The Family Business Advisor

THE FAMILY BUSINESS CONSULTING GROUP

Succession: The Transfer of Power in Family Businesses

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In Shakespeare's great tragedy, the aging King Lear divided his power and land between two of his daughters who feigned love and paid homage to gain favor. The King offered his third daughter an equal share of the kingdom. She was respectful but declined to be insincere in her praise and affection. Lear who sought flattery disowned her. Later, forsaken by his daughters who feigned love, the King wandered the moors for the rest of his life, having lost everything.

In this article, we'll explore ownership and leadership succession in family-owned businesses and point out the common perils to avoid. Succeeding at succession is not only important to families but also to communities and the world. Family-owned businesses generate three-quarters of global gross domestic product and, on average, earn better returns and last longer than either private equity-owned companies or public companies.

Don't Tell Me What to Do

"Nobody is going to tell me when to retire," the aging owner, chairman, and CEO of a substantial family-owned business emphatically asserts during a family meeting. Yet he acknowledges, "Someday, experienced top leadership will be necessary."

The owner and leader in a family business may be called the founder, the chair of the board, the chair and CEO, or simply the president. They serve as a guiding light for the family, the business, the community, and beyond. We can call them the family head.

The family head's identity is the business. It's what they think about the most. The business is where they spend the majority of their waking hours. Media members, industry associates, and community leaders seek out the family head for advice and counsel. Development officers from important philanthropic organizations are particularly deferential. There are no command performances with financers or stock analysts. The family head is in control of their own schedule. Why not have a board meeting near their vacation home if they'd rather not take the time to travel back to company headquarters?

Being the family head means power, respect, and autonomy. Who would want to give that up? Just talking about transition planning can feel like an intrusion on the family head's prerogative.

But if the family head wants to leave an enduring legacy and have the business prosper after they're gone, then they must oversee an effective process of ownership and leadership transition. Otherwise, like King Lear, the family head will destroy on the way down what they built on the way up.

Family Goals for the Business

A key responsibility of any family business owner group is setting goals for the business. This includes defining the vision, values, and expectations for its performance.

For family businesses, a common objective is to thrive across generations. One major reason family-owned businesses often outperform others is their long-term perspective. This doesn't excuse short-term challenges but emphasizes that, for owners aiming to ensure generational prosperity, the long run is what truly matters.

If a goal is for the family-owned enterprise to prosper for generations, then the need for ownership and leadership transition planning is self-evident to anyone willing to consider it from a selfless perspective. Goals like this must be regularly discussed and renewed to remain relevant as the generations unfold.

Even if owners are open to selling the business, effective succession plans and processes will increase its value for owners. Buyers purchase businesses for their future potential. When a business includes capable leaders committed to building an even stronger future, its value increases.

There Comes a Time When You'd Better Have a Plan

The executive chair of a large family-owned manufacturing business is still working 10-hour days as he turns age 70. The chair's right-hand man is in his early 70s and plans to retire only when the chair does. Meanwhile, the chair's 42-year-old son and 40-year-old daughter have spent their entire careers in the business but lack effective leadership skills. The chair has retained sole decision-making authority, discouraging initiative, and showing little tolerance for mistakes.

If prospering into the next generation is a goal, having a well-thought-out plan becomes essential. Certain family questions must be addressed: Who wants to be an owner now or in the future? Who is interested in serving on the board or taking on leadership roles? How will family members become qualified and earn their positions?

The eldest son or daughter may feel obligated to step into a successor role — but they might not want to. Or, if they do, they might not wish to lead the company in the same way as the previous generation.

If family members want to be owners and one or two are willing to serve on the board, but none are interested in taking on business leadership roles, an effective process will be necessary to get the right CEO successor in place.

Succession failures are common. Internal CEO candidates can learn the culture and establish a track record in the organization, but they might not successfully rise to the role of a high-performing CEO. Alternatively, if the company brings a CEO in from the outside and it doesn't work, that can push owners closer to selling the business and abandoning the vision of a family-owned business for future generations.

The rising generation must be prepared for the responsibility of electing directors to the board. Beyond articulating a vision, values, and business performance expectations, electing the board is a primary ownership responsibility. Ideally, an effective and high-performing board will include independent directors with experiences that help support the family's envisioned future. Family-owned businesses with boards that include three or more independent directors perform better on average over the long run.

