Family Business – Continuing the Journey of Success

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FAMILY BUSINESS TOPICS…. TARGETED!

Targeted Topics…….

- Item 1 — Discussion Item One – What is a Family Business?
- Item 2 — Discussion Item Two – Overview of Family Business
- Item 3 — Discussion Item Three – Persistent Challenges Specific to Family Businesses
- Item 4 — Discussion Item Four – Succession Planning- The next leader of your family business
- Item 5 — Discussion Item Five – Q & A

What is a family Business?

- A family business is a company owned by a family and is handed down from one generation to another.
- a small or medium-sized business that is controlled and operated by members of a family. It may be organized as a sole proprietorship, partnership, corporation, or limited liability company.
- a family business refers to a company where the voting majority is in the hands of the controlling family; including the founder (s) who intend to pass the business on to their descendants.
- A corporation that is entirely owned by members of a single family

Overview of Family Business

Did you know……

- Many businesses owned and managed by families or groups of relatives;

- Considerable variation across countries;

- Huge impact on economic growth

Overview of Family Business

TABLE 19.1: FAMILY OWNERSHIP OF START-UP FIRMS

COUNTRY	START-UPS WHERE FAMILY OWNS OVER 50%
United Kingdom	77.5%
Australia	76.6%
New Zealand	74.6%
United States	74.5%
Singapore	64.7%

Overview of Family Business

Did you know……

- 90% of U.S. businesses are categorized as family owned.
- 7 of America's 8 oldest family businesses are farms.
- While 78% intend to pass the business on to children, only 34% create a succession plan (for 25% a will is the only element of that plan).
- 70% of first generation businesses fail to survive into the second generation.
- 15% survive into third generation.
- 1% survive into the fourth generation.

Overview of Family Business

Two things in life are certain – taxes & death

- Taxes we can deal with
- Few of us are prepared to pass on our companies after we depart this world
- Only one-third of family–owned businesses succeed in making the leap across generations
- Most are sold or wound up after the founder's death

Overview of Family Business

Here's a quick look at the variety of family businesses in our region.

- Hong Kong Chinese, Indonesian and Philippines family businesses face succession problems that are similar to other countries;

- In Indonesia, for example, ethnic Chinese form only about three to four per cent of the population but control nearly three–quarters of the country's wealth;

- Chinese family businesses are headquartered throughout the Asia–Pacific region, but the heart of the network is Hong Kong, Singapore, Taiwan and the China coast. Ethnic Chinese are the major source of capital in Thailand, Malaysia, Indonesia, Hong Kong, the Philippines, Vietnam and the China mainland.

Overview of Family Business

- Overseas Chinese account for 80 per cent of all investment coming into China itself. They share a common culture and hard work within a network of entrepreneurial relationships. Top positions are filled by family members with the head of family assuming overall command.

- Chinese family businesses in Singapore are economic assets that propel the modern Singaporean economy. But their hierarchical and patriarchal nature puts them at odds with the state's Western attitudes. They have been transforming from family–ruled and managed to professionally managed family-ruled models as they react to the state and face increasing competition from Western corporations.

- In Thailand, family businesses have driven the industrialisation process. Before the Asian economic crisis in 1997, 220 family business groups produced two–thirds of the gross domestic product (GDP). But globalisation, social and political change and the financial crisis have seen the influence of Thailand's business families greatly reduced.

Samples of Successful Global Family Businesses

As an example, Cargill and IKEA are two businesses that thrived given robust governance and ownership mechanisms – Case Studies of Successful Family Businesses

Cargill

- Top management treated like family
- Groom management from within – current and previous CEOs had several decades of experience with the company (*" Treat the business like a Family"*)
- Separation of family from business – no family involvement in business management since 1961
- Formalised family governance- clear ownership and decision rights among family members (*" Treat the family like a business"*)

IKEA

- Secured Ownership Structure
  - Family owns furniture business through a foundation;
  - This scheme maintains family ownership & protects family against liquidation
- Separation of family from Business
  - Although the family, through the foundation can appoint board members, it does not exercise direct management control over the furniture business
  - As a result, the company can attract and retain top talent to run, develop & grow the business

However, few family businesses survive to enjoy success due to the complex interaction among family, business and ownership

80% of family businesses don't survive the 3rd generation……

- Many successful international businesses have sprung from small family owned companies, e.g Wal-Mart, Cargill, Tata, BMW, Roche, Michelin, Ford, etc.

