

The delicate balance between power and restraint

The demanding role of the outside CEO in a family company

A study by Spencer Stuart

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Spencer Stuart 2006

SUMMARY

Spencer Stuart has conducted a series of interviews with family members and members of supervisory boards, as well as with top managers of major family companies, with a view to evolving recommendations for filling the position of outside CEO¹. We concern ourselves above all with those special problems which arise where this position is being filled for the first time, as successor to a family member.

It is of primary importance not to regard the recruitment of an outside CEO as a personnel issue in isolation. As a rule, changes will need to be made to the rules of corporate governance within the company - changes which will not simply happen automatically, but which call for careful deliberation within the appropriate committees – before any decision is made to appoint. The role and the composition of the supervisory body will be particularly affected, since the interplay between supervision and management will take on a different character: effective control of the company management and competent technical input from independent experts will take on a primary importance among the duties of the supervisory body. In addition, there other framework requirements which will need to be settled, such as the clear separation of duties between CEO and the supervisory body – only in the case of public companies is this matter fixed by law – and critical issues of strategy, communication and company values. Nor should we underestimate the importance of defining the future role of the previous family member CEO. In all of this, finding and attracting the right person remains the greatest challenge. Most companies attempt to avoid the undeniably high risk of appointing an outsider and choose the alternative of grooming a successor from within the company or the group. But an internal appointment carries its own risks, such as the danger of rating cultural fit higher than qualification, or the danger of falling back on a second choice internal solution, despite some doubts, after an external solution has failed.

There are tried and tested ways of minimising the risk in the case of external appointments. There should be several frank and free discussions covering such matters as mutual expectations, value sets and the types of critical incidents which have given rise to conflict in the past. When scrutinising references, importance should be laid on these “soft” issues, as well as on issues of performance.

The remuneration package should incorporate some long-term elements, in order to reinforce the identification of the outside CEO with the interests of the company.

The outside CEO in a family company is faced with specific challenges which do not exist in public companies. First and foremost, he has to interface with the members of the owning family in their various roles, which are not the same as those of normal shareholders. Then there are the other important interfaces which require cultivation, such as that with the supervisory board and, especially, with its chairman.

¹ The term „outside CEO“ describes the top executive position in the company or the group. It includes all conceivable variants required by differing legal structures, such as chairman, spokesman for the management or for the board.

It is regrettable that the term “outside” has become the standard term for a manager who is not a member of the family, particularly as it sound almost pejorative to some occupants of such positions. Non-family CEO would be preferable.

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An outside CEO who wishes to achieve lasting success must have a number of important characteristics. He needs a strong personality, but must be able to rein in his ego; he cannot afford an overly developed need for status or recognition, and must be prepared to accept the right of the family to take the initiative and to make the final decisions.

These special requirements can best be met with a competent performance of duties; this will avoid conflicts, misunderstandings and disappointments. It is particularly important to be aware of those lines which may not be crossed, either by reason of family consensus or company culture. Critical matters could be, e.g. the adoption of a new strategic orientation, the acceptance or reinforcement of the influence of external partners or far-reaching reorganisation measures. The ideal outside CEO would, of course, also possess previous experience which would support a favourable prognosis – previous experience with a family company, for example. This, however, should not be carved in stone as a pre-condition.

It is obvious that the incoming outside CEO has the greater effort to make in the matter of adaptation and learning. But it has become just as obvious that the “tandem” is almost doomed to failure in the absence of a substantial contribution from the departing family member CEO. The ex-CEO must fully accept his new role – usually on the supervisory board – and above all refrain from interfering in operational matters. Other important contributions are loyalty to his successor and direct, prompt communication.

The study is rounded off with the results of interviews with outside CEOs. Most of these address the same points, although with differing priorities. The most prominent concern is the need for professional manning and clear definition of roles in the supervisory board. The influence of non-family minority partners is seen as positive, since it leads to a greater degree of discipline in issues of corporate governance.

Introduction

The business press regularly reports cases in which the appointment of an outside CEO has failed, or where a long period of apparently successful cooperation has ended in a sudden split. The frequency of such reports has led us to take up this subject, and a large number of discussions with owner families have convinced us that there is a considerable degree of interest at the top level in establishing the main parameters for the recruitment of outside managers.

