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Why the Best Family Businesses Plan

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Why the Best Family Businesses Plan

Abstract

Families are about caring and businesses are about money—not a likely formula for a successful partnership. Unfortunately those are the facts and family enterprises around the world have found that planning for these two often-conflicting systems is the key to family harmony and business success. The new Parallel Planning Process is an improved version of a proven tool for aligning the family and business systems' thinking and planning into a comprehensive family enterprise plan. This parallel planning model facilitates communication about the business' potential which is supported by family's investment of its human and financial capital. The article discusses how successful business families develop plans and actions to ensure owner and leadership transitions that promote family harmony and sustain business performance.

Key words: Family Enterprise; Planning; Succession; Entrepreneurship; Leadership; Communication

Family businesses are often seen as dysfunctional, prone to nepotism and family conflict. Even in the business press, the family business model is often portrayed as outmoded or problematic. Recent research, however, has shown that family businesses outperform public companies on key dimensions such as stock price and return on equity. How do you explain this disparity? Our work as researchers, teachers and consultants suggests that family business can be indeed be the best and the worst: the best because they have some particular strengths (long term vision, strong values, committed owners); the worst, because they are more complex than other businesses, and they require more attention, better planning and governance—which they do not always receive.

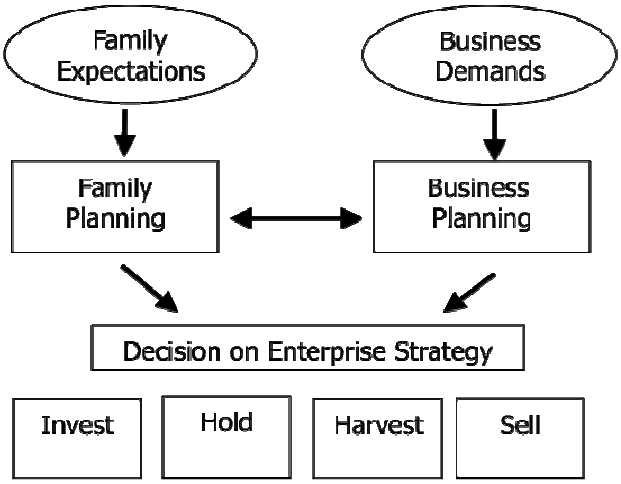
While the principles and benefits of strategic planning for businesses are well recognized, the idea of strategy for the family business is less well understood. Typically, family businesses have sound strategies for their businesses, but planning for the family is mostly neglected or driven by conflicts that need to be resolved. Indeed, in our experience, many business families do not appreciate the value of planning or are afraid of the emotional minefields that such planning may expose. Many fear that the process itself may raise questions that no amount of planning can resolve.

We argue that a lack of planning for the family is a serious threat to sustaining the family's commitment, which is an important competitive advantage of family-controlled firms. The commitment of the founder-entrepreneur to all aspects of the business naturally diminishes with each subsequent generation, as the family expands and a separation of management and ownership roles occurs. It is predictable, but often surprising to a family in the second or third generation, that they should face a new set of family and ownership challenges: how to share ownership among a growing number of family members; how to decide who will lead the business; and what the rights and responsibilities of family owners are. If the family has not planned and made decisions together then every family or business issue has the potential to become a family conflict. On the other hand, if there are clear agreements and plans, on employment for example, then procedure and consistency, not personalities and power, become the drivers of family interactions.

The Family Business Challenge

Family businesses are powerful and complex organizations that create both advantages and challenges because of the overlap of the family and business systems. These systems, when effectively aligned, create significant value for all the stakeholders. But alignment does not come naturally. The family system is driven by emotions and the business system by economics. The interplay of family cohesion and business accomplishment that can arise from this overlap often creates exceptional business performance but at a cost. Without coordination, actions that benefit the business can hurt the family, and family conflicts can threaten business performance. Figure 1 (see below) demonstrates the conflict between family expectations and business needs in planning a family enterprise strategy. The term family enterprise refers to all of the activities undertaken by a business family including its operating businesses, other investments and business activities, a family office and foundation. Business families have four generic enterprise strategies: invest, hold, harvest or sell. Each of these strategies reflects the owners' investment commitment based on the business' strategic potential for value creation. The choice of enterprise strategy is shaped by family expectations and business demands, and results in different strategies, tactics and actions.