- Yet, around 80% of family businesses fail to survive the 3rd generation

- As per the saying, "The 1st generation makes the money, 2nd generation tries to keep it, and the 3rd generation Loses it"

…due to business, family, & ownership issues

Business

- Failure to evolve the business-emotional attachment;
- Inability to successfully scale the business;
- Inadequate succession planning

Family

- No separation between family and business activities
- Family disputes among siblings

Ownership

- Lack of coordinated active ownership and corresponding governance
- Delay in clarifying ownership rights

In fact, many high profiles families overtime have been broken due to family rivalry, and ownership feuds – Family Risk factors for Family Disintegration

"No Separation Between Family and Business" – The Steinberg's

- Founded one of the Canada's successful supermarket chains in early 1940s
- *Challenges*
  - hiring policy putting the needs of the family first
  - Lack of robust family governance mechanisms
- *Implications*
  - Mismatch between people's abilities & business requirements
  - Business exposed to family conflicts
- *Widely publicised conflict led to the sale of the business in 1989*

"Siblings Rivalry- The Dassler Brothers"

- Founded a successful shoe business in 1924
- *Challenges*
  - Ideological divide among brothers
  - Rivalry that extended beyond the brothers to the rest of the family
- *Implications*
  - Business split into Adidas (led by Adi) and Puma (Led by Rudi)
  - Despite the split, the brothers' rivalry translated into fierce competition
- *To the very end, families remained bitterly divided*

In fact, many high profiles families overtime have been broken due to family rivalry, and ownership feuds – Family Risk factors for Family Disintegration

"Disputed Ownership Rights- The Pritzker's"

- Developed a successful diversified conglomerate (owned Hyatt Hotels)

•*Challenges*
- Put the business first and ignored family values
- No mechanism for exit was defined

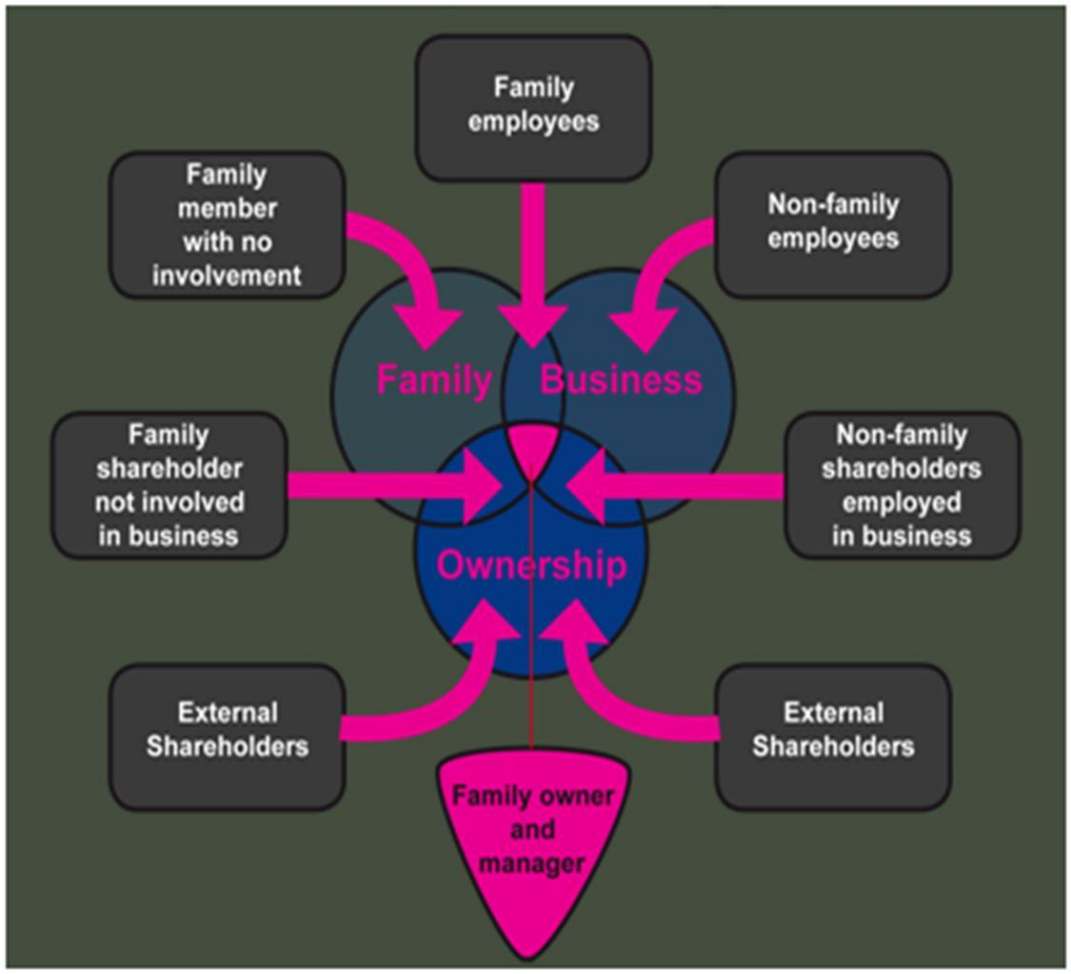
•*Implications*
- Tensions broke between members not working in the business (outsiders) and ones that are in charge (insiders)

