term perspective can be very important for a company and its commercial success. In my experience, clear majority ratios make it possible for acknowledged strategies to be followed properly without being excessively influenced by short-term difficulties. Particularly in large quoted companies, staff can have a confident basis on which to operate if they know that a family is the majority shareholder. Clear majority ratios, I am convinced, create the security that is needed to achieve objectives and bring true added value for the other shareholders.

The most important thing is for families with responsibility for a company to take their role seriously and to act with commitment. This requires, among many other things, close dialogue among individual family members, a readiness for training and continued learning, and also bringing the younger generation into the company in good time. Only in this way will family-run companies be able not only to survive but also to have sustained competitive advantages over companies that have an anonymous shareholder base.

André Hoffmann
Roche Holding AG

1 Introduction and Models

Family business is the most prevalent and pervasive form of business through all of history, yet only recently has the world begun to recognize the importance and distinctiveness of the family-controlled firm.

Today there is a rapidly growing body of knowledge about family business. Research, books, magazines, and academic centers are beginning to shed new light on how business-owning families can better profit and continue. This book seeks to bring together the most important ideas and lessons for business-owning families. Successful perpetuation of family firms is important not only to the owning families, but also to society.

Family-owned businesses represent 50 to 90 percent of the Gross Domestic Product in all free market economies. Family businesses are large and small. Small family companies in Holland represent 75 percent of all the companies in the country. Small family firms in the United States generate 60 percent of all employment. Sixteen family groups in India make up 65 percent of all private sector assets. Fifteen family groups in Chile represent more than 50 percent of the market value on the Santiago stock exchange.

Some of the largest enterprises in the world are family controlled. The Ford family (now in its fourth generation) controls 40 percent of the Ford Motor Company. The second and third generation Walton family controls 39 percent of Wal-Mart. One hundred and fifty year-old Cargill, with US$60 billion in global revenues, is the largest private family business in the world.

Family firms dominate certain industries. In the travel industry the Carlson, Van Vlessiegan, and Maritz families are three of the largest five travel agencies in the industry – each with more than €2 billion in revenues. Consider also the luxury products industry that includes Hermès, Zegna, Puig, Pinault Printemps Redoute, LMVH, Ferragamo, and world-famous watchmakers and jewelers such as Chopard or Audemars Piguet. Then there is the automobile industry, with Porsche, BMW, Fiat, Peugeot-Citroën, and Ford.

What is a family business? A research study at the Stockholm School of Economics defines a family business as one that is controlled by a family and has at least one of the following three characteristics: (1) three or more

family members all active in the business; or (2) two or more generations of family control; or (3) current family owners intend to pass on control to another generation of family. Most family businesses want to carry the business into the next generation. Family philanthropy is a backbone of the social welfare system. For all, maintaining a successful business in the community minimizes disruption of jobs, business relationships, and local pride.

Family businesses are not only pervasive and important, they also perform well economically. Recent studies of family controlled firms on the CAC 40 and the S&P 500 have surprised many with the conclusion that family firms have outperformed non-family firms. Another study of private companies in the United States shows family firms average 25 percent more return on investment.

To perform better, of course, family firms must compete differently. A recent study at Harvard University proved that point. Family controlled firms are more diversified and more vertically integrated, and this pays off with profitability. Other academic studies in the United States show family firms take a longer-term view regarding strategy, use less debt, but have a higher rate of reinvestment in the business. A recent study from IMD in Switzerland shows family firms with a distinct and more profitable company culture. Harnessing the special strategic potential of family firms is the subject of Chapter 2.

Research on family business will no doubt grow in the years ahead. Research centers have recently started up at several prestigious business schools, including INSEAD, IESE, Bocconi, IMD, Kellogg, Babson, Monash, and the Indian School of Business. The International Family Enterprise Research Association (IFERA) was founded in 2001. More than 30 students are pursuing graduate degrees in family business in Finland alone.

Families in business are increasingly joining together to learn from each other. The Family Business Network (FBN), based in Lausanne in Switzerland, consists of more than 1200 families from around the world. FBN chapters in Spain and Finland have more than 150 members each. Les Hénokiens, headquartered in Paris, includes more than 40 family firms as members, each of which has been in business for more than 200 years. One Japanese company is more than 1000 years old and Italy's Beretta is nearly 500 years old.

Long-term continuity is not an anomaly. Recent research shows that family-controlled firms are not just superior financial performers but, despite all the extra family challenges that they must face, also on average exist longer than their counterparts which become victims of merger and acquisition trends.

As awareness grows regarding the special nature and widespread role of family firms, those that do business with these businesses increasingly take notice. Companies that depend on family firms for the distribution of their products, such as Daimler Chrysler, Caterpillar, and beer producers, have developed training programs to help their customers endure as family firms. Other firms, especially those providing financial services, have increasingly focused on family companies as a distinct market segment, with special needs and approaches to decision-making.

The world is just beginning to realize that family firms are pervasive, they perform, they contribute, and they last. But families in business know that in order to do so, they must address several special challenges:

- succession
- business viability
- family harmony
- responsible and unified ownership.

It is these last two challenges – family harmony and competent, committed ownership – that surveys of family business owners acknowledge to be their most complex and concerning challenges. This book has specific chapters (Chapters 3 and 4) addressing the family and family governance.

The remainder of this chapter will discuss five valuable frameworks to help understand the unique nature of the family business. These five frameworks look at:

- The fundamental dilemma for family business success.
- The different perspectives in every family business system.
- Understanding the family system.
- Understanding the ownership system.
- Relating the family circumstances and external business environment to shape the future of the family business.

THE FUNDAMENTAL DILEMMA

Family businesses are different from other kinds of business because they combine family and business. Both the family and the business have their own needs and goals; each has its own life and each has its own beliefs. In fact, it may be helpful to recognize that the rules of effective families and the rules of effective businesses can be contradictory.

Families are governed by equality, inclusiveness, and caring feelings. Businesses, on the other hand, are governed by meritocracy, selectivity, and critical analysis.

These fundamental differences create opportunities for conflict in decision-making regarding employment, compensation, inheritance, reinvestment, and so on. Should such decisions favor the welfare of the family or the welfare of the business?

- In terms of employment, some families believe that the business should provide equal opportunities for all family members, while others are very restrictive and allow only family members with the highest competences to work in the business. The two diverse models can be equally successful. Most families, however, have no clear idea or rule about who can work in the family business and it is this lack of clarity that leads to conflicts and tensions, often resulting in a loss of time and efficiency in the business.
- In terms of reinvestment, families differ greatly. Some families decide to reinvest virtually all the profits in the business so that it

will grow quickly. Others feel that profits generated by the business should contribute to the standard of living of family members or should help them achieve their own individual ambitions and goals, either professional or philanthropic.

Over time, to the extent that decisions like these are not resolved effectively, conflict mounts. The result can destroy the business, the family, or both.

There are two ways to address this dilemma. One approach is to recognize the basic source of conflict and the essential decisions that will need to be made. With those recognitions, the owning family can establish in advance guidelines or policies for these decisions, before the decisions become real and personal. When policies are established before the issue impacts any one person or one part of the family, decisions are easier to make. In fact, the policies or guidelines established actually shape family expectations in the future, perhaps much lessening future conflict.

The second approach to addressing this fundamental contradiction between family harmony and business performance is to develop a philosophy as a family that managing the business for performance is in the best interest of the family. The family comes to believe that a strong business creates extra advantages as a family, not just in income but, more importantly, in identity and opportunity. The greatest such opportunity in the eyes of many business-owning families is that an outstanding business reinforces the family values, which will enhance the perpetuation of those core values for future generations. Values that enhance both the business and the family include trust, integrity, the long-term view, modesty, and work ethic.

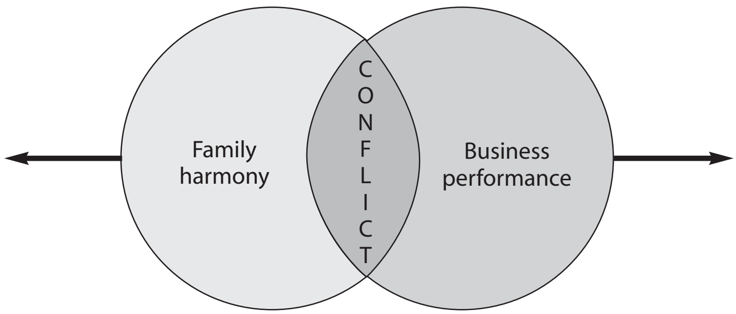

Figure 1.1 *The family business dilemma*

As you read this book, note those policy decisions common to all family firms, for your family to discuss. Also consider the ways in which family and business strengthen each other. The conclusions to these inquiries are documented in a family protocol/constitution, as explained in Chapter 3.

THREE CIRCLES

Perhaps the most universal model of thinking in the field of family business is the insight of Harvard University's Professor John Davis (and others) that family businesses are a complex system of interdependent sub-systems. The three essential sub-systems are the family system, the management system, and the ownership system. These perspectives and their interdependences are portrayed as three overlapping circles.

The *Three Circles Framework* of thinking offers several benefits:

- Thinking about a family business requires considering at least three viewpoints: family, management, and ownership. In most other business situations only the management point of view is considered, other than perhaps that of the shareholders. As was just discussed as

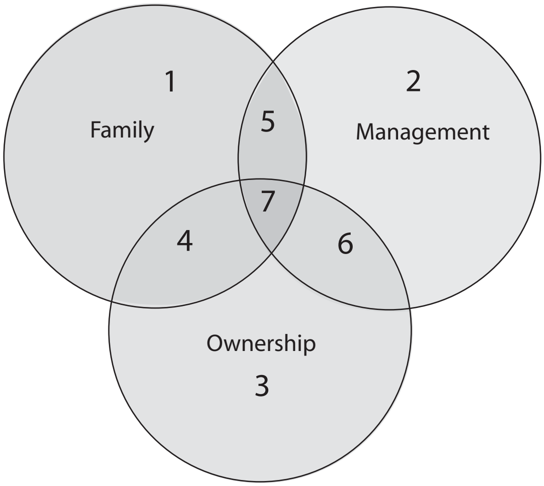

Figure 1.2 *The Three Circles Model*

Source: Tagiuri, R. and Davis, J.A. (1992) On the goals of successful family companies. *Family Business Review* 5 (1), pp. 43–62.

part of the "fundamental dilemma," the family point of view is distinct and important.
- In most situations each member of the family business system holds a particular viewpoint – and others will hold different views, quite naturally.
- Each area of overlap among the three sub-systems needs to be managed.
- Each of the three circles requires particular governance mechanisms and purposes.

Different Perspectives

Consider a critical family business issue: succession to the next generation. Considering the issue with the three circles model in mind prompts the recognition that there are at least three dimensions to success: succession to management leadership; succession to the economic value and control that goes with ownership; and succession to family membership and leadership. Often, succession is only thought of as a managerial issue. Who will lead the company next? How is that person selected and how are potential candidates groomed?

But of course there is more. In fact, ownership and family succession planning may be of greater importance. After all, business leadership needs are obvious and business leaders do not necessarily come from the family. Many resources are available to help prepare and select a future leader of the business.

Ownership succession has its own complexities. Should the economic value of ownership be the same for everyone? Should voting ownership be distributed differently? What are the roles and responsibilities of ownership? How is ownership competence developed?

Similarly, family succession is also an important subject in itself. Who participates in family meetings and decisions – everyone or only direct descendants? At what age? How is the family led and how does the family make decisions?

The three circles model provides assurance that each element of a decision or problem is considered. A fourth circle – and perspective – can also be added: the individual. In most Western cultures, attending to the individual's own needs and goals is part of the thinking process. What is best for each individual? What support is available to nurture individual growth and development?

Adding the individual circle to the framework ensures that another fundamental dilemma of family business is addressed: how to balance the individual's needs and interests with the needs and interests of the collective family community. Different religious and family cultures will think differently about this matter. Perhaps, like the family–business dilemma, the resolution of the individual–collective dilemma is a philosophy that what is good for one is also good for the other. Individuals are strengthened by community membership and support. Communities are strengthened if they include diverse individualists.

Different Points of View

The three circles model shows that each perspective is important in order to understand the total family business system. It also provides a means to note that within the family business system, different people will naturally have different points of view.

For example, some people will only see themselves as family members, not owners or managers, and will see the world from that perspective – what are the interests of the family? Others, especially non-family managers, will immediately see clearly the managerial point of view – what is best from a managerial perspective? As an illustration, those thinking purely from the family point of view – position number one (of Figure 1.2) – will feel very comfortable in expecting a family member employed at the company to also be available for important family events – an anniversary or a family meeting. That person's non-family management supervisor will likely respond that the family member needs to follow all the rules expected of every other employee, without exception. If the employee were to choose a family event, he or she should use vacation time.

Some family firms have owners who are not part of the family or part of the management team. They could be outside investment partners or, perhaps, public shareholders. These people – position number three on the three circles model – will be thinking, what is in the best interests of ownership?

But beyond those points of view are those that hold two or three points of view concurrently. Next generation successors or perhaps employed in-laws can find themselves in position number five. Or a family member not employed in the business, but an owner, position number four. Perhaps some ownership has been shared with non-family managers, position number six. In each circumstance the person can be conflicted in his or her own mind and needs to reconcile the two different points of view. It helps just to know that. Finally, many family business members occupy position number seven – owner and family member and manager. A family member CEO/managing director is classically in such a position.

The key idea for all those in overlapping or conflicting roles is to appreciate that role conflict can be very stressful. It sometimes helps for persons in one of these positions to clarify from which points of view they are thinking or speaking – which "hat" they are wearing. Is it "dad" or "boss" or "major owner"?

Boundary Issues

In each of the overlapping territories of the three circles model (that is, positions four, five, and six) there are particular issues to be managed. For example, family owners need to learn their roles in ownership. Do they have a special opportunity to contribute to the benefit of the company by contributing to the culture of the business or by having a voice at board meetings? What voice do they have in managerial decisions, for example, decorating the office or approving a new diversification initiative?

For manager-owners, how might they realize the economic value of their ownership? Are they conflicted about whether to maximize share value for their own personal retirement or for generations to come of family owners? Are they able to receive all the information about the company usually available to owners – financial statements, shareholding lists, and so on?

Family managers can have challenges working for each other, reporting to each other, or giving performance reviews to other family managers. Many family managers stay clear of socializing with work colleagues. They want to avoid the awkward feelings of "being one of the team," but also being on the family team.

Governing

Each perspective – family, management, and ownership – warrants its own governance structure. In Chapter 4, three governance structures will be proposed: the family council for family governance; the board of directors for management oversight; and the shareholders' assembly and shareholder agreement for ownership rights and responsibilities.

Reflecting back on the boundary issues in the previous section, each of these three governance structures needs to be defined relative to the others. The relationships among the owners' assembly, the board, and the family council need clarification and coordination. Some of the most complex decisions in family business are in the relationships among these three governing groups. For example, who nominates people for the board, owners, or family? How is the family council funded, by family members or by the company?

STAGES OF OWNERSHIP

Recognizing the three sub-systems and the three perspectives – family, ownership, and management – encourages clear understanding of each sub-system. Each has its own dynamics. Each changes over time and with size. For example, we know the management processes are different for 50-employee companies than they are for 500- or 50,000-employee companies. We know that management of a five-year-old company is different than management of a 25-year-old company. General management literature speaks comprehensively about these issues. But how does ownership change with the age of the business and generation of the family?