Figure 1: Aligning family expectations and business demands



Business families need to develop family and business plans because of five structural issues that arise from the overlap of the family and business systems. These structural issues, present to some degree in all family businesses, are not caused by personality differences or conflicted relationships. They are driven by life cycle and life events, family values and

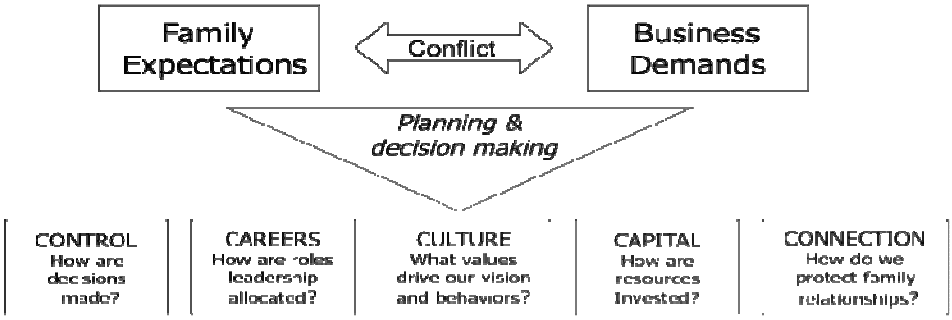
experiences – and the real differences between family (emotional) and business (economic) goals. The issues demand careful planning and decision-making to ensure both family harmony and business performance. They are a predictable and manageable aspect of family business relationships, but they require communication to address their conflicting demands. The five structural issues are:

- Control: How are decisions made?
- Capital: How are financial resources allocated?
- Careers: How does the family create career and leadership roles?
- Connection: How do we keep family relationships strong?
- Culture: What values drive our planning, decision-making and behavior?

If we explore these issues more deeply we can see how family expectations and business demands often result in conflict (See Figure 2 below). For example, next-generation careers are frequently a source of misunderstanding and stress. All businesses need well-trained and capable executives to fill management roles in the firm. Most parents see their offspring as capable and entitled to their family's support, especially for jobs and careers. The parent's logic is simple: we own a family business that needs people and my child needs a job.

It is also important to remember that family members can be an excellent source of talent if they have the skills and attitudes the business requires. However, logic fails when a family member expects a job but lacks the skills that the business needs, if the family has not properly planned a process for hiring its members or there is a lack of fairness in recruitment decisions. Either of these scenarios will create conflicts with possible consequences for the business and family relationships. This is where family and business planning and agreements must be completed, to ensure that family members know the business' requirements, that the family perceives they are being treated fairly and that the business has qualified employees.

Figure 2: Structural Conflicts in Family Business Systems



The steps to address career decisions, as well as the four other structural issues discussed above, are explained by the parallel family and business planning process described in this article. The logical starting point is for the family to meet and clarify its values and then its future vision. The family's values shape the vision statement, which determines what the business will become, and consequently its business strategy. If the family vision is to remain a small, family-managed firm, competing in a local or regional market, then an open door policy for family employment is a possible. The employment criteria for family members, in this business scenario, are primarily interest and loyalty, and family members can certainly fill the majority of the executive roles.

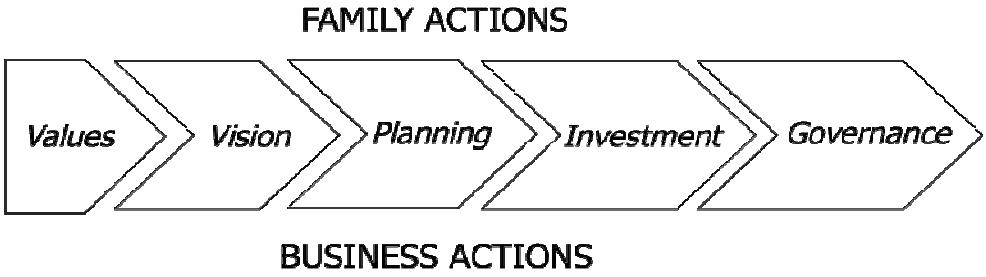
If on the other hand the family vision involves aspirations for growth and perhaps industry leadership, then the family must consider the business' needs for a professional management with the skills to craft and implement this more demanding business strategy. In this second scenario, the business will require a highly skilled management team that could include qualified family and non-family executives in key roles. As this very simple example shows, the PPP starts by clarifying values and then helps families to agree on a vision statement that drives planning to align family and business activities, thus ensuring the best possible family and business performance.

The Importance of Planning, Investment and Governance in Developing Ownership Commitment and Sustaining Business Performance

Many business-owning families espouse values and a vision of a strong commitment to their firm's future success but then fail to take the necessary planning, investment and governance actions required to support the business' long-term performance (See Figure 3 below). A

family's planning and investment of its human and financial capital clearly demonstrates the ownership's belief that their ownership creates a competitive advantage for the business. Baron Jean-Pierre Berghmans, Executive Chairman of the Lhoist Group, speaking to a group of MBAs argues that, "You must have the full commitment of shareholders in a family business if you want to succeed." He cites his shareholders' commitment to investing capital and to serving as executives and directors as two factors that have helped sustain their company's spectacular growth. The family's participation in a privately controlled business as active owners or directors is critical because private ownership can have the adverse effect of shielding non-performing firms from the public scrutiny and market pressures that face publicly traded companies. When family owners are active, they are more likely to keep a sharp eye on performance—their own and their competitors'—and avoid falling into the trap of complacency.