•*Business dismantled with assets – rich/cash poor outsiders being flushed with liquidity*

Challenges facing family businesses

- Family firms have unique problems
- Lack financial capability of larger firms
- Have less management expertise
- Have psychological toils and tribulations

Challenges Facing Family Business –Overlapping Systems (Business-Conflict-Family –Conflict-Ownership)



Examples of family business conflict

- How much should we pay family members?
  - Families typically reward based on need. In the business world people are paid based on market value
- How much equity ownership should family have and should it be given to outsiders?
  - In the real world employers provide incentives to key employees, by offering them an equity stake in its future

Why some family businesses are so successful?

- Family businesses not encumbered by demanding stockholders
- Family members are willing to sacrifice short–term profits for long–term gains
- Research shows that family members are more productive than other employees
- Family businesses preserve the humanity of the workplace
- They focus on the long–run
- They emphasise quality

TABLE 19.2: ADVANTAGES AND DISADVANTAGES OF FAMILY-CONTROLLED FIRMS

ADVANTAGES	DISADVANTAGES
Long-term orientation	Less access to capital markets may curtail growth
Greater independence of action	Confusing organisation
Less (or no) pressure from stock market	Messy structure
Less (or no) takeover risk	No clear division of tasks
Family culture as a source of pride	Nepotism
Stability	Tolerance of inept family members as managers
Strong identification/commitment/ motivation	Inequitable reward systems
Continuity in leadership	Greater difficulties in attracting professional management
Greater resilience in hard times	Spoiled-kid syndrome
Willing to plough back profits	Internecine strife
Less bureaucratic and impersonal	Family disputes overflow into business
Greater flexibility	Paternalistic/autocratic rule
Quicker decision making	Resistance to change
Financial benefits	Secrecy
Possibility of great success	Attraction of dependent personalities
Knowing the business	Financial strain
Early training for family members	Family members milking the business
	Disequilibrium between contribution and compensation
	Succession dramas

Source: Manfred F.R. Kets de Vries, 'The dynamics of family-controlled firms: The good news and the bad news', *Organisational Dynamics* (Winter 1993): 61.

Succession Planning- The next leader of your family business

Succession Planning

……it is a *PROCESS* that ensures the continuation of a business through the generations..

"The final test of greatness in a CEO is how well he chooses a successor and whether he can step aside and let his successor run the company."

