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The role of 'outsiders' in family companies

Peter Leach Associates Ltd
The Family Business Management Series
Principles for owner-directors

The role of ‘outsiders’ in family companies

The Family Business Management Series

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Other titles in the **Family Business Management Series** include:

- Family Governance in Multi-Generational Family Businesses
- Getting the family to work together
- Pay, benefits and incentives in family companies
- Succession management in family companies
- The Family Business Rulebook

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Preface

Family businesses have many things going for them - they tend to be flexible, reliable, proud, they can think long-term, have a strong culture and their people are committed. But they can also carry a daunting set of disadvantages - they can be rigid, inward-looking, unresponsive to change and sometimes swamped by emotional issues. It's a fascinating and complex mixture of advantages and disadvantages, costs and benefits, strengths and weaknesses.

Peter Leach Associates serves the needs of family business people, helping them to find a path through this complexity and to balance the ambitions and needs of their business with those of their family. All family firms are different - and there are no easy answers - which is why this **Family Business Management Series** of jargon-free guides concentrates on principles, processes and procedures designed to help families recognise and address the most important issues and conflicts that tend to arise.

This fourth guide in the series - **The role of 'outsiders' in family companies** - focuses on how building outside influences into the fabric of family business management and governance can help counter their dangerous tendencies towards rigidity and introversion.

Setting up an independent board, appointing non-executive directors, employing non-family managers and the appropriate use of outside advisers and consultants can all contribute significantly to the professionalisation and growth potential of the family business.

The **Family Business Management Series** is an important initiative. It has been designed as a source of practical advice and guidance - pulling together some of the key research findings on family business management and the lessons of the our experience over 25 years of helping family businesses. We hope it will contribute to the efforts of these firms to achieve continuity, growth and prosperity in the years ahead.

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Nobody disputes that family businesses enjoy some very valuable advantages when compared with their non-family counterparts.

Chapter 1

Introduction

Family businesses face serious challenges staying objective and avoiding introversion. Building outside influences into the fabric of governance and management is one of the most important ways of countering these tendencies.

Nobody disputes that family businesses enjoy some very valuable advantages when compared with their non-family counterparts. There is often a distinctive atmosphere at family companies – a sense of belonging, common purpose and commitment that can lead to improved performance. Also, when management and shareholders are united in family businesses this tends to promote flexible work practices and non-bureaucratic decision making.

But family businesses are also prone to some serious and commonly experienced disadvantages. Many of the problems hinge on the inherent conflicts that can arise between family values and business values. Family firms can become tradition-bound and reluctant to change; this is because as well as presenting commercial risks, change in a family business involves overturning practices established by relatives. Rigidity and unwillingness to respond to change is seen by many experts as the single most common factor in the failure of family companies.

Other common pitfalls faced by family businesses include:

- failure to modernise outdated skills
- over-reliance on family management to the exclusion of outsiders
- loss or demotivation of key non-family management due to a ‘family first’ approach
- diminishing vitality as the senior generation grows older
- failure to prepare for and manage succession between generations.

Case Note
The son of the founder of a chain of menswear shops had been brought up in the business and, under his father's direction, had learnt all aspects of its operations. However, he had also learnt that to please his father he should continue to do things in the same way his father had. Thus, when the son came to manage the firm, he concentrated on preserving the status quo. The expectations of customers changed, the company did not respond and eventually the business failed.

Introvert and extrovert firms

Studies have consistently identified one major difference between firms that have suffered from these typical problems of family businesses and those that have avoided them – namely, the extent to which they were introvert or extrovert organisations.

Introvert firms that consciously hold on to traditional ways, restrict their placing of trust, guard commercial information jealously and look to place family interests first, seem to be more prone to problems than extrovert, outward-looking firms. Taking an inflexible, inward-looking approach is likely to be the fundamental cause that leads to a 'clogs to clogs in three generations' outcome, under which the first generation of a family firm establishes it, the second builds it and the third loses it. These firms face going out of business or passing out of family hands because they are some or all of the following:

- inward looking
- unwilling to change
- insensitive to messages from the market-place
- unreceptive to outside influence and ideas
- not able to challenge themselves.

Given that family businesses are often prone to introversion, they – more than other businesses – can benefit from outside influence, advice and support. This guide therefore examines the positive role that various types of third parties can play in family companies, and how firms can make effective use of 'outsiders' as a source of objectivity, experience and expertise. Specifically, the next four chapters discuss the role of:

- an effective, independent board
- non-executive directors
- non-family managers
- outside advisers and consultants.

Chapter 2

Establishing an independent board

Setting up an effective, independent board of directors is crucial for the vast majority of family businesses if they are to achieve long-term success.

Perhaps one of the most striking characteristics that distinguishes the best family businesses is that they generally operate with a strong, independent board of directors. The board of directors, charged with overseeing the company's operations, includes talented, independent, non-family outsiders who have no conflicts of interest.