Figure 3: The five action steps of the Parallel Planning Process



The consequences of passive ownership to a family business were clearly demonstrated at Dow Jones, global financial publisher, which until recently was controlled by the Bancroft family. The Bancroft family's entrepreneurial ancestors were early innovators in U.S. financial journalism founding the *Wall Street Journal* and *Barons* but for the last 30 years the family took a hands-off approach, basically delegating control of the company to non-family management. Because the management team were first and foremost journalists, not business strategists, their focus was on journalism. This narrow focus resulted in the Dow Jones' failure to pursue several significant opportunities in the financial information market that other family businesses or entrepreneurs exploited.

Not only did the family fail to invest its human capital in the business, the family provided little financial support for the business. Dow Jones had been good to the Bancroft family: the family had taken large dividends from the business for decades. Indeed, in some earlier years dividends

had exceeded the company's profits; and just prior to the approving the sale of Dow Jones to News Corp., the family had doubled the dividend it took from the company. All this capital depletion undoubtedly helped undermine the company's competitive position.

For example, Bloomberg L.P., which provides real-time financial information to investment professionals, created a new desktop market for the very information that had been printed by the *Wall Street Journal*. In contrast, another publishing family, the Canadian based Thomson family, repositioned their business from small, local newspapers to become a global legal and business publisher. They recently acquired Reuters and are now one of the largest business news services in the world. Pearson Publishing in the United Kingdom, which for many years published the *Financial Times (FT)* as a British-based competitor to the *Wall Street Journal*, has expanded globally, making the *FT* a market leader in many parts of the world.

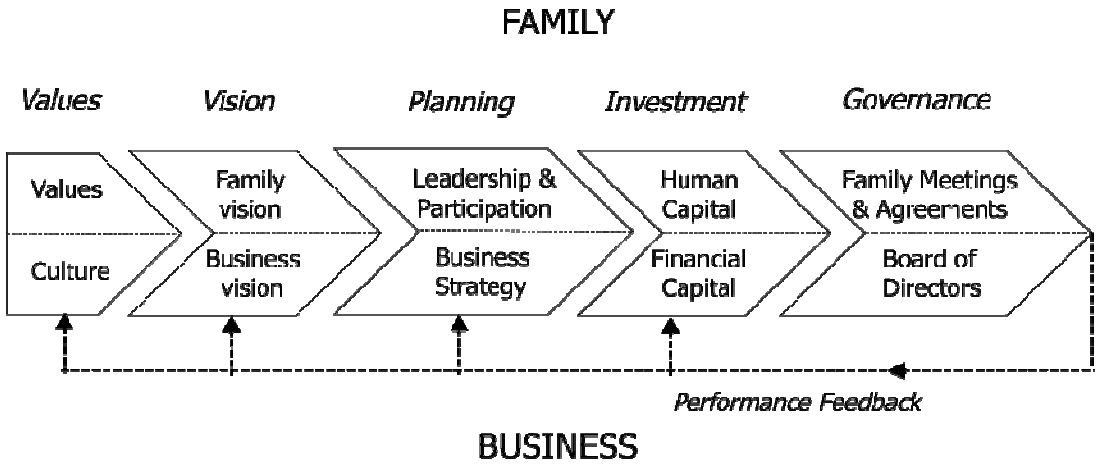
The sale of Dow Jones to Rupert Murdoch would not have happened if the Bancroft family had seriously discussed their family ownership commitment instead of struggling among themselves without developing any plans. If the family had regularly analyzed the business' performance over the last 20 years, they would have recognized a bad trend and a distressed firm that needed a reformulated business strategy. Their lack of action let the business continue to slide until they were forced to sell it to a competitor who represented the journalistic values they opposed. There was also a financial loss: as one of the family members told Warren Buffet; "had things been run differently [at Dow Jones], the shareholders might own a $50 billion business today not a $5 billion business."

The New Parallel Family and Business Planning Process

The central theme of this article is that business families need a parallel planning process that provides rigor and consistency to drive their strategic thinking and actions. We advocate a process-driven approach to planning for global business families because focusing on process (how they do it) rather than content (what they do) recognizes the need for different actions, structures or strategies based on culture, family experiences and economic systems. We argue that the best results come when a family works together to craft their own strategies based on their unique situation and their family business goals.

Successful business families need a framework driven by their values and vision that supports planning, investment and governance activities as they exploit new business opportunities and address their family concerns. The new Parallel Planning Process (PPP) meets this challenge with five interrelated and interdependent action steps for the family and business: values, vision, planning, investment and governance (see Figure 4 below). There is logic to starting any planning process with an exploration of values and vision but this is not way family businesses operate when an important issue arises. In the real world, if a family is struggling with conflicts over the dividend rate they will often want to discuss the issue immediately rather than taking a big-picture view. Business families are action driven and often see planning as a luxury for large corporations. The PPP functions if the family's efforts are issue driven because the five planning steps are interrelated. As a result the family's thinking and action on dividends must be analyzed as a part of their values, vision, planning and investment to create alignment.

Figure 4: The Family and Business Planning Action Steps



The Parallel Planning Process is a strategic tool to help business families explore their role as owners and is designed specifically to address two weaknesses often found in family business planning: 1) limited family communication about activities and 2) a lack of accountability for family and business performance. This article reviews each of the five steps and offers examples and suggestions about how family businesses use them to improve their effectiveness. It will be clear from the discussion of the five steps that they are interrelated and that business and family actions are often difficult to distinguish from one another.

