CHALLENGES AND ISSUES IN MANAGING FAMILY FIRMS

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by

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A significant and clear majority of all private enterprises in the free world are controlled and usually owned by a single family or two families. In the United States, according to a 1971 survey of the approximately 1,000,000 registered corporations 980,000 were in the family owned/controlled category (Industry Week, 1971). About 150 of the Fortune 500 companies are similarly identified (Sheehan, 1967).

In the developing countries, particularly in Latin America, the resolution of the issue of private or state controlled wealth production rests in no small way on the behavior of the families that now control wealth production. Failure to accept major social responsibility, errors in handling industry-government interfaces, inept industrial relations policies and practices -- all of these are time bombs for the wealth producers.

Too little social science research has focused on either the unique or comparative characteristics of family vs. non-family enterprises. For example, are there differences in the reward and control systems of family versus non-family firms? Do training and career planning systems apply similarly to family and non-family firms; and how do the methods of selecting high potential candidates for general management positions differ in these firms?

A review of available literature, in-depth interviews with members of family firms, plus almost twenty years of consulting with founders, chief executives, family owners and professional managers leads to the following presentation of key issues and areas for further study.

I. Issues For Founders

II. Succession Planning

III. The Training And Development Of Family Members

IV. Family Dynamics

V. Growth And Development Of Family Firms

VI. Some Implications For Owners And Managers In Family Firms

I. ISSUES FOR FOUNDERS*

There are a number of major issues which confront most founders at one time or another. Founders are usually concerned about the kind of legacy they leave their family, their business, and society at large. The founder may feel that all he is leaving are the tangible assets of the firm that he built. On the other hand he is also likely to feel that he is leaving many other assets, e.g., goodwill, values, social standing. Dealing with the question "what do I leave" is an important issue for the founder.

In conjunction with this issue, the founder faces the dilemma of whether or not he wants those in his firm to replicate his managerial and leadership style. Similarly he must struggle to determine if he should attempt to perpetuate the values, e.g., free enterprise, social responsibility, he has espoused during his lifetime. An example of this issue can be seen in the following situation. An entrepreneur in Latin America started an insurance business because he saw the need for many of the poor people in his country to have adequate life and health insurance. The entrepreneur charged very low rates to the people who enrolled in the insurance program and the program gradually began to improve the lifestyle of a large segment of the country's population. Thus the founder built his business not only to make money but to serve the people of his country. He gains a great

*Although masculine pronouns have been used for convenience, we recognize that women can also be founders.

deal of satisfaction and money providing this valuable service. If, however, the founder's heirs feel that the insurance business is not as profitable as some other ventures, should they be allowed to neglect or sell the insurance business, or should the founder make every attempt to insure that his heirs will perpetuate this business? On the one hand the founder can see the importance of having such an insurance program for his countrymen; on the other hand he must determine whether it is ethical or even possible to force his own value system upon his heirs.

Who Goes Into The Business

During the lifetime of the founder problems usually arise as a result of the inability of family members to deal with two issues. The first issue concerns who in the family goes into the firm and in what position. If the founder wants his children to be a part of the business he might give a number of cues to his children to encourage them to join. However if the children do not want to be a part of the business -- and there may be any number of reasons for this -- conflict between the founder and the children is likely. For example, the son of one founder reported that his father encouraged him to go into the family firm, but he had other interests. He is an outdoorsman and enjoys working with his hands. He dislikes taking responsibility for and managing other people. Furthermore, he feels his friends and others in the community have stereotyped him as the "spoiled rich kid," therefore he has done his utmost to avoid that label. He deliberately avoided taking business courses in high school and college and nurtured his interest in the outdoors and in jobs that required manual labor in order to avoid that stereotype. He feels his father put pressure on him to fit that image and strongly resents it. But the father feels that he put almost no pressure on his son to join the firm and it has been difficult for him to understand his son's attitude and behavior. This difference in perception has been a constant source of friction.

In some cases, the founder may bend over backwards not to influence his children. One founder said that because his father put pressure on him to join the business, he made every attempt not to influence his son. The son, however, wished that his father had given him more guidance and advice about his career and exposed him to some of the advantages of working in the family business. The son is now working for his father and is doing well but a number of years earlier in his career he felt the need for more direction from his father. How the founder manages the process of who goes into the business may determine the kind of relationship he has with his children and other family members.

Sharing of Assets

The second issue concerns how the assets of the business will be shared within the family. Most family members want their "fair share" of the assets. If the family perceives some inequity in the distribution of the assets conflict will often result. How the founder goes about dividing assets is generally more important than the final outcome if the family is to avoid conflict. The founder must decide if he should make the decisions regarding the division of the assets alone, or should he consult his family and others. The correct decisions and the process for deciding the distribution of assets cannot be identified easily. It depends on such factors as family tradition, the number of family members involved, and the nature of the family relationships.