The IMD *Leading the Family Business* program has been the pioneer in providing educational forums for large older family businesses over the

Table 1.1 *Stages of ownership*

Controlling Owner stage I	**Sibling Partnership stage II**	**Cousin Confederation stage III**
Unilateral decisions	Consensus decisions	Democratic decision process
Authoritarian system	Intense and volatile relationships	Dispersed ownership
Quick decisions	Diversity	No one has absolute control
Others may feel alienated	Creativity	Rules and fair processes
Simplicity	Higher risk of conflicts	Loss of personal interest

past 15 years. From that experience different conceptualizations of ownership were necessary for the different family business participants. The result is to portray a classical ownership evolution over the generations. Three "Stages" are proposed. Each has its own particular behavior and issues.

Most family businesses, especially new ones, have one *Controlling Owner* (stage I). The controlling owner has effective personal power over ownership decisions as (s)he has 51 percent or often 100 percent of the voting power. Controlling owners have the prerogative to make unilateral decisions on almost everything that affects the business.

Founders of family businesses are typical examples of controlling owners, and one such is Baron Bich who founded the BIC company in France. It took him two intense years of research and effort in which he ventured all his savings before he felt he had in his hands a ballpoint pen of good enough quality to launch onto the market. It took him another 20 years to refine the technology. Today the company employs close to 10,000 people worldwide and is run by the second generation.

The advantages and disadvantages of a monopolistic or totalitarian system are well known. Decisions can be fast, but flawed. Decision responsibility is clear. Others, especially next-generation leaders, may feel alienated on matters affecting their destiny.

Each controlling owner must make a fundamental ownership succession decision. Does s(he) pass the ownership to one successor who will then become a controlling owner, or does s(he) share the voting power among his/her offspring or a small next-generation team? Such a team, because it is most commonly a team of brothers and sisters, is referred to as a *Sibling Partnership* (stage II). It is, in effect, an oligopoly of power or a team co-owning the business. Decisions are by a partnership.

Spendrups Brewery in Sweden is an illustration of sibling partnership. The company is active in the production, importing, marketing, and distribution of beverages – mainly beer, soft drinks, and water – and is run by two brothers: Jens Spendrup (president) and Ulf Spendrup (executive vice president).

The advantages and disadvantages of a partnership are different. The relationships are intense and can be volatile. On the other hand, the diversity among the team can lead to better and more creative decisions. A consensus decision-making style is usually followed. Consensus brings commitment; but it can also bring stalemate. The risks of disagreement can be threatening as they can destroy lifelong family relationships motivating expensive exits or redemption by team members that can be crippling to the company.

Over the generations, ownership may become widely dispersed among many owners – usually but not necessarily family members. Because these dispersed owners are often third or fourth generation cousins, this form of ownership is referred to as a *Cousin Confederation* (stage III). Increasingly, distant cousins need to collaborate on decisions. No one has absolute control, and the group is too large for intimate functioning by consensus. Instead they adopt a democratic decision-making process where majority or super-majority rules.

Founded in 1850 in the United States, the clothing company Levi Strauss is run and held by the fourth generation of the founding family. In France, the Wendel Investment Group with 700 shareholders illustrates the level of complexity this third stage of ownership can reach.

Cousin confederations require the development of processes and rules to make them efficient. They risk, however, becoming less entrepreneurial. Bold alternatives can become diluted to gain a majority of consent. When such systems work well, participants feel that they are heard and treated fairly, usually remaining part of the larger ownership group even if they were not in agreement with a particular decision.

There are two important benefits of thinking about ownership according to these three stages. First, as presented, the style and implications of each decision-making approach are clearer to the owning family and to the business. But second, very valuably, the incumbent owners can deliberately consider their next generation options, and prepare for the future stage.

The danger though, is that all participants become so accustomed to the existing state of ownership and power structure that they do not comprehend or prepare for the next stage. Compounding the challenge of ownership succession planning is the problem that those with the power to make the transition to the next form of ownership decision-making rarely have the personal experience with it to feel comfortable and effective at preparing and empowering the next generation of owners into their (likely) different system.

The different stages of ownership will likely also be reflected in different forms of the company's board of directors. The controlling owner will typically prefer an advisory council type of board, if any. The sibling partnership will have a decision-making board, and needs a board that includes most or all of the owners. A cousin confederation will have a board with family owner representatives, to gain confidence that the owners' perspectives are strongly taken into consideration in board decision-making. Management will provide most of the leadership.

FAMILY GENOGRAM

To gain an understanding of the management system, a company organizational chart, including the board, provides the best picture. To understand how the ownership system will function, it is best to see how the (voting) shares are distributed. At the end of the day it is usually true that "the one who has the gold rules."

To understand the family system better, another pictogram is possible, the *Family Genogram*. The family genogram is an embellished family tree that profiles the family and its relationships. Just as managements evolve and ownership arrangements evolve, so too does the family. Each member of the family ages in proportion to each other.

An example of a genogram is given in Figure 1.3. This genogram of the Maier family offers some patterns to observe. First-born sons enter the business and have conflicted relationships with their fathers. Sons-in-law are welcome or encouraged to join the business, but if they divorce they exit the business. Divorce is fairly prevalent. An alliance of the two largest shareholder women cousins is likely.

Genograms look for patterns of any sort – divorce, succession, cut-offs, chemical abuse, life expectancy, and so on. It is particularly important to represent and study the patterns in genograms as families usually repeat actions or decision rules. To reverse those phenomena for future generations requires serious family awareness and the consistent desire to change oneself.

FAMILY BUSINESS VISION

The basic premise of family business is that the family influences the business and the business environment influences the family. Consequently, family business planning differs from the planning done in other kinds of businesses. Understanding how both the family and the business environment affect business strategy is important. Similarly, how the business environment affects both the family's planning and the planning of the business is crucial.

Several family factors such as the number of children, their interests, and capabilities, can have a huge impact on the choice of business strategy. Often independent business opportunities are invented for younger family members. It is not unusual for heirs to have their own location, function, or division.

Family history also affects strategy. What successful or troubling memories does the family have? An early failure, at geographical expansion for

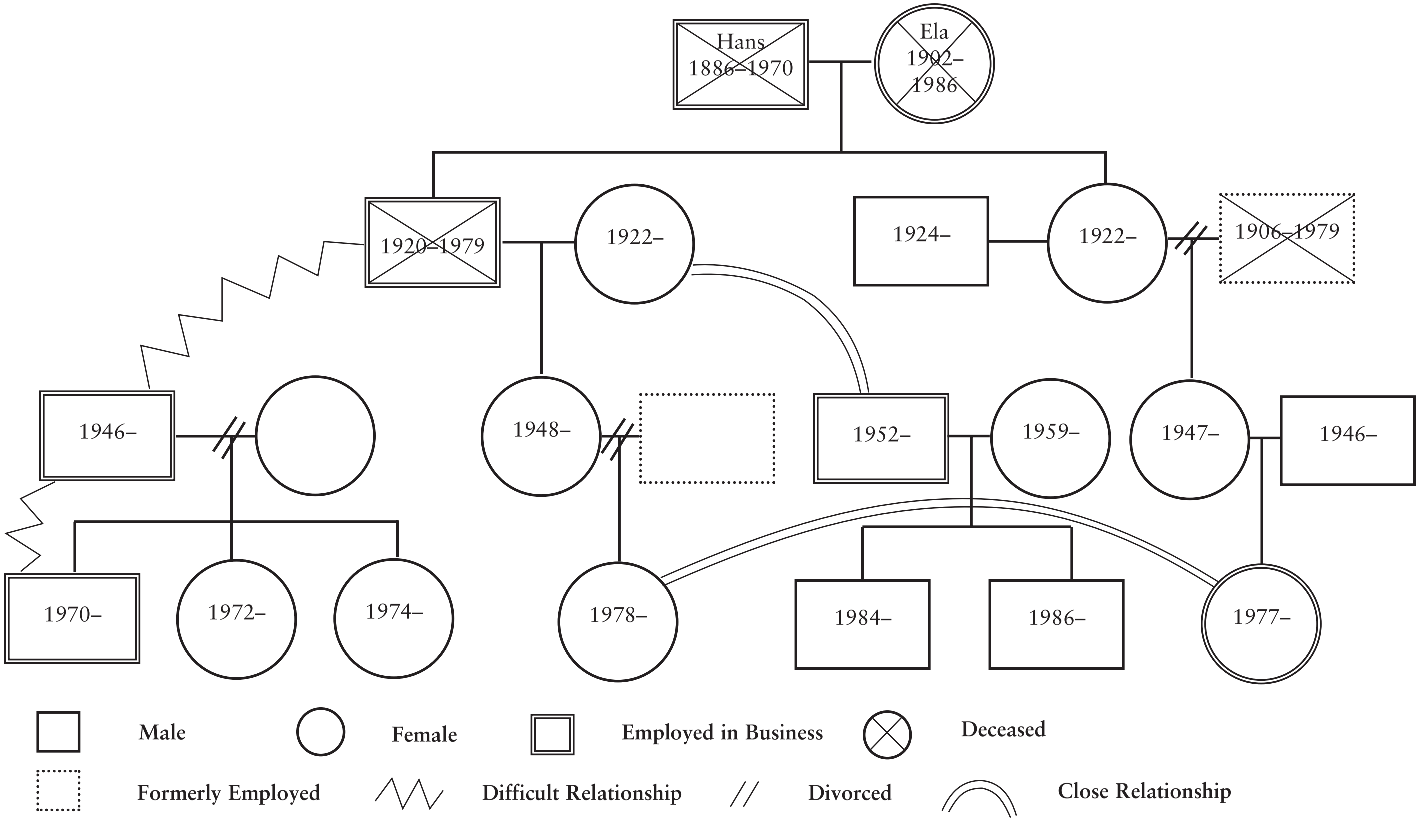

Figure 1.3 *Example of a genogram for the Maier family*

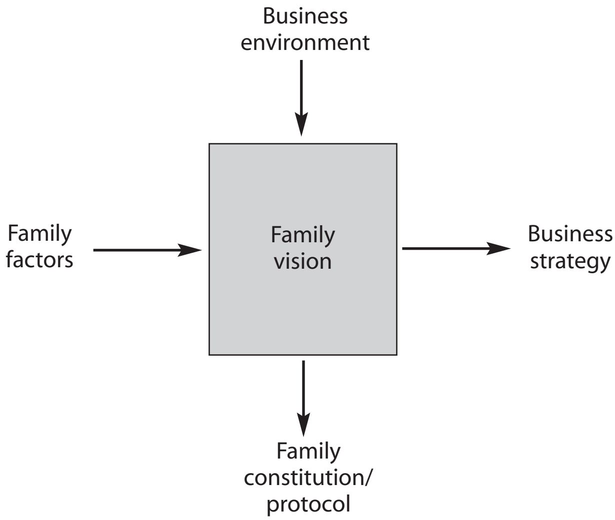

Figure 1.4 *The family business vision*

example, may inhibit that growth for a generation or more. The family's assumptions about people also affect business decisions. Some families do not feel that they can trust outsiders, thereby avoiding independent directors, excellent non-family top management, or strategic alliances.

The business environment also shapes the family's plans for the future. Different countries permit different ownership structures. Estate tax laws often influence family succession. The requirements of the business often affect the employment and compensation policies of the family. The capital intensity of the industry impacts family dividend or redemption policies.

The interpretation of all these factors shapes the feasible as well as the desired *Family Vision* for the future of the family with the business, and vice versa. Understanding these cross-effects helps in understanding the building of the strategy of the business and the family's protocol/constitution.

Family businesses dominate our societies. Typically, 50 percent of all people have a family business within one generation of their history that has supported the family or brought it pain.

Beyond touching most people, family businesses are a powerfully positive force in most economies. Despite the potential for family problems to complicate the business, family businesses really perform quite well in profitability and continuity. Their inherent advantages of the long-term view, passionately committed leadership, and strong values and culture yield excellent results.

CONCLUSION

The following chapters will provide counsel on how to maximize the special advantages of a family business and to lessen the challenges. To help guide the thinking on those topics, five frameworks were presented in this chapter:

1. Mixing family with business creates an inherent dilemma and also conflicts.
2. The family business should be understood from the perspectives of management, ownership, and family.
3. Different forms of ownership may lead to different leadership and decision-making styles.
4. Families have recurring themes and patterns through history.
5. The family affects the actual strategy of the business as the business environment of the company affects the policies by which the family manages itself.

To succeed long-term, a family business needs both a healthy business and a healthy family. Substantial attention to each is essential if each is to be healthy. The two most important processes a business family can create are

- a governance system to guide each part of the system – family, ownership, and management – and
- a proactive succession plan that transitions both the family and the business into the next generation.

Putting governance systems and succession plans in place should be accomplished while both the family and business are strong. Please do not wait for crises to force action.

2 Assuring a Healthy Business

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Enduring family enterprises require a healthy business. Many family enterprises stay small, scaled to fit an economic niche and support a single family. Small family enterprises can exhibit remarkable longevity, without ever growing. For example, there are ten French and Italian wine producers that are more than 200 years old.

Family businesses that grow are much more challenging to sustain, and yet a remarkable number of them also achieve longevity. Today, many of the oldest and largest companies, such as L'Oréal, Cemex, AP Moller Maersk, and Hennes & Mauritz, are family businesses. Recent research proves that, on average, family firms achieve superior financial performance.

However, strong financial performance does not always translate into longevity. Many healthy businesses are sold or destroyed as a result of family disputes, rather than business failings. The most successful family companies maintain a symbiotic relationship between family and business, allowing them to leverage competitive advantages. When these advantages are sustained over long periods of time, family ownership can greatly contribute to business success.

Overly serving family needs, however, can also compromise the welfare of the business. When incompetent family members are taken into management, or when family members receive excessive compensation or dividends from the business, almost inevitably both the business and the family suffer.

A strong, direct relationship between the owning family and its business is what defines a family business. Family owners usually dominate business management and governance. They typically provide the leadership and capital that sustain the company. This direct connection between family members and the enterprise influences many key decisions and also helps

maintain alignment of the long-term vision and goals of the enterprise and its ownership. This alignment of family vision and business goals can create a unity of purpose that should enable much greater business agility and a wider range of strategic options.

Maintaining this symbiotic relationship over time is both challenging and vital. As the family and the business grow, their interrelationship necessarily evolves. This requires attention to the long-term development of the family and the business, as well as their changing interrelationship. At the core of every high-functioning family business is a healthy enterprise, supported by family owners capable of sustaining and growing economic value. The goal is to balance and align family and business needs, so that what is best for the business is best for the family, and vice versa! Family and business perspectives can clash or reinforce each other in four critical areas: business strategy, employment, compensation, and shareholder liquidity. Fostering alignment of family and business perspectives in these areas is essential to optimize the health of the company and enable its long-term success.

BUSINESS STRATEGY

The Genesis of a Business and Strategy

In the beginning, the development of strategy is organic to the development of a business. For many business founders, the enterprise and the strategy are mutually and simultaneously conceived and adapted. The initial strategic goal of a business is to survive. To become established, every business needs to carve out a place in its market, and build a reliable customer base. To achieve this, a business must create an advantage that creates value for its customers. Frequently, other family members are asked to help by working for the business. Family employees are not only convenient, they are trusted. Almost all family businesses are established in this way by entrepreneurs.

Most entrepreneurs ultimately seek to extract wealth once their businesses are established. Many family business founders, however, continue to invest, take risks, and make sacrifices long after their businesses are established, seeking to optimize their development. These founders often have an intense personal identification with their enterprise, and make it into a vessel for transmitting their legacy of values, culture, and wealth to their family and society. Family founders personify the unification of family and management purpose found in family business, and many of them seek to transmit this alignment of purpose to succeeding generations. Often, they do this for the benefit of the business, as much as for the benefit of the family. Many successful families have a sense of mutual historical identification with their businesses, which can create "emotional capital" and greater commitment, long after the founder is gone.