Acceptance of the proposition that outside assistance through the board can contribute enormously to the potential of the family business does not always come easily to family business founders or owner managing directors. The founder's or family chairman's or MD's character is often incompatible with bringing in outsiders: indeed, many actually attribute their success to pursuing their own objectives, in their own way, and paying scant attention to what others have to say. It should come as no surprise, therefore, that introducing outside directors and thus moving towards a more accountable system of corporate governance is often seen as an unpalatable option.

The mythical board

Research confirms that the boards of private, family-owned companies normally consist of family members (see BDO Centre for Family Business, 2003, in the 'References' section). The board's activities are often confined to the minimum necessary to fulfil statutory obligations. These boards operate as a rubber stamp and exercise few, if any, of the serious management functions or the authority that can be vested in a board.

In effect, the boardroom is seen as a family preserve, and to suggest outside directors might add any value is disregarded as implying that the family is not competent to run its affairs. In such family firms the MD's view of independent directors is, 'I created and built this company on my own, I'm the controlling shareholder, and I make all the decisions: what would the involvement of outsiders bring to my company, and why would I want them?' The last point is often the crux of the matter, with MDs taking a negative view about establishing an independent board of directors to which he would be accountable and which would be 'looking over his shoulder' and questioning his operation of the business. Also, there is sometimes a problem at longer-established family businesses that appear to have made the move introducing independent outsiders to strengthen their board of directors. Frequently the decision is taken to introduce only an equal number of outsiders as there are family on the board, so the family chairman will always be there with a casting vote in favour of the family if needed.

There is a misconception among some families that only big, public companies should have broadly based, independent boards. Owners of family businesses, who tend to operate in an atmosphere of informality and secrecy, are less than comfortable with the thought of sharing confidential business information and airing difficult family issues. There is admittedly a trade-off if the benefits of an independent board are to be obtained. Generally, the issue for family business MDs is not that this price is too high, but that they may not fully appreciate how valuable an independent board of directors can be.

Making the transition

Establishing an independent board of directors is probably crucial for the vast majority of family businesses if they are to secure long-term success. This does not mean, however, that every family business is ready to introduce an independent board. Not all firms would obtain enough benefits from such a move to justify the effort and cost involved. In deciding if such justification exists, consider the following questions:

- Are the MD and controlling shareholders committed to making the idea work?
- Is it a growing, maturing company rather than a one-man business?
- Is the business substantial enough so that shareholder and operational issues can be easily distinguished from one another?
- Does the business have sufficient resources to implement and take advantage of an independent board's recommendations?

Of all these questions, the first is the most important. Independent boards can only be effective when the MD or controlling owner has the confidence to accept a degree of reduction in their power and control over the business, and are willing to subject their stewardship to examination by outsiders. There will be less scope for the aura of operational secrecy practised by many family businesses, and greater transparency to allow for informed decision making.

Exhibit 2.1 - Who should be invited to join the board?

- People with a strong track record of business achievements in areas useful to the family company.
- People with skills that complement and broaden those of the existing board members.
- People from a commercial background that enables them to understand the deep-rooted problem areas for family businesses, like introversion, family dynamics and succession management.
- People who are able to identify with the risks, responsibilities, rewards and goals of owner-managers, and who are supportive of the values and principles for which the family stands.

The relationship between the MD and an independent board is subtle and delicate. Unless the MD believes in the concept and is willing to submit to board recommendations, the independent board cannot succeed in helping to develop the business. This does not mean the MD must relinquish all control, and there may be times when he may find it necessary to exercise the prerogative of a major shareholder and make decisions contrary to the board. Board members will generally accept this, but they must believe that their opinions are valued and that their viewpoints have an impact on the business. An effective board should:

- probe
- challenge
- offer recommendations.

It should do this in an atmosphere of mutual respect that is supportive rather than adversarial. This balancing act can only exist among mature people who are willing to subordinate their sensitivities and egos to the good of the company. The board members have a final weapon – resignation – if they believe that the MD is too intransigent.

So, acquiring the benefits of experienced advisers in the form of an independent board does not necessarily limit the MD's flexibility or ultimate authority as owner. Also, while an effective board may require more formal management procedures, these often represent needed disciplines rather than bureaucracy. Family members, active in the day-to-day running of the business, are unlikely to spend precious time preparing detailed reports and analyses when they themselves will be the only readers.

Exhibit 2.2 - Who should NOT be invited to join the board?

- Long-term professional advisers, such as the company's lawyer or accountant. Their expertise is available anyway, and putting them on the board often needlessly creates conflicts of interest.
- Key managers (including family managers). Boards supervise management, and managers should report to the board rather than become members.
- Spouses and relatives with little to contribute to professionally oriented business meetings should not be on the board. Minority investors are best served by seeing that their company has the best possible board.
- Retired employees and friends. The focus of board discussions should be on tomorrow, not yesterday, and few friends are able to provide objective input.
- Customers, suppliers and agents on the board will lead to serious conflicts of interest sooner rather than later.

