Transition Issues in Family Business: Keys to Success

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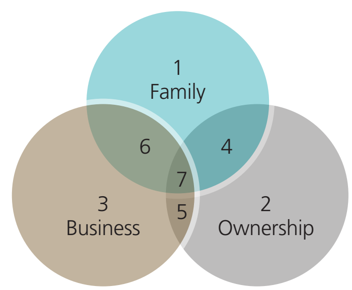
Family Businesses Are Unique

Family businesses can be complex, and as owners know, sometimes difficult to understand from the outside. They face unique pressures and have distinct goals which differ from other businesses. At times, stakeholders making key decisions about the business are not working in the business and may not be "visible" to advisors and even other family members. For transition issues (family succession, sale, and so on) such factors make the pathway to transition much more challenging to navigate.

So why are family businesses often so challenging when undergoing transition? Largely, it is because each family business is actually an integrated system, with three distinct sub-systems, and each can have different values, norms, goals, memberships, and processes. This is commonly called the "3 Circle Model", which was developed at Harvard University in the Family Business Studies area.



As a result, the effects of a family's engagement in the enterprise – whether formally or not – can dramatically affect the decision-making in these businesses. The interactions of these three groups and sub-systems is where the complexity of family business arises, and research has shown that the two most common reasons family businesses fail to transition from one generation to another (70% of family businesses do not pass on more than 2 generations) is a failure of TRUST and COMMUNICATION. Relational issues in family business can become "messy" at times, and are not part of the scope of the work most service providers are engaged for or knowledgeable in.

Family Businesses Are Ever-Moving And Ever-Changing

In addition to grasping the complexity of family business, it is important to understand where on the developmental curve the family business is, as this dramatically affects transition issues. Each of the sub systems develops over time, with further organizational complexity as a result. For example, the family grows from the original Founder to second and third generations, with new spouses and children added in as the family expands. As the number of family members increase, the business may – or may not – be able to support the added number of people who depend on the business.

The business often grows as well, moving from an initial, small start up, to progressively larger enterprises, with increasing staff, volumes, and processes. As the business grows, the skills needed to manage it at inception can become less relevant, and additional experience and skills are needed to meet the challenges of the larger enterprise.

Finally, the ownership can also grow over time, as the Founder adds partners, sells all or a portion of their shares to succeeding generations, or adds external investors. Each of these shifts in development in the family business system expands the challenge of managing the various components of the system, and requires a transition plan that addresses where the business is (as opposed to where it came from) and where it is going. A transition plan that fails to address each of the three circles, and each aspect of development will ultimately come up short in addressing the needs of the enterprise.

So a family business can move over time from the initial start up (often with a sole proprietor), to perhaps a "Sibling Partnership" or even "Cousin Consortium" with multiple stakeholders who may – or may not – be well aligned in terms of goals in the family, the business, ownership, or all three!

A Failure To Communicate

Given this complexity, it is perhaps not surprising that so few family businesses manage to survive through more than one or two generations. As mentioned, the main reasons for this failure have been documented as stemming from two main sources:

1. **A lack of communication within the family** – especially about family issues that impact the business and vice versa.
2. **A lack of trust, which is linked to communication –** especially around unresolved conflict.

Difficulty in resolving conflict for families is a major and common concern, especially given the boundary issues shown in the three circle model. However, since conflict is not only inherent, but inevitable in such a system, conflict by itself is not a particularly bad sign for family businesses. In fact, some degree of conflict is perfectly normal and understandable. Unresolved conflict, however, is a problem, and one that generally does not go away on its own. Not knowing how to resolve the conflict, many families get "stuck" on one issue or another, failing to move ahead (though they know they need to) and progress. Moreover, when they do move ahead – often on their own – their inexperience in the area can lead to unintended consequences which result in transition failure.

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Succession Challenges - Conflict

The complexity of succession and transition planning very often arise from boundary issues across the three circles, and the conflict which naturally ensues. Disney recently announced it will need to re-boot its CEO succession process, after the intended successor announced his resignation from Disney unexpectedly. If companies as sophisticated as Disney struggle with succession and transition, small companies with fewer resources and less formal processes, combined with the dynamics of families, can certainly be expected to find this process daunting.

