6 insights for facilitating success in family-owned transitions

a white paper authored by

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Fast evolution

Family businesses make up more than 60% of all companies in Europe, spanning from 65% in Romania to 80% in Austria, 87% in Czech and up to 90% in Slovakia. The numbers in Europe are impressive according to europeanfamilybusinesses.eu: more than 14 million family-owned businesses in EU which bring around 50% of GDP and ensure more than 60 million jobs in the private sector.

When looking at the family business ecosystem across Europe the difference between Western Europe and Central Eastern Europe are mainly in terms of age of companies and the number of generations involved since their foundation. During the last 30 years family-owned businesses across Central Eastern Europe evolved more rapidly than those in more mature markets.

But this fast evolution and the timing (especially in CEE region where most owners are getting closer to retirement age) reveal the greatest challenge for the family business, and this is transferring the ownership and/or management of the business to the next generation or exit in case the option of transfer does not exists. More than ever, the pandemic showed that circumstances can rapidly change in ways that are beyond the control of any family and a succession plan is crucial. And, what seems the danger is that, especially in CEE region, most family business leaders do not have a succession plan, at least not one documented and openly communicated to all parties involved.

But ownership succession and management succession are two separate things, which do not have to occur at the same time. Assuming that ownership succession is ensured, and one or more children are interested in owning and running the family business the owners still need to think of planning the succession and established governance processes to make the succession leaner.

But what can an owner do when there are no legitimate successors or none of the younger family members is interested in working in the family business, let alone ultimately running it? Especially in CEE where most family-owned businesses are or will be at their first generation transition the risk is that the emotional attachment to the business may not be as deep for next-generation successors as it is with first generation entrepreneurs who’s private and business lives have often been interconnected.

In both cases, ownership or management succession, planning for succession is the key to success. And, to do that, external support is often needed if founders want their firms to stand the test of time.

While an owner can work on management and ownership succession at the same time, we recommend progressing management succession first because it can make the transition easier for the current business owner(s) compared to giving up control of management and ownership at the same time.

When is time to think about management transition and how could it be done? The short answer is the sooner, the better.

1. The owner is a solo manager of the firm

Most dangerous is when there is no contingency plan in case the owner-leader suddenly wants to leave the business or unexpectedly becomes incapacitated or passes away. Too much centralized control or too much dependence on owner puts a family business at risk when the owner-manager gets out of the business.

Professionalizing a family firm is a necessary yet difficult process because, mainly, there are lot of emotional issues involved especially in case of owners whose sense of identity is so tied to their business that they literally don't know 'who' else they are except being the 'leader of the business.' What we advise our clients after they've decided to bring outside managers in to the business is to clarify their new role and consistently stick to it. The biggest temptation they have is to resist providing input when someone comes to them with a question which should be addressed to the new management team appointed to lead.

But let's be honest, it is hard to replace yourself or a family member while it isn't as hard to replace an outsider. Using outsiders early on will give the business more scalability and more flexibility as it grows. One of the solutions for a smooth transition is partnering with an interim executive firm because the fear of losing control over own company is minimal since an interim executive does not aspire to lead the company.

2. Weakening emotional ties of the owner to the business or thoughts of retirement

When that time comes some owners bring in an interim CEO to facilitate the transition from family leadership to a professional governance model. This intermediary step makes the change easier because usually this is a person with the broad experience to lead the company but has no plans to stay CEO in the long term. Over a defined period, usually 2 – 3 years, the interim CEO builds up a professional management team and tightens links between family members and professional executives.

After this transition period, a new CEO (could be a family member) takes the helm and, in many cases, the interim CEO stays as an independent advisor to the family.

Other owners, especially when there is no successor in the family, initially hire an executive to serve as the COO, giving him or her time to settle in and understand the business and its culture. Only after the COO proves suitable through high performance and understanding of the business and owner's vision a complete transition to CEO role could take place (usually in one or two years) by assigning more decision rights

3. There are no well-established governance processes in place

Owners ready to make a step back from daily operational leadership need meaningful, future-oriented strategies, a solid financial base, and optimal processes and structures for achieving their goals and creating more value for the business.