Peter Drucker, A Management Expert

Management succession

- Major problem is lack of preparation for passing managerial control to the next generation
- All an owner has to do is designate which heir will inherit the operation or, better yet, train one (or more) of them to take over the business during the founder's lifetime
- Easier said than done

Management succession problems

TABLE 19.3: BARRIERS TO SUCCESSION PLANNING IN FAMILY FIRMS

FOUNDER/OWNER	FAMILY
Death anxiety	Death as taboo
Company as symbol	• Discussion is a hostile act
• Loss of identity	• Fear of loss/abandonment
• Concern about legacy	Fear of sibling rivalry
Dilemma of choice	Change of spouse's position
• Fiction of equality	
Generational envy	
• Loss of power	

Source: Kets de Vries, 'The dynamics of family-controlled firms', 68.

Succession Planning

….. “70% of all family businesses never make to the second generation

And 90% fail to reach the third”

Bottom line

- Yes, choosing an heir can be like buying a cemetery plot but . . .

- Owners who refuse to face the succession issue place an unnecessary burden on those whom they leave behind

Pressures inside the business

	Inside the family	Outside the family
Inside the business	The family managers	The employees
	Hanging onto or getting hold of company control	Rewards for loyalty
	Selection of family members as managers	Sharing of equity, growth and success
	Continuity of family investment and involvement	Professionalism
	Building a dynasty	Bridging family transitions
	Rivalry	Stake in the company

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Forcing events

- Death
- Illness or incapacitation
- Mental or psychological breakdown
- Abrupt departure
- Legal problems
- Severe business decline
- Financial difficulties

The search for a successor

- Son, daughter, nephew or niece?
- Can founder and heir get along?
- Founder must be a coach and adviser
- Heir must respect the founder
- Heir must be able to initiate changes
- Founder often trains a team of (candidate) executive managers of family and non-family
- Founder hopes natural leader will emerge

Early entry versus delayed entry strategies

TABLE 19.4: COMPARISON OF YOUNGER GENERATION ENTRY STRATEGIES FOR SUCCESSION IN FAMILY BUSINESS

ADVANTAGES OF EARLY ENTRY STRATEGY	DISADVANTAGES OF DELAYED ENTRY STRATEGY
Intimate familiarity with the nature of the business and employees is acquired	Conflict results when the owner has difficulty with teaching or relinquishing control to the successor
Skills specifically required by the business are developed	Normal mistakes tend to be viewed as incompetence in the successor
Exposure to others in the business facilitates acceptance and the achievement of credibility	Knowledge of the environment is limited and risks of inbreeding are incurred
Strong relationships with constituents are readily established	Specific expertise and understanding of the organisation's key success factors and culture may be lacking
The successor's skills are judged with greater objectivity	Set patterns of outside activity may conflict with those prevailing in the family firm
The development of self-confidence and growth independent of familial influence is achieved	Resentment may result when successors are advanced ahead of long-term employees
Outside success establishes credibility and serves as a basis for accepting the successor as a competent executive	
Perspective of the business environment is broadened	

Source: Jeffrey A. Barach, Joseph Ganitsky, James A. Carson and Benjamin A. Doochin, 'Entry of the next generation: Strategic challenge for family firms', *Journal of Small Business Management* (April 1988): 53.

Succession strategy: Context

- Time: The earlier, the better
- Type of venture: Difficult to replace ideas person or a person whose business contacts are key
- Capabilities needed: Do you need an engineer or a marketer?
- Entrepreneur's vision: A successor, it is hoped, will share this vision
- Environmental factors: Sometimes change is needed at the top

Elements of the succession plan

- Identify a successor
  - As difficult as it is, every owner–manager should identify a successor or at least the characteristics and experience needed of such an individual
- Groom an heir
  - Precious time is lost unless a successor is openly groomed
- Agree on a plan
  - Effective succession requires a plan of how responsibilities are transferred
- Consider outside help
  - Promotion from within is a morale–building philosophy. Sometimes it is a mistake

Steps in Succession Planning Process

1. Understand what succession is
2. Discover expectations
3. Examine options
4. Create a plan
5. Check with experts
6. Finalise the plan
7. Implement the plan

Step 1. What Succession Is and Is Not

Succession is:

- A process
- About family, people and relationships
- About ownership, management and estate
- About what is fair
- Driven by the family values, wants and concerns

