WORDS GREG McCANN

What if?

THE NEW 'NORMAL' AND ITS IMPLICATIONS FOR FAMILY BUSINESS

It's time to re-think how we view business and, in particular, family business. What if we didn't assume that passing a business on to the next generation is the best strategy?

We live in a different world. It is easy to focus on the Great Recession as the catalyst for rewriting all the rules – 'never waste a good crisis' is a cliché we hear almost daily. But I want to point out six other factors that call for us to rethink how we view business in general, but more specifically, family business.

1. Innovation is a necessity during exponential change: Recently I heard author Rich Morris say that while in the past a family business may have been able to support three generations on one good business idea, the demands of the world are now such that *each generation* needs *three* good business ideas. Whatever business your family is in, it won't be the same business in just a few years – or maybe less.

2. Cultivating entrepreneurship is a must for cash and character: Continuing entrepreneurship is a crucial challenge for family enterprise for two reasons. Firstly, invested wealth is usually not sustainable, because the family grows at a faster rate than the money. Secondly, the risk of eroding the family character is high, especially for the next generation, if they are seduced into living off passive income. Character and entrepreneurship are two vital skills to cultivate in your next generation.

3. Technology suits the young: Not only is technology increasing at an exponential rate, but for the first time in history it is the younger generation that is mastering it more readily, effectively and creatively. Can your family business survive today without a Facebook page, tweeting and software integrated into almost everything you do? What percentage of your sales or customers arrives through your website? What happens when your computer goes down? Do you go to someone younger for help when it does? Mindfully managing technology is no longer an option.

4. Diversity in the workplace is a given: And not just in the traditional areas of race, gender, religion and ethnicity, but also lifestyles, generational differences, politics, career expectations and attitudes in general. We are all exposed to so many perspectives that it can seem overwhelming, hard to manage and even chaotic. Will this mean that tolerance and diversity need to be more explicitly considered as values in alert family businesses? Understanding human relations will be crucial.

5. Diversity in the family is a given: More so than at any time in our history, it is common to have three or even four generations in the workplace at the same time. And these generations come from varying life experiences. Imagine a matriarch who lived through World War II in a shareholder meeting with a Gen Y'er and how they might differently view technology, long-term planning and partnering with China. It needs planning. We need to value the new and the old.

6. We're all global: According to the US Small Business Administration website, more than 90 percent of US businesses that export are small businesses. From the impacts of currency fluctuations to oil spills to terrorist attacks from the other side of the globe, all family businesses are now global. They are impacted more directly by world events than ever before. From an operational point of view – from your suppliers to your customers, your lenders and even your regulators – is your family business interacting internationally? Take a world view.

FAMILY BUSINESS CHARACTERISTICS

Systemic risks

Every family business faces at least two possible systemic risks, especially in the founding generation. Often a family business starts off as two autocratic and closed systems: the family and the

business. As closed systems, both the family and the business are at risk as they avoid objective feedback, which creates a tendency for mistaken assumptions and an inability to self-regulate. Secondly, families often value harmony and, especially in the first generation, are prone to keeping secrets, not getting outside advice and having the owners as managers (and thus making the owner's role of holding management accountable far more difficult).

Another related problem is professionalising the family, the business management, business ownership and the family's wealth. By 'professionalising' I mean an approach that from the beginning cultivates proactive planning and honest and direct communication and develops the relevant structures, policies and agreements that create a sustainable organisation – beyond the personality of any one individual. Recognising the two thirds failure rate of succession, there is an ever-increasing need to proactively address the systemic weaknesses in your business to help beat these odds.

Passing it down

How many family businesses, especially those in the founding generation, believe that the ideal is to continue to operate as a family business? We don't know what percentage of family businesses intend to pass their business on to family, but it seems only logical to conclude it's higher than the third of family businesses that actually achieve it (according to JH Astrachan and MC Shanker's article 'Family Businesses' Contribution to the US Economy: A Closer Look' in *Family Business Review*, September 2003).

In my decade and a half working with the next generation in the classroom, the vast majority of my students say that their parents – overwhelmingly founders – "want me to do whatever I want in my career, but I know that they really want me to take over some day".

Perhaps far more common is for families to simply not talk about difficult issues, including predictable transitions. One survey found that 40 percent of the family businesses surveyed planned to pass the business on to family members and about 20 percent intended to sell it, yet a clear majority did not intend to transfer any ownership in the next five years. (KPMG and Family Business Australia Survey of Family Businesses 2009.) One wonders if key members of the family and the business share a common vision or even an understanding of what the next transition is and how it will be addressed.

If you add to the challenges the increasing reality that even if it's passed on to the next generation the business won't really look like the same business, then this well-intended wish becomes even more problematic.

If the mindset of business-owning families is to *presume* that they ought to work toward passing the business to the next generation, then this runs against the odds, the risks and the field's shared experience.

That doesn't mean the family business is doomed. As an aside, certainly not all family businesses have this mindset and my experience is that the family businesses that have succeeded beyond the founding generation are often the exceptions to this conventional thinking. Furthermore some businesses don't lend themselves to being passed on, such as when the founder has a unique talent, when the customer base is unavoidably too small, or other such characteristics.

We can see that involving the family in the business may be akin to using nuclear power – it *can be* very beneficial, but it's never something to go into casually. However, it is a stretch to consider a successful approach is any which leans towards a two thirds failure rate.

What if?

What if we look at the 'new normal' of the business world – the six factors discussed above – coupled with the odds of successful succession (on the evidence, a 33.33 percent success rate), and shift our presumption to assuming that in *most cases* the family business *should not* be passed on to the next generation?