As discussed in our last study (“Corporate Governance in successful family businesses”, published in 2004), most family companies above a certain size will have to face this issue sometime or other. Following an initial period of exclusively family management, the appointment of a non-family CEO takes the business into a second stage of development (mixed management), which forces it to answer a number of fundamental questions. This is even truer when the business enters the third phase, in which the family – for a variety of reasons – decides to withdraw totally from operational management and to control the business via the supervisory body or partner committees.

The study relies on statements from partners, members of supervisory boards and senior managers of well-known family companies in Germany, Austria, Switzerland and Liechtenstein.

Within the illustrious ranks of those interviewed are to be found almost all the legal forms of family company. Once again it became obvious that the common cultural characteristics which mark the family business far outweigh the significance of the particular legal form or of size. This holds also for quoted family companies, where supervisory and management roles – different from country to country – are defined by law.

The conduct and the expectations of the participants – even in non-quoted companies – are influenced to a not inconsiderable extent by the different traditional board systems. While the two-tier model, with clear segregation of supervision and management, is prescribed in Germany and Austria, the single-tier system is the rule in Switzerland – as in the Anglophone economies – where the supervising element (non-executive directors) is naturally more closely involved in the strategic management of the business.

In the nature of things, all the companies we looked at have had experience with the appointment of outside CEOs. 40% of those interviewed are currently working with their first outside CEO, while 60% have already had experience of change, either planned or unplanned. 20% of the companies rule out the possibility of a return to a family CEO. 80% allow such a return in theory, but half of this group sees it as highly unlikely in practice. 50% of participants do, however, allow for family members occupying senior or lower level management positions under the outside CEO – as part of training for the top position.

As far as ownership is concerned, over half the participating companies are totally family owned, although some of these might well have quoted subsidiaries. The rest have external partners – always with minority holdings – most of whom are external shareholders taken on in the context of a stock exchange listing, with some sleeping partners and private equity investors. In terms of annual turnover, the companies looked at range from three-digit millions of Euros to double-digit billions.

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The issue of an outside CEO arises either where there is no suitable candidate within the family, or the family is unable to reach agreement on a potential candidate.

“Fewer and fewer family members in the CEO slot in companies with a turnover in excess of Euro 500 million.”

There is no universally valid answer to the question, at what point in a company's development will the appointment of an outside CEO become necessary; it depends on individual circumstances.

On an empirical basis - for manufacturing companies, at least – we can state that there are fewer and fewer family members in the CEO slot in companies with a turnover in excess of Euro 500 million. Clearly, it becomes increasingly difficult for the partners, at the point of generation change, to find someone with the right management qualifications within the family. It may well be different for families with a larger number of partners, but here we are more likely to run up against the difficulty of agreeing on an individual. In by far the most of the cases we investigated, the outside CEO reports to a supervisory body, either established by the partners or prescribed by law. In 80% of cases with exclusively outside management, the position of chairman of the supervisory body is occupied by a family member. The remainder choose external persons in whom the family places particular trust. Generally, these will be lawyers, auditors or experienced managers. Where there is no formal supervisory body, control is exercised by family members or groups of partners. This usually results in a “tandem” of a family member and the outside CEO.

We are not concerned here with the general requirements of a manager in the CEO position, since these are basically the same as in a public company. This study is purely concerned with those additional factors and circumstances which will determine the success or failure of an outside CEO in a family company. We concentrate primarily on the first appointment of an outside CEO. The situation is especially difficult when he has to follow a partner CEO who, over a period of time, has imposed his particular, individual stamp on the business and led it to substantial growth.

1. Corporate governance and basic parameters

As has already been stated, the replacement of a partner CEO by a manager from outside the family brings a change in the balance of power and the communication processes within the company. The family CEO, who previously looked after the interests of the other partners, is no longer directly involved in the operational management, or no longer responsible for its day-to-day running. Up to this point, the family could always assume that “our man” was at the helm and nothing could go wrong. Furthermore, it had always been possible, up to now, to resolve problems and reach agreement in an easy, informal manner. We see the consequences of this in the way in which committees – if they existed at all – generally came to be used as voluntary forums for an exchange of views, incapable of exercising any real control or making any real decisions. Their role was often not precisely defined, and their composition was frequently a matter of personal relationships.