Strategies for Growth

Family companies can grow to a substantial size. With time, their core businesses will carve out significant market share as they grow and mature. Often, as businesses mature, their growth slows, and it becomes necessary to pursue the development of new opportunities in other markets. When companies commit to continuing growth, diversification into new markets becomes a dynamic process. In family business, the stages of family development also drive diversification. The development of multiple business units is a common feature of sibling partnerships, and often serves to give individual family members separate management authority and responsibility. This can also serve to promote the development of new, strategic market segments and business competencies. Because of this family dynamic, some families pursue strategic diversification long before their original business reaches maturity.

Succession periods provide both strategic opportunity and challenge for family businesses. The long tenure of leadership found in family companies can lead to entrenched strategic paradigms. Successful successions in family companies, however, can create powerful opportunities for strategic reassessment. Successors often question long-held business assumptions, drive better business performance, and more aggressively pursue new ventures that can create growth. In family business, the key to renewing strategy is often the effective transition of control to succeeding generations. When this is accomplished, family companies maintain a powerful ability to innovate and sustain their entrepreneurial cultures.

Capital Strategies

As businesses age and diversify, strategy is increasingly shaped by the deployment of capital. The different business units must constantly be assessed for their strategic potential, and capital must be effectively deployed. Sustainability, profitability, and growth are the key elements of strategic potential to assess. Often, capital must be harvested from a mature or no-growth unit and redeployed to another that has greater long-term potential. Very few large businesses achieve longevity without redeploying capital, and many of the most successful enterprises are only marginally connected to their original businesses.

In the cousin generation and beyond, many family businesses become holding companies, and their strategy becomes increasingly focused on capital allocation. The harvesting and redeployment of capital can be challenging for family businesses because of historic or personal ties to particular business units. Despite these challenges, many older family businesses become quite adept at strategic capital deployment. As families grow larger, they tend to develop more of an investment perspective, focusing increasingly on financial performance. This change in perspective, coupled with their concentrated control, often transforms large family ownership groups into very effective stewards of capital.

Unconventional Strategies in Family Business

Family businesses share many other distinct strategic features. The first and most elementary of these features is their ability to be patient. Strategy in family companies is based on a long-term orientation, which allows them to adopt many unique, and sometimes unconventional, strategies. Family businesses can make investments that other businesses would perceive as too risky, because their potential payoff is too far in the future. Their long-term orientation also allows family businesses to take advantage of bad economic cycles. When an industry falls on hard times, many family enterprises "go against the grain" and buy in at bargain prices. This strategy can provide instant diversification or increased market share, but it also requires fast action and then patience. Family businesses are often able to make fast decisions, and then have the patience necessary to create value. Families also tend to maintain strategic investment in their businesses during recessions, when other companies cut back. Given time, the strategic and value investing of family businesses can produce greater long-term value creation.

Family businesses also defy conventional wisdom regarding diversification and vertical integration. When diversifying, most businesses look to broaden, strengthen, and leverage their core position in a market or industry. Many family enterprises, however, enter industries or start new ventures completely unrelated to the competencies of their core businesses. This seemingly "haphazard" diversification can actually reduce the family's inherent business risk by aggressively diversifying into industries with different economic characteristics and potentially better future prospects. Similarly, economic theory does not favor vertical integration, but many family businesses pursue this strategy quite successfully. Vertical integration refers to businesses that expand to fill multiple roles in their supply chain. Many business experts believe that outsourcing, rather than vertical integration, is the most efficient way to organize a supply chain. Integration, it is thought, creates bureaucracy and ongoing internal disputes. Family businesses, however, can use their long-term culture to minimize these issues, and they often succeed in leveraging greater coordination and profits from vertical integration.

Family businesses are also known for carving out unusual market niches. Many family businesses do what others do not like to do and often dominate highly hazardous industries or "dirty work," like scrap recycling. Some family businesses develop highly specific areas of expertise, and many of these are known for developing specialized processes, tools, products, or knowledge. This combination of assets and expertise is often developed over long periods of time, and family businesses seem particularly adept at transmitting knowledge and experience to new generations of leadership, and maintaining institutional memory.

Memory is often a special aspect of family business strategy. Family businesses pay attention to their history and the lessons learned. They are able to pursue unconventional strategies, because they have experience with the challenges and opportunities of pursuing them. Older family firms have often weathered rough economic periods, and they retain the knowledge and experience necessary for the next downturn. They also actively transmit knowledge across the organization and down through generations. The historic perspective and institutional memory of family businesses allow them to take a long-term view, and adapt effectively to the naturally occurring cycles of change that impact business and shape strategy.

Parallel Planning for the Family and Business

Strategic planning is a common best practice in business today. Family businesses pursue strategic planning processes like those found in other companies. Professional managers work closely with boards of directors to develop the vision, mission, and goals of the business. They use various planning techniques to develop a rigorous strategic view of the enterprise and its environment, and they identify the most critical strategic business initiatives to undertake. Family companies, however, face the additional challenge of assuring the alignment of business strategies with family ownership objectives.

Family business strategy, therefore, must take into account the family ownership's vision and values, including ownership expectations for return on investment and distribution of income. Every family business develops an embedded shareholder value proposition, encompassing the desired investment characteristics and objectives of the enterprise. These include well-defined target levels for risk, return, liquidity, and growth. This value proposition is the foundation for all strategic decisions made by the company, but it is not fixed. In fact, its potential for flexibility is one of the great advantages of family businesses. Family businesses can be more responsive to the strategic needs and opportunities of their enterprises, but to accomplish this, the family ownership must pursue parallel planning processes.

Just as business planning is an ongoing process, the owners' planning should also be ongoing. The family ownership needs to keep up with strategic developments in its business, and prepare itself to be responsive and supportive of the business. In addition, family ownership groups themselves are not stable, and can change dramatically over time. Keeping up with the business and the family creates a continuing need for constant planning. Growing families need to continue to formulate and communicate clear and comprehensive ownership objectives and policies regarding the shareholder value proposition, succession, and governance. Continuous planning around all three of these areas is critical to the family business longevity, and is particularly important with each change of generation.

EMPLOYMENT

The Nature of Work

Almost all family businesses are started to create employment, and many small family businesses serve primarily to employ family members. The nature of employment changes, however, as businesses grow. While human capital remains extremely important, as businesses change scale, the effective organization of labor becomes as important as hard work. As companies grow, the work they do is increasingly specialized, organized, and directed. An organizational structure is created to define responsibility and authority, align decisions, coordinate direction, and create accountability. As organizations grow, the competencies, knowledge, and skills of individuals become increasingly specialized. Coordinating and optimizing collective labor becomes ever more complex.

Family businesses share all these employment characteristics with other businesses, but they are also distinct in a number of important ways. Family businesses tend to value their people very highly. Many view their employees as key stakeholders in the enterprise and recognize them, with loyalty, as the foundation of their success. Many family businesses are also significant contributors to local economies through the creation of employment, and they often develop close associations with the communities where they are located. These close associations can add great value to the business.

Family Employment

Family businesses face the additional challenge of effectively managing family employment. In small family businesses, family members are often the source of relatively cheap labor that will work longer hours and provide greater employment flexibility. In small family enterprises, family employment is often the business of the business. As a family business grows, however, this is soon no longer the case. Yet, many families continue to actively recruit family members into the business, and the development of a family successor is often a key early variable in family business survival. Recruiting family managers can be vital to the survival of family companies, but as they grow, the employment of family members is no longer the only reason to be in business.

Family participation and leadership can be critical to reinforcing family values in the company, which is often an important component of family business success. Many family members, in fact, begin working at a very young age and come to associate family, business, and work very closely. Work becomes a kind of "birthright" for many of them, but with this "right" often goes a tremendous burden and responsibility. Family members commonly work harder and longer, and show great stamina and dedication, as they invest incredible quantities of "sweat equity" in their enterprises. The close involvement of families with their businesses is one of the critical reasons they succeed, but it is also the source of many issues. Family businesses can be nepotistic, and this often raises the questions: How much nepotism is good? And at what point is nepotism bad?

Family Employment Policies

Many family businesses develop formal employment policies for family members. Often, the development of these policies is associated with an increase in the size of the business or the family. Once a business reaches a size where labor specialization is the norm, competency and qualifications become more important in the selection of personnel. Family members must increasingly bring to the business professional training, and the accompanying knowledge and skill-sets that qualify them for given positions. Increases in the size of the family can also generate a need to formalize and standardize the entry process for family members.

Most family employment policies begin with setting standards for entry into the business. In family business, there is often a historic pattern of family members entering at a young age and working their way up from the shop floor. Family employment policies usually replace this old pattern with specific qualifications and requirements. Some policies require technical training or formal business education before entering. Often, policies have a requirement of several years of outside work experience. Most employment policies state that family members must come into the business by filling the particular job that matches their qualifications and experience.

In addition to regulating entry into business, family employment policies often create requirements for advancement and promotion. Often, these policies seek to objectify the criteria for advancement, and require family members to have qualifications at least equal to those of other job candidates. Many policies state that family members can only fill openings for existing positions as they naturally occur, and that no jobs may be created or people moved to "make way" for a family member. Also, many family employment policies restrict direct reporting to immediate family members, or some families require that family members report to a non-family employee in their initial position in the company.

While these practices are becoming more common, many families also recognize the value of giving family managers a breadth of experience. Family managers may no longer work their way up from the shop floor, but an exposure to varied aspects of the business is still seen as having great value. Many family businesses consciously give their family managers a breadth of professional experience by moving them through a sequence of jobs in the organization. This professional training is usually coupled with active mentoring, often by veteran, non-family managers. Many families use non-family executives and independent directors to direct the career development and evaluation of younger family members. This helps remove the impact of family biases in employment and promotion.

Ultimately, employment policies can govern the selection of leadership. Some families maintain an expectation that family members lead the company. In this case, the planned development of family candidates is usually a key component of a long process of leadership selection. Other families adopt a "family blind" policy of leadership selection, and focus on professional qualifications and experience. They pick the candidate with the best combination of competencies for the job, family member or not.

Leadership in large businesses requires the organization of teams, which bring together many different competencies. In large family companies, family leaders are commonly prominent members of the leadership team, but highly qualified, non-family CEOs are also quite common.

COMPENSATION

The Value of Work

The labor market drives remuneration in business. Thus, compensation reflects the value of labor, which is comparable, replaceable, and based on competition. This business paradigm can often be challenging in family companies, particularly as it relates to the compensation of family members.

In many ways, family managers are not comparable or replaceable. The ownership perspective they bring to management – and the management perspective they bring to ownership – is often what enables family businesses to leverage value from their concentrated control. No business can assign value to this, and the labor market certainly does not "compete" for this value-added element.

Family compensation is often quite challenging for family businesses. In small businesses and start-ups, family members are often paid under market value to keep the business going. Family labor is usually extremely important in the early development of family businesses, and it is often seen as essential to future business continuity. Sometimes, succeeding generations are paid more than their market value, or given extra perks, in order to ensure that they come into the business. Sometimes, "needy" family members are given jobs in order to ensure their economic well-being or the continuity of ownership. On the other hand, some families continue to pay family members less than market value in order to maintain a frugal business culture. Family values and culture often get mixed up in compensation, and, over time, families tend to develop compensation philosophies that reflect this.

The desire to be "fair" within the family can also distort compensation, sometimes causing family members to be paid the same, regardless of the value of their positions. This practice can last a long time, but usually does not survive in large family companies. As businesses grow and develop sophisticated human resource management techniques, they assign a value to each position. As this happens, distortions to family pay are usually eliminated, and family members are paid according the value of their position. As this happens, however, the family issue of "fairness" often leads to secretiveness about compensation. To promote family harmony and avoid conflict, many families withhold remuneration information. This practice, however, often erodes trust and leads to family conflict, rather than preventing it. Transparency in compensation is best practice, but the transition to variable compensation and transparency is often challenging for families.

Early in family business development, the value of equity is often not recognized and differentiated from the value of labor. This can also distort pay for family members, as some portion of compensation is thought to be linked to ownership interest. As family ownership groups grow and their companies build equity value, the need to compensate ownership interests separately and directly becomes increasingly apparent. Separating compensation from shareholder distributions can be a challenging transition in family business, and often involves tax issues.

But a lack of separation inevitably distorts family compensation, and can create problematic expectations.

Understanding the value of equity and labor separately is an essential transition in family business.

Formal Compensation Policies

Growing family companies tend to develop formal compensation policies. Families often begin policy development by articulating the family philosophy about remuneration. First, they answer questions about how family members should be paid and whether their pay should be based on the same model as other employees. In addition to family issues, the size and needs of the company are also important considerations. Most families are attentive to business best practices, and pursue compensation based on a market value model.

Many sources, including professional consultants, can be used to help build a rational, market-driven compensation model. Once a market standard is established for the organization, the family's compensation philosophy directs whether the business will pay more or less than the market average, and how family members fit into the system. Usually, family members are paid like other employees, in keeping with the goal of aligning compensation across the organization. Once a market-based standard is created, it must be regularly reviewed and adjusted to reflect internal labor needs, regular raises, and changes in the external labor market.

In addition to base pay, annual incentive plans are also a common feature of best practice remuneration. Annual incentive plans can be based on individual goals and/or company performance. Incentive plans are usually designed to support particular initiatives and their success is usually measured through specific financial results. In addition to annual incentive plans, some businesses have long-term incentive plans, often tied to measures of value creation. Well-designed incentive plans are often a significant portion of compensation, and they can help retain and motivate the key managers that drive the organization's value creation.

Creating best practice compensation policies requires a clear articulation of the family's remuneration philosophy. The family's values, goals, and principles regarding compensation need to guide all remuneration decisions. Formal policies should be based on this philosophical foundation and they should serve to align compensation with ownership's business goals. These goals should include building shareholder value, motivating valued employees, and creating competitive competencies that benefit customers. Developing compensation policy is a vital and complex part of business, and it is particularly challenging and important in family businesses.

SHAREHOLDER LIQUIDITY

The Investment Ethic in Family Business

Many family businesses grow shareholder value aggressively in their early generations by plowing cash flow back into the business. They grow equity value, while giving little thought to liquidity. Sustained growth is the primary goal, and this can be accomplished quite efficiently when capital is grown, and reinvested. Founders develop this investment ethic as they establish their companies, and it is often transmitted to succeeding generations. High levels of reinvestment are found in many family businesses. This ownership ethic supports the long-term success of the business by providing patient capital at a lower cost.

Ownership successions often challenge reinvestment paradigms. Ownership transfers can trigger inheritance taxes, which in turn can cause a sudden increase in the demand for liquidity. Generation successions also tend to increase the number of shareholders who are not active in the business. These shareholders bring an investor perspective to ownership and often focus on return on investment rather than just growth. This can lead to a paradigm shift in the family's investment ethic. Shareholders increasingly see the equity they own as a personal asset, which should generate a rate of return comparable to other investments. Current income becomes an increasingly important aspect of their investment returns, and by the second or third generation, the regular payment of dividends is a common feature of many family businesses.

While current income becomes increasingly important, many family investors continue to desire long-term growth in value. They view stock ownership as a means of growing and transferring personal wealth to their children. The trade-off between current income and reinvestment levels can impact long-term growth rates, risk tolerance, and the ability to leverage capital through debt. These issues, coupled with a desire to avoid taxes, can sometimes induce large family ownership groups to continue higher than average reinvestment. To support this, many families find it necessary to provide some shareholders with the option of selling shares and exiting ownership.