The founder must also deal with many other sensitive questions such as:

1. Can in-laws become chief executives or board chairpersons?
2. Can females (daughters and daughters in-law) be considered for top jobs?
3. If a daughter marries does her share go to her husband?
4. Do I leave money or stock to my grandchildren through trusts, etc. or do I leave that up to my children to decide?

The problems which families encounter are to a large extent a function of the founder's ability to deal with these issues. Furthermore, how the founder answers these questions influences much of what goes on in the family and the firm.

Advising the Founder

In relation to the preceding issues is the question "who advises the founder?" Typically founders rely heavily on family lawyers and accountants for advice. Although these advisors have expertise in the legal and technical aspects of resolving these dilemmas, they may be quite unable to give sound advice concerning other family issues. For example, it may be difficult for these advisors to counsel a founder about his relationship with his son. Some founders are recognizing this and are turning more and more to family counselors and other consultants in the behavioral sciences for help in dealing with some of their dilemmas.

Some questions for further study on this topic are:

1. What criteria should be used in getting advice?
2. Should one use a group of separate specialists or a team?
3. How do you weigh the different economic and social advice?
4. How important are the family consequences of various decisions?

Management-Ownership Dilemmas

Family firms are faced with the problem of deciding to what extent the family will be involved in the management of the business and to what extent the family will exercise its ownership rights. Again, the founder usually takes the lead in answering these questions. As owners, the family frequently determines the composition of the board of directors, executive committees, and the board of trustees. Furthermore the family decides to what degree they are responsible for selecting individuals for various positions, e.g., chairman of the board, CEO, etc., and determine the roles of these individuals and boards. The family decides what rights are to be given to those who occupy these management and governing positions and what powers are reserved for the family. Who is to have control over information and decision making is a critical question for the family. In some cases the family may want complete control over all ownership and management responsibilities. In others, the family may not be interested in managing the firm and turn over all management responsibility to professional managers.

II. SUCCESSION PLANNING

Who Plans for Succession?

Developing a plan for succession is an integral part of the dynamics of family firms. Deciding who should be part of succession planning is the first step in this process. There are a number of alternatives. The founder could develop the plan alone, or he might include members of the board of directors along with other non-family advisors. He might also include his wife and/or children in resolving this issue. In some cases he might even remove himself from the process and leave the succession question up to the board of directors or some other governing body. The major point is that the founder must decide to do something about the succession issue because he is central to that process.

Importance of Planning

Many founders, however, feel that planning for succession is not important (Christensen, 1953; Hershon, 1975). Having founded, nurtured, and watched his company grow the founder is very reluctant to relinquish control of the enterprise that is his own creation (Levinson, 1971; Barnes and Hershon, 1976). Furthermore the founder may feel that selecting and training someone to replace him is "comparable to building his own casket" (Calder, 1961). "Letting go" of his company can be extremely painful and therefore the founder frequently procrastinates in developing succession plans.

The significance of this procrastination is often not understood. Several studies have shown a direct correlation between a succession planning process that is known to be operable while the founder is in charge, and what happens after succession both to profits and people. Where no planning system has been known to exist before the founder leaves, profits tend to drop after the replacement takes over (Trow, 1961), and a significant number of good managers -- both family and non-family -- may leave because of conflicts resulting from the lack of planning (Tilles, 1970; Barnes and Hershon, 1976). In most cases the founder has important ties with the firm's suppliers, customers, government agencies and other interest groups. If the founder fails to prepare someone to manage these relationships after he is no longer present, then these assets can be easily lost. Many business fail because they are not prepared for succession (Steinmetz, 1969; McGivern, 1978), in fact only 30% of all family firms survive into the second generation (Poe, 1980).

Time Span

The founder needs to determine the time span of the succession plan, i.e., is it for the next five or the next twenty years, and what executive positions are to be a part of that plan, e.g., should the plan include the chief operating officer and other top executives as well as the board chairman and the CEO? Finally, succession planning can be viewed as a continuous process or merely a single plan developed at some point in time. Thus the founder and his family's perceptions of succession planning play a key role in this process.

Criteria

Another issue concerns the development of criteria for the various positions which members of the family as well as non-family members may hold. Some common criteria used by family firms for the position of chairman of the board are:

1. Family member -- which may or may not mean blood relation.
2. Experience with the firm.
3. Experience in the business field.
4. Technical competence.
5. Public image.
6. Energy and enthusiasm.