# Time for an outsider

## Succession planning for the family business

SpencerStuart

## About Spencer Stuart

Spencer Stuart is the foremost privately held, global executive search firm, spanning over 50 offices in 25 countries. Since 1956, Spencer Stuart has been providing select clients with a range of human capital solutions, including senior-level executive search, board director appointments and strategic leadership services. The firm conducts nearly 4,000 assignments each year, partnering effectively with clients ranging from the Fortune 500, to mid-cap, to emerging growth companies across a broad range of industries and sectors.

Widely regarded as the firm of choice for CEO, board director and other top-level executive searches, Spencer Stuart's worldwide consultants have the judgment, insight and expertise to find the ideal fit for each company's unique circumstances and business goals. Clients choose to establish long-term relationships with the firm based on exceptional client service, unmatched access to the most sought-after leaders and consistently successful results.

Spencer Stuart has a nearly 50 year history of providing senior-executive recruiting services and counsel on leadership issues for family-owned businesses and public companies alike. Spencer Stuart is the only major search firm to have a dedicated team of consultants possessing a combination of extensive industry and functional search expertise with an understanding of the unique dynamics of family businesses that can affect succession planning and recruiting. The firm's consultants regularly advise family business management, boards and family councils on critical leadership needs.

"Time for an outsider: Succession planning for the family business" is the first in a series of articles exploring family business leadership issues, including succession planning, recruiting the best outside candidates and successfully integrating the outside hires into the organization.

DRAMATIC STORIES ABOUT WARRING family factions, paternalistic and insular cultures and weak governance have given the family business a sometimes-deserved bad rap. But the characteristics behind those criticisms — passion for the business and paternalistic and decisive leadership — more often have served as key strengths distinguishing the family-owned company.

Companies such as Dell, Walgreen, Wal-Mart and Wrigley underscore the rich history of enterprise and innovation that has characterized the family business. But of the thousands of family businesses launched each year, many will not survive beyond the founder because of the challenges related to passing the business from one generation to the next. Succession planning is one of the most important responsibilities of the leadership of any company, but it is particularly critical — and, typically, more complex — in family companies.

Why more complex? In many family companies, there is a presumption that the next generation will assume management roles with the same dedication and drive of the current one. These companies therefore must groom heirs who not only have the business experience and skills, but also have the passion for the company and the respect of employees and outside investors. And family businesses typically place a high value on maintaining the company's unique culture and promoting from within, but still must ensure that they have the "best and brightest" in management.

## The family business

Though the precise impact is not known, family businesses represent a significant economic force. Some 30 percent of S&P 500 companies and as many as 90 percent of all companies, according to some estimates, are family businesses. Studies have shown that family-owned businesses account for 60 percent of total U.S. employment, more than 75 percent of all new jobs and 65 percent of all wages.

And if the family business is an important driver of the overall economy, it also appears to be an important factor in success. A November 2003 *BusinessWeek* special report, in which Spencer Stuart participated, found the family business has unique advantages over its nonfamily counterpart that can translate into superior performance. Family companies outpaced nonfamily companies in annual revenue growth, 23.4 percent versus 10.8 percent, and income growth, 21.1 percent versus 12.6 percent. The study also found that the annual shareholder return averaged 15.6 percent for family companies, compared with 11.2 percent for nonfamily companies.

What gives the family-owned company its edge? First, with the family name and reputation on the line, the success of the company is personal. Founders and their families typically have a passion for the business and its success that can be difficult to match in nonfamily companies, even with a generous salary and stock options. With the family legacy at stake, leaders of family-owned enterprises often are willing to put company interests before their own personal interests. Without a large bureaucracy to move or overcome, family companies can make decisions quickly and pounce on opportunities.

Another advantage is the family's long-term financial interest in the company. With an eye more on long-term growth and profitability than quarterly swings in the stock price, family business leaders tend to reinvest in the company and make decisions with a view to sustaining the organization's health and viability over the long haul. And because management and, often, directors are so heavily invested in the company, they have an incentive to pay attention to the details and invest the necessary time in the company.

Despite their many strengths, family-owned businesses also face unique challenges. Family disputes over ownership, management or the direction of the company can distract the business or even grow so bitter as to threaten the company's survival or the future of family ownership. In addition, companies that fail to provide for ongoing shareholder liquidity can run into conflicts when a family member needs to or wants to cash out of the business.

One of the most important challenges for the family business to overcome, and unfortunately, one of the most commonly neglected areas in our experience, is planning for the succession of the top leaders.

Of course, family businesses are far from alone in neglecting to plan for succession. But for companies so closely associated with an individual, the sudden, unexpected loss of the founder or strong family leader can create confusion and uncertainty for investors, customers, suppliers and employees. Conversely, a family business with too many heirs that has not prepared for an orderly management turnover may be setting the scene for a disruptive battle in the boardroom and, perhaps, the courtroom.

We have seen through our work with family businesses — and statistics bear this out — that the majority of founders or CEOs of family-controlled businesses prefer that a member of the family carry on the management of the company. Fewer than half get their wish. With no family member able or willing to move into the CEO position, more than 50 percent of these companies must turn to an outsider.

In our experience, it is not that the top management of family businesses does not give thought to succession, but that it often fails to apply the same diligence to succession that it does to other key strategic issues. For example, founders often have informal succession plans — perhaps an heir apparent in mind. But if they have not secured buy-in from family stakeholders and the board of directors for their choice or objectively assessed whether the heir has the necessary skills and experience to step into the CEO role, their chosen successor may be unable to move smoothly into the top job, or may be set up to fail.