Unlike public companies, private family enterprises do not face the same pressures to have successors lined up and prepared. In fact, it is often true that Founders of a family business are not really interested in preparing too soon for succession. The reality that "death is not optional" may draw a smile and a mental nod, but all too often fails to galvanize the company leader to take action on this front.

Since the Founder is usually both the CEO and chief shareholder, their approach to transition is difficult to challenge and therefore the importance of preparing for succession and transition often sits idle until some kind of "trigger event" (health scare or worse) pushes them to move forward.

Family First versus Business First

Another reason family businesses struggle with transition is linked to whether they weigh the value of the family higher, or the business. A "Family First" business makes decisions at times that optimizes circumstances for family members. For example, hiring a family member less qualified than would otherwise be obtainable in the market. This is usually consistent with the reason why the family has a business in the first place – they can provide employment to family members, whether or not they are the most qualified candidates. In the case of succession, this can create significant risk to the enterprise.

By contract a "Business First" family business typically makes decisions which optimizes for the business over the family. In this case, a non-performing family member is more likely to be terminated. Literally, fathers fire sons, and brothers let their sisters go. These kinds of decisions may be right for the business, but invariably have impacts in the family dynamic which in turn can affect the business and transition.

It is important (as much as possible) to treat the business like a business, and the family like a family – and not to confuse the two too much. However, there are bound to be times when there is a tension between the needs of the business and the family which needs to be balanced.

Succession Vs Transition – Not All Businesses Should Be Handed Down

Some good starting questions on transition include:

- Does the founder want to exit managing the business and/or ownership? Are they ready?
- To who will the business and ownership pass? (family, employees, other)
- When? (what kinds of timelines are they working with – good transition takes time to set up)
- On what basis? (do they need to get cash out of the business for retirement, etc)

Posing these kinds of questions helps the founder and family work through issues which can be of tremendous benefit to moving them along the transition path. Doing this in a constructive manner usually requires engagement of a broad range of stakeholders from the family, business and ownership circles, and typically a facilitator skilled in family enterprise, with no vested interest in the outcomes.

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The Inevitability of Change

Heraclitus once wrote: "No person ever steps in the same river twice...." Both the person changes, and so does the waters of the river. Similarly, changes in business and in people as time passes means what made sense in years past is often not what is needed for the future of the family business.

As a result, proper preparation of the transition plan requires steps that factor in changes over time. Here are a number of steps recommended to maximize the likelihood of a more successful transition.

1. Build a picture of where the family and business are, and where they are going, so what is needed for leadership/transition is clear.
2. Have a discussion with potential successors – who wants to be in (or not)? (do we mean a successor for the business, ownership, or both)?
3. Discuss the impact on the family of transition – the stresses and opportunities.
4. Involve the owner/relevant business managers in the planning, as well as other family members.
5. Build a training plan for successors – job descriptions, 360 feedback, performance review, compensation.
6. Create a place and process for decision-making regarding succession.
7. Set up a process for building the authority of the successor.
8. Build a plan for how ownership transitions from a financial perspective.
9. Ensure successors understand responsibilities as well as rights.
10. Have a back-up plan in place – just in case.

Governance Structures

One of the best ways for a family based enterprise to move ahead on succession or other strategic initiatives is to have appropriate governance structures in place. When the company was starting out, this may well have been the Founder and their spouse sitting at the kitchen table, making decisions as they came up. At some point, as the company grows, adding a Board (often Advisory) for the business becomes a helpful step in getting great support to help the company develop.

In a similar vein, the family needs a process for governance of business issues that impact the family, and family issues that impact the business. This is where a Family Council (or Family Board) comes into play. This process has some similarities to a company board, with regular meetings, clear goals and values for the family, and so on. Putting this kind of Family Council in place dramatically reduces the risks to the family – and their business – of failure due to a lack of trust and/or communication.

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Conclusion

Family businesses are complex structures, but despite their challenges, they are valuable places of industry and commerce in our economy and worth sustaining. Excellence in transition in the challenging world of family business needs to factor in more elements than non-family enterprises, but there is process to help families through transition issues, and navigate the way to a healthy and happy family, as well as a profitable and productive business. The two are not mutually exclusive – and working towards balancing them is more than worth the effort.

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