In Touch with the Board

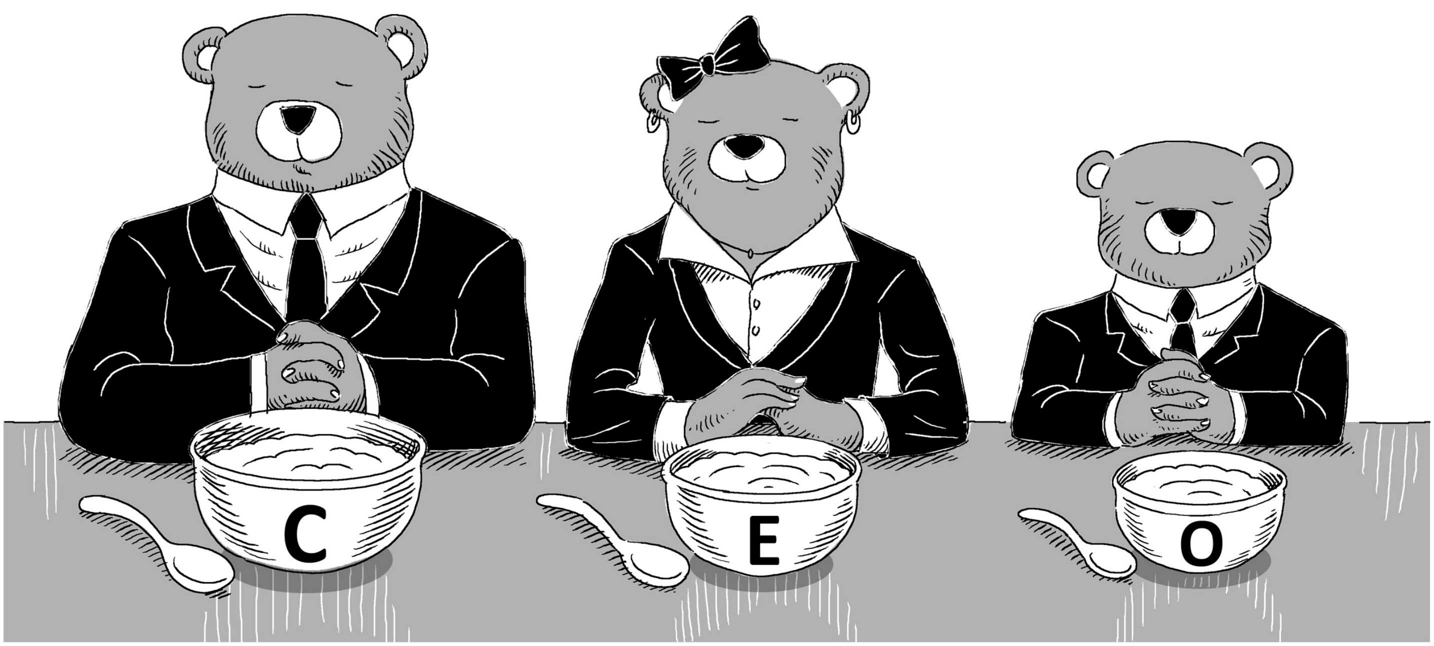
A Russell Reynolds Associates Series

**Leadership for a Changing World.** One in a series of communications from the Russell Reynolds Associates' CEO/Board Services Practice, *In Touch with the Board* addresses best practices in board composition, assessment, succession planning and other critical corporate governance issues.

# CEO Succession in the Family-Controlled Firm

The process of selecting a non-family member to be a CEO or other senior leader at a family-controlled firm is fraught with emotional, business and governance challenges. In this issue of *In Touch with the Board*, Clarke Murphy and the CEO/Board Services Practice identify the key factors boards of family-controlled companies must consider in their succession planning and provide a diagnostic framework to help boards navigate the process.

