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Who's 1st in the Family Business?

by David Dudon

The answer to that question says a lot about how the business is run and its prospects for the future.

IT IS OFTEN SAID THAT experience is the best teacher. I've also heard that the best way to learn is to teach. When it comes to managing family businesses, I've done both.

For sixteen years, I served as President and CEO of the machining and fabrication business that my father had started. I love my family, and it was a joy to work with them in this way. Our business relationship enabled us to create a body of memories unique among most families, and we were blessed with enough financial success to provide a living for all of us. Yet, it was not always easy. Family businesses are still businesses, so they encounter all the same struggles and barriers to growth as non-family operations. In addition, when professional relationships are also blood-related, one must deal with another set of challenges. It can be very difficult to make sound *business* decisions when those most affected will be sitting at your Thanksgiving dinner.

For the last two years, I have taught business management courses, including courses on family businesses, as an adjunct professor at the University of Dayton. I guess they figured I was an expert with some knowledge to pass along, so they asked me to teach. In reality, preparing for my first class showed me how dumb I really am. Somehow, I've now made it through four semesters without the administration realizing that they are actually paying *me* to learn. What an experience this has been! In preparing notes, reading books, and communicating my experience, I've gleaned numerous lessons that I wish I would have known when I was actually in business myself. (If my students ever read this, I'm toast.)

I actually have a second outlet for teaching: my own advising business. After exiting my family business, I began advising CEOs and executive teams in the areas of strategic thinking, strategy execution, and team alignment. Because of my experience in and passion for family businesses, many of my clients fit this mold. It's gratifying to share the things I've learned with those who are still in a position to apply them. Together, my clients and I continue to learn what works best and what does not work at all.

Through all of this, I have found there to be three types of family businesses. Let's call them Family First, Business First, and Shareholder First. Each has its own culture, authority structure, and objectives. Each has its own way of making decisions, and the consequences (good or bad) of each type are real. I like to illustrate these types using the relationship between the three leadership entities common to all family businesses: the family, the CEO (who is usually the entrepreneur who started the business), and the management team.

If you are a leader in a family business, I'm sure you'll see yourself in one of these models. Perhaps this article will prompt some thinking that is long overdue – or simply a good refreshment of some good work you've already done. If you are *not* in a family business, the principles in this article still apply to you. While family businesses are certainly unique, good management is good management no matter what type of business yours is.

FAMILY FIRST

The Family First business is easy to define. If the CEO is a Johnson, and your last name is Johnson, then you've got a spot in the business – perhaps even the leadership team – whether you are qualified or not. That may seem like an excessively strong statement, but I've seen a lot of family businesses, and it's not uncommon.

As its label implies, the Family First business is all about the family. The CEO (usually the founder) defines himself by the business, so it's very important to him to keep the family name at the top. Therefore, he demonstrates unflappable loyalty to his family whether they are invested or not. The CEO communicates almost exclusively with the family. Financial numbers are handled not by the executive team, but by the family. The family even exerts tremendous influence over who does what in the business.

Much has been written about the importance of trust in executive leadership, but in the Family First business, it's simply not there outside of the family circle. Ownership chooses not to share information with the management team, much less the employees. No matter how hard the management team works or how much value they create, the family keeps them in the dark, and they can only do the best they can with the limited information they're given. One might call this a communication issue, but it's much more serious than that. It's a lack of trust, and it's purposely designed that way.

The family's motivation to operate this way is simple: money. They want to live the life of a king, complete with fancy cars, big vacations, large houses, and financial rewards for their grandchildren. The attitude is, "We're giving people jobs; what else do they want?"

Air Field (Brian Laurich)

Let me be clear. The family has every right to operate this way. After all, they do own the business, so it's up to them how they want to run their company, invest their resources, and distribute the financial yields. With this right, however, comes the "right" to the consequences of their decisions. In most cases, they're not good.