Shareholder Liquidity Planning

At any time when the company gives cash to shareholders, they are getting liquidity. Liquidity is a payment for the value of capital the shareholders own in the business. Liquidity generally takes two basic forms: dividends and stock redemptions. Dividends are distributions of cash to shareholders that are paid on a per-share basis and represent a current return on equity. The payment of cash dividends does not change the number of shares held. Stock redemptions are the second form of liquidity, and these involve the repurchase of shares for cash. Shareholders who chose to sell are exchanging stock for cash, and reducing the number of shares they hold. Dividend and redemption policies are highly variable in family business, and they often reflect the family's values and history.

Dividend policies are hard to create in family companies, and once created, they can be difficult to change. Some families decide to keep dividends quite low and stable so that they, and the company, are protected from variable business performance. Other families tie dividends directly to a percentage of net earnings, and allow them to move up and down with the performance of the company. Often, a target for dividend rates is created, using a range of percentages for net earnings and/or return on share value. Dividends then stay within this target range, and usually change more gradually, reflecting longer business trends, rather than year-to-year fluctuations.

Dividends paid, of course, reduce funds available for investment in business growth. Therefore, families search for the proper balance of owner income and strategic reinvestment. Family businesses pay particularly close attention to this balance, and often the dividend rate is a direct reflection of how emotionally invested the family is in the company's future.

Demand for liquidity is a measure of the sustainability of the family business. When the family begins to harvest value from the company, rather than investing for growth, the long-term survival of the family business may be threatened. Often to avoid this, the shareholders that demand the most liquidity are bought out. Some families have shareholder agreements, which govern the sale of stock. Setting a value for the shares is quite challenging, and "making a market" is often difficult. When there is significant demand for liquidity, the company itself is often called upon to redeem shares. Stock redemptions typically involve a third-party appraisal to set a price, followed by a limited offer from the company to repurchase shares. Shareholders can choose to sell or retain their shares. Sellers realize liquidity and surrender shares to the company. The company usually cancels the shares, giving the remaining shareholders a higher percentage of the company's future income and value.

Creating dividend and redemption policies can be quite complex and challenging in any business, and even more so in a family business. But these policies are vital to the future of family businesses once they reach a certain age and size. Changes in the configuration of the ownership group often determine the need for liquidity, and balancing these needs with the best interests of the business is a key challenge of a mature family business.

CONCLUSION

Family businesses face many special challenges. They must bring together family and business needs, and find creative ways to reinforce a mutually beneficial relationship. Maintaining this symbiotic relationship over time is both challenging and vital. This often requires the continuing development of a family vision and culture that supports clear business goals and values. Effective families tie shareholder and business interests closely together in pursuit of the common goal of continuity. Successful families are able to maintain this close tie for remarkably long periods of time, and they do this by adapting. As the family and business grow, their needs change, and so does their interrelationship. To meet the challenges of change, families adapt their historical practices to match the requirements of the present day by reviewing the family's business philosophy and translating it into policy in the key areas of strategy, employment, remuneration, and shareholder liquidity.

Many families are remarkably successful at balancing and adapting the relationship between their business interests and the ownership needs. Each family and business does so in its own unique way, which becomes a collective expression of both its history and culture. The ability to maintain this relationship through many changes and across long periods of time is probably the most important element of family business success. It is what allows the families and their businesses to go continually forward and meet the demands of their common future together.

3 Family

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Family in business is like a nuclear reaction. In an uncontrolled state, family can be as explosive as a hydrogen bomb, and in a controlled state as efficient and powerful as a nuclear power plant. But how does a family achieve a controlled state? How can a family protect against circumstances that can destabilize and lead to explosions? This chapter examines the core issues in the family, and provides some ideas as to how to manage and develop the family.

FAMILY STRATEGY

A successful family strategy ensures that all involved understand their mutual goals and how all will act to achieve them. While widely recognized as critical for all business processes, an explicit clear strategy for families in business is recommended. Even typically private and often disruptive processes such as birth, marriage, and death may benefit from strategic planning. Families often think, "But that is private and should only be thought of in the name of love!" However, these changes greatly affect family stability and business dimensions as well, particularly with regards to ownership and family employment.

Historically, biological reproduction and marriage have been two processes of utmost importance for the continuity of family power. Biological reproduction ensures that there is at least one heir to inherit the business. For continuity, having a family is vital. The next crucial question is, therefore, who are to be considered as family members? Only sons? Only blood relatives? What about in-laws, widows and widowers? Or – more difficult – divorcees? A Dutch family business owner gave an illustration of these difficulties when he asked about

attending a family business conference, “May I bring my wife or is it for family only?”

There is no right answer to the question of who is family, but for every business-owning family the question should be answered so that individuals can plan, expectations are set, and a sense of fairness is ensured.

Marriage Strategies

Most next-generation business owners understand the profound life impact of ownership when they are about to marry. Over a hundred years ago, many families had formal marriage strategies. For example, the French tire-making Michelin family encouraged family members to marry cousins in order to keep ownership control within the family. Marrying aristocracy has been a strategy for the entrepreneurial Wallenberg family, ensuring the necessary political and social support for business activities. In other families, marital links between families have been an important mechanism to ensure enough capital for growth or the right societal ties. Through intermarriage of wealthy families, capital from one family can become available to another, thereby reducing overall family financial risk.

Marriage has a substantial effect on who is considered as part of the family and on who will run the business. In India, a woman might bring business ownership as a dowry when marrying. After the wedding, her husband traditionally becomes the proprietor and perhaps also manager of the business. In Japan, a son-in-law may be formally adopted into the family of his wife to ensure continuity and sustain the family name.

In earlier generations in the Western tradition, only the sons-in-law – never daughters-in-law – were formally involved in the firm. Even today, it is far easier to think of examples where sons-in-law hold crucial and formally acknowledged positions within family businesses, such as CEO or chair of the board. Often daughters-in-law join the company board of directors after the death of their husbands. A widow in Spain advanced to the position of chairwoman.

The construction of the family, therefore, can be seen as a process with a strong influence on the firm. In-laws, as long as they are married, are generally considered to belong to the family. Yet when divorced, in-laws are more often than not ejected from the family. On the other hand, widows are part of the family as long as they do not remarry. In order to avoid emotional debates for individual couples and individual family members, some families chose to make principles to guide how long and when to consider spouses, divorcees, and widow(er)s as family members. Even if not formally owning or belonging to the owning family, spouses will, as parents, have an influence over business activities through their children.

Ending a marriage is also a process that families around the world consider as an important area for strategic planning. There are frequent stories about how a family lawyer, often just a few hours before a wedding ceremony, coerces a soon-to-be spouse to sign a pre-nuptial agreement. The lack of pre-nuptial agreements has caused family branches to lose control of businesses. In some cases, families even refer to divorced spouses as the ones who "took" the company. Because pre-nuptial agreements may cause anguish for the engaged couple, many families have established policies regarding marriage and divorce.

Role of Wives

Women have typically not been visible to historians of family business. Generally, wives and mothers have been active participants in the construction and reconstruction of the family's relationship to the firm. They have a management-like role, although admittedly a role usually performed in a societally defined subordinate position relative to that of men.

Historically, wives in the first generation of business ownership had access to the management arenas and processes of the home. They typically were not owners nor employed by the firm. They made their home the great meeting place for family and company. They also bore the family name, and were therefore perceived by outsiders as influential members of the family.

An often overlooked role wives play in business families is that of a business angel or venture capitalist. There is a tendency to legally neglect the importance of women in wealth creation, wealth accumulation, and wealth preservation. There are many examples of invisible business angels in owner families. In several families, the legacy of a wife was used to either finance a start-up or diversify the business. In one family business, the husband had an idea but no money. His wife had been saving to buy a motorbike. Instead, she put her savings into her husband's idea. Despite this, "outsiders" refer to the husband as the entrepreneur, even though the family itself acknowledges the importance of the founding couple. In another case, the wife founded the company but was forced aside by her husband and father-in-law. She then stated "It his dream and my money."

In a third example, a family business was built upon small enterprises owned by the founder's first wife. The wife had come into the business as an inheritance from her first husband. After she died, her second husband remarried. The business grew to become one of the main employers in the country. At his death, his second wife succeeded him as business and family leader for nearly ten years. Today, the family refers to the second wife as "the first iron lady," but still they do not consider either of the wives as founders.

Biological Strategies

"There is a huge difference between being a wife and being a mother," said a family business owner. This points to the self-evident fact that reproduction is necessary for family continuity. It also suggests that even when divorced, both parents influence business activities through the children.

Birth is also an area in which families have pursued strategic planning for many generations. In some royal families, key employees had to be present during the entire birth procedure, ensuring that the baby actually was born from the body of the queen and was not exchanged for some reason. The first and most important condition for succession and continuity is the actual existence of a next generation! Why leave such an important prerequisite to fate? In aristocratic and royal families, a defined succession order has been in effect for generations. For monarchies, the order of succession is often stated in constitutional law. What happens if there are no heirs? In larger families this is generally not a problem. In some cases, sons born to mistresses have been welcomed into the family in order to secure both ownership and management continuity. In other cases, adoption or business sale has occurred, and occasionally a business empire may be left to charity.

Strategies Concerning Death and Inheritance

Another area that demands strategic planning is death, regardless of how strange that may sound. It is important to be prepared for a situation in which the "wrong" person dies in the wrong country and in the wrong order. One strategy for families to ensure continuity is to be very open and transparent about individual wills and other personal or private documents (such as pre-nuptial agreements). All such legal and contractual agreements should be coordinated so that conflicts between them do not become major issues later. One method for doing this is through a shared family office or shared legal counsel. Even in situations where the family would like to ensure individual privacy among family members, a trusted third party makes certain that everything is well coordinated.

Open documentation can also aid difficult emotional conversations about action plans in both the short and longer term. For example, a funeral is neither the right time nor right place to discuss planning. The family should have plans to deal with personal grief, and develop strategies for responding to other people's grief and offering condolences. Crisis action plans (who does what, how, and in what order) should be developed.

Inheritance Strategies

Ownership succession requires knowledge about who will inherit, what they will inherit, and how and when they will inherit. Over generations, different inheritance principles have been used in business-owning families. These principles are strongly based on the culture of individual families, not just on principles within a country's legal system. Business-owning families make their choices partly in accordance with their cultural and social background. Some consider that if there is only one heir, choices are easy and no conflict will arise in the family. Others would argue that a larger population of potential heirs increases the probability that at least one of them will be competent enough to manage the company. And yet others believe that even if a family has choices, a single heir should control the family business to protect it from inevitable family conflict.

Many different ownership scenarios are possible. In the long run, if the family can resolve its differences, a more equal ownership distribution may create unity and motivation to work on behalf of the family and business. However, not all cultures have the opportunity to select ownership distributions: for example, Shariah law requires Muslims to follow strict inheritance laws as to who will inherit and what will be received.

In Scandinavia and other northern European countries and cultures, three different succession principles have been prevalent – primogeniture, seniority, and equality. In the first two, a patriarchal logic has been used, where gender and seniority have guided the division of ownership among heirs. Sons have inherited larger shares of the companies than daughters (if daughters have inherited anything). Older sons have inherited more than younger sons. With primogeniture, the oldest son inherits all stock. Other heirs are compensated with assets such as estates and financial holdings if any exist.

With the seniority principle, only heirs who work in the business are eligible for inheritance. When daughters are not allowed to work in the business, they do not inherit stock. Hence, the son with most responsibility in the business is guaranteed a larger share of stock. From other cultures, there are examples of families who would rather adopt a son-in-law than pass ownership to a daughter. This gender-based succession order was prevalent in Western societies through the 1960s. Since then, a more equal inheritance has gained in popularity, where all heirs inherit their parents' assets equally regardless of gender or involvement in the business.

Today, a major change towards a 'crown princess' succession is taking place. An increasing number of daughters of family business owners are groomed and selected as successors. Previously, only daughters in families with no sons were promoted. As one very successful female second generation entrepreneur put it: "I am the only son my parents ever received."

Today, in Western cultures, an increasing number of daughters are appointed as successors in competition with brothers. Some of them are also announced as successors to a very wide public at a rather early stage.

Social Strategies

Not only financial assets are passed on during succession. Social, cultural, and symbolic assets are also inherited by the next generation. The social inheritance is made up of the social networks established by the family over generations.

Importantly, families establish and maintain social relations and contacts, which can be mobilized and drawn upon when needed. Social networks also influence the position of the family in national and international business society. Passing on and strengthening social networks also serves to ensure the family's professional know-how by educating future generations about the social customs of the family business, trade, or profession. Women of the family often emerge as important actors, bearing ultimate responsibility for ensuring that social relations limit business risk and increase business and family returns. Entertaining, for example, is not only a private affair, it is also a strategy for converting social networks into financial gain.

Cultural and Educational Strategies

Over generations, business-owning families also develop cultural assets. These assets consist of the family's collective knowledge of its trade and a set of values, that is, the family's perception of what the business does, how it does it, and why it does it. To ensure continuity of the family's accumulated knowledge of the trade or industry, formal and informal educational strategies are used. In previous generations, children were trained on the job, either within the family's own business or through apprenticeship with other business families. In the past, parents, older relatives, and key employees were significant contributors to educational strategies. Education took place at home or in the family business.

Today, there is an evolving trend to move from a family-controlled on-the-job training towards an institutionalized and academic education of the next generation. These changes in education strategies follow general trends in society. Next-generation leaders are trained in business schools, and some families have created regular training sessions for their younger members which include education on business issues, family values and history, and the family business itself. The next generation is also encouraged to work outside the business in order to gain different experience and a sense of personal identity and accomplishment.

As families grow older and larger, personal relationships among owners should be developed and nurtured to promote family and ownership unity. Learning the history of the family provides a sense of belonging. Having fun together as a family is an important condition for staying together as a business-owning family!

Values

Not only professional knowledge of a trade, an industry, or a profession is transferred from generation to generation. When children grow up in a home where business is actively discussed and business partners are invited as guests, a transfer of values also takes place. Values are views of how the world is organized and interpreted, and what is important in interacting with other people. Values provide a basis for action, in that they guide what is good or bad, and therefore which actions are right or wrong. Values are formed as a result of cultural and social environments when individuals grow up, and are affected by ethnicity, nationality, gender, religion, and class. Values develop in interaction with others. Primarily, socialization takes place at home, where significant role models include members of the family, friends of the family, or others spending time at the home, including employees and other business associates. The entrepreneur might emphasize values connected to business and ownership. The spouse is equally important for the inculcation of family values. Later, socialization takes place when children are starting school, where teachers, fellow students, and friends become more important.

Research tells us that basic values do not change much after people reach 20–25 years of age. Then it takes a profound experience or crisis to impact values. In family businesses where owners have been raised by parents who have shared the same set of values shared by the business, values tend to be rather stable for many generations. The business can and often does have a reinforcing effect on a family's values. While individual personalities may vary a great deal, basic values tend to be very similar among family members. Many families use this common base to build an even stronger platform for the future.

To strengthen families, it is wise to articulate and routinely discuss values. Making values visible and open is one way of strengthening not only the family but also the relationship between family and business. In-laws generally perceive the business-owning family's values more easily than blood family members can. When learning how to relate to their "new" family, they learn to decipher how the family relates to one another. Through that process, they become experts on interpreting, visualizing, and acting according to the family's values. This is one of the reasons why in-laws can often play leading roles in the development of a family values statement.

Family homes and estates often play a vital role in helping to visualize family history. In some business families, there are even family business museums built as a result of the family education process. In others, existing business museums are a source for the owners to learn about family history. In one publishing family, their next-generation program uses the portrait gallery of all published authors as one of the educational arenas. In a furniture producing family, the old factory has been transformed into a museum with both a business and family emphasis. Another process for visualizing family history and family stature in society is to engage in philanthropy. This helps to create good will toward the family name.