Family Values and Vision

Business families are driven by values that reflect their shared beliefs, experiences and goals. The first planning step is to clarify family values and begin the process of exploring the family's shared vision. This vision consists of two parts: first, the future state of the business (size, markets, employees, profits) and second, a clear understanding of how the family contributes to and benefits from the business' success. It may sound obvious that the family needs to contribute to the success of the business it owns, but this is not always the case, as we discussed earlier with the Bancroft story.

When an entrepreneur creates a business there is a personal commitment to the business' success that aligns their values and vision. But quite naturally, as the family and business grow, and as ownership and management roles are separated, there can be changes in some or all of the family's interest in and support for the business. It is important to recognize that the family's values drive the business vision and strategy that develops. A family that values and expects large dividends will develop a very different business strategy from a family that wants to grow their business through investment in acquisitions.

The family's values and behaviors as owners and leaders also shape how the business' culture develops. The firm's culture is a shared set of beliefs held by the organization and its stakeholders about how and why the firm is successful. Family business culture is a powerful tool for motivating employee performance and creating behavioral norms that support the firm's strategy. Pictet & Cie, the Swiss Private Bank, uses its marketing to communicate the owners' three core values of respect, integrity and independence. Like most family businesses, Pictet's actions are driven by these values and their work environment is based on them. In these times of stress and uncertainty these values become fundamental to demonstrating to employees and other stakeholders what behaviors support the bank's continued success.

Planning for the Family Business

Planning is an effective tool in any organization setting for assessing the firm's situation, identifying opportunities, agreeing on goals, allocating resources, coordinating actions and ensuring accountability. Generally family businesses develop business plans similar to other

for-profit organizations. During the start-up phase the founder drives an active planning process based on exploiting new opportunities. As the business grows and other professionals join the founder in managing the firm, it becomes more adaptive to its environment and planning becomes a shared activity. The final phase is strategic planning, where the board and management team work together in an ongoing process of assessment and alignment of the business' strengths and weaknesses with the environment's opportunities and threats.

Cargill, a multi-generation family business, illustrates the power of parallel planning for family businesses facing difficult circumstances. The Cargills and their in-laws, the MacMillans, have owned the world's largest agribusiness company for over 100 years but it is a family history filled with conflicts and recriminations. The business was founded and controlled by the Cargill family until the early 1900s when a son-in-law from the MacMillan family became the CEO and his family the majority shareholder. This difficult ownership transition, to an in-law, and the subsequent loss of Cargill family control generated strong resentment between the two families. Many Cargill family members believed that their family business had been "stolen" from them, while the MacMillans felt unappreciated despite having "saved" the business from financial ruin.

The resulting animosity between the two families did serve one useful purpose; it focused both families' attention on building a shared vision based on their core values of entrepreneurship, fair play and a commitment to long-term family ownership. Early on, the families began planning to ensure that the business was protected from family strife and that professional management roles were earned based on qualification and performance. Family members competed with non-family executives for promotions and often the non-family members won. A global growth strategy, based on low dividends and high investment, was implemented. Cargill invested in a state-of-the-art communications system and were early users of computers giving them a significant competitive advantage when markets crashed or trends were bad.

The link between the business' strategy and sound planning for the family was also evident in: their family education programs; the five board seats reserved for family directors (with five for independents and five for management); regular family meetings; and a strong family council. Cargill even organized a stock buy back to purchase shares of family members who no longer felt a commitment to the business and wanted to exit as owners. The stock was then

sold to an employee ownership trust making Cargill's employees the single largest voting block, not a bad way to build employee commitment. The Parallel Planning Processes at Cargill meant that, despite inter-family conflicts, the business was protected from family interference and was able to perform effectively.

Planning for the Family: Participation and Leadership

As the Cargill case demonstrates, business planning is important but it is planning for the family that sustains multi-generational ownership. It is also the latter kind of planning that presents the biggest challenges because of emotions, differences in talent and motivation and family relationships. Business interactions are professional and temporal, meaning that plans require clarity and a relatively short time frame; family relationships, in contrast, are emotional and last forever. Family issues, like succession, careers and ownership, are personal and highly emotional making it simpler to avoid rather than confront the issues. Family planning is also typically not a part of the family's experiences; founders do not need or want formal structures or processes and the sibling generation adapts this informal style working on a personal sibling-to-sibling basis. Consequently in most successful first- and second-generation firms there is limited amount of formal planning about the family because an informal and reactive model has always worked well enough.

The involvement of the cousins' generation, with a larger number of family members preparing for career or ownership roles, usually triggers thinking about more formal structures and processes to ensure fairness and professionalism. Planning for the family's ownership and leadership also requires careful thinking about building and protecting family relationships in the next generation. Cousins lack the natural connections and shared experiences of siblings so they need to learn to work together. In the founder and sibling generations, active involvement as employees and directors is the norm. As the family grows in size and the business becomes more complex there is often a separation of ownership and management roles that requires the family to develop plans and family agreements that clarify planning, decision-making and leadership roles for family and business.

