Family-Owned Businesses & The Executive Search Consultant

By Patricia Epperlein*

- In the USA, 90% of businesses are family-owned. They contribute towards 40% of that nation's GNP and pay approximately half of its total wages.
- 59% of France's Top-500 industrial companies are family-owned.
- It is estimated that 70% to 85% of all businesses worldwide are family-owned.

The numbers are impressive. However, it is also estimated that 2 out of 3 of these businesses will at some point go out of business due to internal disputes among family members.

30% of family-owned businesses reach the second generation, and only 15% reach the third and beyond. The critical moment for these businesses is invariably during the succession phase, and it is much too important to be ignored. Planning for succession and the professionalization of the business is necessary for the organization's survival.

Many of today's gigantic multinational corporations started out as small family businesses, overcame internal conflicts, reached the third generation and, via a solid business plan that included a family and corporate succession plan, achieved superior performance. They acquired market and institutional value, identified the best investment opportunities and innovated, with emphasis on quality and operational efficiency. But even though any business might have been thriving with the founder leading the company, in a global economy the decision-making process needs to be different in order to achieve better results.

HOW TO PROFESSIONALIZE A FAMILY-OWNED BUSINESS?

One approach would be making sure that the next generation of family members is well equipped to take over. Peter Waite, President of InterSearch's Australian partner office and himself a second generation business leader, describes the following example: "As family businesses grow and develop we have seen in recent times the emergence of a Family Council, where all shareholders and stakeholders, as well as assets of the family, are reviewed and plans enacted for succession and generational transferring of assets. Assets include not only the operational business, usually the greatest asset, but also relate to property, shares and cash."

He explains how the Family Council meets to review investment strategy and dividend flow, and may also devise a Family Constitution. The Constitution may outline the roles of family members, both active and passive, and the rules of engagement for family members to join the operational businesses. Needless to say, the Family Council is a completely separate body and does not guarantee membership of the company board. As an example, the Family Constitution of a client of ours states that, should the next generation of family members wish to join the company, they may require 5+ years of external work experience and possibly a relevant trade certificate or university qualification. The position description and key performance indicators are well documented and performance is reviewed annually.

In some cases, continues Waite, the client requirement may be an interim 1-3 year appointment where the incumbent is required to mentor and up-skill a particular family member to enable a smooth transition in the future. Sometimes these difficult decisions need to be made for the benefit of the business. An executive search organization can assist by providing an independent assessment, feedback and career counselling to the individual family member, helping diffuse potentially damaging and emotional family issues.

A second approach would be hiring managers from outside the family. This "professionalization" phase should be incorporated in the long-term strategic plan of the company, allowing for the family to reflect about its future and that of the company at an earlier stage. Mary Kier, Vice Chairman and Managing Director Consumer & Retail, Diversity of Cook Associates, InterSearch's partner firm in the USA, shares with us the following story: "I have been proud to work with many family businesses to build their executive teams. I fondly remember sitting with a brother and sister who sat on the Board of a small company (under $10 million U.S.) and weaving together the details of the position specification for the CEO role. The most recent CEO, an extended family member, had abused his power and put the company in some complicated legal issues."

She explains how these siblings needed a guiding hand and a warm heart to listen to their stories of their father building the company, the power struggles which occurred when their father passed away and even the internal grief the family endured when one branch of the family went against the other. "The brother and sister were delighted that I would assist them in so many ways, including guiding them through the interview questions and even sitting in on all candidate interviews. They hired the new CEO knowing that this person would be a caring advocate, committed to the company's welfare nearly as much as they were."

PREPARING FOR CHANGE

During professionalization, the company needs to keep on growing. But the family usually grows at a faster rate than the company, placing a lot of pressure on management to obtain higher profits. Continuity is critical, and a well thought out succession plan is not enough to guarantee success. It is important to guarantee a pipeline of successors within all management levels, not just for the CEO. And the chosen successor needs the approval and support of the owner and the other family members. Several executive search firms today have consultants specializing in family-owned businesses, and they have become an essential asset in managing the succession planning process. When working on such projects the search consultant should take into consideration that professionalization does not necessarily mean changes in ownership status, and that it is essential to respect the company culture and to understand the particularities of a family-owned business.

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It is critical to understand that family-owned businesses have unique characteristics that potentially give them a competitive advantage over other enterprises. Family-owned businesses have a long-term vision and commitment, and are not solely bound by quarterly results. For them, success is bound to personal success. They have the possibility of creating a culture where all employees feel more committed to the same cause and the organization serves to preserve family ties from one generation to the next. In such organizations, three icons are normally preserved in a successful succession phase: the Family, the concept of Ownership and the Company, and the Shareholders. These three icons should be successfully professionalized. In most cases the company structure will be composed of an Executive Management team, with a CEO and a Board of Directors – with family members and sometimes independent board members serving on it. When the company is publicly traded, a board comprised of shareholders will also be formed. In general, most professionalized family-owned businesses adhere to the best practices of Corporate Governance, even those that are not publicly listed.