Hiring and Nepotism Strategies

In multigenerational business-owning families, family members can come to regard the business not only as a business but also as an heirloom. Accordingly, they then perceive it as an indispensable asset, belonging to all the members in the family. The business as an heirloom is a symbol of the financial, cultural, and social continuity of the family. The heirloom symbolizes not only financial assets (the financial efficiency and profitability of the business) but also social and symbolic assets (the family's know-how, values, social networks, and status in both industry and society).

Families also tend to forsake individual consumption for the survival of the heirloom. The business can be valuable emotionally to the relatives. It represents the remembrance of elder generations and family tradition. Family shareholders, therefore, seek not only maximum return on invested financial assets, but also maximum return on social, cultural, and symbolic assets.

For successful family businesses, it is a question not only of managing the business but of managing an heirloom. Maintaining the cultural, social, and symbolic assets of the family becomes equally (or almost) as important as profitability. However, the very nature of a family business is to balance the logic of family and business. Neither can be put before the other. If the business would overpower the family, it would become a mere business. If the family would overpower the business, it would become nothing more than a family, and perhaps not even that. Nepotism, in the sense that competent owners must be well prepared for professional roles, is of absolute importance for the survival of both the business and the family.

In older family businesses, non-family professional managers may be equally or better qualified than family members for managing the business and financial assets. However, non-family managers cannot be expected to watch over the family's traditions as rigorously as the family would. For the specific task of managing an heirloom, family members have exclusive motivation and competence. Their competence stems from upbringing and acculturation into the family's symbolic and social capital. From their social environment during childhood they received the first lessons in the family's profession and a social network. Formal family meetings can enhance those lessons. Family members have the most to gain by balancing the rationales of the business and the family. Nepotism is of crucial importance, as family members are the guardians of the continuity of the heirloom.

COMMUNICATION AND CONFLICT MANAGEMENT STRATEGIES

"It's just not worth it," say many owners when describing the trade-off between business ownership and family conflict. If tradition and family togetherness are benefits of business ownership, bad communication and conflict are significant costs. Most non-business-owning families believe that having a healthy family requires no extra work, but successful multigenerational business-owning families have learned that family is often harder to maintain than business. Family requires programs to enhance and practice communication and manage conflict.

The number of business-owning families that practice communication skills and actively seek to improve communication is growing. There are seminars on family business communication and many books on the subject. Still, misperceptions about effective family relations are almost built into the very fabric of family business. Differences in power, age, and experience all play a strong role in individuals not perceiving the actual intent of messages sent. In addition, family history can play a strong role in whether or not people can communicate well. For example, past injustices can lead to current mistrust in which all communications are met with a skeptical attitude.

Practice makes communication easier, especially practice in discussing difficult and emotional topics. For this reason, many families have set up regular family meetings in which the business of the family as well as business issues are discussed. Many important questions can be asked and answered in a family meeting: Who can work in the company? Is the family responsible for family education? How do we tend to family members during times of crisis? These are all issues that can be addressed in family meetings. In larger families, the mechanism of a "family council" can serve as representatives of the entire family. The family council can meet more frequently than the family as a whole to discuss critical family issues, and can report to the entire family one or more times a year.

The management of conflict poses some real communication challenges. While some conflict can be very positive, it is often the case that the emotional nature of many family business disputes leads to conflict avoidance. Family jealousies, matters of who has benefited the most from family and business, and even more psychologically oriented issues such as who feels loved, are all issues that impact how conflict shows itself in a family. While some professionals believe that it is necessary to have in-depth discussions of the roots of conflict in order to resolve them, it is often preferable to learn how to manage rather than resolve conflict. Having a system in place for detection and management of conflict works well for many families.

Conflict management systems should outline the process for the identification and management of conflicts. Whenever possible, the smaller disputes can be resolved using such a system. Someone needs to be responsible for identifying conflicts. Once identified, the parties involved should have a "cooling-off" period in which the conflict is not discussed and the parties attempt civil behavior or try to avoid one another. A mediated conversation can be the next step, and if unsuccessful, some type of arbitration or adjudication may be called for. This can involve family or non-family members. Finally, all conflict management systems ensure that the parties are acting in accordance with whatever decision was reached.

It is also worth noting that different styles of resolving conflict should be used depending on the type of issue at hand. For example, in the allocation of capital to ventures, a competitive strategy, in which the best projects are awarded the greatest funding, may be appropriate. In situations where decisions will set a direction for the long term, a more collaborative and discussion-oriented process is preferred. When there is a crisis at hand and a decision needs to be made quickly, accommodation, in which one party gives in to another, is most expedient. In circumstances where the outcome of a decision is not critical, it may be wise to use a compromise strategy. And when the conflict is too emotional for any easy resolution and no immediate decision is needed, avoidance is a viable option in the short term.

Conflict is, of course, easiest to manage before the conflict occurs. By recognizing potential conflicts and developing guidelines in advance, families may be able to resolve conflicts before they occur. Some families go so far as to create a family "protocol" or "constitution" in which many of the easily predictable family business crises and challenges are anticipated and answered.

INTEGRATED PLANNING: FAMILY PROTOCOLS/CONSTITUTIONS

Particularly in Europe and increasingly around the rest of the world, family "protocols" or "constitutions" are being implemented to articulate the values, philosophies, rules, and expectations of family members involved with the business. These living documents are flexible, and require routine review and revision to meet the needs of the family and business. Essentially, a protocol/constitution is a collection of policies about how the family and business interact. It generally contains a philosophy of the family or values statement as well as a family mission.

Some Protocol/Constitution Policies

- *Entry/employment/exit*: Who can work in the business, how are they promoted, what are the rules about leaving the business, and can people be asked to leave or be terminated?
- *Compensation/perquisites*: What is the philosophy behind how family members are compensated? How are raises and other forms of compensation determined, and who determines them?
- *Shareholder agreements*: Who can own? Who can sell, when, and to whom? Who votes?
- *Liquidity*: At what price are shares bought and sold, and how are the transfers financed? Who determines the price, or is it a formula? Is there a minimum that can be bought or sold? Can stock be pledged as loan collateral?
- *Board of directors*: Who can serve? How is that determined and by whom? What is the role of the board and what decision-making authority does the board have? What is the structure of the board and what committees does it have? Are board members compensated, and how is the level of compensation determined? How does the board interact with the family?
- *Family council*: How is it formed? What is the role of the family

council? Who can serve, what are the roles of council members, and how is that determined? What is the council's role in family education and in attending to family members who are in crisis? What authority in the family and business does the council have? Are council members compensated, and how is that determined? What is the structure of the council and what committees does it have?

- *Family office*: Should there be one? What is the role of the office, including coordinating legal matters, tax compliance of family members, estate plans, and non-business investment?
- *Dividends*: What is the family's basic philosophy regarding dividends? How are dividends determined and who sets the dividend?
- *Communication and code of conduct*: What are the expected behaviors of family members in communicating with one another? How does the family communicate with the business and with the public? Who is responsible for communicating with the public, and what is the level of disclosure allowed? What issues are confidential within the family and between family members? What is the expected level of disclosure of business issues with family members in general and shareholders in particular?
- *Philanthropy*: Does the family have coordinated philanthropic activities and, if so, what are the family's priorities? How much should philanthropic contributions be devoted to causes that directly benefit the business? How should philanthropic decisions be made and by whom? How should the family's philanthropic initiatives be funded? If there is coordinated or common philanthropy, as in a foundation, should those making philanthropic decisions be compensated, and by how much? How is the success of philanthropic contributions evaluated, and by whom?
- *Loan program*: Should the company loan money to family members? How much and under what circumstances? Is stock pledged against such loans?
- *Venture program*: If a family member wants to start a new business, should the family and/or company loan him or her money or provide equity capital? If so, how much can be devoted in real terms or as a percentage of assets? How large an equity or debt position can the family or company take in the new venture? How are new ventures evaluated, and by whom? Should the creator of the new venture have the right to buy shares back from the family and/or company, and if so under what conditions and when?
- *Archives*: Is anyone responsible for collecting, cataloging, and storing important documents and items related to the company and family

history? How are people responsible for the archives chosen, and by whom? Are they compensated, by whom, and how much?

There can be more or fewer policies than those listed above, depending on the family's desires. Since it is a living document, the protocol/constitution can be revised, expanded, or reduced. The important point is that these policies are created before the issues they resolve become conflictive.

When creating policies, it is also important to create a process that ensures fairness both within and across generations. It is a good idea to use a fair process, one in which all of the family feel the protocol/constitution accurately represents the family, so that it is respected by all.

Family is arguably the most important part of a family business. With investment and effort, family continuity can be assured.

4 The Importance of Family and Business Governance

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Corporate governance has gained tremendous attention in recent years. While the process is greatly discussed, it is not always well understood, especially in family businesses. Family business governance is a system of processes and structures put in place at the highest level of the business, family, and ownership to make the best possible decisions regarding the direction of the business and assurance of accountability and control. In a well-developed family business, this involves understanding how the business and its governance structure – the board of directors and the management's executive committee – interact with the family and its structures (the family council, shareholders' committee, and so on; see Figure 4.1). This chapter explores the respective roles of these structures, their composition, and their function.

Good governance is critically important to all businesses. Its purpose is to ensure that the business has well thought-out and articulated direction – that its goals, mission, and values are clear. Good governance assures control; the decisions made by owners, directors, and executives serve the goals, mission, and values of the business and are respected throughout the organization. Thus, good governance leads to accountability, ensuring responsibility through rewards or remedial action for getting the job done. Family businesses are complex entities where the roles of the family, management, and ownership can be easily confused. Sound governance enables the family to have a clear understanding of its business and of its role in it. Good governance fosters shareholder commitment and promotes better marketplace performance. Finally, good governance facilitates transparency and trust – key ingredients for the long-term sustainability of any family business.

The goal of this chapter is to describe the function of governance structures of a family business and to clearly distinguish the roles and responsibilities of business owners and their board of directors from those of the chief executive and management team. In most countries, the most powerful governing structure of a business is its board of directors. Board members are generally elected by the shareholders at an annual general meeting, and have legal authority and responsibility for the direction and performance of the business. The board works through the chief executive officer and senior management to ensure that the business performs as intended. Businesses often suffer from confusion about the roles and the tasks of board and management.

This confusion is even greater in family businesses, where family owners are often simultaneously on the management team and on the board. They may have been raised to believe that being an owner confers the ability to govern and manage the business. Becoming an effective director or a strong, talented professional manager requires a lot more than inheriting shares.

To achieve effective governance, family businesses must provide clear distinctions between the tasks and responsibilities of board members, on

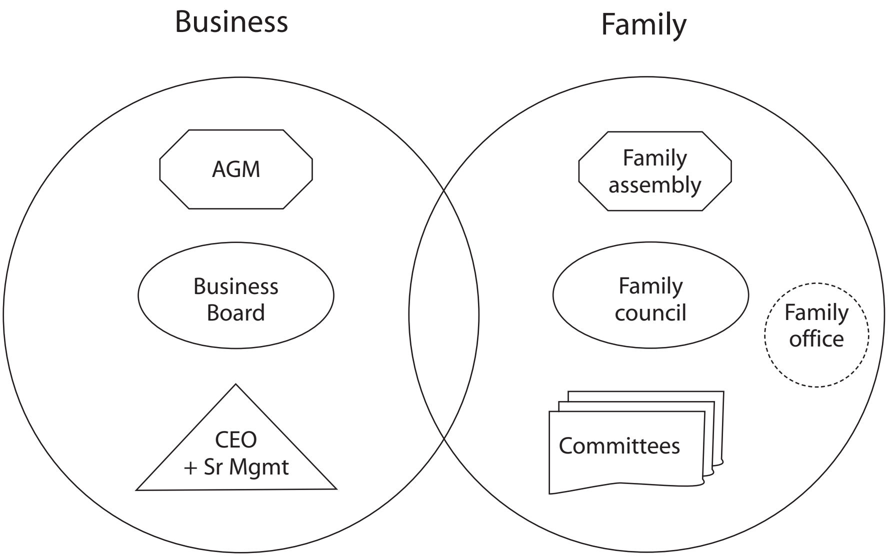

Figure 4.1 *A family business governance system*

the one hand, and executives on the other. For example, while approving the strategy of the business is a key task of the board, implementing it resides with management. Formulating strategy is accomplished by top executives, often with interaction and input from the board. In the end, however, the board's responsibility is to provide clear guidelines to management. In turn, management will report on progress made and goals achieved to the board.

The board's first duty is to ensure that management decisions are based on objective, accurate information, not on personal biases or perspectives. Even the most trustworthy and dedicated manager can be unconsciously influenced by three different perspectives:

1. The technical perspective, whereby managers select alternatives based on their own knowledge.
2. The psychological perspective, whereby managers make choices based on their own values and preference systems.
3. The ethical perspective, whereby managers make decisions which favor what is best for the larger group even if that entails personal sacrifices.

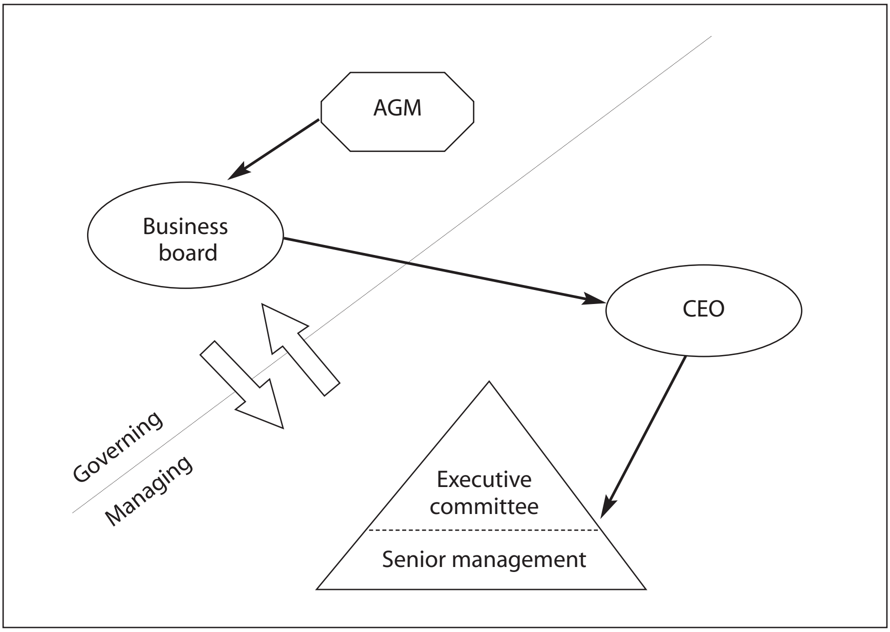

Figure 4.2 *The separate roles and responsibilities in a business governance system*

How can the board ensure that management decisions are not biased? Ensuring board and management are comprised of people with diverse backgrounds, ages, and opinions is a good start, especially in family businesses. Experience shows that families who have opened their boards to external independent expertise – and are listening to their directors – gain clarity and sharpness in goal setting and are better placed to succeed in competitive markets.

Second, the board must accept the challenging responsibility for the validity of information used in management decision-making. The board appoints auditors to check on the accuracy of the company's information and to report to the board, not management. Family business boards should ensure that external directors are truly independent, with no ties to the family. Without true independence, bias and conflict of interest can poison decision-making. This chapter will take a look first at the business side of governance and then at the family side of governance.

BUSINESS GOVERNANCE

Good family businesses are those that successfully survive over time. They are characterized by having governance structures that effectively exercise their responsibilities.