“The change from family to outside CEO means a change in the role of the advisory board”

The situation changes profoundly when the owner surrenders the CEO role. For this reason, companies should use this occasion to redefine the role of the advisory board and to rethink its composition, not only from the point of view of the owners, but also from that of the outside CEO:

The owners will need to ensure that, under new, non-family management, strategically important subjects continue to be dealt with professionally, business strategies, opportunities and risks continue to be assessed realistically and resources continue to be employed optimally. The fact that the owners’ private interests are identical with those of the business naturally inclines them to pay attention to these issues, but the newly arriving outside CEO is starting from a different position, and may well also need to learn the business. This means that he will need support and direction, without, of course, being interfered with in the day-to-day running of the business.

Since spheres of action are cleanly defined only in the case of public companies, they need to be thought out in detail and then laid down in other cases. This means that a number of specific issues, such as voting on questions of strategy, the nature and timing of communication with the supervisory body or its chairman on a catalogue of issues deemed to require consent. In addition, it is of considerable importance for the outside CEO to know who is judging his performance and how he is being judged, particularly where he has come from outside the company. This is another important function of newly designed supervisory board.

When installing an outside CEO, it is a good idea to strengthen the role of the supervisory body (supervisory board, advisory counsel, partner committee) to such an extent, that it is no longer dependent on instructions made in a plenary session of partners. In order to clarify relationships and decision processes, the advisory body should have the last word on business-related decisions.

These new ground rules should be in place, at the latest, when the outside CEO assumes office. It is a widespread practice in family companies to set up advisory boards with up to nine members, two thirds of whom are not family members. Non-family members are selected according to the following criteria:

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Defined competencies and specified experience, which are of importance for the business of the company (market, technology, function etc.)

Integrity, together with personal and financial independence of the individual.

Family companies are turning more and more to external consultants to find members for their advisory bodies.

It is unwise to ignore the importance of defining a fulfilling and satisfying task for the retiring family CEO. A move to the chair of the advisory body is a frequent, but by no means the only possible, solution. One of the advantages of this solution is that it ensures an effective exercise of control by the advisory board in the medium term, thanks to the experience and business competence of the previous, family member CEO.

The changeover to non-family management will place a permanent strain on the manpower resources of the family; that of identifying and preparing suitably qualified members for the supervisory bodies (non-executive roles).

There are other basic parameters which need to be thought about and established when appointing an outside CEO:

In a case where one or more members of the family occupy line management positions below CEO level, these will need to be critically examined before the arrival of the outside CEO, and to have their position explained to them by the partners. If necessary, agreement should be reached with the outside CEO, on the basis of a professional assessment, as to whether or not the family member ought to stay in this position.

The change from family to outside CEO needs to be professionally communicated, both inside and outside the company. Internal communication should be aimed at forestalling fears concerning the future, which might arise from a perception that the family is “withdrawing” from the business. It is advisable, therefore, to let management and employees become used to the idea of the change gradually, rather than allowing the news to burst like a bombshell, presenting them with a *fait accompli*. The communication should make it clear that the family will continue be involved in the company under the new regime and will ensure the successful continuation of the company, through the exercise of professional supervision and the commitment of qualified family members. Problems can also arise outside the company, with customers, suppliers or financial partners who have been accustomed to dealing with the owner in person and have not been adequately prepared for the change. Apart from the bare communication of the change, we recommend a personal introduction and handover by the retiring family member CEO. It could well be advisable, as part of the transition process, for the ex-CEO, with the agreement of his successor, to continue to play some representative, non-operational roles (e.g. in industry associations etc.).

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2. Recruitment or appointment of the outside CEO.

Basically, the same ground rules apply to the appointment of an outside CEO, as those obtaining in any well managed company. Using a quoted company as an example:

Ongoing task: The selection of suitable successors is a permanent process. Once or twice a year, the chairman of the board should inform the chairman of the supervisory board or the personnel committee of candidates from the top or the next management level, who might be eligible to take over individual departments or the CEO position.