Effective, working boards

The principal responsibilities of an independent, working board of directors are to establish corporate policy and oversee management performance. The MD is responsible for routine operations, but should submit policy issues and important decisions for board consideration and determination. These include, for example:

- changes to the scope or nature of the company’s operations
- overall strategic planning
- approving individual strategies in areas such as marketing production, investment and financial management
- changes to the company’s organisational structure
- major corporate decisions, such as selling the business or a significant portion of its assets, along with mergers, acquisitions and large investments.

Overseeing management performance is the second important board responsibility. Duties in this area include:

- monitoring the effectiveness of management in implementing corporate strategies
- planning for management succession
- setting management remuneration levels.

Clearly, a number of these corporate policy and management responsibilities can involve sensitive family questions that many founders are reluctant to face up to – in particular, succession, organisational structure, job definitions and remuneration of family members. These are, of course, precisely the sort of issues on which the unemotional and objective viewpoint of independent board members can be especially helpful.

Because the board will be involved in helping the family to resolve issues in the family company, it is important that board members establish a relationship with the family. It’s role should not be seen as institutionalised arbitration when family views are divided, but if the board has the family’s confidence and respect it can be very valuable in helping to defuse potentially dangerous situations and proposing alternative strategies. A vivid illustration of this is provided in cases where the MD has suddenly died or become disabled. Rather than the unprepared family being saddled with responsibility for the business, the board can take over, if necessary hiring a professional manager; the business can then continue to operate in an orderly way with the support of the family until, if appropriate, a member of the next generation is ready to assume leadership.

Chapter 3

Non-executive directors

Good non-executive directors act as advisers, arbiters and sources of contacts. Their independent contribution to boardroom discussions can help improve a family firm's competitive edge.

The rationale

Non-executive directors can bring a new dimension of experience and independent objectivity that is less often found among family members or employees.

The typical profile of non-executive directors are people who have made their career in large enterprises – often a quoted PLC – and have taken on positions of considerable responsibility, for example at divisional director level. They do not want to take on full-time commitments, so the idea of attending board meetings six or 12 times a year and using their store of knowledge and experience to help a smaller company is often very appealing. Another resource pool for non-executive directors comprises people who have run their own business at some stage and then sold it. They often make excellent non-executive directors, bringing in tow their entrepreneurial 'get up and go' spirit.

Non-executive directors can make an enormous contribution (at modest cost). Particular benefits include:

- objective and seasoned guidance on business strategy from successful business people
- an unbiased sounding-board for family-owned business challenges, such as succession
- mediation (not decision making), helping the family to resolve any disagreements and reduce emotional stresses
- specialised expertise that may not be available internally
- a network of contacts that can be mobilised on behalf of the firm. This covers areas such as potential sources of new business, capital, connections in industry and government, as well as international contacts.

Less tangibly, a good non-executive director can also act as a catalyst, pushing for significant shifts in corporate strategy or objectives that may be beyond the scope and imagination of the internal directors (eg acquisitions, revamping the senior personnel structure, going public and so on). Overall, the outside director should be the informed critic of the board, challenging decisions and making sure that it thinks and plans.

Case Note: ‘How I see my role as a non-executive’
This ‘professional’ non-executive director retired early from a senior position with a PLC and joined the boards of six companies, three of which are medium-sized family businesses.

The way I approach the job is to always try and take a step back from things and to ask simple, basic questions like, ‘Why are we doing this?’, ‘What are we seeking to achieve?’ and ‘Should we perhaps be doing this another way?’ In the early days I was amazed to find that family members felt these questions revealed a rude and hyper-critical attitude on my part! The trouble was that the family had tended to follow developments and say ‘That’s all right with us’ and ‘The board’s doing an excellent job’, but it was clear to me that this was sometimes the wrong atmosphere in which to be taking vital decisions about the company’s future. So I believe in occasionally trying to give my colleagues a bit of a jolt. There’s no magic in it, and it’s almost always just common sense. But the point is that things easily get a bit claustrophobic at family firms and a few basic questions usually work wonders in clearing the air, sparking off discussion and helping us move towards the right decisions.

Selecting the right candidate

It’s vital to form a clear idea of the sort of blend of personality, talent and experience that will be of most benefit to your company. In general terms, you’ll want non-executive directors to be bright, logical, analytical, honest and well respected. They should be prepared to stand up for their opinions and be a ready source of constructive advice. Personal chemistry is very important – there must be mutual respect and rapport. There will be no benefit if either the MD or the other owner-directors take umbrage in the face of criticism from the outside director. Give and take is essential on both sides if the board is to perform effectively.