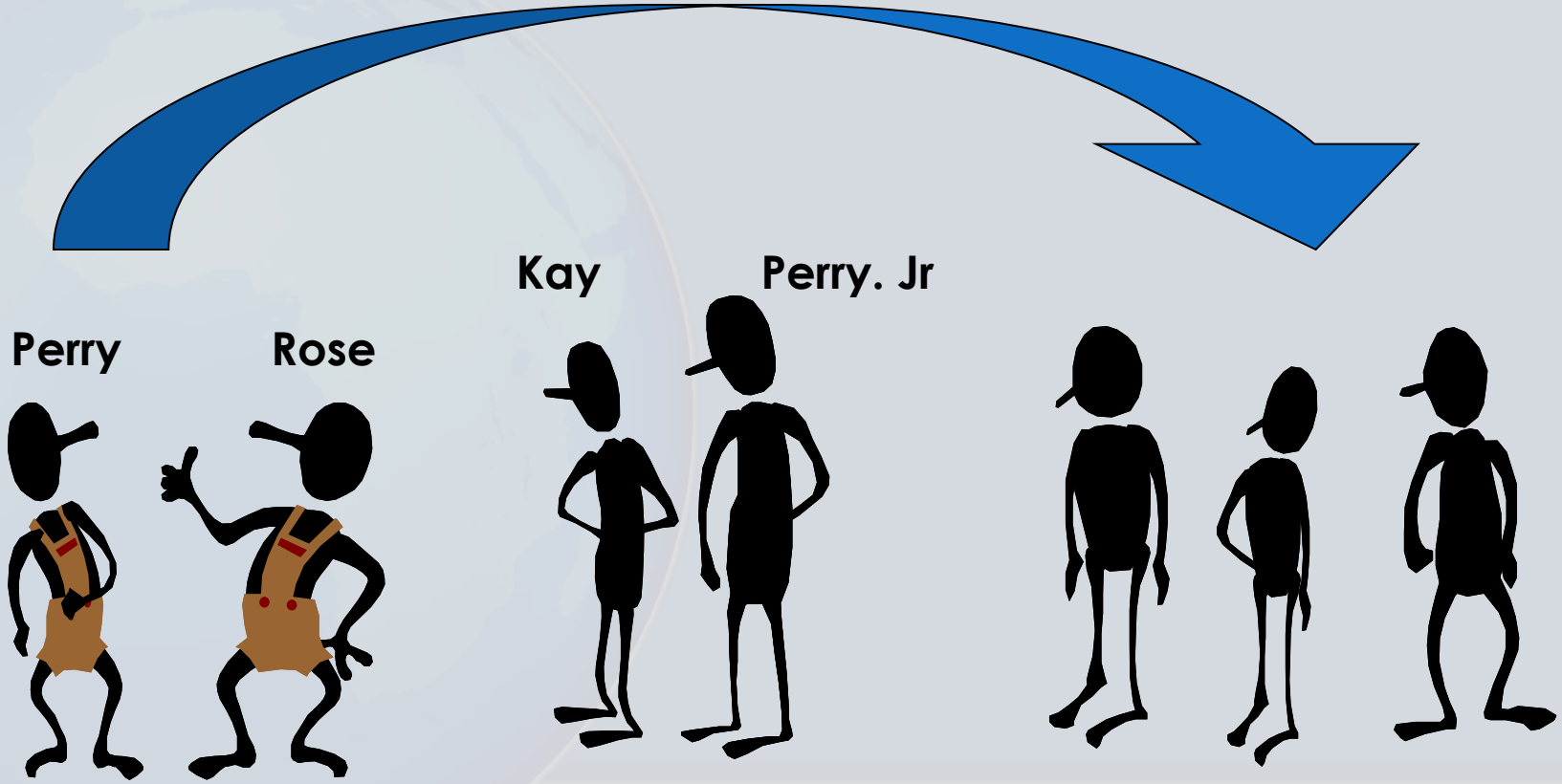
Succession is not:

- An event
- One person's problem
- About minimizing taxes
- About equity
- Driven by technical issues that are handled by lawyers, accountants, etc.

Step 2: Discovering Expectations

- Should involve all family member (whether in the business or not)
- Assumptions at any stage about other's wants or expectations should not be made
- Say no to secrecy!

Say NO to Secrecy!