Inclusion of external candidates: The future success of the company depends on the suitability and the leadership strength of the CEO. For this reason, the best candidates available internally should always be measured against the best managers in the business outside the company. Qualified, external references should be demanded for all candidates, whether internal or external. Should there be insufficient talent available in-house, then steps should be taken to recruit managers from outside in good time.

Selection in accordance with a rational requirement profile: The management and the supervisory boards should jointly work up a requirement profile covering the technical qualifications and the personal characteristics of the future CEO or member of the management board. The candidate profile should be drawn up in accordance with the long-term strategy of the company. The best will be filtered out by comparing candidates with the requirement profile.

Setting up a search committee: The best way of ensuring discretion and confidentiality is to set up a small group within the supervisory board, charged with making the selection. The present chairman should play only an advisory role. In practice, a three-man search committee, not necessarily relying on employee consent, has proved itself ideal.

Most of the people we spoke to try to avoid external recruitment, and appoint a candidate from within the company. The advantages of the internal solution are obvious:

It avoids the major risk of an external recruitment: lack of knowledge of the person and his cultural imprint.

The internal candidate is known and trusted.

He identifies with the value set of the company and knows the key people. He is familiar with communication and business style, as well as with the industry and the customers.

One should, however, be careful to avoid making dangerous compromises, purely on the basis of cultural fit. Internal appointments have their own disadvantages:

The most serious disadvantage is the loss of a much larger population from which to choose the ideal candidate – the whole external market.

You may be foregoing an opportunity to move the company into a new stage of development, in that you exclude candidates whose advantage lies precisely in the fact

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that they have not been emotionally, technically or culturally pre-formed. It is noticeable that Anglo-Saxon companies more frequently adopt this solution, whereas German companies tend to go for the safer option.

Where the family, after years of observation, has come to know not only the strengths, but also the weaknesses of the internal candidate, it may be harder for him to become fully accepted than would be the case with an external candidate.

“Even if the internal candidate has the edge, you should not lose the opportunity to compare him with the options available on the external market.”

Some industries, such as the branded or consumer goods industry, have a very large pool of external candidates, due to the relative similarity in marketing methods, the comparatively limited relevance of the product and the large number of companies operating in the market. The choice is generally more limited in technology-oriented industries, since they frequently operate in markets dominated by a few major players. Here it is worth while taking a look at external candidates from outside the industry, as long as all other factors suit the profile. There is a tendency to attach too much importance to knowledge of the industry.

Understandably, most of the internal appointments (60% of those interviewed) come from positions with P/L responsibility (business unit managers, managers of subsidiaries etc.); a long way behind, in second place, come promotions of CFOs, with, even rarer, CEOs being appointed from other departments (sales, HR, production, development).

Particularly in critical company situations, one ought to consider recruiting from the external market, since an outside candidate will bring qualities which are more important than conformity with custom in a situation of urgency: impartial analysis and vigorous action.

Where the lack of an internal successor makes it necessary to recruit from outside, professional management of the selection process offers the best way of minimising the risks. This would also be the suggested approach to managing an immediate succession (with little or no transition).

At this point I would repeat that we are not speaking here about the classical personal and technical management competencies, needed for the successful management of a company. We are dealing here, first and foremost, with the evaluation of the cultural imprint and the ability to handle the critical family interface.

The most important contact for the new CEO will be the retiring family CEO or some other representative of the family acting as chairman of the supervisory body. It will be his task – possibly involving the spouses – to sound out whether or not the ideas and the value set of the candidate are sufficiently in harmony with those of the family. Since these principles and values are highly individual, we can only offer a few examples here:

Basic attitude to business ethics

Issues of basic strategy (use of capital market, growth by acquisition, acceptable level of debt etc.)

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Management and communication style

Personal attitude to family values and issues

Religious values and social engagement

It will also be important to establish a clear separation of responsibilities between the outside CEO and the family contact, and to reach agreement on how they will work together. While it is a good idea to adopt the practice prescribed for public companies, it is not absolutely essential to do so. However clear the separation may seem to be (between operational and supervisory), some points may well need further clarification in family businesses:

Who represents the company externally, or how will this duty be split? Who deals with the press?