The Role of the Board

To efficiently fulfill business governance responsibilities, family firms should meet several conditions:

- The relationship between shareholders (owners) and the board of directors (board) must be constructive, with each group performing its own specific duties. Company bylaws assign responsibilities to the board, and if not delegated, they must be exercised every day of the year. On the other hand, owners are assigned fewer responsibilities, which are performed only when they meet, usually once or twice a year. The family owners should provide the board with their values, vision, and goals.
- The board must be able to work as a high-performing, active, and useful team. In addition to acting as a group of outstanding professionals, board members should strive to follow the rules of good teamwork: sincerely stating their own opinions, without hiding gaps in knowledge or dishonest intentions; listening to other team members, with the intention of understanding their lines of reasoning; being flexible in response to new information; avoiding repetition of the same arguments; using time well; and evaluating the effectiveness of each team member as well as the team as a whole.
- The board must make its decisions relating to governance without meddling in management's responsibilities. Senior management should be highly involved in board discussions prior to the board's reaching important decisions. Once board decisions are made, management should be allowed to implement decisions and then be held accountable for results.

Family businesses often have difficulty in living up to these standards. They often establish boards with one or more of the following characteristics:

- *Not wanting accountability*: Often a lack of accountability impedes succession planning, organizational development, and strategy revitalization.

- *Wanting without wanting*: A family business leader grudgingly sets up a board of directors, but allows it to act as long as it does not go against his or her own position. The functioning of the board may be undermined by rare sporadic meetings, failure to create agendas or provide information, or by not allowing the board to talk on meaningful topics.
- *The instrumentation of the board*: The board is used as a battleground for pursuing private ends to the detriment of the good of the company. For instance, the retired CEO wants to relive the past, a family owner wants to assert his or her personal financial goals, or an unhappy family member wants to irritate others.
- *The adulation bubble*: Sometimes a powerful family business leader creates a board comprised of cronies, underlings, or people easily influenced to vote in a particular way.
- *The false equality*: This refers to the temptation to set a board composition that reflects the best possible balance of legal ownership rights to create false equality. Rather than selecting directors for their ability to foster marketplace success, the size and composition of the board is driven to include all owners. Respecting "blood" rights, in an attempt to ensure that all children, all generations, or all branches of the family are represented, results in boards that are unable or unwilling to deal with tough issues, or that focus on family rather than business matters.
- *Respect for elders*: This refers to appointing the senior member from each branch of the family to the board. By copying the genealogical family tree, this approach misplaces respect for branches and seniors by not focusing on attracting highly skilled directors.

Excellent family business boards both create economic value and increase the unity and commitment of family owners. In addition to the duties of care and diligence required of all directors, excellent boards diligently attend to how the board's tasks are defined; who makes up the board; how the board functions; and the role of the board's chairperson.

Tasks of the Board

The scope of the board's objectives and tasks should be clearly articulated and approved by the board. A board charter should be developed. Typically tasks assigned to a board of directors include the following:

- Approving strategic decisions and actions, including defining products, markets, geography, and competitive advantages; entering, exiting, and increasing certain businesses of the company; and mergers, acquisitions, or major investments.
- Approving financial decisions, such as significant changes in capital structure, debt, accounting changes, and tax-related policy.
- Election and evaluation of the CEO and approval of senior management. The board is responsible for evaluating, compensating, developing a crisis plan, and if necessary firing the CEO. The board is also concerned with top management succession, and ensuring that senior management is qualified to implement strategy and guarantee continuity.
- Monitoring the implementation of strategies, benchmarking with competitors and industry trends, and making decisions to correct any weaknesses identified.
- Supervising the company's audit plan and risks. The board receives and analyzes audit reports, and makes timely decisions on corrective actions. The board ensures that risk contingency plans are in place.
- Submitting proposals at the shareholders' meeting regarding the allocation of profits and dividends. Boards typically set dividends or distributions to shareholders.

Composition of the Board

Board effectiveness is strongly influenced by the number and qualifications of board members. Best practices related to these factors include these:

- *Appoint an odd number of board members*: Boards should have enough board members to provide sufficient resources to govern, but few enough to allow effective teamwork. Five or seven directors are recommended for medium-sized businesses and seven to eleven for larger businesses. An odd number of directors insures against a deadlocked vote.
- *Include independent directors*: Independent directors are members of neither the family nor the senior management team. They will not be influenced by friendship or personal gain. The presence of highly qualified independent directors is of extraordinary importance to family businesses. It encourages self-discipline by family directors, it

increases the faith owners and managers can have in the governance system, and it forces decisions on business success. When given the task, independent directors can ensure that decisions involving family members (employment, mentoring, evaluation, remuneration, career development, retirement, or even dismissal) occur as objectively and professionally as possible. To enhance board effectiveness, there should be at least three independent directors.

- *Set the term of office for directors*: In the case of independent directors, this term is typically three years, with the possibility of serving for several terms. In the case of family members there are many more variables to take into account, such as the age, the percentage of ownership, the number of other family members on the board, or candidates to the board. Often, certain board seats rotate among family members.

Functioning of the Board

For smooth and effective functioning, the board typically adopts certain rules and processes including:

- *The number of meetings*: A set number of meetings are scheduled well in advance. Depending on the complexity of the business and the needs of the family, the number of board meetings may vary. At a minimum, family business boards meet at least quarterly, with meetings lasting at least four to five hours. Often business boards meet more often, particularly in times of crisis or transition.
- *Documents*: Information sent to directors sufficiently in advance is critical to the proper functioning of the board. The board package should include the agenda, financial information, background material related to issues confronting the board, and whatever else that might enhance directors' insight and efficiencies.
- *Agenda*: Great care should be given to the agenda and time of the meeting. The board must meet at times when it is free to work and when people are less tired. The agenda must allot very little time to providing information and much time to encouraging constructive discussion and decision-making.
- *Performance evaluation*: The best boards periodically formally evaluate the performance of each director as well as the performance of the board as a whole. Focusing on the knowledge, qualifications, attitudes, and contributions of each board member, individual evaluations can

highlight areas for personal improvement. The evaluation of the board as a team should seek to address changes to be made to increase the value it adds.

Role of the Chairperson

The chairperson's role is critical in family businesses. He or she must manage the board with strength and wisdom, deal with sometimes quarrelsome family members, facilitate good discussions, conduct relations with other governing bodies, and hold the CEO accountable. In short, the chairperson must understand the family mission, the shareholders' vision, and be a bastion of professionalism, unity, and commitment.

The recommendations made here in terms of processes to support business performance offer a framework for success. The most important factor, however, is the qualities board members must have. These include prudence in the choice of goals and the organization of resources, sincerity in the expression of intentions, loyalty in the performance of responsibilities, and strength in the quest for the good of all stakeholders of the family business.

FAMILY GOVERNANCE

The functions of family governance are to achieve, maintain, and increase family members' unity both among themselves and with their family business; promote stable and committed ownership; and ensure that shareholders adopt a professional attitude towards the business so as not to impede operations.

More specifically, effective family governance:

- Enables all members of the family to know and appreciate the family business.
- Enables family members to know each other.
- Develops a sense of stewardship and pride among family ownership.
- Guides the development and progressive implementation of a family protocol/constitution.
- Encourages involvement of the largest possible number of family members in activities like participating in business education programs, setting family policies, designing and carrying out activities aimed at enabling the family to have fun together, keeping the

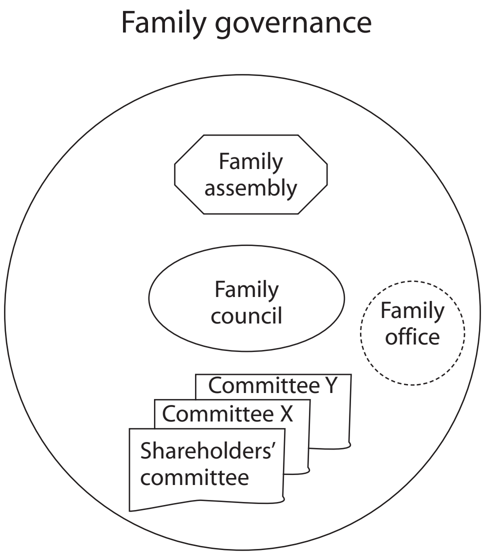

Figure 4.3 *Family governance system*

family archives, writing the family history, and supporting family philanthropy.

- Promotes family values and develops family leaders.
- Facilitates family communication.

Obviously, to achieve all of these important functions, an organization is needed. In the most advanced and sophisticated family businesses, the family organization may include a family assembly, a family council, a shareholders' committee, and in some cases a family office. Special committees may focus on such critical areas as family employment, education, and social interaction (see Figure 4.3).

Family businesses with a small number of closely connected family members will not need all these structures. They will need, however, the ability to plan for continuity, transmit values, and communicate and resolve conflicts.

Family Assembly

A family assembly is a formal meeting in which family business information is shared and family members have the opportunity for closer contact. For the family assembly to function well a number of questions should be answered.

- How often should the assembly meet? How long should meetings last? What subjects should the assembly address?
- Who can attend assembly meetings? At what age does membership begin? Should spouses be included?
- What should be the qualifications for family assembly leadership? How should the chairperson and committee members be selected?
- What guests and outside experts should assist the family assembly in family education and presenting family business information?

Family Council

The family council is a body that performs two very important functions: developing and implementing the family protocol/constitution and anticipating problems that may arise among family members in their relationship with the family business or with each other.

The family council governs relations between the owning family and its business. It may report to both the board of directors on business matters and the family assembly on family matters. However, the board of directors has authority for the business and is responsible to the shareholders. Family councils run into trouble when some of their members try to turn them into “surveillance councils” to keep an eye on the board of directors or management. In large families, members who are not managers in the family business may see membership of the family council as “their chance” to have power.

Still, the family council is the most important body of family governance. As the board of directors is to the business, the family council is to the family. It is often comprised of representatives from the different generations and family branches, and should include in-laws as well as blood relatives.

Family council leadership is a crucial and sensitive matter. The best person to preside over the family council is a “leader with a heart,” a person who is appreciated and respected by all or almost all of the family’s members. It is best if this person, who may also preside over the family assembly, is not the chairperson of the board of directors or the CEO of the business, and he or she must have enough time available for interaction with the family members.

Meetings should be held at least once a year, or more often as needed by family goals and circumstances.

When family businesses have large numbers of related owners (sometimes running into dozens or even hundreds), shareholders need a body representing them in the governance structure and working to address their concerns and interests. The shareholders' committee fulfills this need and works specifically at resolving issues such as strategy, asset allocation, performance, dividends, redemption of shares, and succession. This committee is also responsible for drafting, implementing, and amending the shareholders' agreement. Long or short, this agreement typically includes information about ownership entry and exit, company valuation, owners' rights and duties, as well as the decision-making and voting systems.

The family assembly also provides the framework for the existence and oversight of the family office created by some large families who have substantial wealth. Although each family structures its family office to best serve its particular needs, family offices often offer services to family members including help in the management and investment of liquid assets, accounting, tax advice and support, family communications, and family member career planning.

A good governance system does not need to be as complex as that described here, but it needs to develop processes to address business, family, and ownership issues. Ultimately, families must address each of these three on an equal basis, and pay particular attention to the relationships and overlaps among them.

THE RELATIONSHIP BETWEEN BUSINESS GOVERNANCE AND FAMILY GOVERNANCE

Families who establish a good governance system achieve a respectful cooperation between shareholders and the business as well as between the business and family. When the process is working well, people from all sides are ready to work on issues in a flexible, open, and honest way. They devote the time necessary to get the job done.

Families should be clear and consistent in their communication with the board. They should speak with one voice and make sure that important information is communicated in writing. Board members, with the chairperson's leadership, should encourage joint meetings and make sure that the agendas of board meetings cover matters of particular importance to the family.

Two examples illustrate how family and business governing structures work together. In CEO succession, for example, the family may determine that it hopes to continuously produce company leaders. Long in advance, the family puts systems in place to groom the best and most motivated family candidates. The board, however, makes the final choice and appoints the CEO.

A second example relates to family business values, vision, mission, and strategy. One of the most fundamental contributions a family can make is to support the business's culture, built on the foundation of family values. The family identifies its values and defines its mission, and communicates these to the board. The board in turn will make sure that management's strategies, decisions, and actions are aligned with the family values and objectives.

CONCLUSION

Good governance leads to clarity within the family, between the family and the board, and to a stronger family and a stronger business.

Family business governance has only recently attracted significant attention. Family businesses have traditionally been very slow in addressing governance issues. Significant portions of them still do not have independently functioning boards. The complexity of simultaneously addressing business, family, and ownership matters probably explains why only a small percentage of families over the world have adopted formal governance systems for family and business. The benefits of effective governance – transparency, clarity, trust – lead to more successful businesses and families. Good governance is not easy, but it is well worth the expense, time, and effort.

5 Succession

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Succession is the final test for any family business. If the test is failed, the efforts of a whole life as entrepreneur or owner-manager can be ruined. And the test cannot be avoided because the biological clock ticks for all.

This chapter deals with the main issues related to succession. Succession will be explained as a process detailed in three phases. Both ownership and leadership succession will be covered, and also how the two are interrelated.

Ownership succession is defined as the complete and irreversible legal succession from one owner (group) to another. It does not necessarily involve a child or children succeeding their parents. Leadership succession is defined as the transfer of ultimate management responsibility from the person currently in charge (CEO, managing director, owner manager) to another person (regardless of this person's family ties). In most legal systems the owners have the right and the duty to name and hire, as well as to dismiss, the leader through the board. Thus, from a legal perspective, ownership succession is more important than leadership succession. While leaders can be dismissed and new ones hired, in most countries it is very complicated to get property back once it is transferred.

While management succession has received much attention by writers and consultants in the family business field, ownership succession has not. The lack of attention given to this topic undoubtedly has to do with the strong management focus in family businesses, as well as the commonly held view that ownership transitions have many financial impacts that are best left to estate and financial planners and to attorneys. But family business leaders and owners must understand and effectively manage ownership succession, because decisions about future ownership set the company on a path where the implications will be felt for generations.

SUCCESSION IS A PROCESS

While succession issues in family businesses often seem to "explode" at a certain moment in time, the process is best understood as being played out over time. Succession typically follows certain patterns found globally in nearly every business family and its family business. The process proceeds in three distinct phases: the pre-succession phase, in which preparation takes place, whether planned or unplanned; the so-called "hot phase," where the changes occur; and the post-succession phase, where the newly defined situation is installed and the balance within the family and the business is established and secured. The "hot phase" can be divided into six steps:

- the build-up of developmental pressure;
- the triggering phase;
- the disengagement, in which old truths lose validity;

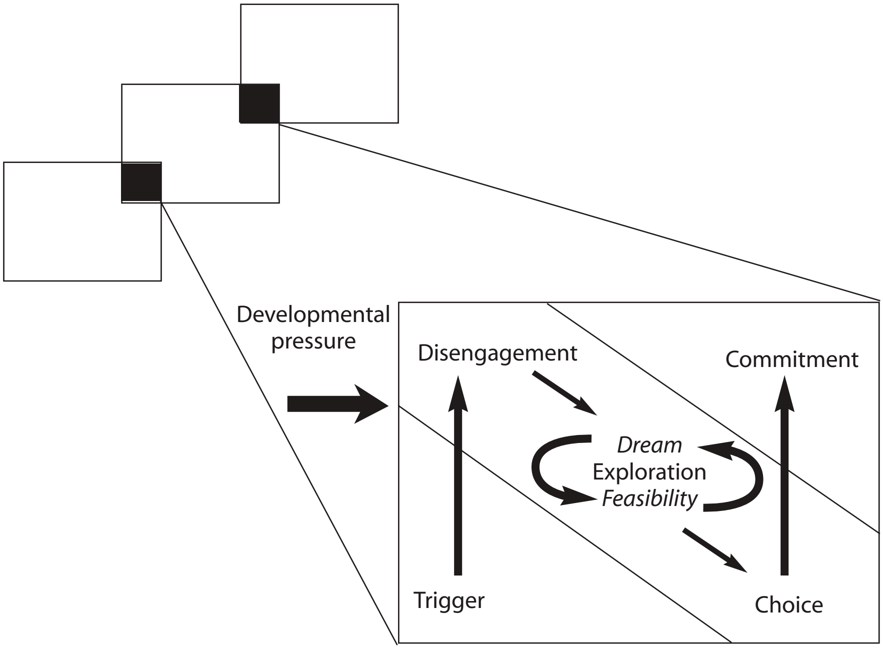

Figure 5.1 *The six steps in the "hot phase" of succession*

Source: Gersick, K.E., Lansberg, I., Desjardins, M., and Dunn, B. (1999) Stages and transitions: managing change in the family business. *Family Business Review,* 12 (4), p. 290.