Another key consideration is that the skills, experience and temperament of a non-executive director must complement those already in the company. It may be inappropriate to take on someone whose main background is in the same business as your own, because experience of other sectors could bring a fresh dimension to your company. For instance, if you're looking to strengthen the firm's financial expertise, consider candidates with experience in raising external finance from banks, private equity capital or other sources. If marketing has proved a persistent weakness it may be that you'll benefit most from taking on someone with a strong track record in building brands. Seek a balance that will introduce some new and valuable skills to your business.

Successful boards recruit retired people as non-executive directors. Although they may have the time and experience to make a valuable contribution, if they have been away from business life for a while it can be very easy to lose touch. If the candidate's principal concern is to top up their pension with directors' fees they may not display the sort of detached, objective perspective you are seeking. Similarly, employing professional advisers such as your accountant or solicitor is likely to be questionable on the grounds of objectivity.

Once you've drawn up a written profile of the type of director you need, the next step is to find him, or her, and this is not always easy. The legal responsibilities (and potential liabilities) of directors are significant, and the ideal candidates are often busy, successful people who are unlikely to be strongly motivated by the relatively nominal fees offered. On the other hand, many highly qualified people are seeking non-executive directorships and find they provide a rewarding experience. Becoming an important influence in shaping the destiny of a growing, successful firm can be a very stimulating challenge.

A number of organisations keep registers of people who are willing to take on non-executive directorships. Recruitment consultants offer a fully fledged candidate search and appointments service, while the major banks, venture capital groups, accountants and professional bodies such as the Institute of Directors also keep lists. Personal contacts are another source of candidates, but avoid choosing close friends or, indeed, someone closely aligned with a particular branch or generation of the family. Similarly, people who do business with your company may not have the objectivity and independence you need. Also, don't underestimate how useful an understanding of family business dynamics might be – a rare but potentially valuable quality in a non-executive director. Deciding on the best candidate can be difficult and this is an area where it is generally recommended to seek outside advice before making an appointment.

Finally, remember that the first selection may be particularly important because their calibre and experience will tend to set the standard as far as later candidates are concerned.

Board practices

Establishing written guidelines setting out how the board should function is a good idea. These will obviously be subject to change as the board evolves, but they serve to help you clarify your expectations as well as evidencing your seriousness of purpose, thus helping in the recruitment of board candidates. The role and operational rules of the board should be defined in the guidelines, and information about directors' terms of office and fees should also be included. In addition, you should review the contribution of your non-executive director/s on a regular basis as part of a board evaluation process that looks at how effectively the board works in an overall sense.

Consistent with the motivation behind why non-executive directors agree to serve, their fees should represent a fair return for the number of days they are expected to contribute rather than performance-based remuneration. Fees payable will depend on factors such as the size of the company, the nature of its operations and the frequency of board meetings.

Chapter 4

Non-family managers

The decision to appoint outside managers is often a very difficult one. It marks a cultural shift for family businesses, but is often an important first step in making the company more open to external influence and can help secure its future.

Relationships with the family

Successful non-family managers in family businesses are often interesting characters with the psychological make-up and attitude to enable them to fit into an unusually demanding working environment. The job doesn't suit everybody, and there are many instances of talented managers who have resigned because they've run out of opportunities, or because the politics and emotional cross-currents in family-owned companies have become too much of an interference in their work. But managers who are able to cope with such factors are often very good indeed.

At the recruitment stage, family companies often have a problem finding talented outsiders willing to work for them and, once found, they also have a problem in retaining and motivating them. For family businesses in which there is no clearly stated family vision and set of values supported by policies defining the family's relationship with the business, these problems can be very serious. Issues that may prevent non-family managers integrating effectively and being given a fair chance include:

- Is the firm being run effectively by the family – and if it is, why should they be bringing someone in?
- What chance is there of acquiring an ownership stake, or even a leadership role?
- Will the salary and overall compensation be commensurate with non-family firms?
- Is it likely that decisions may be overruled by family members?
- How extensive will be the influence of non-family management?

Once recruited, the autocratic management style of an owner can inhibit the development of competent non-family managers. Many start to worry about the effect of family tensions on the business and on their ability to get on with their job properly. They are also frequently unsure of their job security in circumstances where the owner is not planning management succession, his or her children may not be qualified to run the business, and the most likely outcome is that the company will have to be sold.

Another source of insecurity can arise if family members are suspicious about the loyalty of non-family employees who, as a result, can find themselves excluded from key planning or operational information: unlike family members who ‘can’t leave’ the freedom of employees to do so, taking specialist knowledge with them, becomes a major worry for some owners.

On a more positive front, sometimes the role of a loyal, trusted manager within the organisation is cleverly institutionalised by the family. A respected senior manager can become a counsellor and mentor to the next generation or, if there is no obvious successor in the family to lead the business, may be asked to run the company.