The Shape of Ownership Succession

SC Johnson is an example of a family business that has successfully transitioned across generations while retaining a centralized ownership model as a north star. Established in 1886, SC Johnson has flourished as a family-owned business through five generations, with the Johnson family retaining significant control over the company's operations and strategic direction. In their case, a designated family leader with voting control serves as the company's guiding light, ensuring that the family's values and legacy are preserved. This model has allowed SC Johnson to maintain a strong connection to its roots while innovating and expanding globally. The Johnson family also established a robust governance structure including a family council and a board with independent directors.

Other family enterprises transitioned from a centralized ownership model to broadly distributed family ownership. For example, Laird Norton began in 1855 as a frontier logging operation and evolved into one of the longest-standing family companies in the United States. Built upon generations of success in the lumber and building materials industry with hundreds of family shareholders, they transformed into a diversified family enterprise that invests in promising private companies and real estate.

Whatever the structure or majority ownership, there is an important need for good communication among owners. Effective processes include providing opportunities for understanding the family enterprise and participating in the development of vision, values, and expectations for business performance. Often there are opportunities for involvement in philanthropic endeavors and planning the processes themselves, like family meetings.

To be an owner or beneficial owner may be the end goal for many family members. Ownership creates a sense of pride and offers an opportunity to regularly interact with extended family members who are often geographically dispersed as the generations advance.

Some family members would rather invest capital elsewhere. Many multi-generational family enterprises regularly offer share redemptions. From a business perspective, it helps focus family business ownership among those most interested. Owners without redemption opportunities can feel trapped. Relieved of that feeling by ready redemption opportunities, family members sometimes decide to remain owners. If they'd prefer to move on, they can exchange their shares for capital to help them pursue their own dreams.

The Leadership Transition

The time to have a plan for CEO succession is always now.

The board's primary responsibility is to elect the CEO, making succession planning a constant priority. What is the plan in case of an unexpected death? What if a current retirement outlook is accelerated by the unexpected illness of the family head or their spouse? How can leaders inside and outside the organization be developed or cultivated so there are options for filling leadership roles when needed in the future? Boards with independent directors ensure these critical questions are continually addressed.

Family heads often hesitate, asking, "Why should I retire or give up being CEO?" But if the goal is to prosper into the next generation, then a clear transition plan with defined milestones is essential. Without planning, family and non-family leaders under the family head may feel demoralized, put in less effort, or leave the business. Developing leadership internally is a purposeful process that requires responsibility and accountability. It requires the room to fail and the opportunity to learn from it.

Succession also requires the next generation to engage in leadership roles for which they are interested and qualified. If the next generation isn't engaged or ready, then effective alternatives exist such as promoting non-family members from within or recruiting leaders from the outside.

There is Life After Active Business Leadership

The founder of a large family business leaves his business role to care for his ailing wife. His daughter becomes chairman and CEO, leading the business to significant growth and expansion. Some years later, when the founder's wife dies, there is no longer a role for the founder in company leadership. Nonetheless, he acts as an effective ambassador: greeting dealers who come to headquarters for meeting days, taking them through the historical gallery, and telling the story of the founding.

There is life after active business leadership. That can take the form of interviews with a historian or biographer leading to a book, fireside chats with family and leaders filmed for posterity, or simply greeting customers with the founding story. The family head can be a sounding board, letting leaders decide for themselves how to proceed. The retired family head's engagement is valuable and appreciated when they leave it up to active leaders to decide what to do. When sharing with family members and leaders, it's important to include the failures. What did the family head learn? How did they keep going through difficult challenges?

Engaging in the community, the nation or the world through philanthropy, mentoring, consulting, board work, or public service can be fulfilling encore endeavors for a retired family head. There may be naming opportunities for products, company facilities, or opportunities associated with philanthropic endeavors that can honor the family head and the family enterprise.

In addition, there is something wonderful about exploring new places, seeing friends more frequently, or spending time on hobbies during retirement.

The Final Stage of Greatness

The family head's most important legacy is the successful transition of ownership and leadership of a family enterprise. Family heads do not become merely retired CEOs. Instead, successful succession is the fulfillment of their lives. It is their final stage of greatness.

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To learn more about our firm and how we serve families like yours, call us at (773) 604-5005, email info@thefbcg.com or visit www.thefbcg.com. There is absolutely no obligation.