Managing the CEO succession process and ensuring a strong executive team are the ultimate board responsibilities. And while all succession and team-building processes are complex—requiring the board to consider numerous factors that include future strategic threats and opportunities, the expected performance of various candidates, the implications of its choice on its human capital capabilities and many other considerations—certain CEO succession and executive hiring scenarios especially are challenging. One such scenario is that of the family-controlled firm[1] that has decided to conduct an external search for a CEO or other senior executive. This hiring process may represent the first time a non-family CEO or C-suite executive takes the helm of the firm, a division or a function. Or it may be that family members relinquished managerial control decades ago but remain shareholders today. In either case, the presence of family dynamics, history, culture and expectations provides an additional layer of complexity to the senior executive hiring process.




[1] "Family controlled" describes any company, public or private, in which members of a single family exert significant strategic influence. This could be by holding the company's senior management positions, seats on the board or some combination of the two.

**Contrary to common perception, within this complexity, there also is an opportunity to tap into a positive family force at a critical time of transition**. To do so, boards, along with family member managers and/or shareholders, must approach the succession task with an analytical mindset and process that balance the strengths and needs of the company, the level of involvement of the family, current business imperatives and the emotional backdrop against which the transition is occurring.

## Identifying the company's "distinctive familiness"

The notion that a family-controlled company's family history can be a *positive* force is rather recent. Traditionally, family firms seeking to bring in an outside CEO or other non-family leaders saw the move as "professionalizing" the enterprise. In this way of thinking, in order for the firm to reach its next level of growth, it must look and act more like non-family firms—be more linear and clinical in the decision making, place greater focus on efficiency and short-run returns, and be less personal or emotional in its human capital strategy. This earlier approach viewed the cultures and priorities of "family" and of "business" as inherently in conflict.

**In contrast, the thinking of family business experts has evolved in recent years to recognize the fact that a family business may enjoy unique strengths precisely because of its family roots and historical path.** The unique interplay between the business, the family unit and the individuals within the family, in fact, may give rise to values, assets and capabilities that the board and leadership should preserve even as the company transitions to or continues with non-family leadership. For example, there is research to suggest that family firms can make longer-term capital investments, execute more quickly on entrepreneurial decision making, and have greater employee loyalty and a deeper commitment to the research and development needed for new businesses than non-family firms.

The family-based characteristics that give the firm a market advantage have been called the firm's **"distinctive familiness."**[2] This distinctive familiness and the aspects of the company that support it must be preserved rather than diluted by the external CEO or senior executive team member being recruited.

It is important to note that this distinctive familiness changes over time and is dependent on where the firm is in its life cycle. When the founder is still CEO or there is family in senior management, the

## Influence of family-controlled firms

The practicalities of senior leadership succession in family-controlled firms is a highly relevant topic for a greater number of executives and boards of directors than one might think, given the worldwide prevalence of family-owned or controlled enterprises and the impact they have on their national economies.

**According to the Family Firm Institute, family businesses create an estimated 70-90% of global GDP annually.** In North America, for instance, the greatest share of America's wealth lies with family-owned companies, comprising 80-90% of all business enterprises in North America.

In Latin America, the majority of Brazilian businesses are family-owned, representing 70% of the largest Brazilian business groups.

In Europe, 79% of German businesses are family-controlled, employing almost 45% of the country's active workforce and creating more than 2/5 of the national turnover.

In Asia, the fact that Chinese family companies control a proportion of economic wealth much larger than their relative share in population is well-known (e.g. 3% of ethnic Chinese family-owned enterprises in Indonesia own approximately 70% of the country's businesses, controlling around 80% of the largest companies in the country).

[2] Habbershon, Timothy G. and Williams, Mary L., "A Resource-Based Framework for Assessing the Strategic Advantages of Family Firms," *Family Business Review* 1999, 12:1.

firm's family-based advantages are likely to be very concrete in nature, such as hands-on leadership, technical knowledge and business relationships. For a later-stage company run by third- or fourth-generation family members, however, the distinctive familiness is likely to be more abstract, centered on cultural assets and practices like the values employees embrace, the reputation the firm maintains in the marketplace or its business model and organizational structures.