What if we saw this presumption as a starting point – a tool to help family businesses be more proactive in the planning, preparation and communication relative to managing their inevitable transitions, including succession?

My hope is that this new professionalised approach will inspire a more proactive approach to addressing transitions, resulting in higher succession rates.

What might a professionalised family business look like?

If we presume that the family business will not be passed on to the next generation, it raises some interesting questions. It may shift the unspoken assumptions both generations have about passing it on. It might, for example, help shift attitudes about the next generation needing to earn (individual) credibility and marketability in the marketplace.

In a broader sense, how might this presumption impact the family, the business, the ownership and the family's capital – especially the relationships between them?

Professionalising means:

- The family needs to make certain the next generation grows up to be independent and credible and free from a sense of entitlement. That they only work in the business when they are credible, motivated and ready and all the stakeholders are informed of this early and often;
- Management needs to be empowered to create the infrastructure and policy and do the planning required to move beyond dependency on the founder or other family members. This doesn't mean the family won't be involved in management, but it does mean that management is not dependent on the founder or any family member; nor is the family's continued involvement a given;
- Ownership needs to cultivate a sense of stewardship, including the ability to hold management accountable and to set the firm's strategy. The family may certainly be involved as owners, but governance will move towards including non-family members who can help to prepare for the family staying or transitioning;
- The family's capital needs to be looked at as an investment

2/3

TWO THIRDS OF FAMILY BUSINESSES FAIL AT SUCCESSION

that can be redeployed. It also needs to be viewed as the *family's* capital and evaluated by the family in economic and non-economic terms (e.g. values, legacy) for effectiveness*; and

- Overall, the family business should be able to constantly and proactively prepare for predictable transitions. This includes having (paid and unpaid) advisers with a shared vision.

Management

In the professionalised family business model the business becomes a vehicle for expressing family values and investing the family's capital. It is *presumed* that the business will not be passed on to the next generation (in either management or ownership roles). Again this presumption is a starting point.

The presumption can be proven incorrect, and might well be for somewhere near a third (give or take) of family businesses – where, on objective assessment, those family members are deemed to be the most appropriate people for those roles. Ideally this approach shifts the assumption, often unspoken, that the next generation will automatically take over, to a long-term serious discussion about whether they *should* take over.

Under the professionalised family business model, both the family involved and the non-family managers are professionalised from the start. The intention to create the necessary systems, structures, planning and accountability is present from the outset. Evolutionary pressures don't drive this need to professionalise the management, because it is part of the collective vision from the start. This vision must be created in the context of other such firms in the marketplace as benchmarks, not in isolation of the founder's personal financial needs or lifestyle.

This intention to professionalise (which mindfully avoids creating a bureaucracy) starts from day one and is relative to the family values and goals, as well as the business' strategic plan, size and growth of the business.

Ownership and governance

In the professionalised family business model the family's capital is invested to best serve the family as stewards of wealth and the business. The owners are mindful of the inherent risks of owning and managing a family business. Governance is professionalised early and aggressively. The need for this is demonstrated by the fact that only a tiny minority of small and medium-sized family businesses have separated the roles of management and ownership (evidenced by the tiny minority of such firms that have effective boards, any outsiders on their boards or appropriate criteria for board members). The board must measure management's performance in relation to both company goals and performance of the industry. This model says that a professionalised ownership structure means these roles are separated from the outset. Management answers to the owners via the board, and the board sets the strategic direction for management.

Family capital

This needs to be thought of as a fourth system, different from the family business but interdependent with the systems related to it. As the family moves beyond the founding generation, the family capital needs to be cultivated as separate and independent of the management and ownership of the business. The family capital should be one of the professionalised systems. As such, it should be coordinated with the family's efforts to make certain that family members' character isn't corrupted, credibility is cultivated and entitlement is avoided.

In the professionalised model, the intention from the outset is to treat the family's capital as transferable and not inherently attached to any business. As such, the use of capital must be assessed, at least from an economic viewpoint, relative to other options available to the family. Furthermore, the capital or wealth is not something the future generations are automatically entitled to.

Implications and next steps

The professionalised family business model challenges us to manage the inherent and predictable transitions of a family enterprise more proactively, more professionally, more intentionally and more profitably.

The new model also serves the other stakeholders, including the family members that are neither owners nor employees; non-family employees; advisers; creditors; clients; and ultimately the broader community. It asks the family, especially the founding generation, to work diligently to clarify, commit to and communicate their expectations and prepare for transitions in these four systems. In fact, this may be in support of efforts many advisers are currently making with their family business clients.

Innovation is never easy, and on a macro level it will be up to the family business field to define what constitutes success with this new approach, especially when assessing outcomes in a more holistic manner.

On the individual family business level it is incumbent on each family at each generation to define what constitutes success for them. The vital institution of family enterprise, which sustains the world's economy and is the steward of values and long-term thinking in our culture, deserves no less. ●

*The Family Firm Institute's Goodman Study, which was charged with reviewing how the field looks at succession, suggests we need to look at the *family* as the system that transitions the wealth or capital. The author would like to thank Chris Johnston FAICD for his feedback in the writing of this article.

Greg McCann, JD, CPA is a professor of family enterprise at Stetson University and the founding director of the Family Enterprise Center (1998 to 2006 and 2010 to present) and creator of the Holistic Model. He is also the founder and principal of the family enterprise consulting firm, McCann & Associates.