The Wates family demonstrates how thinking strategically about the family supports their vision of long-term family ownership. The Wates have controlled one of the UK's largest

construction companies for more than a century. Like many family businesses they faced a leadership crisis when the five senior family leaders and owners began to contemplate retirement. While several members of the next generation worked in the business, none had served in senior management or at the director level and there was uncertainty about who was interested and capable of committing to these leadership roles. The senior generation recognized the issues and working with their children began to develop plans to explore the next generation's interest in a new business model based on non-family management and the family becoming governing owners.

For the Wates family, the processes of preparing for the transition to the next generation of owners involved three steps. First, the family met, discussed their vision and confirmed the importance of strengthening the management team with the best available managerial talent to develop and execute strategy. A decision was made to recruit an experienced non-family CEO from outside the family business because professionalizing management would support the generational transition process. With the business leadership identified, and a new CEO and Finance Director in place, the family could turn their full attention to developing plans for the family ownership and governance transition.

The second step was to engage an outside family business advisor to help the family prepare a comprehensive transition plan focusing on developing their next generation's talents as professional owners and directors. A series of meetings helped the family confirm that, while they all believed in the business' future, several next-generation family members did not see themselves in leadership roles or even as owners. This prompted the family to assess the family's talent bank objectively and to craft individual development plans for each of the committed next generation members using psychological assessments, coaching, executive education workshops, and governance experience. The results were successful with two next-generation family members joining the Wates Group board and two others involved in senior executive roles.

The final step of the transition was a restructuring of the ownership to reflect the decision by two of the next-generation family members to pursue careers and interests unrelated to the family business. A strong Wates value was active ownership so the two senior family owners decided to request a buy-out of their branches after their children chose not to be involved. The Wates family succeeded in their generational transition because they considered the linkage between the family and business planning process at each step. The ownership

change, the next generation leadership transition and appointment of a non-family CEO and chairman meant the family needed a new family charter (or family agreement) spelling out ownership roles and governance structures. As Andrew Wates, the former Executive Chairman of the group says: "We are at the beginning of our family journey today, not the end of it."

The choice of the next CEO was an important business decision for the Wates Group but equally important was planning for the next generation's professional involvement in ownership and governance roles. In multi-generational family businesses there are several roles that support the family's success (see Figure 5 below). Leadership functions that were the responsibility of one or two family members in the early years now belong to a diverse family-leadership team comprised of different interests, talents and capabilities. As the family and business grow, the CEO's role must focus on the business' strategy and performance. This means that the family needs to take responsibility for ensuring that family members are prepared to serve on the family council, the board of directors and other activities such as the family office and foundation. Clarifying and developing these roles and ensuring they are staffed with capable family and non-family talent are an important outcome of family planning.

Figure 5. The roles created by multi-generational family businesses

Executive	Business board member	Professional advisor	Family council, office or foundation roles	Active owner

The Wates case demonstrates the importance of planning for the next generation of family leaders and of creating new roles as the family's relationship with the business changes. The decision to have a non-family chair and CEO meant that the family needed to create a new governance structure in the form of a family holdings board to ensure accountability and maintain family influence. This new family holdings board retains the family's control of the family's financial investment and active participation in the core business as well as other family interests. The holdings board, chaired by the former Executive Chairman and senior family member, also created another tool for the family to share knowledge and support the development of the next generation. As the family and business mature, the family's role increasingly becomes governance. Alignment of family and business governance processes

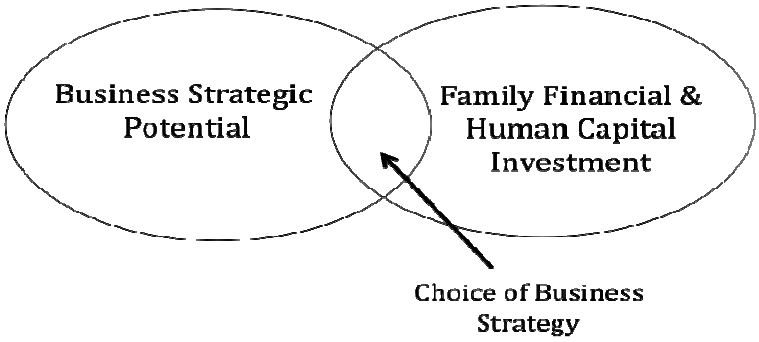
among family, owners and management is therefore an important family responsibility.

Family Commitment: Investing the Family's Human and Financial Capital

The owners' investment decisions represent their level of commitment to the family business' future. After the founder and sibling phases, owners directly influence the business through their financial investment and active participation in ownership and governance roles (we will discuss human capital later in this section). Deciding on the level of financial investment is one of the most important outcomes of planning for business owning families. This decision, on the level of reinvestment versus dividends or other family payouts, clearly demonstrates the owners' level of commitment to their business. A family that regularly takes an 80% dividend has a very different vision of the family business than a family that takes out a 20% dividend. Maintaining family commitment is important because high-potential businesses need the family's leadership and financial support for their continued growth. When a family business is performing well it is easy to become complacent and expect the dividends to continue to increase but without investment this is highly unlikely.

