All stakeholders' interests must be considered

BY GEORGE A. ISAAC

Understanding and properly addressing family dynamics—the "softer issues" between family members—is key to ensuring the long-term sustainability of your family business. Unfortunately, frank consideration of family dynamics is often postponed by senior family members, ignored by corporate boards and deferentially avoided by the succeeding generation.

Family members have needs and interests that change over time based upon age, marital status, lifestyle, income levels and risk tolerance. Younger family members may be looking to the family business for work experience or an attractive compensation/perks package. Older family members may be focused more on cash distributions to augment their retirement funds. Some may want to diversify their holdings outside of the family business to spread their risk. These personal needs can conflict with the needs of the business, creating clashing viewpoints among family business stakeholders that can affect the company's longevity.

Active vs. passive stakeholders

Many family businesses have both "active" and "passive" family stakeholders. Active stakeholders are family members who are employed by the business. Passive stakeholders are family members who are not employed by the business; they may or may not have an ownership interest.

We have found in our family business consulting that the CEO often misunderstands family members' strong emotional bond to the family business. At a core level, it will always be "Dad's [or Mom's] business" in the eyes of their children. The attachment goes well beyond financial rewards and employment. This natural affinity can have an exaggerated impact on family stakeholder dynamics and on the success of the business itself. Once these personal issues explode, they become difficult to resolve. Worst-case scenarios can involve rampant jealousy, naked greed, intrafamily lawsuits and a tarnished public image.

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Personal grievances can polarize a family very quickly. We have seen family members who do not speak to each other and don't participate in holiday or milestone celebrations because of family business tensions. No one wants the family business to destroy family harmony and multigenerational family relationships.

We recently worked successfully with a historically prosperous family business client who faced threatened lawsuits, business ruin and health problems principally because of failed family dynamics. Such underlying tensions frequently break into the open after the patriarch or matriarch of the family is no longer engaged in the business and family members turn aggressive in pursuing personal agendas.

Avoiding these unhappy and potentially costly events requires facing and resolving certain issues while the senior generation is still actively engaged in the business. We recently helped another client work with all her children and their spouses to define and secure each family member's needs and desires. We facilitated the thoughtful communication necessary to resolve family members' emotional and financial needs while preserving the future viability of the family business. The result was an agreed-upon, written plan addressing current needs and desires with a methodology for addressing future issues as circumstances undoubtedly change.

The most common family dynamics problems center on the key issues of mutual respect, power/control, perceived fairness and compensation. We help our clients deal with these issues based on what we call our "Three Cs for Success."

The Three Cs for Success

Consideration of family members' emotional and financial needs provides the framework for positive family business dynamics. The first step is defining the family's values regarding the business. Understanding your family history can be a powerful starting point for establishing a sense of commonality of interest. Questions your family should consider include: What are the values we all share and trust? Why was the business started? Why have we kept the business in the family instead of selling it? How do we balance family needs with business growth and maximum profits? What does the business require to continue its success?

Next is the thorny issue: reconciling the needs and desires of passive and active shareholders. This requires clear identification of, and agreement on, roles and responsibilities as a family member, shareholder, family council member, board member, CEO and manager. Separation of family matters from business matters is essential, as they can easily overlap, conflict and create complex future problems that become difficult to resolve.

Communication is critical, not just for active members but for all stakeholders in the business. It is advisable for the CEO to regularly communicate individualized business updates to all key stakeholders. Verbal communication from the CEO with supporting written reports is much better than merely issuing quarterly or annual reports, since some family members may not read these reports or understand their content. Open communication signals that the CEO recognizes and respects all family stakeholders as important and is willing to take the time to discuss the business with them. The result will be goodwill and appreciation from active and passive family members. A CEO who maintains good communications and provides family members with open access to information can flush out concerns before they become magnified and keep the family united in pursuit of common and individual goals.

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Compensation usually centers on issues of fairness and equity between and among active and passive family members. If only active family members receive cash benefits from the business, problems with passive members can arise. Family members must have a mechanism for considering and addressing all compensation issues. Discussion should include overall company financial resources, compensation and perks for family employees, shareholder returns, the company's future capital needs and shareholder distribution needs and desires. Independent professionals can help bring sensitivity and objectivity to these discussions and assist in developing successful compensation strategies.

Passive stakeholder strategies

Passive stakeholders frequently have a minimal voice in the management of a family business. They often feel "trapped," with no control of the business and no meaningful options to get out. This complicated situation often sets business interests against personal ones; e.g., capital for expansion vs. a passive shareholder's financial needs. These issues can be addressed through professionally guided discussion and a shareholder agreement drafted with the help of legal and financial professionals. The result is proper planning that enables the stakeholders and the business to achieve shared goals.

Helpful passive stakeholder strategies include:

- Electing one or more passive stakeholders to the board of directors (in addition to the family council).
- Naming an appropriate and representative passive stakeholder as the board chair, to provide more balance and foster communication between active and passive shareholders in decision-making processes.
- Inviting stakeholders who are not board members to attend board meetings (apart from executive sessions).
- Encouraging passive stakeholders to attend company outings, special events, award ceremonies, retirement parties and other company social events.
- Regularly sending financial reports, business plans and other communications to passive stakeholders.
- Avoiding discussion of business matters or issues at family outings; or if it happens, including passive family members in the discussion.
- Avoiding any action that makes family members feel like "second-class" participants in the business.

Active stakeholder strategies

Active stakeholders may also create family dynamics problems, so the CEO must also develop a set of strategies for dealing with them. These include:

- Respecting organizational boundaries.
- Delegating responsibilities and authorities appropriately.
- Avoiding micromanaging or second-guessing of other family members' actions or decisions.
- Treating all family stakeholders similarly to other members of the management team.
- Respecting, motivating and retaining non-family managers who are critical to the growth of the business.
- Implementing formal performance reviews, succession planning, training and development, accountability for results, performance-based bonuses and other professional management tools for family and non-family employees.

Managing family dynamics

Poor family dynamics can destroy family harmony; healthy family dynamics will support and foster a long and successful family business future. Understanding and addressing the differing needs of all family stakeholders is essential. Other ways to manage family dynamics include clearly delineating duties and responsibilities, promoting transparent and regular communication, developing an agreed-upon compensation plan for passive and active stakeholders and creating a vehicle for long-term conflict resolution. FB