For one thing, Family First businesses rarely survive beyond the second generation. Usually, they last only as long as the original entrepreneur stays involved. The lack of trust starts with him, and it's been present from the beginning. He started the business by doing everything himself, and he's never stopped. Decades have passed, and despite his "CEO" title, he still hasn't learned to manage; he only knows how to *do*. The business was built on his passion, speed, and tenacity. When a client had a problem, he was quick to solve it, and this speed built the business. Sure, employees and management teams were hired along the way, but it's still the entrepreneur running the entire show.

The problem with this is obvious. When that same entrepreneur decides it's time to retire or passes away, there's nobody to take his place because he has not trained anyone properly. Worse, his organization was built to support him, not to perform the work for him. This is usually when the next generation steps into their "rightful" leadership roles. (They are Johnsons, after all.) The problem is that they don't know what they're doing. Therefore, they call on anybody they can find in the organization who has an idea of what to do, resulting in management by committee. Consequently, the strength of the business (speed) is totally lost, and the company starts to decline.

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In *How the Mighty Fall*, Jim Collins illustrates the progression that companies go through on their way to decline. Stage 1 is "hubris born of success," and that's exactly what we see in the Family First business. The business may still be growing, but beneath the external signs of success, they have lost their competitive advantage because the new generation is trying to make decisions that they're unqualified to make. Every growing organization hits a leadership barrier at some point; in this case, the Family First business hits it because the leaders are only there for their last name.

Within the leadership issue is a talent issue. According to Collins, "no company can consistently grow revenues faster than its ability to get enough of the right people to implement that growth." (He calls this Packard's Law.) Great talent won't put up with the Family First business for very long. Collins explains why when describing Stage 2 in *How the Mighty Fall*:

> A Stage 2 company can fall into a vicious spiral. You break Packard's Law and begin to fill key seats with the wrong people; to compensate for the wrong people's inadequacies, you institute bureaucratic procedures; this, in turn, drives away the right people (because they chafe under the bureaucracy or cannot tolerate working with less competent people or both); this then invites more bureaucracy to compensate for having more of the wrong people, which then drives away more of the right people; and a culture of bureaucratic mediocrity gradually replaces a culture of disciplined excellence.

Interestingly enough, these businesses usually do end up with a consistent, loyal workforce; it's just not composed of the *right* people. Workers grow complacent in this environment, taking advantage of a decent wage and a family ownership that consistently pays it. The attitude tends to be, "We are who we are; we'll never get any better, and that's okay. I'll just stay here, do the best I can, and keep my job." And that's exactly what happens. The organization reaches a certain level and never progresses further. They'll explain it as being the product of adverse market forces or some other excuse, never facing the brutal fact that the reason they are where they are is that they lack sufficient leadership.

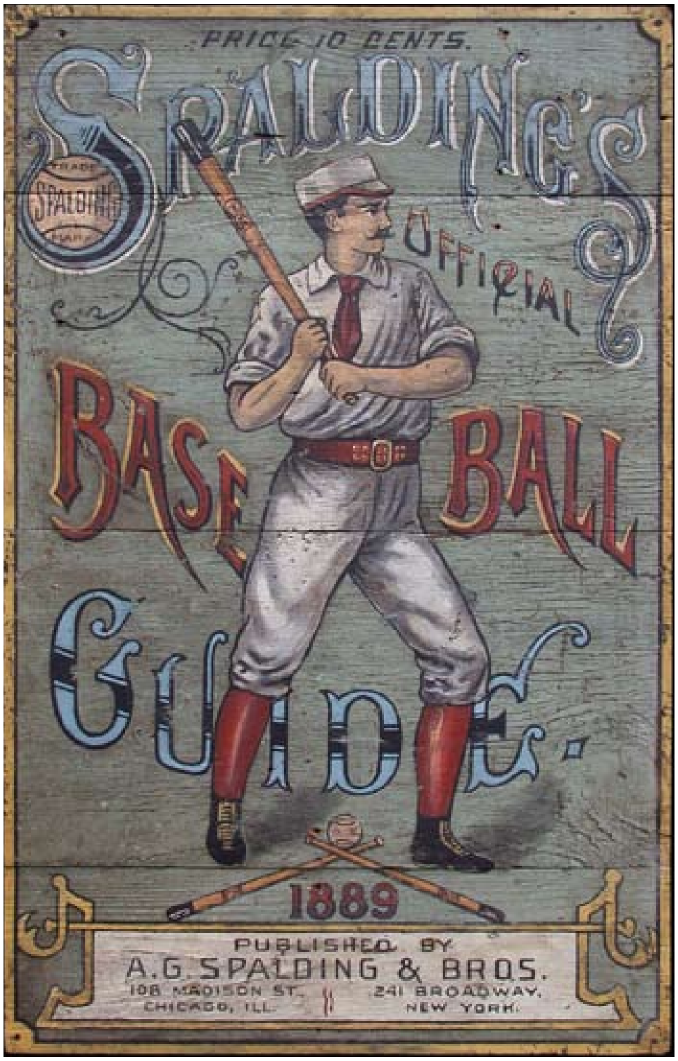
And the family distrusts whatever leadership they do have. Why? Well, they're not Johnsons.