- exploration, in which the people involved seek a new vision;
- the choice; and
- the commitment.

PREPARING FOR SUCCESSION

Succession means change. Change means insecurity, and produces heightened anxiety. Thus, many family business leaders logically prefer not to deal with succession. On the other hand, even if there is a high level of reluctance to prepare for succession, the process is inevitable. In the worst case, it is triggered by the death of the controlling owner or CEO without any preparation being in place.

Both the family and the business benefit from preparation for succession. Preparing the family for succession is a lifelong process. Beginning with upbringing and education, preparation is often interrupted in the "hot phase" of succession, which is all too often unplanned. How can the family be prepared to take advantage of the opportunities afforded by succession and avoid its threats?

The more family members are informed and trained to interact in a mature, respectful way, the more they will reap the benefits of the succession process. Family members should know about the family, ownership issues, leadership issues, about the company itself, and about the succession process. Knowledge about the family includes their own history, basic understanding of the lifecycle of human beings, and the evolution of family business ownership. For example, the family should understand that if succession is triggered when participants (predecessor/successor) are in a turbulent period of life (for instance, puberty, midlife transition, and late adult transition), the succession process is likely to be more challenging.

Knowledge about ownership includes understanding the rights and responsibilities of owners, the nature and structure of the family's assets, different forms of ownership organization and their consequences (responsibilities, taxes, and so on), and the family's shared goals and strategy related to ownership. The owners of a family business need an ownership strategy for all of the family's assets including the family business.

Defining an ownership strategy starts with the definition of the family's wealth on the one hand, and with the clarification of the family's shared values on the other. The process is informed by answering questions like: Do we want to do something together as a family? How do we want to work/act together (for instance, defining shared rules)? What do we want to achieve together? And what resources do we have and how do we want to develop them?

A family also needs to understand its responsibility to install competent business leaders, and to develop structures and processes that ensure management accountability. These tasks can only be fulfilled by well-informed, responsible owners. These responsible owners understand how leadership is organized within companies (roles, responsibilities, and tasks) and are aware of how leadership is legitimized and accepted within their society. Responsible owners also learn to recognize the essential qualities of leadership.

Next-generation ownership preparation involves understanding the company's products and markets, being aware of key customers, competitors, and suppliers, and understanding basic financial reporting by the company (being able to read balance sheets and profit and loss statements, and understand some key financial ratios). Incoming owners need also to be aware of how a successor is chosen and the role of the owners in this process.

Just as important as the family's understanding of the company and ownership are the skills related to communication and conflict management. They should also answer questions related to family goals and values like: "Who are we?"; "What do we want?" and "How do we want to go forward together?". Research demonstrates that independent, mature personalities who have built their own identities are much more able to communicate within the family and ownership group in a constructive way than those who have not.

Once the family's shared values are discussed and agreed upon, an ownership strategy needs to follow. This requires that an ownership structure be put in place that ensures realization of shared goals. For example, to ensure the financial security of the departing generation, plans must be established to provide adequate and reliable income, especially in smaller family businesses. Adequate funding of retiring owners requires long planning lead times. When control is shifted to the next generation, the older generation often experiences a sense of loss of power, identity, and meaning. Lifestyles may change, with the loss of perks that previously went with the position of business leadership. What were business expenses may become personal expenses. The earlier that families make plans for the financial dimensions of succession, the more time they have to implement these plans.

Preparing the business for succession is closely linked to the preparation of the family. When the family has established its basic direction, outside advisors can help to prepare the company for succession. For example, attorneys can help determine the best legal structure for a family business when ownership held by one person is shared with a group of people in the next generation. Company bylaws may need revision. Company and family policies may need to be developed concerning issues ranging from the qualifications of family members who wish employment in the family business, to formulas by which dividends or distributions may be paid. Shareholder agreements may be written or rewritten. The nature and composition of the board of directors most likely will change. How these changes are accomplished depends on the culture of the society, family, and company. Ideally, however, these matters will be worked out prior to succession being implemented.

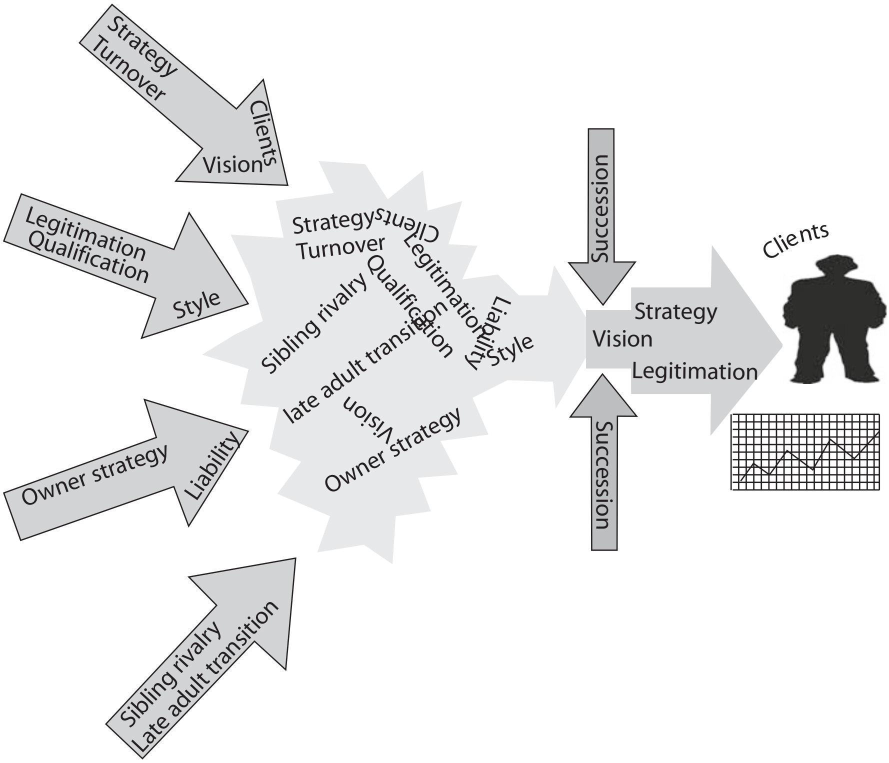

Figure 5.2 *The succession catalyst*

THE "HOT PHASE" OF SUCCESSION

As pressure for succession builds, the "hot phase" begins. Clients express concern over the company's continuity plans. Banks may suggest beefing up the board of directors. Maturing members of the next generation ask serious questions about their own careers. Non-family managers are concerned about their security and opportunities when leadership changes. This phase is often characterized by a mélange of different viewpoints, with solutions being presented even before issues are defined. Various legitimate self-interests are expressed in a never-ending stream of discussions. The problem in this stage is to organize the process, often by finding an expert who can capably and independently manage it. If the "hot phase" drags on, the company may be damaged by the loss of focus on running the business. Family harmony may be harmed.

The powerful mixture of influences raises the tension within the whole family business system. Issues from all areas emerge in the family. For example, sibling rivalry might surface. Questions of leadership style or strategy of the company might be discussed. With growing tension, the likelihood of a triggering event rises as well.

The trigger may be any incident that ignites the process, whether on purpose or by chance. Purposeful triggering assures more control than leaving the process to chance. Deciding to proactively address succession-related issues, often by hiring a consultant to aid in the process, is a triggering event. Dimensions of the process can then be discussed and planned. Topics to be covered include who is to be involved in the process; how the decision will be made; and what timing, education, and communications are appropriate. How decisions will be ultimately made depends on the family and company culture. Skilled management of family conflict is one of the key success factors in the succession process.

The timing of ownership transitions is one critical variable in a healthy succession transition. In countries where there are no or low estate taxes, parents are tempted to keep the ownership during their lifetimes. This is generally a mistake for both business and family reasons. It is usually much better for the business for the new business leader or leaders to have ownership control within a few years of assuming the responsibility of running the company. The senior generation has every right and incentive to test the new business leaders. Once that testing is done, however, the voting control of the business should be passed on. Even when the senior generation requires financial support from the business (adequate financial planning can alleviate or reduce this need) control of the business should pass on. If not, employees, customers, suppliers, and others can be confused about who is actually in charge of the business. Generational struggles over ultimate control of the business can result in damage to the business and the family. From a family point of view, depriving the next generation of ownership control could limit their ability to feel like adults, because they remain subject to the decisions of their parents, creating tension between the generations and potentially reducing the effectiveness of the younger generation as parents and leaders.

POST SUCCESSION

As a business family approaches ownership transition, family discussions should focus on business and family life after the transition, especially regarding how siblings or cousins will relate to one another. The financial and other needs of the seniors must be taken into account during this period. With the transition of ownership, the younger generation assumes much more authority and the senior generation has less. While the family authority of the senior generation can last for many more years, their overall responsibility and authority levels decline. The younger generation should make sure that members of the senior generation feel appreciated for the opportunities they provided and are recognized for their accomplishments. In some cases, it is useful to structure an ownership agreement that allows the senior generation to receive a financial reward if the company does particularly well after ownership is passed on, but the needs of seniors for recognition are usually greater than those for financial rewards.

Once the process has started, old truths may not be valid any more. Former rules and rituals may not apply. This is the time when the entrenched system can be changed. This is the time with the highest risk, and at the same time, the period in which to change what was an entrenched system. During the phase of disengagement, many inevitable changes must be faced. Issues previously not allowed to be discussed are now "on stage". Succession means giving up the old balance within the family and the business system and finding a new one. Old patterns of influence give way to new ones and sacred cows may be slain.

The time between the old and the new offers the opportunity to newly align family, business, ownership, and management. The time should be relatively brief, as members of a business-owning family as well as non-family managers and employees can only bear insecurity for a limited period. The discussion should be driven by the owners' shared values and goals. The shared vision of the company's future has to integrate both the family and the business. On one hand there are the expectations, hopes, and fears of the incoming as well as departing family owners and members; on the other, there are the economic realities faced by the company framed by new strategy and vision, clients' needs, and company resources. Integrating both systems in a way that ensures continuity and success is a great challenge.

Exploring the vision that will become the driving force of the future of the family business incorporates an analysis of the company's position in the market, the needs of the clients, and the resources available. During this phase everything is allowed to be thought, said, and explored. Choices made and plans for the revitalized organization depend on the culture of the family, the society it is embedded in, and the company.

Choices and plans cannot be developed in a vacuum. Implementation and acceptance are critical to success. How choices are made influences acceptance. Even if the choice is not favored by everyone affected, assuring

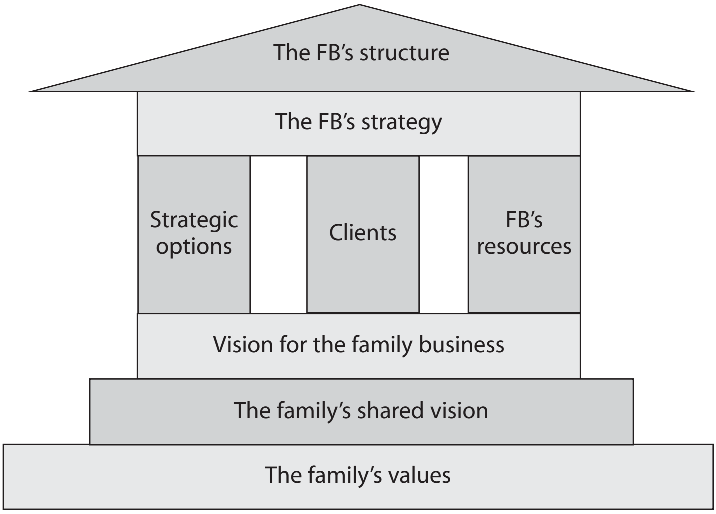

Figure 5.3 *The Family Business House*

procedural justice heightens acceptance levels. People who are affected by decision outcomes tend to accept the result more easily if they have had a voice in the process, even if the result is not their favored one. As well as having a voice, clarity and consistency during the process of decision, flexibility, and overall commitment to fairness also enhance the acceptance of the results.

Some families have smooth transitions. Some welcome new shareholders who undergo ownership training. The rituals depend on two main factors: the size of the group of shareholders, and the age and experience of the family as a business family.

A family business can be seen as a house (see Figure 5.3). Succession means reconfirming or newly formulating the foundation of the house, and then rebuilding it, bit by bit, with those who are involved, starting from the bottom and going to the top. The succession processes that fail in family businesses are often proposals from outsiders, who start with building the roof before even thinking about the fundamentals. In adopting these, families seek to achieve solutions that are highly professionally designed, but the proposed solutions have nothing to do with the peculiarities of their own families and businesses. These outside proposals also often lead to long-lasting and expensive conflicts once they are put in place.

Ownership succession drives leadership succession, as the owners decide who will lead the business. The decision of who will own the business affects other business and family decisions, such as who will be the

CEO or family leader, and influences key relationships within the business and family. The ownership structure (who owns how much of what "class" of stock or other form of ownership) can take many forms, and the form it assumes represents a crucial decision.

OWNERSHIP SUCCESSION ALTERNATIVES

Consider the father owner-manager of a family business, who has to decide whether to pass on ownership control to one or to several of his children. These two options can produce dramatically different behavioral outcomes.

If this father passes on ownership control (typically more than 50 percent of the voting stock) to just one heir, an alliance among the sibling shareholders will not be required to make strategic decisions for the company. The new majority owner can make unilateral decisions. This can free the new owner-manager from the need to coordinate with brothers and sisters, and streamline decision-making. Ideally, the new controlling owner will be competent and responsibly consultative with minority shareholders, and the other siblings will believe the distribution of ownership control is fair. Of course, the other siblings who either work in the business or are passive shareholders may or may not appreciate being minority owners. And while disaffected relatives who are minority shareholders may not be able to steer the company, they will still be able to stir up family and even business trouble for the new leader.

A second option is for the father to divide ownership control between two or more of his children. The result of this decision would vary depending on many factors, but primarily on the ratio of sibling owners working in the business as opposed to those not working in the business. If ownership control now rests with "active" (employed in the business) family members, these siblings will need to treat one another as partners in all major business decisions, regardless of their company titles. If all of the active family members are competent, cooperative, and bring complementary talents to the table, this partnership arrangement can be highly productive and satisfying. If these conditions are not met, the partnership arrangement can result in confusion over management roles and decision-making authority, stagnation over key decisions, and competition for power.

If the new shareholder group also consists of "passive" owners (individuals not employed in the business), additional dynamics can appear. Passive shareholders can be financially and morally supportive of management, but they also generally desire some financial benefits (dividends or other distributions of cash) from their ownership. They may seek employment, board seats, consultative roles, or other benefits. The existence of passive shareholders, especially powerful ones, adds a stakeholder group that, at the very least, requires communication and attention. Moreover, actives and passives may or may not agree on the direction and priorities of the company. Certainly, parents who are pondering how to distribute ownership of the family business must think through the likely outcomes of various choices.