Just as a family firm enjoys certain advantages due to its family history, it can be encumbered by family baggage as well—what can be called **"constrictive familiness."** It is this constrictive familiness that often leads family members, boards and non-family leaders to conclude that "family" and "business" do not mix. In reality, however, these constrictive familiness factors simply need to be addressed and mitigated, which can be done without losing the positive aspects of family involvement. If a co-CEO leadership structure created to accommodate two siblings has led to conflicted decision making, the company can revert to a traditional single-leader structure. If talent management and incentive strategies are not attracting top talent, the HR mindset and practice can be changed. If family member managers, board members and shareholders are in conflict, the issue should be addressed head-on and used to create more robust governance policies. The next CEO and his or her team must preserve the enterprise's distinctive familiness and confront its constrictive familinesss—and any aspects of the firm culture that enable those impediments.

**Identifying those characteristics is not always straightforward; the family-specific aspects of a family business that help or hinder it are not always immediately obvious.** This is exacerbated by the fact that family decision makers often think about their company as "just a business" and neglect to probe the role of family in their enterprise. Family businesses also may have a private "family language" that gives them a highly effective way to communicate but that can hinder the organization from looking at the firm's strengths and weaknesses in a more analytical way. For that reason, it is incumbent on the board to include this objective analysis in its succession planning. Applying a set of diagnostic questions can help in this more

## Case study

**An iconic global manufacturing company overseen by fourth-generation owners and managed by a tenured chief executive struggled with several challenges that threatened revenue growth and raised questions about its long-term ability to survive.** To remain competitive, the company would need to make a significant investment in technology, but the family shareholders struggled with the amount of capital this would require. Similarly, intergenerational disagreements regarding product development strategy jeopardized the company's decades-long standing as the leading manufacturer in its category.

**The challenge** As the company searched for a new chief executive, it was necessary to strike a balance. While the long-term commitment of the family and its distinctive familiness were desirable, there was a need for a strong, autonomous decision maker whom the family could empower to take the company in the right direction.

**The solution** Rather than limiting the search to executives with experience in family-owned organizations, the search committee pursued leaders at private equity-backed companies with proven experience in managing rapid change. Candidates needed a track record of increasing productivity and driving growth through a consensus-building approach and inclusive leadership style. Ultimately, this produced a chief executive with the patience and drive to succeed.

Figure 1: Organizational structure and family involvement over time

| | |
|---|---|
| **Governance** | **Personal/Informal → Positional/Formal**<br>*Does the firm maintain an informal, unwritten "family" decision-making style or is it governed by the policies and procedures one might find in a non-family firm of its size?* |
| **Family Involvement** | **Owner/Manager → Director/Benefactor**<br>*Are family members actively involved in the day to day of the company (as was the case at the company's founding) or does their influence now manifest itself primarily in the boardroom and as shareholders?* |
| **Life Stage** | **Early/Founder → Later/Multigenerational**<br>*Is the firm still run by its founder or has leadership passed to a third or fourth generation—significantly increasing the number of constituencies and potentially introducing a more complicated political environment?* |
| **Leadership/ Decision Making** | **Hierarchical/Individual → Participatory/Collective**<br>*Is the firm still directed by individuals in a command-and-control style or is authority more broadly distributed?* |

analytical process (see the **"Diagnostic Questionnaire"**).

## Contextual, external and emotional factors

Having identified the characteristics of the firm that need to be preserved or mitigated when choosing outside executives, the next step is to probe further and identify the contextual, external and emotional factors that determine the environment in which the succession process takes place. Having done so, the board then can incorporate the implications of that environment into the selection process.