Case Note: the bridge

A specialist manufacturing company, formed in the late-1940s, was founded and run by an autocratic genius. Nothing happened at the factory that he didn’t know about, and he carried all the management procedures and performance figures in his head.

The company prospered under his control, although it was still something of a one-man business, until, in the late-1970s, the founder died very suddenly. He had two sons who were involved in the business, and two daughters who were not. The sons represented the eldest and the youngest of his four children, but neither was prepared to take over as the new MD. This task was therefore given to the general manager, who had been with the firm since it began, and who acted as a ‘bridge’ between the two generations of the founding family.

A few years went by, with both sons continuing to work in the business, and eventually the point was reached at which the family felt able to resume management control. It happened at a convenient time, with the bridge deciding to retire, allowing the younger son to take over as MD and the elder son to become chairman. Subsequent to this management reorganisation, the family has retained control of the business and it has enjoyed dramatic growth.

Reliance can also come to be placed on non-family managers for structural reasons. As a family business matures, particularly by the time it reaches the third generation, it tends to acquire its own identity, distinct from that of the founder. At the same time, management by consensus has ceased to be viable because there are so many family members, all of whom have a stake in the business. This combination of factors generally leads to greater dependence on non-family managers as the best means of maintaining the continuity of the business.

A piece of the action

Key non-family managers are sometimes unwilling to remain with the company unless they are given financial incentives, possibly including shares or share options. Where there is an atmosphere of family friction, and there are family members who may have acquired their positions as a result of favour rather than competence, there's a natural tendency for non-family managers to feel that they are the only people doing any real work and, in the circumstances, they ought to have a stake in any success arising from of their efforts.

As share ownership is generally jealously guarded by the family, this often results in an impasse. One possibility is for the company to issue non-voting shares to the employee, or shares with restricted transferability. Another possibility is creating a long-term bonus scheme that does not involve real shares, but nevertheless enables the employee to participate in any future appreciation in the value of the company. (Incentive plans, are examined in another guide in this series entitled **Pay, benefits and incentives in family companies**).

In fact, many managers in family businesses do not expect to own shares in the firm. They often derive satisfaction from less tangible benefits such as the informality of working in a closely knit team, the personal relationship with the owner, and a feeling of confidence knowing they are not simply part of a faceless institution?

Motivation and rewards

Motivation of non-family managers is a key issue in the development of family businesses. There must be clear evidence of a career path for such employees and of comparability of reward for responsibility and expertise between family and non-family members.

We've seen that non-family managers have fears about how effective they will be in the job and whether they will be given a fair chance. If the company is professionally managed and there are clear policies defining the family's role in the business, most of these problems disappear, or at least are minimised. The benefits that flow from such a separation were highlighted in the **Getting the family to work together** guide in this series. For example, key positions cease to be the exclusive preserve of relatives, while remuneration and assessment are more objective. Indeed, the overall result can often make the family business an attractive career path for capable non-family managers:

- new recruits can expect quicker exposure to a wide variety of decision-making situations
- managers find it easier to influence policy and get things done than in, for example, a large, publicly quoted company
- managers enjoy a more personal and satisfying working environment
- managers have greater opportunity to interact with the owners and other key decision makers.

Clearly, a number of these corporate policy and management responsibilities can involve sensitive family questions that many founders are reluctant to face up to – in particular, succession, organisational structure, job definitions and remuneration of family members. These are, of course, precisely the sort of issues on which the unemotional and objective viewpoint of independent board members can be especially helpful.

To sum up, the common denominators of family businesses that enjoy the benefits of dedicated and highly motivated non-family managers are:

- family and non-family members are recruited and evaluated according to merit – identical, objective standards apply

- acceptable career development opportunities are provided for non-family managers, and remuneration is related to fair market principles
- if there are any diverging views or conflicts between family members, these are not allowed to affect the business
- a management succession plan has been put in place by the owner, and has been explained to non-family managers
- the valuable role played by non-family managers and all employees in fostering the success of the business is openly acknowledged and rewarded.

It's important to evaluate periodically your relationships with outside professional advisers.

Chapter 5

Advisers and consultants

Chosen wisely, and used properly, outside professional advisers and consultants can contribute significantly to the professionalisation and growth potential of the family business. But watch out for possible conflicts of interest.

Outside professional advisers (such as lawyers, accountants, bankers and consultants) offer an extra dimension of competence, experience and objectivity to issues affecting both the business and the family. In practice many family businesses start off with small local advisers, but quite soon outgrow them.

Are your advisers keeping pace with you?

When the business was set up, a branch bank manager may have lent the founder some money, a solicitor filed the appropriate forms with Companies House and a local accountant prepared the first statutory accounts and perhaps helped to organise the bookkeeping system.