In the case of family businesses, a hired management team and CEO are usually faster at assessing problems and making decisions since there are less emotional obstacles to overcome. But the profile of these executives is decisive in the success of the business. They need to be autonomous so that they are able to implement policies that are in the best interest of the company (which may not necessarily always be the same as the family's best interests). It is important not to adopt an attitude of "us and them". They must incorporate all the interests involved. They need to know that the Family and Shareholders have the right to information. What is required is for the CEO to establish an organized communication and reporting flow. Hired executives need to be humble without being subservient and act from knowledge and example, avoiding the imposition of ideas.

From their side, the Family and Shareholders need to understand that the CEO and the independent Board members are there to build and improve performance. Changes will invariably occur in the transition, but the company culture needs to be respected and preserved. The family's appropriate behavior can help legitimize the process of hiring new executives, especially since the founder/family will be actively involved in the selection process.

The rest of the management team, non-shareholders and non-family members also have to be prepared for the onboarding of the hired executives, so that the whole team is in line with company objectives. It is also important to manage the expectations of those managers who thought they would take on a higher position. Consequently, all shareholders and family members have to be prepared to give up absolute power and learn how to share it.

The role of search consultants as independent advisors becomes critical during this transformation process. Walter Rach, Managing Director Food & Beverage of Cook Associates/InterSearch USA, highlights that it is important to remember that levels of control and autonomy granted to non-family member executives from the owner family vary greatly, depending on the family as well as on how advanced the transformation process really is and how much time passes by. "For example, the CEO of one of my clients was famous for his 'on again/off again' approach regarding his involvement in the day-to-day running of the company. As a result, the turnover rate of CFOs at this company was very high because the CFOs could not adjust to this aspect of the owner's style."

"I discovered this through interviews with company executives," Walter reports, "and, when I was given the opportunity to conduct the CFO search, I took great care to screen for and identify individuals who had demonstrated experience in being tolerant, understanding and flexible with dealing with mercurial executives. As a result, the new CFO I placed was aware and accepting of the owner's method of operation and this made the owner more comfortable in working with this CFO as opposed to his predecessors."

AWARE OF THE CHALLENGES

Outside of the USA, family businesses in many markets are still reluctant to invest in the services of a professional retained search consultant. Binita Ghosh, an Indian colleague, describes how more than 60-70% of InterSearch's clients in India are family-run businesses, including major market players such as Avantha – Thapar (India's No.1 paper company and the leading diversified group), Indian Seamless Metal Tubes, IFB Industries, Saraya Industries, etc. Nevertheless, family-owned businesses are hesitant to use premium search firms because they may not fully understand all the benefits, focusing on the cost as a deterrent.

As a result, InterSearch has developed new models for business engagement. The first step to approaching family businesses is, of course, knowing how to reach them. The consultant interested in working with such organizations can join relevant family business networks or associations, partner with Universities/ Colleges that focus on family business enterprise or with other management consultants or lawyers who specialize in this - when an external Management Consultant has already gained the trust of the company, it is much easier for him to introduce the search consultant to the family.

To attract more business from family run organizations, InterSearch India follows a process of Pre-talent Mapping. In this process talent is mapped and brought upfront to help the clients understand and plan according to the needs of their organization. Only then can a search consultant move forward, towards the hiring process to help structure this new business model.

The good news is that once these family-owned businesses find an advisor that they can trust, they tend to be the most loyal customers. Sebastiano Viani from InterSearch Italy describes the situation with a client, an industrial company with a turnover of €60 million: "It took many months of meetings with the CEO, the son of the founder, before he was convinced to proceed. I am delighted that our cooperation is still going strong after three years. A new management team was recruited, existing staff was assessed, qualified firms for temp services were introduced and, when the client started developing international business outside of Italy, InterSearch offices in other countries were chosen to recruit the right people because they were already familiarized with the company's particularities."

Other challenges unique to family-owned businesses have to do with the possible lack of formal organizational and compensation structures, no defined policies and procedures, or other factors that make designing a position profile rather challenging for the search consultant. Few family run businesses have international or global presence, some lack customer orientation and brand recognition, which make them relatively less appealing for high qualified candidates compared to a MNC.

Also, when there are two or more shareholders, as is often the case, there might be a divergence of views concerning the profile of the position the consultant must recruit for, and about the company's future in general.

"Many times," - adds Binita Ghosh – "family run businesses would like to employ candidates from good management schools and from the top 20 MNC's, but most of the time they are not in a position to match the compensation a big multinational usually offers to such managers."

Successful family-owned businesses must be prepared to change, to grow and more importantly, to implement a succession strategy that will help this company move forward. As a search consultant, be prepared to be proactive. Communicate with your client on the opportunities that are arising, but at the same time, be prepared to discuss the challenges so that your clients can always make informed decisions.

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InterSearch is currently represented in more than 40 countries, staffed by local professionals selected for their experience and reputation in their own markets and their ability to operate internationally.