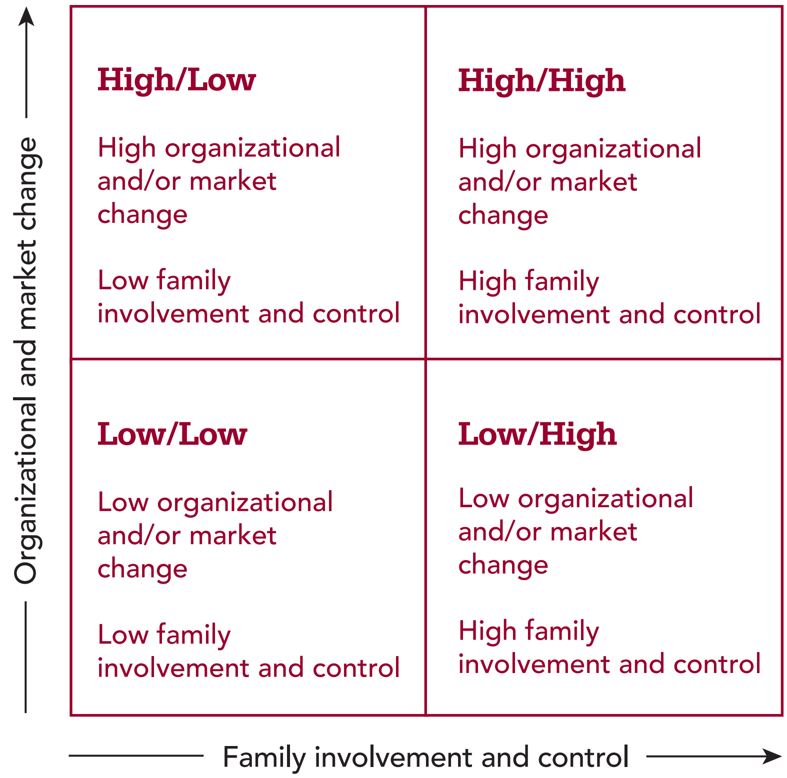
**First, the board must assess the involvement and control of the family in the business.** This not only dictates in a very material way the environment in which the next CEO or senior executive will be working, but it also helps determine the qualities the company needs in its next leader. Is the family part of the hands-on senior leadership of the firm or is its presence confined to the boardroom? Does the company make decisions "like a family" or has it adopted more formal policies and procedures? **Figure 1** gives four spectra that can be used to measure the influence of the family on the firm; taken together, they provide a useful multidimensional profile of family involvement.

**Second, the board must incorporate the external market environment in which the firm is operating—**factors that are independent of the firm's family ownership but which are nonetheless critical to success. Is the market environment fairly stable and the company strategy strong so that what is needed is a leader who can build on a solid foundation? Or is the market undergoing turmoil and change brought on by globalization, falling barriers to entry or rapid technological innovation, requiring more of a transformational leader?

The above factors then can be combined into a two-dimensional model that plots the organizational and market change the company faces against the level of family involvement and control, resulting in four distinct environments in which succession can occur (see **Figure 2**).

Each of the four environments brings its own set of CEO requirements. **But the board then must take into**

Figure 2: Four possible family-firm succession environments




**account the "emotional charge" within the family regarding the change.** To what extent is there agreement among the family members regarding what their own relationship with the company should be? What is the communication capability of the family as a group? Is the family culture one of openness and exchange or is it secretive and closed? Whether this charge is positive or negative adds another layer of requirements to be considered in the candidate screening process.

**High change, low family control**

*If the emotional charge is positive:* This situation suggests a classic transformational leader—one who can come in and quickly establish a new direction for the company; the replacement senior executive could even be a short-term leader by design. With low family involvement and a lack of family tension, the primary concern will be that the transformation be successful.

*If the emotional charge is negative:* If the family is fragmented, there is the risk that the transformational leader will exacerbate those divisions, as various groups react differently to the change unleashed by the new senior executive. With the family exerting influence in the boardroom but not actively involved in management, it is important that the firm's governance guidelines on voting, control and senior management changes be clear and that there is agreement about them. Establishing explicit boundaries will allow the transformational leader to meet the task at hand while respecting the rights of family members.

**High change, high family control**

*If the emotional charge is positive:* In this situation, a transformational leader is called for as well, but he or she also must be able to build a strong partnership with the family, which may be relinquishing day-to-day control for the first time. Even with that partnership, change is likely to happen more slowly than the new leader would like—a situation which he or she must be able to manage.

*If the emotional charge is negative:* The transformational leader must be able to traverse an emotional minefield and be prepared to spend significant energy building trust and establishing a comfort level. This challenge will be heightened by the task of transitioning out a family member CEO or other senior leader. A third-party family dynamics coach who specializes in family business issues can be helpful in assisting family members through the many issues this transition will raise for them.

**Low change, low family control**

*If the emotional charge is positive:* This quadrant has the fewest external factors weighing upon it. It calls for a "steady at the helm" leader with a proven track record in the core business.