A business family that wants to seriously explore it ownership thinking in economic terms needs to answer two questions about their investment decision. First, what is the potential of the family business for long-term value creation? Second, what level of financial investment (reinvestment versus dividends) and human capital (family leadership and governance talent) is required to support a sound business strategy (See Figure 6 below). The model does not specifically address psychological or emotional motivations for family business decisions because it is intended to link investment with management's strategic business planning. This does not mean these other factors are not important but rather should be considered after the economics of the investment are assessed.

Figure 6: Strategic alignment of business potential and family investment



Family investment or disinvestment decisions are difficult because they impact on so many family concerns: individual life styles, wealth creation and protection, the family legacy and the family's psychological ownership. The owners' decision about how much of the firm's profits should be reinvested versus paid out to shareholders is the point at which a business strategy moves from planning to implementation. The investment level and dividend policy is not a one-time discussion but rather an ongoing dialogue among the owners, board and management. It is prudent to keep a relatively low dividend or payout rate so that cuts are not required during tough economic times. The board can always increase the dividend if there are strong results or if the business does not need the capital.

The Family Business Investment Matrix is a framework (see Figure 7 below) to support discussion and planning so that thinking and the exchange of ideas can occur. The Family Business Investment Matrix does not recommend an investment decision but rather operationalizes the decision using different performance and investment criteria. It is a tool to help families engage in a meaningful discussion about how their vision and shared commitment are expressed by their financial investment. The owners still have all the options; they can choose to sell a strong business or keep a weak business for other reasons. Many families maintain brands or divisions of the family business for legacy reasons. What is important is that the process encourages communication among the owners about how their investment impacts the family's wealth, business stewardship and family relationships.

Figure 7: Family Business Investment Matrix (FBIM)

Business' Strategic Potential	Family's Ownership Commitment: *High*	Family's Ownership Commitment: *Average*
Strong	Invest +++	Invest ++
Medium	Hold ++	Hold +
	Harvest +	Hold +
Weak	Sell	Sell

Action	% of funds invested*	% of funds for dividends
Invest +++	60-100%	0-40%
Hold ++	30-60%	40-70%
Harvest +	10-30%	70-90%
Sell	0	100%

*Indicates the range of financial investment (*Sell, Harvest +, Hold ++, Invest +++*)

Typically the management and board of directors begin their strategic thinking by reviewing the firm's competitive situation, identifying opportunities and then developing strategic scenarios for aligning the business and new opportunities. For example, a strong firm could consider an acquisition or joint venture in a new market. If management believes in the potential of an acquisition or new market to create economic value they would work with the board to approve a plan and determine the level of financial investment required. We define the capacity of a firm to create economic value as the *Business Strategic Potential.* A firm's strategic potential can be categorized as: *High,* a market leader with strong value creation potential; *Medium,* a steady performer with average value potential*;* and *Weak,* an uncompetitive firm with limited value potential or possibly even value destruction. The firm's strategic potential and management's plan provide a basis for discussing the family's investment options. The discussion of the ownership group or the board of directors, representing the owners, about their firm's strategy and potential value creation is in itself a positive outcome from the process.

The second variable, *Family Ownership Commitment*, is a qualitative assessment based on the family's vision for what the business can become and how the family contributes. In simple terms, at what level is the ownership group willing to invest financial capital in the business? This model describes family ownership commitment (Investment) at two levels as a *High* and *Average*. It does not address *Low Commitment* owners because low commitment would suggest a lack the motivation to meet the business' needs and these families should probably redeploy their assets in passive investments.

Highly committed owners have four possible investment scenarios depending on their business' strategic potential. A *Strong* business creates an opportunity for the owners to *Invest* in order to build on the business' strengths and market opportunities. A *Medium*-strength business suggests a level of investment to sustain performance from either a *Hold* or a *Harvest* decision. A *Hold* decision would represent a stronger investment commitment, whereas a *Harvest* decision would represent a plan to create more liquidity for the family. *Weak* businesses with bad economics, mature industries, strong competitors or old technology are often best served by a *Sell* strategy to redeploy the family's assets into other investments. These weak businesses can also offer great returns but the human and financial investment is high as well as the increased risk of failure.