This team usually works well until the business begins to grow and requires some additional specialist services as well as a more sophisticated general service. For instance, taxation advice may be needed in relation to a complex transaction, the company may want to establish foreign bank accounts, obtain legal advice on the terms of a business contract, or it may wish to acquire another company. The time arrives when the original advisers can no longer cope – the business they are advising has outgrown them. Families tend to be loyal and want to support people who have supported them in the early years, and there may be a reluctance to contemplate a change in the interests of gaining the most appropriate adviser available.

It's important to evaluate periodically your relationships with outside professional advisers. Visiting them regularly is a good idea, even if there are no immediate problems. Keep them in touch with what's going on and with your plans. Challenge them to come up with creative ideas – if your advisers can only help you on the routine aspects of their field and never make thought-provoking suggestions about your business, this is a clear sign that it's time for a change.

Consultants

It's fair to say that consultants do not all enjoy a glowing reputation in the business community. There's a common belief that consultants are excellent at 'examining your watch and telling you the time' – in other words, at providing you with a useful compilation of your problems but little if anything in the way of constructive advice and solutions.

On the other hand, when you do not have the expertise within the company for a specific task, it often makes sense to engage a good consultant to help. You do not add them to your payroll and, once their job is completed they leave, and if they have been effective you enjoy a long-term benefit that would not otherwise have been possible. Before you engage consultants, however, check their professional credentials, and talk to others who have used their services. Insist that the scope of the engagement and the fee arrangement are spelled out clearly in writing in advance. As with most things, but particularly with consultants, you get what you pay for. The general rule is to seek the very best your company can afford. There is a range of government grants available that can help to defray the costs of consultants for smaller companies, and it's important that companies take advantage of the various government initiatives in this field (for example, the locally based 'Business Link' business support, advice and information service).

Good professional consultants are to be found specialising in virtually every facet of commercial activity. There are industry specialists covering, for example, specific industrial sectors, consultants who aim to analyse and solve particular operational problems (eg production control), as well as management specialists, expert in areas like strategic business planning, the introduction of IT systems, or human resources, training and development.

Areas where family business need help

The vital importance of a strategic plan that establishes clear ground rules governing the family's relationship with the business and defines the responsibilities of family members is discussed in the **Getting the family to work together** guide in this series. An experienced family business adviser or consultant can often help and facilitate families deciding on their goals and policies by bringing an objective perspective to this critical stage of the planning process.

The involvement of a professional outsider may also be valuable when the family council meets to discuss the issues raised by its strategic plan. A good approach to begin the process of forming a family council is with a one-day retreat, with relatives gathering in a quiet environment away from the everyday surroundings of job and home. A non-confrontational atmosphere will help family members discuss their future in a constructive way, and all the family strategic plan issues should be on the agenda, usually with the aim of setting out any conclusions of the discussion in a draft of the family constitution – essentially a statement of intent that sets out the family’s shared values and its policies in relation to the business.

The chances of a successful retreat are usually improved if a family business consultant or other experienced professional adviser is asked to act as a facilitator. The facilitator could be responsible for setting the agenda, chairing or moderating the meeting and ensuring an atmosphere in which everyone feels free to express their concerns. The facilitator will usually interview all family members in advance of the meeting in order to identify the sensitive issues – the emotional ‘hot spots’ – that must be faced up to. If possible, interviews should also take place with ‘outsiders’ like the company’s accountant, banker or lawyer – ideally people who have had dealings with the family and the business over a number of years and who are able to express well-founded, impartial opinions about both.

An important aim of preliminary meetings with family members (held on a one-to-one basis) is to begin to establish an atmosphere in which people feel they can talk honestly and openly about the key issues. They also help to ensure that discussion at the family retreat is tailored to the particular difficulties and needs of the family and their company. The facilitator is not there to solve the family’s problems – indeed, it should not be assumed that he or she knows all the answers. The role of an impartial facilitator is:

- to help the family to discuss the issues in an informed and logical way
- to guide family members as they seek out a consensus
- to help them draw together their decisions and codify the results in a written family constitution.

In addition, specialist mediators can help resolve rivalry and conflict situations within families, for example, by assisting in the establishment of objective family member evaluation procedures, family wealth allocation and fair remuneration principles. Similarly, the questions of share ownership and estate planning are complex and often fraught with emotion, and specialist advice can minimise both tax liabilities and the potential for family disagreements.

Finally, the family can call in an expert to help with succession or changes to the organisational structure to ensure continuity in the future. As we saw in the **Succession management in family companies** guide, succession represents a major, sometimes insuperable hurdle for family businesses, and one should not assume that the problems that surround it will resolve themselves, or that they will be easy to handle.

