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What Happened to the “Family”?

Preventing Family Dynamics from Destroying Your Multi-Generational Family Enterprise

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Most business owners have heard the grim statistics. Roughly 70 percent of family businesses fail to survive past the first generation. An even greater number – up to 90 percent – do not make it past the 2nd generation. The simple truth is that for the vast majority of Americans dreaming of creating and sharing wealth through a multigenerational family business, a disappointing scenario is more likely. Holding together a multi-generation Family Office is even more difficult since the core legacy and natural focal point, “the business”, may no longer be present providing easier options for family members to branch off on their own.

This is heartbreaking on two levels. First, a huge portion of family wealth is often tied directly to the success of the business, leading to potentially devastating consequences. What makes it more tragic is that many of the family dynamics that can threaten the longevity of the business are easily solved by addressing “softer issues” associated with passive and active stakeholders in the enterprise. Unfortunately, these considerations are often overlooked by senior family members, deferred by succeeding generations and ignored by corporate boards.

Needs-Based Differences

Any approach to managing family dynamics for generational businesses must recognize that the needs of family members are not only diverse, but inconstant. Their priorities and interests understandably change over time and based on factors including age, marital status, life style, income, and risk tolerances. Younger family members may look to the family business for work experience or an attractive compensation package. Older family members tend to be more focused on cash distributions that augment retirement savings. Others may reasonably want to diversify holdings to spread risk, but have investment objectives that differ from those of the rest of the family. Any area where interests do not align is a potential flashpoint for family conflict that can affect enterprise longevity.

With each succeeding generation, the challenges are magnified as extended families come into play. Instead of dealing with siblings, for instance, owners now might be in business with cousins. As owners broaden to include the idiosyncratic values of geographically scattered relations, the fundamental reason for being a part of a family enterprise can be lost and the experience becomes impersonal. In short time, the family enterprise can come to be viewed as a constraint on access to inherited assets or an obstacle to liquidity. This can lead to an adversarial relationship with the CEO or Board.

Through our consulting experiences, we have found that the CEO often underestimates the strong emotional bond that family members feel toward the family business. At a core level, the family business, or the wealth created from the family business will always be "Mom or Dad's business" in the eyes of their children. This attachment goes well beyond financial rewards and employment opportunities. This natural sentimentality can result in an exaggerated impact on family stakeholder dynamics and on the enterprise itself. In the worst cases, the egos, jealously and greed can result in counterproductive lawsuits and damage to the family's public image and reputation. Once these personal issues ignite, they become very difficult to resolve.

Personal grievances can polarize a family almost instantly and take decades to resolve. In some cases, we have advised families that do not speak to each other because of perceived or real slights. They skip holidays, weddings and other milestones because of family business-related tensions. Underlying frictions most commonly rise to the surface when the prior generation becomes disengaged from the family enterprise and personal agendas are pursued by the next generation.

Active vs. Passive Family Stakeholders

One way to mitigate challenges arising from disparate family objectives is to define enterprise stakeholders as either active or passive. Active simply means that you are an employed family member that is on the "inside" of the business, with better access to information and control. Passive stakeholders are members of the family that are not employees, and may or may not have an ownership interest. In many cases, depending on individual preferences, spouses and children are considered passive stakeholders.

Avoiding these unhappy and potentially costly events requires facing and resolving certain issues while the prior generation is still actively engaged in the business. We recently helped a client work with all of 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 family enterprise's future viability. The result was an agreed upon written plan addressing current needs and desires with a methodology and governance structure for addressing future issues as circumstances undoubtedly change. We find it is extra important to understand and respect the needs of each stakeholder at an individual level so that an overall structure can be developed to meet individual as well as enterprise needs.

We have defined the key areas most frequently at the core of family dynamic difficulties as: Mutual Respect, Power/Control, Perceived Fairness, and Compensation. Our approach helps our clients deal with these issues by concentrating on the "Three C's for Success."

The Three C's for Success: Consideration, Communication & Cash!

C*onsideration* of family members' emotional and financial needs sounds obvious, but is often not addressed in any measurable way. This above all other provides the framework for positive family business dynamics. The first step is defining the family's collective values regarding the business. Understanding family history can be a powerful starting point for establishing a sense of commonality of interest. Start with a few basic questions:

- What are the values we all share and trust?
- Why was the business started?
- Why is it still around?
- How do we balance "family needs" versus the enterprise's needs for growth and ROI?