In most cultures, parents are inclined to treat their heirs equally in terms of the value of the inheritance. In some cultures, males receive a larger inheritance than do females, but within genders equality is typically maintained. And because the assets of a business family are largely invested in its business, an equal inheritance typically means equal ownership in the business. While this outcome has profound consequences for the family and business, parents may see no other alternatives that would be perceived as fair. In most cases, however, families have alternatives but choose not to exercise them.

Parents find it difficult to look ahead to the day they will pass their assets on to their children. They could anticipate that one or more of their children will not be appropriate owners of the family business, because they do not want to be, or would not be responsible, or because they will not cooperate with the new business leader. They could begin to increase the value of their assets outside the business. To many business families, however, this notion borders on blasphemy. Most owner-managers tell their family members that the family business is the best investment they could have, and insist that they reinvest everything in the business. In today's competitive environment, aggressive reinvestment in the business is often necessary, leaving little to be invested in other assets. Without assets outside the family business, a family's inheritance options are limited.

A family whose assets are primarily in the business can still pass it on so that only those heirs who will be responsible owners receive shares. The remaining heirs can receive promissory notes from the business, and be paid their inheritance over time. Another alternative is for some heirs to receive voting shares and others non-voting shares, thus concentrating decision-making power in limited, well-qualified hands. Yet another approach is for ownership of the business to be held in a trust that is voted by one or more family members, while all heirs receive a share of dividends. The choices of an ownership model are many, but there are two important reasons why few families use these options.

First, families are highly sensitive to issues of fairness, and very uncomfortable with inequality within age cohorts. Siblings, for instance, point out even small differences in what they receive from their parents, often claiming that these differences are unfair. Unfortunately parents usually give in to such pressure, and the family ends up equating fairness with an equal distribution of anything that is being contested. When equality is the family standard for fairness concerning small things, dividing an estate in any way other than exactly equally will be seen as a violation of a family principle.

Second, parents are reluctant to suffer the anger and resentment of their children regarding perceived injustices. In the case of inheritance, they are more likely to take the easy path, sometimes creating chaos and conflict in the next generation. Parents are in a much better position than are their children to determine the right ownership group for the company. They could at least create buy–sell agreements, valuation policies, and other ownership agreements so that their children do not have to wrestle with these issues. But because they do not want to rock the boat, have inadequate professional advice, or are poor planners, most parents miss their chance to put into place structures and agreements that will help their children deal with messy ownership issues later.

In addition to concentrating ownership in a constructive way for the business, and/or setting up ownership agreements that can allow a new ownership group to emerge, parents can also help reduce the family's financial dependency on the business. We know that families tend to grow at a faster rate than the ability of the company to generate profits from which the needs of both the company and the owners must be met. Each generation becomes accustomed to its parents' lifestyle. If the next generation expects the business to fund a part of its desired lifestyle, the result will be either disappointed shareholders or a business that has been drained of needed investment capital.

A central question for families to answer regarding ownership succession is, what will be the top priority? Will it be an aggressive business, maintaining family ownership control and leadership, maintaining family harmony, or growing the family's wealth? A family must establish its priorities and recognize that its choices have consequences. The choice should emerge from the family's shared values and vision.

LEADERSHIP CHOICE

Once owners and managers have established the company's strategic direction, the selection of the new leader should be based on determining who is best to carry it out. Options for succession include non-family managers, pure family management, or a mixed (family/non-family) management team. All three options have advantages and disadvantages. The bigger a family business becomes, the more often there are mixed or even pure non-family teams leading the business. Then the family concentrates on a controlling and advising function, depending on the legal system under which either the board of directors or of the controlling board operates (such as Aufsichtsrat in Germany, or Verwaltungsrat in Switzerland).

To be successful, the incoming leader must consider all stakeholders including shareholders, family members, employees, and the outside world (suppliers, clients, banks), whether or not the leader comes from the family. Family members often face greater difficulties in being accepted. One of the reasons is the long shared history with other family members. It can be hard to comprehend that the little boy who only a few years ago cried because he did not want to learn how to ride a bicycle is now able to run a multi-million dollar (or euro) company. To increase objectivity and clarity, outside judgment is often used in these circumstances. Clear standards need to be established. Maybe most importantly, the successor should be chosen because he or she is highly capable, not because he or she needs the job or the family wants to maintain family harmony. Mature and relatively independent people are usually the best leaders, because they can make thoughtful, objective decisions that most benefit the company and its stakeholders.

The leadership job in a family business differs from generation to generation. Following the founder is an especially difficult task. Founders have been neither followers nor successors. Most entrepreneurs are very control-oriented. For a founder to step down before the issue is forced biologically is often a threat to his or her existence. The business may be the founder's identity, passion, and primary means of fulfillment. Giving up what may be close to an obsession is extremely difficult. To watch someone, even one of one's own children, do things differently is even harder. There is no recipe about how to succeed a founder, but it is clear that this is the hardest leadership succession of all.

SUMMARY

Succession is the final test for any family business. It is a lifelong process that integrates the development of the family and the business. As families prepare for succession, they learn how to interact in constructive ways in order to take responsibility for the business (and their family's wealth) in the next generation. Succession is influenced by environmental peculiarities such as taxes and legal structure on the economic side, as well as by the psychology and culture of the owning family.

The main issues of succession relate to ownership. While family values are the fundamental glue, the decisions of who should participate in ownership and how ownership is structured will determine the future of the family business. Leadership follows ownership and has to fulfill the requirements set by the owners' goals. Most interestingly, the necessary decisions will work for the good of the business only if upbringing and education in the business-owning family have led to open and fair communication among mature individuals who respect each other's interests.

6 Conclusion

Just as nature needs different trees and plants that yield crops at different times of the year, just as different flowers make the world a colorful and beautiful place to live, the business world needs different kinds of businesses and business structures to sustain the economy. All businesses, including family businesses, have an important role to play in the global economy.

As has been seen throughout this book, family businesses are complex entities with specific challenges. They need to achieve a difficult equilibrium between the business world and the family world, making sure they address the issues of each without neglecting the other. They need to reconcile the rational world with the emotional one – the most difficult challenge of all, which is embedded in nearly all the decisions that families in business have to face. Those decisions may include ensuring the business is run competently and professionally, even when this imposes strict rules and long training schemes on family successors; finding ways of financing business growth while still maintaining control; addressing change when it is needed even though it may mean cutting off product lines or activities traditionally associated with the business, and possibly with the family itself. These situations, and others, are potential sources of conflict, and they need careful monitoring and managing to ensure continued success for both family and business.

This complexity and its inherent challenges are not easy to overcome. Quite a number of families struggle with these issues, and as a result devote less attention and energy to their business. It is important for them to know that they are not alone: practical tools (see Appendix 1) and specialized help are available. Thanks to the devotion of a handful of academics and experts who pioneered work on these issues 25 years ago, families in business are now offered a wide range of conferences, organizations, books, magazines, and services accessible worldwide (see Appendix 2).

Advisors can provide an external, neutral look at intricate situations and help reflect on possible ways to solve them. They can help bring objectivity to processes, and serve as sounding boards, facilitators, or mediators when necessary. They can also bring the benefit of sharing similar issues they have experienced with other families in business. In choosing advisors, families should pay attention to three aspects:

- level of expertise and experience,
- absence of conflict of interest, and
- mutual appreciation and trust.

It is also important to realize that having to go through difficult times is not exceptional, and does not have to threaten the family business – quite the contrary. Research on long-lasting family business dynasties shows that most of them have had to face wars, recessions, difficult family crises, and market revolution as well. Instead of breaking as a result, these businesses addressed the issues with a readiness to change that made them stronger by increasing their determination and capability.

Family businesses have much to offer to the economy. Focusing on their specific strengths helps families achieve high business performance. Having relatively flat organizations and usually a small number of shareholders can facilitate quick decisions and implementation, which can bring significant competitive advantage in a world where the fast mover often wins the prize.

High-performing family businesses also typically excel in personal contacts, with customers, employees, suppliers, and distributors. They tend to build strong long-term relationships based on trust and reciprocity. The owning families often show a unique commitment and dedication to their business, giving their businesses a strength not often available to businesses with widely disparate ownership and, therefore, widely differing interests.

These qualities, the high performance and the strong family values on which their business culture is based, are most probably the reasons that public opinion has looked favorably on family businesses in recent years, and that in many countries, family businesses are consistently voted the best companies to work for. In times where short-term profitability is prioritized by the markets, many find it reassuring to know that some business leaders do think about the world in 20 or 50 years' time, care about the environment, and build roots in their community.

Families in business have two unique pillars they can use as a strong foundation for long-lasting business success:

- *Combining generations*: If it is achieved, the harmonious and synergetic combination of generations in the family business can bring the best from the drive, impatience, and energy of the younger, as well as the wisdom and experience of the elder.

- *Giving time to time*: All families know that success takes time. Time is needed for children to grow, for adolescents to rebel before finding their own way, for businesses to be built, for products to be perfected, for strong customer and customer relationships to be forged, and for acquiring a solid reputation. Applying this knowledge gives families in business the opportunity to focus on the long term and to search for excellence.

These two unique pillars are beautifully reflected in Gandhi's words: "There is more to life than increasing its speed." While families in business can be fast in the decision-making process, they take time to build a meaningful business for their family as well as for their community.

Postface by Karl-Friedrich Scheufele

In the middle of preparations for the celebration of the hundredth anniversary of Karl Scheufele GmbH – the original goldsmiths and watch-makers business my great-grandfather founded in Germany in 1904 – I pause to look back at all those years. Filled with pride at the achievement, I try to identify the key factors to our success.

Karl Scheufele GmbH is part of the Chopard group today. Chopard was acquired by my father in 1963. He was 25 at the time, and Chopard had five employees. Today, it employs 1200 people and is the largest family-run luxury watch and jewelry company in the world.

One of the reasons behind this success is that we are a family-owned business. The roots of most businesses are found in their founding families. Like trees, family businesses grow many branches and they need much care, trimming, and at times pruning. What makes the tree strong is its trunk, represented in the business by the owning family's spirit and values.

In addition to values, families bring a tradition and a personal touch – setting them apart from widely-held listed companies which too often consider only the rational and financial aspects. There is a soft element and there are emotions in our approach to business – an important distinction, particularly in our industry, where people like to see who is behind the product, who has designed a particular watch or necklace. Many people have told us over the years that they could feel the presence of our family throughout our organization – in our products, in our communications, or in our approach to customers and suppliers. We are no less professional but a little more human. This is a tremendous advantage.

As a family, we are visible. We guarantee stability. Most of our competitors have experienced huge management transitions in the past three to four years. We have not. We have been around for 100 years and intend to last. At Chopard there is continuity. Our clients and distributors know there is a family named Scheufele behind our products, giving them a feeling of security and of belonging.

In our business, all family members are active and play dual roles as owners and as executives. The five of us – my parents, Karl and Karin; Caroline, my sister; Christine, my wife; and myself – choose to be involved and visible. Our efforts are not a burden. Far from it, they are a pleasure. The responsibilities, however, can at times be worrisome. In a family-owned business you are directly involved financially. That is another very important difference from other companies. When you invest your own money, the risk-taking factor is different. Business-owning families are more thoughtful about financial risk. We take less risk in one way: we are prudent. We take more risk in another way: we can follow our own vision. At times we take higher risks but in a controlled manner.

Working with family also forces us to seek consensus. We must build strong relationships among our family members. Things have to be clearly defined, and a professional approach to the business is needed to help us control or overcome emotional situations.

Creativity too is very important in our industry. We are lucky to have talented family members. We are all creative, especially my sister, Caroline, who is in charge of our jewelry business. On the other hand, we have less affinity and talent in other areas of the business, for which we have decided to seek external competence.

Any business family has to be open about its strengths and weaknesses. It is not because you are born a Scheufele that you necessarily know how to make watches. Over the years we have analyzed ourselves again and again. We now know exactly where we are strong and what our weak points are. We are not shy of seeking external help where we need it.

The essence of our success over so many years comes down to two aspects. The first is one of the most important lessons we learned from our parents: nothing can be taken for granted. In our family, each generation had to overcome difficult periods and managed to rebound. Our business in Germany went through two wars. At one point it was completely destroyed and my grandfather rebuilt it. My father was only 20 years old when he had to take over the company from my grandfather, who was then very ill. The company was nearly destroyed and he had to rebuild it again. Today, we have the privilege of working in a company that is performing well, but one should never forget that there will be difficult situations ahead.

The second aspect of our longevity is also one that went through the four generations of our family: passion for our products and for our work. We are deeply committed to our business and to passing strong values on to our fifth generation.

Karl-Friedrich Scheufele
Co-President, Chopard SA
Geneva, Switzerland

Appendix 1
Practical Tools

Many aspects need to be addressed in a family business; many issues have to be dealt with; many tools can help you in the process. When you are overcome by the complexity of the situation, focus on the points below. All are described in more depth in this book. Please be patient and give time to time.

Communication
Family protocol/constitution
Strategic planning for the business
Continuity planning for the family
Conflict management
Independence on the board of directors
Family governance
Succession planning

Appendix 2
A Few Useful Contacts

Two or three key words on the web usually provide access to a lot of useful information. Start searching under "family business" or "family firms." Major business schools around the world offer specific programs for families in business. In addition, here are a few search starting points:

FBN, *the Family Business Network*

A world network for families in business, with local chapters in many countries.
www.fbn-i.org

GEEF, *the European Group of Family Enterprises*

A European network devoted to lobbying and the promotion of family businesses within the European Union.
www.iefamiliar.com

FFI, *the Family Firm Institute*

A network devoted to academics and service providers.
www.ffi.org

FEP, *Family Enterprise Publishers*

Offers many specialized articles, booklets, and books.
www.efamilybusiness.com

Information on the authors of this book

If you have questions or would like to know more about the authors, keying in their names followed by "family business" on the web will provide access to the information you are looking for.

Recommended Books, Articles, and Publications

Aronoff C. E., Astrachan J. H., and Ward J. L. (2002). *Family Business Sourcebook* (3rd edition). Marietta, Georgia: Family Enterprise Publishers.

Beckhard R. and Dyer G. W. (1983). Managing continuity in the family-owned business. *Organizational Dynamics*, 12, pp. 5–12.

Carlock R. S. and Ward J. L. (2001). *Strategic Planning for the Family Business*. New York: Palgrave Macmillan.

Danco L. A. (1982). *Beyond Survival: A Business Owner's Guide for Success*. Cleveland, Ohio: University Press.

Family Business Leadership Series, a series of topical booklets. Marietta, Georgia: Family Enterprise Publishers.

Family Business Review (FBR), an academic journal. Marietta, Georgia: Family Firm Institute.

Gersick K. E., Davis J. A., McCollom- Hampton M., and Lansberg I. (1997). *Generation to Generation: Life Cycles of the Family Business*. Boston: Harvard Business School Press.

Kenyon-Rouvinez D., Adler G., Corbetta G., and Cuneo G. (2002). *Sharing Wisdom, Building Values – Letters From Family Business Owners To Their Successors*. Marietta, Georgia: Family Enterprise Publishers.

Lansberg I. (1999). *Succeeding Generations: Realizing the Dream of Families in Business*. Boston: Harvard Business School Press.

Neubauer F. and Lank A. G. (1998). *The Family Business: Its Governance for Sustainability*. London: Macmillan.

Shanker M. and Astrachan J. H. (1996). Myths and realities: family businesses' contribution to the US economy – a framework for assessing family business statistics. *Family Business Review*, 9(2), pp. 107–23.

Ward J. L. (2004). *Perpetuating the Family Business*. London: Palgrave Macmillan.

Ward J. L. (1991). *Creating Effective Boards for Private Enterprises: Meeting the Challenges of Continuity and Competition*. San Francisco: Jossey-Bass.

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