The Family Business Advisor

THE FAMILY BUSINESS CONSULTING GROUP

The Five Fundamental Building Blocks of Strong Family Businesses

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Business activities are often compared to sports. The analogy is straightforward. Sporting events take place in arenas, where coaches field their best players to execute their strategies. The goal is to win. Business owners follow a similar pattern, organizing and assembling leaders and employees to charge boldly into competitive marketplaces. The goal is to make profit.

Before competing in a new sport, one must first learn the basic set of skills – the fundamentals – that are the foundation for success in the arena. When a team loses, its coaches often adjust their training and practices and re-focus on the fundamentals. In American football, the fundamentals are called blocking and tackling. In baseball, fielding and hitting. In basketball, dribbling, shooting and rebounding. Without proficiency in these basics, it is hard to imagine that any team would achieve victory in the arena.

I believe there are five fundamental building blocks of family business that must be learned and consistently revisited in order to give the business the best chance for success.

1. Aligned Owners

Owners who are not aligned consume precious energy and resources as they try to wrestle each other into agreement.

Here's an example: Two branches of a family in Latin America each owned 50% of a $500 million manufacturing company. Annual free cash flow was $75 million. The leaders of each branch disliked and distrusted each other, for many decades. Their most recent disagreement was about how to distribute profits. Many hours of many days for many months were spent trying to convince the other side to alter their point of view. Each time a proposal emerged and alignment seemed imminent, attorneys were called in for final document reviews. New arguments emerged, and the cycle continued for three years. The real disagreement? One branch wanted an 18% profit distribution and the other 20%, a difference of $1.5 million. Split in half and after taxes, this amounts to less than $400,000 per family, not including legal and consulting fees. Was it worth the time and resources expended?

A better investment of irreplaceable time and energy would be to work to reach agreement on the six essential alignment questions:

Purpose: Why are we in business together? (e.g. we believe our family business is a force for good in our community and we are its stewards)

Goal: What are we trying to accomplish? (e.g. a statement of owner's alignment or becoming the best place to work in our city)

Core Values and Code of Conduct: How will we treat each other and make decisions? (e.g. guiding principles, rules of communication, calendaring meetings)

Accountability: Who is involved, what are their respective roles and responsibilities, and to whom they will be accountable for their activities?

Metrics: How will we define and measure success? (e.g. culture and employee satisfaction surveys, revenue growth, profitability, return on equity, risk, distribution, productivity)

Timeline: When will we work on becoming aligned? When will we reach alignment?

If alignment is not met within the timeline and if little to no progress has been made, a logical question to respectfully consider is whether the family is the right owner for the business. Would it not be wiser to liquidate or go through a shareholder buyout rather than continue to try to convince or coerce the other side?

2. Effective Board of Advisors/Directors

The evolution of board governance in family businesses is predictable. Early stage entrepreneurial companies often have what are colloquially known as rubber stamp boards. They exist on paper but don't really function as intended. As owners and businesses evolve, so do their boards. Advisory boards are often put in place prior to a transition of the business from the founder to siblings. Advisory boards might include family members and two or three non-family outsiders.

Fiduciary boards are more formalized and have a legal responsibility to protect the interests of the shareholders and ensure that the business is managed well from both a legal and financial perspective. In fact, each owner has the same fiduciary responsibility to all other owners, a point not often considered when selling or gifting shares to children or other family members.

The board has four primary responsibilities. First, to understand and protect the interests of the shareholders. Second, to understand the company's competitive strengths and work with management to set a strategy that leverages them. Third, to oversee and hold management accountable for the successful operations of the company. Fourth, to plan for continuity through ownership and leadership succession planning.

How well a board fulfills its responsibilities, be it advisory or fiduciary, relies on three main factors: 1) how clearly its purpose and function is defined by the shareholders, 2) how talented and engaged its directors are, and 3) how well it is led. As family businesses evolve, it is crucial for family shareholders to understand and pay close attention to establishing and maintaining an effective board. A high functioning board can provide great value to shareholders and help them to pursue an authentic, compelling vision.

3. Strategic Planning

In athletics, talent and hard work go a long way, but champions aren't crowned without extensive competitive knowledge. In business, enterprises start with a belief that a product or service will be valuable to someone. This belief leads to the pursuit of identifying that someone – the ideal customer. Next, business leaders must understand what key activities they can provide better than their competitors. Fusing those two pieces together – understanding where a company's strength will be most well received and valued in a service or product offering – that is where competitive advantage lies.

