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Seven essential initiatives ensure family business growth and survival

BY GEORGE A. ISAAC

Despite seemingly blue skies and calm waters, family businesses, like boats on the ocean, face continual and potentially dangerous threats. The ultimate price for failure to prepare for and meet these threats is extinction. Unfortunately, this is the fate of most family businesses after the second generation.

Looking to the future of your family business, you have two strategic alternatives: maximize the company's value and sell it, or grow the firm for future generations. Today, selling your company is no longer an attractive option. Capital gains taxes reduce your wealth, while prospective returns from reinvesting your remaining proceeds in fixed income and equity securities remain paltry.

Without doubt, growing your family business over the long term is your soundest option for navigating future economic challenges and creating (and preserving) family wealth. You can help secure your company's survival and ensure your family's future prosperity by taking several essential steps.

1. Build a sound governance foundation.

Understand and align your shareholders' goals! These are your critical first steps to maintain a healthy family business and prepare for transitions. Your personal needs as owners and your company's business needs each change over time, often dramatically. Both require continual adjustment to keep your goals on target and your ownership aligned.

Once goals are aligned, ownership must agree upon operating and business decision-making policies. Issues such as majority vs. super-majority voting requirements, board membership and authority levels, ownership cash distribution policies and restrictions on ownership transfers must be addressed and codified. A good corporate attorney can help identify the issues and document your agreements in a "Shareholders' Operating Agreement."

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You then should establish both a strong board of directors or advisers and a family council to manage governance.

The board will focus on business issues, including strategies, finance, organization, business plans, succession plans and performance oversight. The board's main goal will be to represent the interests of all shareholders.

The family council will address the "family" issues that arise in every family-owned business. Its mandate will be to manage family member communications, networking and conflict resolution; individual and overall family member investment objectives; and estate planning and ownership considerations, and to set direction for the board regarding family business philosophies, culture and priorities.

2. Proactively manage family dynamics.

Managing the "family" side of business is a critical task for the ownership group, at times more important than managing the "business" side. Many families do not appreciate its importance until irreversible damage has been done.

Most family problems occur around what I call the "Four Cs for Successful Family Dynamics": consideration, communication, connectivity and compensation. Family stakeholders must feel that their ideas are honestly considered, that they are connected to the business and being kept well informed and that they are being fairly treated financially. Specific strategies and initiatives must be developed and agreed upon for all four Cs.

Many CEOs and boards focus on the business issues; they mistakenly believe that these "softer" issues will take care of themselves. They think successful business results will resolve problematic family dynamics. They don't!

Worse yet, small family dynamics problems do not go away over time. They simmer in the background until a future triggering event raises the temperature to a boiling point. At that stage, disagreements are infinitely more difficult to resolve. Minority ownership "issues" often become majority ownership "problems" if not promptly resolved.

3. Focus on business strategy.

The business environment changes constantly. Technology, competition, economic cycles, evolving customer needs, disruptive value propositions, new regulations, and your own financial and organizational capabilities together lay out a complex jigsaw puzzle. Regularly reviewing—and challenging—your strategies is essential for long-term success.

Strategic plans should be developed by your senior management team and reviewed, challenged and approved by your board. Communicating approved strategies to all of your stakeholders (i.e., management team, employees, key vendors and customers) is critical to obtaining buy-in and ensuring implementation. An outside facilitator often can improve the results of this planning process. The facilitator can help ensure that the approach used to determine the appropriate business strategies is fact-based and respectful of all team members' opinions.

4. Invest in the 'right' organization.

Strategy drives organizational requirements. Your goal is simple: Hire the best people you can afford, put them in the right positions and reward them well for performance. Top performers will pay for themselves many times over. Poor performers will be very costly—well beyond their payroll cost.

Determining family members' roles in the organization can be tricky. Those decisions must be based on capabilities and work ethic, not birthright. In addition, boundaries are important, as family members wear multiple hats as owners, board members, managers, employees, future owners and family members. There are many ways to have family involved and feeling "special" without compromising your management team's performance. A customized family policy manual, often called a family constitution, is a good start. It establishes the "ground rules" for family members participating in the family business as owners, managers and/or employees.

The best organizations empower all team members. When possible, every manager should be highly motivated and clearly authorized to run his or her part of the business and meet specific goals. Acknowledging and rewarding outstanding performers, identifying and removing underperformers, training the next generation and planning for succession are essential practices of successful businesses.

5. Manage against metrics.

What you measure (and reward) drives your results. Quantifiable performance metrics, developed with input from your people and aligned to support the business plan, provide a roadmap for success. The prerequisite is transparency in financial and operating systems. Keeping goals simple, clear and attainable makes performance assessment straightforward—either you accomplished your goals or you did not. Eliminating excuses for poor performance is important to keep your team focused on priorities.

Sharing performance metrics throughout the organization can motivate your teams, when done appropriately. Doing so communicates goals and creates peer pressure to perform and contribute.

As CEO of the Isaac Group, I shared production metrics and goals for the first time with our direct line equipment operators. The result: Our main plant doubled production without requiring any capital expenditures. Empowering individual employees to focus on their personal and unit performance metrics motivates them to meet their objectives.

When you set goals, share information, empower your team members and reward performance, everybody wins.

6. Commit to a culture of growth.

Any business, and particularly any family business, must grow to survive. Operating costs rise, business markets change and product life cycles get shorter. And, as a family grows, there are more "mouths to feed."

Businesses either grow and stay healthy or stagnate and die. Yes, there are "lifestyle" businesses that generate good cash flows in spite of a stagnant business model, but it is doubtful these businesses will make it to the next generation or realize a good price if sold. Furthermore, it is difficult to recruit and retain top talent in a stagnating company.

A culture of growth forces a business to be competitive. It requires the business to develop new products and services, deliver a solid value proposition to customers, focus on profits and sustain an entrepreneurial spirit. A company with a culture of growth generates the financial resources to reward both its people and its ownership, thus perpetuating an upward performance trajectory.

7. Cultivate an 'investor' perspective.

Most family business owners fail to look at their company from an "investor" perspective, even when the family business is their largest investment and source of wealth. They confuse business returns on equity with realized shareholder returns.

Until shareholders receive cash, their returns are 0%! Low levels of cash distribution result in lower shareholder realized returns, inadequate shareholder liquidity and increased exposure to unforeseen "tail risks." This often leads to problematic family dynamics that create major rifts within the family and threaten the longevity of the company itself.

Look at your family owners as investors. You must run the family business to maximize realized shareholder value, and continue to address individual and business goals diligently to keep the ownership group satisfied and aligned.

Focus sharply on cash flow generation and distributions, in addition to profits. Measure and report on annual changes in equity valuation, realized shareholder returns and performance against annual business plans. Publish the results in an annual shareholder report. Consider partial transfer of "trapped" accumulated wealth in the operating businesses into newly created family investment entities. This will diversify your family's investment portfolio, provide increased asset protection and shareholder liquidity, and reduce overall family wealth management risk.

Undertaking these seven core initiatives will enable you to improve your business decision making and develop an ownership group that is supportive of creating an enduring, multigenerational, highly successful family business. FB