Say NO to Secrecy!

- Perry and Rose built a successful farming operation.
- Their child Perry Jr. was interested in inheriting and operating the farm. His sister Kay was a school teacher and was never involved in the farm.
- The parents were concerned that the two children would have great difficulty getting along with each other if the farm was left to the two of them outright.
- Perry and Rose decided that the best way to deal with the situation was to pass the ownership of the farm to their grandchildren by placing the farm in a trust.
- The farm was to be managed by Perry Jr. according to a detailed management plan in the trust document.
- They never involved Kay and Perry Jr. in the planning process. In fact, they intended to keep their succession plan a secret until Perry's death.

Say NO to Secrecy!

- But, as so often happens in families that are close personally, the secret slipped out. Perry Jr. was absolutely furious and felt betrayed by his parents.
- Surely they did not trust him to bypass him with the farmland in this manner after he had spent so many years working the farm alongside Dad. He felt he deserved his shot at owning the farm.

The parents had a good plan, but to spring it on the children after you are dead is never a good idea. All parties would have been so much better off if the children had some input in planning process, had time to digest the advantages of the plan, and had time to possibly even buy into the plan in terms of wholeheartedly endorsing it.

Step 3: Examine Options

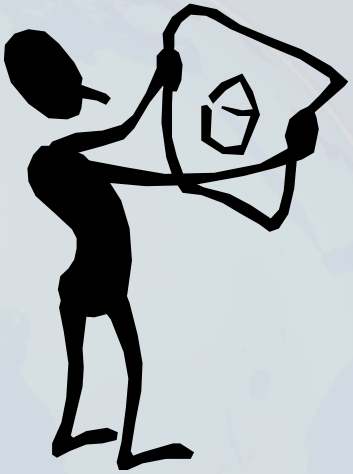
Key Questions:

- What role, if any, will family members play in the succession plan?
- What can we do to treat all offspring fairly?
- How can I prepare for either a different role in the business or for retirement?
- How will the transfer of ownership be handled?
- How will the successor(s) be trained?
- How will the change in roles be communicated to stakeholders?