As an example: a client in the restaurant business knows that their strengths lie in efficiently and graciously serving more guests per day (called table turns) than their competitors. With this knowledge in hand, they make choices about how they decorate their properties, prepare their food and train their staff members. These choices are designed to help them win and keep the customers who will value them the most. As an example, they don't have televisions in their bars and restaurants. Why? The television watching customer is most often male, tends to dine and watch alone and is prone to continue watching until a sporting event is completed. He slows the cycle of operations and hinders the restaurant from leveraging its competitive advantage of higher than market table turns.

As a result, the owners and managers focus their investment of resources in developing facilities and training that appeals to the dining out female. The "date night decision maker" one might say. A customer who tends to place more value in the ambience, the subtle beauty of the décor, the graciousness of the servers and the high quality of the food.

4. Merit-Based Leadership

Families must find the most talented leaders to operate their businesses, regardless of their position in or connection to the family. In the fable of "The Goose and The Golden Egg," greed and a lack of critical thinking leads a countryman to destroy his unique animal. With careful thought and planning, a successful business family can avoid a similar fate. Why is the Golden Goose so valuable? It lays golden eggs. Eggs (benefits) that the family can use to provide for their needs and support them as they pursue their life's objectives. Keeping the goose healthy and strong is the most logical collective effort the family should undertake. Rather than worry about who gets to control the goose, the most important question to answer is: Who is the most talented gooseherd? (Yes that's really what it's called!)

The two most essential questions in family business succession are 1) Does any member of the next generation have the desire to lead the company? and 2) Can she or he lead as well or better than a non-family leader? If the answer to either question is "No," a non-family leader must be identified and hired. These simple questions are often forgotten in the emotion and competition that accompanies succession.

A former client is a successful entrepreneur and a world-class athlete. When he and I first got to know each other, I asked him about his children. Did they pursue sports in college like he had? Yes. Had any of them achieved athletic success to the same level as he had? No. When I asked him why he thought they had not excelled he said, "They are talented kids but they just didn't love their sport like I did. And still do. The love of the game fuels you to work harder than anyone else at turning your talent into on-the-field superiority. Desire unlocks the door for greater success. But ultimately it is your talent that opens the door and gets you into the biggest arenas."

If members of the next generation have the sincere desire to lead the family business, how can current leaders judge their abilities objectively? Based on our 25 years of advising business families, we have identified two critical elements in this process. First, the family must develop and distribute a family employment policy that defines its strong commitment to merit-based company leadership. Second, the owners must put together a focused, well-run board of directors/advisors, with family and non-family directors, and lean heavily on them as they strive to identify and hire the most talented leaders.

5. Engaged Family Governance

Most family businesses fail to transition to the next generation. From founder to siblings and siblings to cousins, the failure rate is over 65%. Why? One might guess that company leadership or strategy-related issues might be the culprit, such as lack of access to growth capital or inadequate strategic knowledge. Years of solid research from numerous credible institutions shows that, in over 60% of cases, the underlying reason for a failed transition is family dynamics and conflict. Disagreements about a vision for the future, strategies for growth, who should lead, accountabilities, compensation, shared family assets, standards for family employment, how to make decisions together and how to manage interpersonal conflict – they all create a palpable level of tension. Without appropriate governance, this tension will naturally escalate into enough turmoil that will lead family members to choose to disengage and pursue individual professional paths.

Taking the time to envision, create and maintain a system of family governance will benefit every family business. No two family governance systems should be exactly alike because no two family businesses are exactly alike. Start by identifying a team of at least three family members who share a desire to perpetuate the family business legacy. Have them pick a leader from among them. Encourage them to set a two-year calendar with half day meetings every six – eight weeks (or more often if there is more urgency). Give them the mandate to work together and with other family members to answer the six essential alignment questions identified earlier in this article (see 1. Aligned Owners), but this time from the family's perspective.

And finally, excellent governance comes down to excellent communication. Excellent communication is Clear, Respectful, Authentic, Consistent. It's arguably the single most important piece of family business success. So, CRAC the code for excellent communication.

Execute the Game Plan

Just as in the world of competitive sports, family business owners must master and consistently practice the fundamentals if they are to remain successful. Whether you and your family are rookies in the world of governing your business or seasoned professionals; continuous improvement through practice is the key. Any family will benefit from a consistent and thorough review of these fundamental areas. As an idea for doing so, in your next family meeting, have each participant work together to complete the following:

- Write down and create a personal priority list of the five fundamentals.
- Compare each other's priorities, explore and discuss each other's reasoning, listen to each other with a goal of understanding each other's unique perspective.
- Tally the scores and determine the collective priorities of the group.
- Take out personal calendars and, using a two-year timeline, pick one day every quarter to focus on each one of the fundamentals. Begin with priority one, end with priority five.
- Through discussion, assign one person to be accountable for each fundamental.
- Agree to the expectation that those who are accountable for each fundamental will lead the preparation for and management of the meeting.

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