If early attempts of governance start with discussions with the company lawyer or accountant, over time, the topics move to competitiveness, route-to market strategy, owner' vision around growth, risk, profitability and liquidity, organizational design, risk management, accountabilities, guidelines for appointing future leaders, compensation & benefits, decision rights and the extent to which the owners want family members involved in the business and what their roles will be. There are no two governance approaches identical because they must fit the family business.

However, in their effort to professionalize, some companies overcomplicate the organization's structure and processes, affecting its effectiveness. The structure should support the company's growth needs over medium term rather than long term and should reflect the company's culture and history as well as the owner's preferences. To ensure successful transition, rather than creating manuals for every process, transition teams should focus on defining cross-functional and critical business processes as well as key support processes. New processes must keep the strengths that the family and company culture bring to the business and retain and protect the existing advantages, rather than dilute, the company's distinctiveness.

Besides structure and processes, a strong control system is needed to be put in place (such as management information systems) because it gives the owner / family the confidence that when they delegate decision making, they will still be kept informed about performance.

4. The designated child is not ready

What do you do if the designated child or children to lead the family business are not ready yet to lead (too young or too unexperienced) or even not willing to take over the family business?

An interim management team can manage the business for a period of time until the next generation in the family is old enough or experienced enough to take over management of the business if they want to, of course.

By assigning the operational side of the business to professionals (permanent teams or interim managers), owners can ensure that their families and firm survive at least until a family member is ready to take over. Having a solution in place, even if it means skipping a generation, can make a company far more credible in the eyes of employees, customers, suppliers, and attractive to potential investors.

Moreover, the more a founder can convince the next generation that the firm is managed like any other corporation the more likely young generation will feel attracted to playing an active role in the company instead of looking for opportunities outside the family business.

5. Complexity of the business

The more complex the business is, the more time for a proper transition is needed. Some of our clients recognized that a diversity of viewpoints is essential because family businesses need to overcome the challenges of growing complexity when competing in a regional or global marketplace. Especially lately, owners need a broader perspective, and involving multiple points of view, from outside the business can contribute to that. Complex does not mean necessarily complicated, and an external perspective could help also in simplifying processes and bringing more clarity and leaner operations.

Interim or permanent managers bring a perspective to the table that an owner might not have and could also play the voice of reason when decisions might be too influenced by emotions.

6. Stagnant growth

Some family businesses stagnate once they achieve a predetermined level of growth. Reasons are diverse, from lack of financing opportunities to internal operational issues. Usually, owners have a natural preference for organic growth and a much more prudent approach to M&A than their corporate counterparts mainly due to their long-term focus which implies quite conservative portfolio strategies based on competencies built over time, coupled with moderate diversification around the core businesses. Many times, the owner might be a blocker of growth because of lack of time to make all the necessary decisions especially when there is no intermediate management structure in place and decision making tends to be delegated upwards.

Wrap-up

Even though we are strong promoters of professionalization of family business we feel the need to reiterate the big difference between Ownership and Management which, if understood well is the basis of success in a family-business transition. For a transition manager to succeed in a (especially first) transition it is crucial to acknowledge that in such companies, family-comes-first philosophy may dictate decisions. At the same time, Owners / family members need to recognize that leaving the decision involving value creation to someone else may be in the best interest of the company.

Of course, separating ownership and management is, however, not without its disadvantages which span from slower decision-making and reduced flexibility and agility when responding to change, to conflicts of interests between owners and management team. Nevertheless, in many instances, the advantages are bigger than the disadvantages, most of which can be managed through implementing sound governance.

International cooperation

This white paper is a contribution of SMW's partner Interim Management Advisor (Ana Ber) from Romania.
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