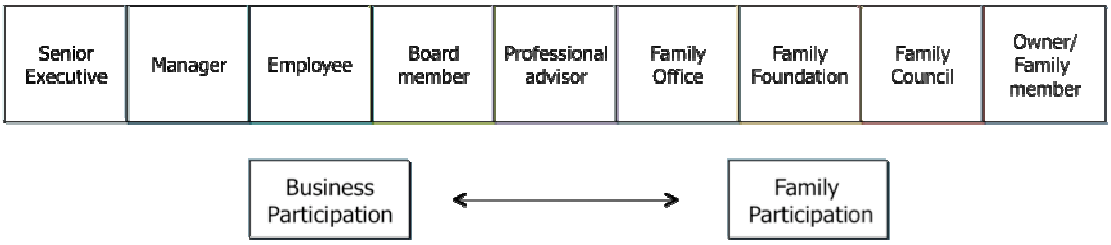
Many families will determine that, based on the family's values and vision, they should diversify their wealth reducing their ownership in the core business. These *Average*-commitment owners also have four possible investment scenarios based on their business' strategic potential. The same investment logic applies to *Average*-commitment owners but the investment rates would be skewed toward higher levels of liquidity or capital return to the owners. A business can succeed with *High* or *Average* ownership commitment because management can develop plans based on the investment available.

The Bancroft case demonstrates how the Family Business Investment Matrix could have provided a more rigorous decision-making approach to business strategy and ownership investment decisions. Even the *Wall Street Journal* reported on the family's lack of an ownership direction and internal conflicts, "The dissension was quashed 20 years ago and again the late 90s, but this time it could not be ignored, as even older members of the family had developed doubts about the company's performance." The younger Bancroft family members realized the need either to sell the business or to actively support and fund a reformulation of the business strategy into new markets like financial information. The senior family members defined their "commitment" as protecting journalistic integrity rather than ensuring the competitiveness and economic viability of the firm. The lack of family consensus on investment and ownership resulted in the family business being sold for less than the business' value 10 years ago to a competitor, despite the family's distaste for his journalistic and commercial practices.

Human Capital Investment

A committed business family also needs to consider their investment of the family's human capital. This second form of investment, especially as capable owners, represents the family members' willingness and capability to support the family business (see Figure 8 below). When qualified family members serve in ownership or leadership roles it strengthens the family business' ability to act and mobilize its stakeholders around critical decisions and actions. As the Wates case demonstrates, a family can't guarantee next generation family participation but it develop family talent and create a climate where family service and stewardship are reinforced by the family's values. The family can also develop plans to support the development of experienced family and non-family candidates for executive, director or advisor roles to represent the family's ownership interests.

Figure 8. Family Ownership, Leadership and Governance Roles



A critical factor in the family's participation in ownership and leadership roles is ensuring that qualified family members are selected and that they perform on the job. This is where family agreements play an important role in mediating disputes over how family members are selected for family and business roles. It is important to have clear criteria and well a communicated nomination process that are applied consistently to avoid damaging family conflicts between family members. The next section on governance is closely related to the idea of ensuring family performance. An effective family- and business-governance mechanism can prevent a family member from claiming a role they are not prepared for or from continuing in a role where they are not performing.

Family and Business Governance

Businesses create boards to encourage planning, decision-making and accountability to address their social, legal and economic tasks – business families have the same challenges with the addition of emotions. The board's strategic role is to govern by supporting the creation of sound business strategies, monitoring the business' performance and ensuring that the business has capable leadership. In the founder and sibling phases the business board also provides *de facto* governance for the family because of the strong overlap between the two systems. As the siblings begin to think about succession and the involvement of the third generation the need for more formalized family governance activities becomes evident. The informal discussions at work and the shared authority for decisions need to be replaced with structures like regular family meetings, an empowered business board and written family agreements. Also as the business grows and professionalizes, informal family governance is no longer effective for planning and decision-making with highly trained executives and a strong board of directors.

Family governance is a much more complex topic than business governance because the structures and processes required depend on the family's values, characteristics, shared experiences and business situation. A second-generation business owned by two siblings who both work in the firm requires much less family governance than a fourth-generation firm comprised of multiple generations and branches. It is also not so much a matter of creating family governance as formalizing what already exists. "Family meetings" are a part of everyday life in founder and second-generation firms with informal meetings occurring whenever family members are together for meals, holidays or even at religious events. As one INSEAD MBA and next-generation member shared, "I can't remember a meal or family gathering where business was not discussed." As the family grows in size and complexity (geography, branches, ownership, etc.) the family needs to replace this informal family communication with planned family meetings or, if the family is larger, a family council. The family council is created when the family grows too large or geographically dispersed for them to meet together easily on a regular basis.

A family meeting (or council) serves as a board for the family but instead of focusing on business issues it works to maintain effective family relationships by improving communications, providing a forum for planning and decision-making and creating a degree of family accountability. The family meeting, just like a board meeting, is about developing

plans and taking decisions to address family concerns created by family-business ownership. Topics for family meetings can include family values and vision, family policies and agreements, management succession, philanthropy, ownership education, dividend and investment decisions, the election of family directors or any other topic important to the family's functioning and/or relationship to the business. In very large families there may also be a separate owners' assembly that specifically addresses ownership concerns and relationships with the business.

The lack of effective family governance can have devastating effects on a family business when unresolved conflicts spiral out of control. The McNeely family experience demonstrates the consequences of weak family- and business-governance structures. Space Center Enterprises was a family business founded in 1916 by Harry McNeely, Sr. and later managed by his two sons, Donald and Harry, Jr., who joined in 1937 and 1949 respectively. After the brothers had successfully managed the business for many years, however, the existence of Space Center was threatened, not by any economic or competitive forces but by a family discord that pitted the two brothers against their two sisters who were minority owners.