BUSINESS FIRST

The Business First family business is owned by a Johnson, but it's not about the Johnsons. Family members must be qualified to progress in the business. It should come as no surprise that in my experience, Business First organizations operate way above the curve relative to their Family First peers. In some cases, these businesses may not even have any family on the executive team.

The CEO of the Business First business is still loyal to his family, and he still keeps family informed and involved to the extent that they can be helpful. However, the business has its own identity separate from the family name. Naturally, the CEO would love future generations to succeed him, but only if it is good for the business. In fact, all business decisions are made on what is best for the business, not the family.

What makes a Business First company work right is what makes any company work right: executive team alignment, clear strategic thinking, and strong strategy execution. They focus on getting the *right* people on board, not just the right last name. They are loyal not just to the family, but to the employees who make the business work and whose livelihoods



1889 Spalding Baseball Guide (Brian Laurich)

depend on its success.

Trust in the management team is high. After all, they were hired to do a job, so they must be equipped to do it. The ultimate goal for the CEO is value creation, so profits are largely reinvested in the business rather than divested to the family.

Obviously, the long-term prospects for the Business First company are much better than the Family First company. Having built an organization with capabilities greater than his own, the CEO enjoys the confidence of knowing that when he decides to step down, the business will continue whether his children are running it or not.

However, such a seamless transition can only occur if the founder has carefully formulated a succession plan. In many cases, most of his assets are in the business. When his life ends, the family usually inherits the assets whether they've been involved in the business or not. This can create a very difficult situation for the organization. Suddenly, non-involved family members are driving company cars and even collecting paychecks simply because they have inherited ownership. Because they are owners, decisions cannot be made without their approval. Thus, every decision is slow and based on a "what's in it for me" mentality. Consequently, the Business First mentality becomes a Family First mentality, and the organization declines (not to mention the family relationships).

The moral of the story is that in the family business, succession planning is absolutely essential to maintain harmony both in the business and the family. It is also the only way to ensure that the Business First business *remains* a Business First business.

SHAREHOLDER FIRST

The Shareholder First family business looks much like the ideal Business First structure with one key difference: even the CEO is not family. The family members are the owners – period. They are not involved with the day-to-day operations in any way. They're not looking for power, and they're not looking to strip the business of cash. They just keep their hands off, and if it continues to build wealth, they're happy. They understand that growth takes time, so they buy into a long-term strategy and trust their management team to execute the plan.

The Ford Motor Company is a good example of this. The Ford family, led by the 13 great-grandchildren of Henry Ford, still owns a controlling interest in their iconic namesake. But they don't directly run the company. In fact, CEO Bill Ford, Jr. fired himself and hired an outsider, Alan Mulally, to replace him in 2006. By all accounts, the management team confidently runs the company with the confidence of the Ford family's support.

A FOURTH MODEL?

It's quite possible for all three leadership entities to intersect. In this case, the family *is* the executive team. This rarely lasts long, however. With time, the business will take on one of the three structures already discussed. As the generations pass, it's very difficult to maintain a full integration of family and business operations, and I'm not sure it's even desirable. The business must be free to function as a business, unhindered by personal ambitions or the legacy of a family name. The lives of many – employees and family members – depend on it.

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