Beware conflicts of interest

With appointments to advise a family company, it is crucial that both advisers and family business people are aware of the potential for conflicts of interest. A careful definition should be agreed at the outset detailing:

- for whom the adviser is acting
- on which matters
- the nature and extent of the adviser's responsibilities
- towards whom the adviser owes a duty of care.

But the problem is not confined to new appointments. An illustration is set out in the case note panel of how easily the boundaries between formal and advisory roles can, over time, become blurred, leading to conflicts of interest.

Case Note: how auditors risk conflicts of interest

Auditors who have acted for a family business for many years will quite naturally have developed a close relationship with individuals at the company. Although an officer of the company and under a statutory duty, an auditor may be asked by an individual shareholder (often the majority shareholder) in the family business to provide, say, personal tax advice.

In this type of situation, the formal boundaries around professional relationships and duties can become obscured, and conflicts of interest (in this case in relation to minority shareholders whose interests may well be affected by the tax advice) arise all too easily.

Conflicts of interest affecting advisers are particularly troublesome in that they are rarely obvious, black and white situations that exist from day one. Rather, they tend to come in various shades of grey, and either materialise quietly and progressively over a number of years or are, instead, triggered suddenly by a single unforeseen event or set of circumstances.

The key point for advisers facing such a dilemma is to maintain independence, integrity and distance so that they are able to retain objectivity. The key point for family business clients is to try not to ask advisers questions on subjects that fall outside their pre-defined brief. Both these guidelines are very much easier said than done!

Further conflict of interest issues arise when an adviser is appointed as trustee of a settlement involving a family business client. Trusts crop up a lot because they can provide flexible solutions to a variety of family business-related problems. A minority stake may often be gifted, to be held for the benefit of, say, three or four young children. The interests of such beneficiaries may well differ from the interests of the company directors for whom the adviser is acting on a day-to-day basis. In such situations, conflict problems all to readily arise because advisers find themselves acting for just one generation or one side of the family.

Relationships underpinning an advisory role

Often a firm’s relationship with a particular family business adviser develops out of particularly close ties between the adviser and just one company director or owner. The adviser gets to know and works with other directors or owners and officials in the company, but the original link tends to remain strongest and effectively underpins the advisers relationship with the firm as a whole.

In this situation, as well as possible conflicts of interest, the adviser could be seen by others at the company to be allied with, and sympathetic to the views and outlook of that particular owner or director. It helps if family business clients are on their guard to try to avoid such undercurrents, but, more to the point, family business advisers must take a very strict and uncompromising stance in these circumstances. If there is any possibility that their neutrality might be seen to be compromised, he or she should step aside from the particular advisory role they are being asked to play and arrange to be replaced by a colleague who has no historic links with the firm. Family business issues are generally complex, and always emotionally sensitive, and – put simply – if a family business adviser is regarded by a particular branch or generation of the family as perhaps not wholeheartedly neutral, their effectiveness in promoting successful resolution of the problems and issues facing that business is almost certain to be flawed.

Whether the company ends up adopting any of the strategies or options put forward by the professional adviser is ultimately an internal decision by the owners. Of course, a good adviser will have enabled the family to come up with their own strategies rather than have proposed these to them. But, in considering and discussing all the alternatives, external advisers can rest easy knowing they have done their job, and family business board members can be comforted by knowing they’ve secured objective guidance helping them to decide the best way forward for their company and its shareholders.

Chapter 6

Conclusions

By being outward-looking and willing to take advantage of external skills, family businesses are better able to grow and respond successfully to change.

To grow beyond the one-man business stage, a firm must make use of outside expertise. The transition is not an easy one. As the company becomes larger and more complex, the foundations have to be laid for a more structured, less centralised organisation. The task is significantly more difficult for family than for non-family businesses, because there's a strong temptation in many family firms to depend on internal experience and internal judgements. Without some external input into these companies, they are all too easily prone to become introverted, inflexible and uncompetitive.

In this guide we have examined the principal resources available to family businesses to help them build outside and objective influence into their management structure – namely a strong, independent board, non-executive directors, non-family managers and outside advisers. In summary, the key points have been that:

- establishing an independent board of directors at the right time is probably crucial for the vast majority of family businesses if they are to achieve long-term success
- such a board brings objectivity and experience to operational and policy deliberations, and imposes important disciplines by requiring MDs to articulate and justify their plans
- an independent board should establish a close relationship with the family. It can play an important, impartial role supporting the family and helping it to resolve problems and difficulties
- non-executive directors can be especially valuable to family-owned companies, offering seasoned guidance, specialised expertise, and networking connections
- dedicated and well-motivated non-family managers provide family businesses with an extra competitive edge and the opportunity for achieving superior performance

- outside advisers and consultants can contribute significantly to professionalising the business. Their selection should be based on competence and their performance periodically reviewed.