Consequences to the family and business were disastrous. After losing a bitter court battle the brothers were forced to split off some of the company's holdings to pay the court judgment in favor of their sisters. The courtroom drama convinced Don, the oldest brother, that he never wanted the family involved again, whereas Harry still believed in the advantages of family ownership. These differences over the future vision resulted in the remaining family firm being again restructured into two separate holding companies, each led and owned by one of the brothers.

Harry, Jr. determined that the second split was his opportunity to recreate a family business that reflected family values of fairness, professionalism, social responsibility and family commitment. His first step was recruiting a group of experienced outside executives to sit on a new board of directors and to support his goal of rebuilding the family business. He also determined that the majority of the board would be outsiders and that each of his next-generation family members would serve a one-year term to learn about governance firsthand. He also began to educate his children to be effective owners, directors and possibly directors by sending them to family-business leadership programs at a well-respected business school.

Harry Jr.'s experience with his brother and sisters helped him realize the importance of communication and of using family and business governance as tools for making decisions that support both business performance and family unity. When his oldest son, Paddy, returned to Space Center, ready to take on top-level operational responsibilities after working outside the company for ten years, it was the board of directors, supported by family meetings that crafted a succession plan and clarified his role. As the issue of ownership transitions to the next generation unfolded Harry again relied on his board and family meetings to make plans and decisions that satisfied the needs of the family, business and other stakeholders.

The McNeely family will always share the heartbreak of an unresolved family business conflict (Don never again spoke to his sisters) and a prolonged legal dispute. The positive aspect for this family is the resulting deep appreciation of governance activities in helping a family work together. Beyond rebuilding their business, Harry has also united the cousins from all of the family branches, including those that that sued, to serve on the board of the family foundation. The interaction of sound governance and a core family value about working together has enabled the third generation to continue their grandparent's legacy of service to others through philanthropy.

Family Ownership as a Competitive Advantage

Research shows that family businesses financially outperform their widely traded peers and we believe that this competitive advantage can be attributed to effective family ownership and specifically family commitment. Identifiable owners, who share values and a vision for the business and family, can serve as the social glue to unite the employees, management and stakeholders. This shared sense of purpose is something that is missing in most organizations today. The family's commitment to participating and providing financial investment creates a platform for the employees and management to strengthen their long-term commitment. The advantage of well-defined values backed up by focused behavior is clearly being demonstrated during the current economic crisis.

The performance of family firms in the banking and automotive industries, the hardest hit by the recent financial crisis, clearly shows the advantages of family ownership and influence.

While many banks struggle to recover from risky investments and poor decisions, and the largest publicly traded automakers enter bankruptcy and reorganization, family firms in both industries are steadily moving their organizations into stronger competitive positions. It is not a coincidence that no family-owned banks are in trouble. Why have the family-controlled banks, including Banco Santander, Julius Baer Group, C. Hoare & Co., Pictet & Cie and Lombard Odier Darier Hentsch & Cie, not faced serious losses? The main reason is their commitment to a set of values around long-term performance and value creation. Their strong business cultures supported organizations where employees, management, directors and owners all focused on building their clients' long-term wealth rather than short-term profits and bonuses for themselves.

The same observation can be made in the auto industry, where despite devastating sales conditions across the industry BMW, Fiat, Peugeot, Porsche, Tata Motors, Toyota and Volkswagen are positioning their companies for the future. These firms are long-term players with strong family leadership and ownership looking at new strategies to consolidate the industry and strengthen their financial and competitive positions. The difference between the widely traded and family-controlled car firms is identified as family leaders and owners who are planning for the future by investing their financial and human capital. They are working to create exciting organizations that are innovators in building products that are technologically and emotionally rewarding to build and own, thereby delivering value to their customers, employees, stakeholders and owners.

When Family Businesses Are Best

Families are about people and businesses are about money, so conflict between the two is inevitable. A Parallel Planning Process helps business families become what we call *professionally emotional.* The new Parallel Planning Process is an improved version of a proven tool for sustaining family commitment by aligning the family business' values and vision, planning, investment and governance into a comprehensive family enterprise approach. This approach facilitates communication about the business' potential that supports the family's commitment to investing its human and financial capital. As the family grows and develops and the business expands and become more complex, the family and owners need to be proactive in their planning and decision-making to maintain family influence and

ensure value creation. We believe that the five action steps of the Parallel Planning Process offer a logical template for business families at any stage of business or family development.

The 21st century is a new era of global opportunity for human creativity, particularly for family businesses around the world. Family-owned businesses have a competitive advantage when they align values and vision, planning, investment and governance processes for their family and business activities to make both more professional and mutually supportive. We know that our advice to use planning to "treat the family like a business" may appear as counter intuitive but our experience shows that professionalizing the family interactions supports harmony, trust and stronger family relationships. We also believe that "treating the business like a family," driven by values and concern for human needs creates an organization with motivated people working together to create long-term value.

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