Family First Versus Business First

Carl

Farmer
Owner



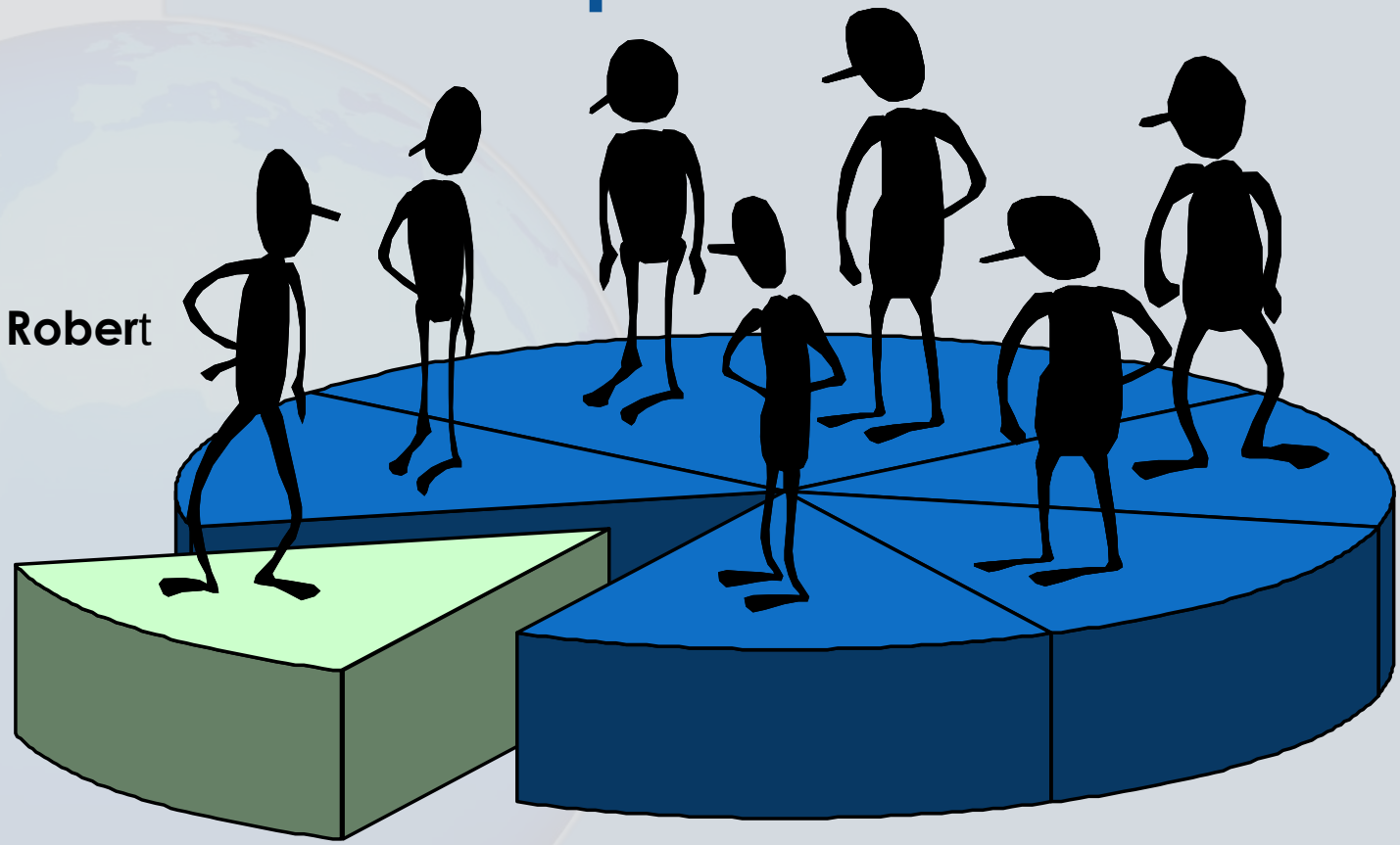
Jan
Physician

Bob

Joe

Friend, part-ti
Farmer, Key
employee

Fair Versus Equal



Step 4: Create a Succession Plan

- Plan for transferring management
- Plan for transferring property
- Contingency plan for managing disruptive events

Choosing the Successor

What specific attributes would you look for in a successor?

- Education
- Experience
- Personal characteristics
- Skills required
- Job responsibilities

Grooming the Successor

How do you provide opportunities to make decisions, take risks, and develop management skills?

- Initial evaluation
- Management training
- Career growth
- Regular feedback
- Timetable (allow 5 years to 15 years)

Step 5: Check with Experts

- Use them to comment on your thinking, not to do your thinking for you;
- Should be visited only after you've thought about the process

Step 6: Finalize the Plan

- **<u>Write it down!</u>**

Step 7: Implement Plan

- How to announce the plan?
- Develop program with action plans
- Set target dates
- Schedule follow up/review of program
- Keep everyone informed
- Review the plan periodically

Succession Planning

Critical Issues:

- Transfer of management
- Transfer of assets
- Anticipating disruptive events

How to actually go about addressing these issues and persuading the family to do so ?

- Use of 12 factor matrix
- A formal fixed price assignment
  - Information gathering
  - Confidential one to one interviews
  - Development of proposals
  - Testing of proposals
  - Family meeting
  - Set of agreed actions
- Implementation separately thereafter

What is the 12 factor matrix?

- A methodology that helps the family
  - identify their issues
  - Treats the business like a business
  - Treats the family like a family
  - plan for the future
  - work together to develop the appropriate strategies for the family and the business
  - provide an opportunity to explore the views of all the family members

What is the 12 factor matrix?

- Then to manage their challenges by developing
  - **communication** between individuals
  - succession planning and **transition** from one generation to the next
  - **plans** for the future
  - dealing with conflict
  - retirement planning
  - Considers and balances the **impact of the business on all the stakeholders**

The12 factor matrix

Succession planning	Remuneration planning	Equity ownership by family members
Family members not involved in the business	Introducing & rewarding non-family executives	Retirement and estate planning
Bringing family members into the business	Strategic planning	Financial structures
Preserving wealth	Resolving conflict	The family creed

Q&A

Thank You