As you can imagine, reconciling the needs and desires of the passive and active shareholders can be a thorny issue. This requires clear identification and agreement of 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 be intertwined, fostering conflict and creating unforeseen problems in the future.

Communication is similarly critical, not just for active members but for all stakeholders in the business. Two widely accepted governance organizations, the Family Council and a Board of Directors are extremely helpful in creating a strategy for providing clear and consistent communications through participative governance of a family enterprise. As a former 4th generation family business CEO, I advise my clients to regularly communicate individualized updates to all of their key stakeholders.

Verbal communications from the CEO with supporting written reports is much more effective than exclusively issuing quarterly or annual reports. Some family members may not read or understand the content of a report. Part of the value of the communication is the CEO is recognizing and respecting a family stakeholder as important and willing to take his or her time to discuss the family affairs with them. The result will be goodwill and appreciation from active and passive family members. Good communications and open access to information by family members flush out concerns before they become magnified and keep the family together in pursuing common and individual goals.

C*ash* for both active and passive stakeholders is the third issue that must be addressed thoughtfully. Cash and other benefits are often a hidden problem affecting family dynamics that speak to issues of fairness and equity between active and passive family members. If only active family members are receiving cash benefits from the business, problems with passive members are more likely to arise. Family members must have a transparent structure to evaluate and address such compensation issues. Discussion should include overall enterprise financial resources, compensation and perks for family employees in relation to shareholder returns, shareholder distributions, and future enterprise capital needs. Bringing sensitivity and objectivity to these discussions is necessary to negotiate a family operating agreement to legally memorialize these and other important stakeholder issues.

Passive Stakeholder Strategies

Passive stakeholders frequently have a minimal voice in the management of a family enterprise. They often feel "trapped," with no control and no meaningful options to get out. This dangerous situation can lead to lawsuits, disruptions to business operations, and poor family dynamics. Such circumstances often set enterprise interests against personal ones, such as weighing the need for capital for expansion versus a passive shareholder's financial objectives tied to the business.

Some best practice passive stakeholder strategies that we have developed with our clients include:

- Developing a legal shareholder agreement addressing policy issues such as individual shareholder rights, key decision making authorities, shareholder distribution policies, governance issues, etc.
- Electing passive stakeholder(s) to the Board of Directors (in addition to the Family Council);
- Naming a passive stakeholder as the Board Chair to provide more balance and communications between active and passive shareholders in decision-making processes;
- Providing board meeting attendance rights for non-board members (apart from executive sessions);
- Inviting passive stakeholders to enterprise outings, special events, award ceremonies, retirement parties and similar company social events and perks;

- Providing regular financial reports, business plans, and other stakeholder communications to passive stakeholders;
- Avoiding the 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 a "second class" participant in the business.

Active Stakeholder Strategies

Active stakeholders may also create family dynamics problems, so they must have a conscious set of strategies as well. These include:

- Respecting organizational boundaries;
- Delegating responsibilities and authorities appropriately;
- Avoiding "micro-managing" or second-guessing of other family members' actions or decisions;
- Treating all family stakeholders similar to other members of the management team;
- Respecting, motivating and retaining non-family management who are critical to the future of the enterprise;
- Utilizing formal performance reviews, succession planning, training & development, accountability for results, performance based bonuses and other professional management tools for all employees--family stakeholders and non-family employees.

By understanding and addressing the differing needs of all family stakeholders; clearly delineating duties and responsibilities; promoting transparent and regular communication policies; developing and executing an agreed-upon shareholder agreement for passive and active stakeholders; and creating a vehicle for long term conflict resolution, your family dynamics will support and foster a long and successful family enterprise for generations to come.

George Isaac has 30 years of family business and family office experience including serving on 14 public and private corporate boards and consulting on over 100 client engagements. See www.GeorgeIsaac.com for information on his family business and family office consulting practice, additional articles, video interviews, references, and experience. Mr. Isaac can be reached at 805.969.662 or gisaac@gaicapital.com .

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