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Family Business Part I

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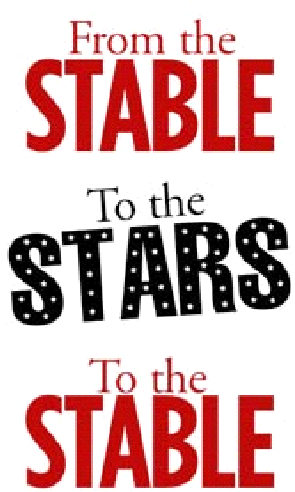

Want your family business to survive and thrive from generation to generation, long after you're gone? In Part I of our three-part series, family business expert (and sixth-generation family business member) Matthias Redlefsen shares some universal principles of family businesses.

Family businesses form the backbone of our economy. Eighty five percent of all companies in the United States are family businesses. They provide 60% of all jobs and produce over half of the country's GNP.

However, no matter how important our family businesses are, keeping the business in the family generation after generation is a real challenge. Statistics show just how tough it is: Only 40% of family businesses make it to the second generation, 12% into the third and just 3% to the fourth.

This problem of family businesses surviving from one generation to the next is not a purely American phenomenon. It's known in almost all languages of the world.

In Germany, for example, the saying is "Der Vater erstellts der Sohn erhaelts dem Enkel zerfaellts" (The father puts it up, the son maintains it, the grandson loses it). And in Italy, people speak of "Dalle stalle alle stelle alle stalle," which translates to: "From the stable to the stars to the stable."

No rule is without its exception, of course, and perhaps the most exceptional of these is the Avedis Zildjian Company of Norwell, Massachusetts, the oldest family business in North America. This world-famous cymbal maker was established in 1623, and today is managed by sisters Craigie and Debbie Zildjian, the 14th generation of the Zildjian family.

Interestingly, at least 26 of the 100 oldest family businesses in the US are active in areas such as farming, agriculture, horticulture and ranching, which bodes well for us!

However, keeping a family business alive and kicking doesn't happen by itself. It's a tough management job—in the family as much as in the business. However, when everything is working well, there are few things in life more rewarding than harvesting the fruits of your labor alongside your family members, and contributing to something that will continue in your spirit long after you are gone.

This joy has nothing to do with business size. It applies to large family businesses such as Walmart just as much as to the mom & pop store around the corner. The advantages of family businesses compared to anonymous capital companies are many. Family-run companies think more long-term. Their ownership structure is much more stable, the management at the top does not rotate as often, and the strategy is not assessed on a quarterly basis.

In spite of this long-term outlook, family businesses are usually able to make decisions very quickly. Because the owners are at least, in some part, also the ones who run the business, there's no need for complex decision-making hierarchies. The truly important decisions are not made in the conference room but are decided at the kitchen table and are rapidly translated into the business. This also applies to what happens inside the company. Because of their flat hierarchy, family businesses are in a position to act quickly and flexibly, and thus save on complex and expensive overhead.

Last but not least, family businesses have a personal touch, something that anonymous corporations lack. The fact that there's an actual family involved in the company is something employees can identify with and draw motivation from. The family and its members provide the company with a face—and that cannot be replaced by a even a thousand mission statements.

No matter how impressive all these advantages may be, the weaknesses of family businesses also present dangers. First, there's the major problem of adequate finance. While public companies can more easily find funds through the stock market and other financial instruments, this is not possible for family businesses without losing at least some control and giving up part of their independence.

But by far the greatest risk for the family business is conflicts within the family. Most family businesses die from the inside. Just like a rotten piece of fruit: When you see the signs on the outside, it's too late. The family ties and relationships within the business make the discussions and arguments complex and tricky, because they can get in the way of making the right and often necessary business decisions. It's impossible to come to hard decisions, such as firing your brother, without ruining Thanksgiving!

Mastering the art of running the family business consists of consciously utilizing one's strengths, while simultaneously controlling the risks. What does this mean in real terms? Here are five keys:

1. Be aware of your resources

> Family businesses have to earn their money before they can spend it. They're not in a position to tell an anonymous analyst or remote manager of a faraway conglomerate some tidy equity story, collect a few million dollars and invest wildly in what might turn out to be sensible investment. The balance sheet of the family enterprise consists of "sweat equity," and the liquidity is thick as blood.
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> The main focus should be on liquidity. While the profit figure can be optimized downwards to save tax or upwards to please the banks, the cash flow shows the true efficiency of a firm. Only companies that have control over their cash flow are capable of facilitating the breathing space

they need to maintain their independence. Cash is king! This does not mean, however, that one needs to save money at any price. You simply have to remember that every cent you spend has to be earned back twice. This is also the reason why family businesses—at least the good ones—have high levels of cost transparency. They know what their costs are and they act accordingly.

2. Be simple

The most underestimated costs are the costs of complexity. Complexity costs are invisible. That is what makes them so dangerous. The number of products, customers, suppliers or locations—all these features increase the complexity. A good IT system and a high degree of standardization can help to manage the complexity. Avoiding complexity is even better. This is not an easy task, because keeping the business simple means that you have to say “no” to a lot of things, including business opportunities that seem to make a lot of sense, at least in the short-term. Saying no isn’t always easy, especially when other members of the family are involved.