*If the emotional charge is negative:* This is similar to a non-family company in which the new CEO must contend with dissatisfied shareholders. In this case, the CEO must be able to draw upon strong communication and diplomacy skills.

**Low change, high family control**

*If the emotional charge is positive:* This situation calls for a strategic thinker who can use the luxury of time to slowly prepare the company for the future. Then he or she will have to actively partner with the family and help maintain its sense of unity.

*If the emotional charge is negative:* Without the urgency brought by an imperative for change, a negative environment within the family can lead to a passive-aggressive stalemate between the senior executive and the family. He or she will have to be comfortable confronting hard issues and having difficult conversations to keep such a standoff from solidifying. This also is a situation where an outside family dynamics consultant particularly can be helpful.

## Case study

**A family-controlled, publicly-held global consumer products company determined that the organization needed to act quickly to address gaps in its succession planning strategy.** This was initiated because the family-member chairman and CEO was diminishing his involvement in day-to-day operations and had not sufficiently groomed a successor. Also, for the first time in the company's history, there were no family members on the senior executive team reporting to the chief executive.

**The challenge** The board's independent directors requested a succession plan that included non-family candidates, providing an adequate pipeline of qualified leaders to effectively take over operations in a planned or emergency transition. Issues debated by the board included whether to separate the chairman and CEO roles, appoint an external candidate to direct operations and/or retain a family member as chairman of the board.

**The solution** The board assessed the internal candidates and simultaneously agreed to search for an external candidate as an immediate successor to the chairman and CEO. There was tension in the process, given the need to ensure a revitalized perspective was brought to the company through succession but also to enable the company to find a leader who would be committed to maintaining its unique culture. The ultimate balance was found in an external candidate appointed as president and chief operating officer rather than as chairman and CEO. This provided a two-step approach to incorporating valuable external perspective and expertise into the management of the organization—a solution that acknowledged the importance of "fit" for the candidate, the expectations of the roles and the familiness of the organizational culture.

## In summary: Identifying the right selection criteria is key

Combining an identification of the characteristics of the company that need to be preserved or changed with an analysis of the contextual, external and emotional environment in which the succession is taking place provides a rigorous, multidimensional set of criteria that can be used to inform the succession process. While recruiting an external CEO or other C-suite member to a family-controlled firm always is complex, the appropriate selection criteria generated from the right analytical tools can significantly smooth the process and increase the chance of long-term success.

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*This article and the models shown in Figures 1 and 2 were developed in collaboration with Timothy Habbershon, Adjunct Professor of Entrepreneurship and Family Enterprising, Babson College.*

## Diagnostic Questionnaire

**Are the shareholders aligned in their long-term views regarding:**

a. The continuing role of the family?
b. The vision, direction and form the company will take?
c. The governance and organizational models?
d. The distribution of power in decision making?

**Are the structure and responsibilities of the board clear regarding:**

a. Family representation?
b. The nominating process and term length?
c. The role of the chair?
d. The scope of the board's authority and relationship with management?

**Who has control and input of the hiring decision?**

a. Is it purely a board or search committee decision?
b. Do family members have veto power or a role in the interview process?
c. Are there family members—perhaps outside the board or search committee—who must be consulted?

**What are the organizational and decision-making models?**

a. Hierarchical, calling for a leader to make top-down decisions?
b. Collaborative and consensus-driven, requiring conversation and iteration?
c. One in which there is "shadow control" by family members, regardless of the model?

**If there is an outgoing CEO or executive:**

a. What role will he or she play going forward?
b. How will the transition to the new leader be reinforced to the existing organization?

**If there are family members in other C-suite roles:**

a. What is the nature of the relationships?
b. How will the professional and ownership/board roles be balanced?
c. Is there a person who can act as a mediator regarding these issues?

**What special requirements are needed in a leader at this point in the organization's trajectory?**

a. A short-term sage who can oversee a transition period?
b. A "shock absorber" who can insulate the organization from board or shareholder turmoil?
c. A next-generation mentor who can prepare younger leaders?
d. A strategic leader who can navigate the company to a higher position in the market?

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