The business school view by Professor Nigel Nicholson, London Business School*

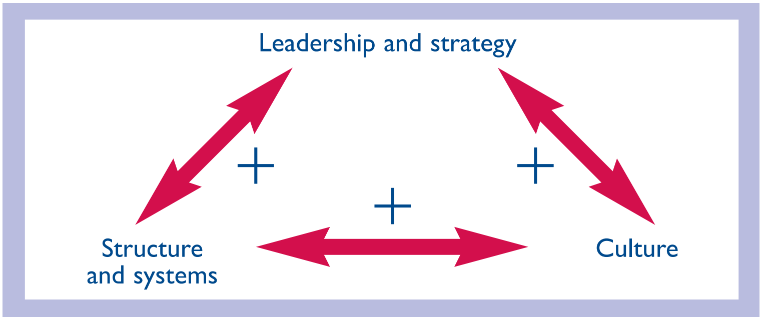
The competitive advantage of open cultures

An underlying theme of this guide – the invisible thread that unites governance with the role of external advisers and non-family executives – is culture. It is both a cause and effect of having the right mechanisms and measures in place to deliver adaptability and excellence. Culture makes possible novel solutions to the classic problems facing every firm. Having the right systems helps to build and sustain a positive culture, and culture is the crucial link between structures and performance excellence.

The trouble with culture is that it is a slippery, soft and elusive concept. We all know it matters, and both excellent and malignant cultures shout their existence to newcomers and old-timers alike. But culture is difficult to define, practically impossible to measure and usually hard to change. However, it is the principal source of comparative advantage for family firms over other firms. It is also the achilles heel where it is insufficiently supported by good business practice.

The business literature, drawing on anthropology, portrays culture as akin to an iceberg. What stands out above the waterline is the sight, sound, smell and touch of the place – how people express themselves, interact and use the visible space. The larger, less visible mass below the surface consists of the shared meanings of the organisational community, their assumptions, ideas about the world and deep values. These are important because they limit what people pay attention to, how they work together and what they are prepared to do in the face of pressures to change. It is culture that determines whether a company can hold itself together, adapt to environmental change and achieve sustained performance. Culture divides the firms that work in a climate of trust from those where suspicion and fear rule. It is what underpins the firm where innovation is really valued, as well as the one that is deeply conservative and change resistant. It is the factor that makes one business environment intensely warm and sociable, and another cool and individualistic.

What keeps culture in place? Leaders set the tone, while structures and systems establish the patterns. As regards what one can do to create a culture that will sustain the kind of openness that characterises good governance, without loss of control and integrity, the figure indicates the role of culture in the working of the business. Success comes from positive alignment between these three elements.



The first element is leadership and the strategic direction of the business. In family firms this is often a key to distinctive excellence – a long-term perspective is underpinned by leadership continuity and vision. The break points here come when family is internally divided, where non-family leadership is pulling in a different direction to family, or when insufficient intelligence is gathered from external sources. It is structures and systems – especially well-designed governance arrangements – that enable these problems to be mastered, and it is culture that supplies the motivation and spirit to find the common ground of shared values and purposes to overcome difficulties.

The character of a business derives from the kinds of patterns that circulate between these three compass points. Consistency matters. One common and consistent pattern is the family firm headed by an autocratic family patriarch, supported by top-down control systems and a culture where everyone defers to authority. This can achieve results, but only so long as the environment remains predictable and flexibility is not needed – a model that the modern business world will not sustain. More fitting our times is the open culture, but this requires leaders who can listen as well as direct, and systems that can bring in and integrate the challenge of outside perspectives. The greatest problems occur when the three points are pulling in different directions, such as when leaders don't 'walk the talk' – ie their stated vision is contradicted by what they actually are seen to do. It is also a common occurrence that reward systems and operating rules run counter to strategic objectives and cultural values.

In family firms there is often a strong alignment between leadership and culture. The problem is typically the insufficiency of systems and structures – especially governance to guide action and implement change. The solution lies in the hands of leaders and the choices they can make.

Especially in family firms, structures can be reformed by enlightened and well-advised leaders, which in turn enables new strategies to develop, positive cultural values to flourish and for fresh blood to enter the business. By such means are culture, leadership and business processes mobilised toward renewal.

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Peter Leach Associates Ltd

The continued success of the family business sector is critical to the UK economy. Yet, surprisingly, little guidance is available on these unique and complex issues that family businesses face. One organisation, however, makes available the guidance and help family businesses need.

Peter Leach Associates specialises in advising family-owned businesses and the people behind them. With over 30 years of experience in the field, Peter Leach is one of the world's leading family business consultants and facilitators. He has a successful track record of working with and transforming numerous family businesses across the world.

From our experience, built up over many years of working with family businesses we know that no two are the same - nor are the commercial or competitive pressures that affect them. For that reason, we tailor our approach to the specific needs of the family and the business involved in each assignment we undertake.

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