3. Be different and daring

Limited resources don’t just force family businesses to be simple, but also force them to focus. If you try to a little bit of everything, you will drown in mediocrity. At the start of the focusing process you should ask yourself, “What makes my business unique?” Is it the products and services? In that case, you should concentrate on innovation and creativity, and on development of new products and service. The efforts of all employees should be aimed to achieve this. Alternatively, a differentiation on price can be at least as effective. In order to be able to deliver long-term lower prices than the competition, a business has to work more cost effectively than the competition for a long period. In this case, innovation first concerns the processes involved, rather than the products.
No matter what type of differentiation a family business decides on, it needs to be ready to question its existing business model and to change. Never forget: Tradition doesn’t mean to worship the ashes, but to keep the fire burning.

4. Be a good example

People always follow people. This is a wonderful principle, which can simplify leadership enormously. Just lead by living the good example. Being a family member in the business means that you’re constantly watched. You can use this to your advantage. Behave in exactly the way that you’d like everybody in your business to behave. For example, if you set great store on punctuality, be punctual at all times. If you like neatness, be neat. Seeing the boss pick up a plant tag off the greenhouse floor is a thousand times more effective than posting memos all over the place.

Conversely, it also means that your negative behavior will be noticed and copied within the company. For example, it will be hard for employees to understand why they have to go without a Christmas bonus when they see the boss drive in after New Year’s Day in a brand new car. Practice what you preach—otherwise you’ll quickly lose your authority.

5. Treat your family just as professionally as you treat your business

> Personal ways of preserving the family business are very important, but it’s just as important to have professional guidelines in place for handling the many issues and questions that will arise. Open communication is key. Here are some of the common business issues that you need to talk about and establish guidelines for:
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> > • What are our goals for our family business? How important is our capital gain, how important is our independence, and what does this mean for our business strategy?
> > • By what guidelines are family members allowed to work in the business?
> > • By what guidelines do family members get promoted in the company? Who determines that?
> > • How do we deal with family members who aren’t good enough for the business?
> > • How do we recruit and motivate our external management?
> > • How much information is passed on to non-active family members, and how are they informed?
> > • What is our dividend policy?
> > • How do we remunerate family members? How do we deal with fringe benefits such as company cars, cell phones and secretaries?
> > • How do we behave in public? Who represents the business and the family?
> > • How do we deal with in-laws? What are their opportunities within the business? What are the limitations?
> > • How do we integrate in-laws into the family?
> > • How do we maintain family cohesion over the generations? How do we maintain our necessary individual freedom?
> > • How do we handle things should any family shareholder wish to leave?
> > • How do we handle conflicts within the family? How do we deal with taboos?
> > • How does the family arrive at decisions regarding the business?
> > • How do we introduce the next generation to the business? How can we get them to be genuinely interested without putting pressure on them?
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> It’s not so important how your family answers each of these questions. The essential part is that you talk about them and address them openly. Making these questions a subject for discussion prevents misunderstandings and disappointments caused by unspoken expectations—the strongest explosive for the family business.

The primeval roots of family conflict

To get control of this risk, it’s vital to tackle the problem right at the root. Only on the surface are family arguments about issues such as management, strategy, compensation or inheritance. Beneath these obvious issues, family businesses hide two primeval conflicts, conflicts that have existed as long as anyone can remember.

The first is the battle of the generations. Fathers wish their sons to be strong … but not stronger than themselves. Sons, on the other hand, want to beat their fathers. In the Greek mythology this dilemma was experienced by Oedipus, and it has not been resolved since. But it doesn’t have to be. The main thing for father and son to do is address the issue of their rivalry and overcome it together. In a scenario of strong generational rivalry the period of handing over should be kept as short as possible, thus limiting the time that they have to spend together in the company and reducing any possible friction. By the way, generational conflict between father and son are also the reason why a succession from father to daughter often works much better. It's an opportunity that far too few family businesses are considering.

The second primeval conflict is sibling rivalry. Cain slew his brother Abel out of jealousy. David was abandoned by his brothers because of envy, and Jacob deceived his father by pretending to be his favored brother. These biblical examples are not unrelated to the present day. They apply to the reality of the family business.

Children compete for the resources of their parents starting from early childhood. The good news is that this may provide them with social skills, motivation and ambition. But it contains the constant danger of ambition changing into jealousy and envy. To accept and openly discuss these phenomena in the family is perhaps the most important tool for maintaining the family business.

All conflict in the business family is about the same three issues. It is about money. It is about power. And it is about love. These are the three "currencies" in which business families function and trade, and it's important to find out which "currency" is the most important to each individual family member. When, for example, you have a son who does not feel your love and appreciation, don't try to make up for this by giving him shares in the firm. It's a better idea to take him along on a vacation with you, alone, and spend some quality time with him. So whenever you have a conflict in the business family, ask yourself: Is it about money? Is it about power? Or is it about love?

Families that jointly manage to overcome their conflicts about money, power and love are able to develop a strength that will take their business very far. Because after all, behind every strong family business stands a strong family. This is a prerequisite for any long-term business success.

Therefore, treat your family in the same professional way as your business. Grapple with your family just as intensively as you do with your customers, fellow workers and products. After all, in family businesses success is basically a question of education.

Matthias Redlefsen is one of two Managing Directors of Ernst Benary Seeds of Germany (and is married to the sixth-generation owner, Klaudia Benary-Redlefsen). He earned a doctoral degree in multi-generational family businesses, and before joining Benary was an expert consultant on the topic. He comes from a long line of multi-generational family businesses on both his mother's and father's side of the family. He can be reached at Matthias.Redlefsen@benary.com.