## Planning for leadership succession

At any company, one of the most important jobs for the board and CEO is ensuring an uninterrupted flow of capable management. To maintain continuity and prevent last-minute scrambles to identify the next generation of leadership, executives and boards of family businesses must actively plan for succession and, when they must consider recruiting an outsider, take care to find an individual who not only has the appropriate leadership skills, but also is compatible with the organization's culture.

A strong, involved board of directors, particularly one that includes outsiders, can be invaluable in developing an objective process for succession planning that includes developing criteria for future leadership, benchmarking internal candidates and identifying

skill gaps. Like the board of a public company, the board should establish a committee that is charged with ensuring that succession planning is top of mind.

*The companies that are most successful at maintaining management continuity plan regularly and systematically for CEO succession.*

Another important player in the succession planning process is the family council, which represents the family owners who may not be in management or on the board of directors. In well-governed companies, the family council works to achieve family consensus on important company issues, including succession, before they go to the board. The family council becomes a critical element to successful governance in most well-run family businesses.

The companies that are most successful at maintaining management continuity plan regularly and systematically for CEO succession. They view succession planning as an ongoing and real-time process; at least once or twice each year, the board and CEO review on a formal basis who would take over in the event of a crisis and consider the current CEO's timetable for retirement. These discussions should be linked to the strategic planning process. Succession also should be a regular topic for discussion at family council meetings.

Succession planning begins by taking into account the company's strategic objectives — such as a planned expansion into new geographic or product markets — and challenges. The board must identify the skills and expertise the company will need over the next three to five years given its strategy and circumstances. This process should conclude with the development of a detailed position specification outlining the qualities and experiences that are required of the CEO.

Often, the family already has identified potential internal candidates to succeed the current management. In such cases, the board should evaluate those individuals in relation to the established CEO criteria, benchmarking their skills, abilities and experience against the industry's best-in-class. By periodically calibrating likely internal candidates against comparable outside leaders, companies can ensure that the best candidate from across the broadest possible universe is chosen. Assessments also are valuable for identifying skill gaps and developmental needs of internal candidates, which then can be addressed.

## Time for an outsider?

Sometimes the succession planning process reveals that no family member is available or ready to assume control of management or that the company is at a stage when it requires leadership with specific expertise. In these cases, the board and family council must consider whether to recruit management from outside the company. Among the situations when a company may want to recruit an outside manager are when:

> No insider is ready or has the support of the board because of the early departure of the CEO or because the hoped-for candidate is not meeting expectations.

> The grace period granted to an outsider will provide additional time to put a new strategy in place or add new talent to the team.

> Major change is needed, such as a new strategy or organizational shake-up.

> The company is underperforming versus the competition.

> The company is in the midst of a scandal.

When it is necessary to recruit a nonfamily executive, some companies may be tempted to try to bring in an outsider to serve in the No. 2 position, as a sort of CEO-in-waiting, or to groom the next generation of family leadership. Be aware that few of the most qualified, in-demand individuals would be willing to accept "waiting" or back-up positions unless strict deadlines for succession are agreed upon in advance.

Once companies have decided to consider outside candidates, many find it valuable to work with an outside consultant who is not only knowledgeable about the industry and talent pool, but also familiar with the issues specific to family businesses. An executive recruiter can help identify the particular qualities and skills required for the position, cast a wide net for the best possible candidates and vet unsuitable candidates. Engaging a third-party also distances management and sitting directors from the process, helping to diffuse sensitive issues related to internal candidates and making the process more transparent and credible. Search consultants also can help potential candidates understand and navigate company-specific issues and facilitate salary negotiations between the company and the outside candidate.

Before engaging an executive recruiter, companies should make sure the firm has the appropriate industry search experience and can demonstrate that it understands the demands of the role and the leadership requirements unique to family business executives. The firm also should be well versed in corporate governance best practices and prevailing compensation standards and provide case studies and client references that demonstrate its track record.

## Conclusion

Family businesses form the bedrock of the nation's economy and, increasingly, are viewed as having some important advantages over their nonfamily counterparts. To ensure that their inherent competitive edge is maintained over time, family company management and boards must be diligent about planning for succession.

The most successful management transitions occur when the board, family council and management regularly work together to develop CEO criteria that is closely aligned to the organization's strategic objectives, ensure that likely internal candidates are benchmarked against the best-in-class and address any skill gaps. When they do need to look externally, family companies benefit by working with outside search consultants who know governance best practices, the talent market and the particular leadership needs of the industry and company.

The key to successfully recruiting an external candidate for CEO — or any senior executive — is identifying an individual who not only possesses the specific skills and expertise that are needed for the company's particular stage and direction, but also is sensitive to the unique issues and dynamics of a family business. Without this combination of skills, expertise and sensitivities, neither the outside CEO nor the family company he or she leads is likely to be successful.

## About the author

**JONATHAN WHITE** is a consultant based in the San Francisco office of Spencer Stuart. His executive search practice focuses on executive management assignments for family-owned business clients in a breadth of industries, including high technology, financial services, industrial and consumer products and services. Through this work, Jonathan has developed a keen understanding of the nuances of executive transitions at family-owned businesses and he leads this specialty for the firm in North America. Jonathan has held other leadership positions in the firm, including office manager of the San Francisco office from 1996 through 2001.

Prior to joining Spencer Stuart, Jonathan conducted executive management search assignments for a boutique executive search firm. Before entering the executive search field, he was president and vice president of a number of pre-IPO, technology-related companies. Jonathan began his career in marketing management with IBM, after which he served with ComputerLand Corporation as director of international product marketing, director of strategic planning and general manager of the franchisor's national accounts division.

Jonathan earned a bachelor's degree in business administration with honors from California Polytechnic State University, San Luis Obispo, and holds an M.B.A. in marketing management with honors from the University of Southern California.

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