Who attends meetings of trade associations, conferences, etc?

What means of communication will be used, and how frequently?

How often will the owner attend management meetings?

It will be also be of crucial importance to both sides to establish a clear idea of what sort of issue could lead to a rupture. Some examples mentioned frequently:

Action incompatible with family values

Persistent interference by the family in the management of the business

Inappropriate behaviour in public

Insensitive use of status symbols

Political intrigue with individual family members

Erecting barriers against the family; insufficient contact

The question of previous experience in a family company can be important when appointing an outside CEO. As we said in our study on corporate governance, however, most companies do not see this as an absolute must, and we believe this to be the right approach. In the final analysis, what really matters is the personality of the candidate and his cultural compatibility. In most instances one will in any case be forced to widen the search to cover public companies and their subsidiaries, since restricting the field to family companies would narrow the choice too much. Besides, the knowledge and skills gained in public companies can be extremely useful for family businesses.

In cases where he is succeeding the owner CEO directly, it has often shown itself to be advantageous for the candidate to have had previous experience in dealing directly with private partners. This is especially relevant where relationships between the partners are not quite stress-free and the outside CEO is going to have to handle the transition with a high degree of tact. This aspect becomes less critical where the family has grown accustomed to non-family management.

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We would be inclined to advise against a handover period of longer than three months, since this will diminish the attractiveness of the position on offer. Some companies do insist on a probation period, primarily in order to have an opportunity to test the issue of cultural compatibility. But since this approach, by its nature, implies the possibility of failure and premature separation, top candidates will be unlikely to give up a safe contractual relationship in favour of such an offer.

“Sensitive issues, which could lead to conflict, should be identified and thrashed out in advance”

It is a different matter when all are aware that a newcomer to the management team is being groomed to take over the CEO position and will be taking on specific duties during the transition period. The handover period, however, should not be longer than one year; otherwise the authority of the retiring incumbent will be weakened (“lame duck”).

We have known isolated instances of a successor candidates being employed, whose role of crown prince was known only to the family or the supervisory board, and who then had to go through probation periods of various lengths. This approach looks more like an internal recruitment and, since others are unaware of the crown prince role, there may be a risk of offending other internal candidates.

If the outside CEO is prepared to accept a lengthy transition period (more than six months), then it is important to make a clear functional distinction between him and the outgoing CEO. A common practice is to use an existing vacancy in another C-level function (CFO, HR, etc.) as an entry. In some cases, a new role is created, or split off from an existing one, for the duration of the trial period. This is then reversed once the succession has taken place.

The remuneration package plays an important part in attracting and retaining the outside CEO. Owner CEOs tend to look at the salary package as being of secondary importance, since their own primary income consists of their share in the profits. The following are some of the solutions we have observed:

Since the element of ownership is absent, the long-term identification of the outside CEO with the company is fostered by an appropriately designed component in the remuneration package, apart from basic salary and performance bonus. For example, there could be an incentive bonus for increasing profits over a three year period, such bonus to be held in an interest-bearing account, commensurate with performance, but payable only at the end of the three-year period. Then, new targets can be set for the following three years.

Only in exceptional cases, and even then only to a modest extent, will the outside CEO be granted a share in ownership. Where it is granted, the family will usually reserve the right to re-acquire the shares when the manager leaves. The share option schemes sometimes offered in quoted companies are viewed with a high degree of scepticism, since they are not an effective way of really tying a manager to the risks and opportunities, and will frequently lead to the adoption of short-term business goals.

The higher element of risk involved for the direct successor to an owner-CEO is not infrequently compensated by a salary package in excess of market average.

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In designing the remuneration package, the remuneration of other non-family members in the management team will have to be kept in mind, in order to avoid envy and resentment and to foster a climate of successful cooperation within the team. It has to be remembered that other members of the management team will also be affected by the changes in the basic conditions. It might be wise to adjust their contracts as well before making the break.

3. What is required of the outside CEO

3.1 Behaviour and personal characteristics

Our experience, confirmed by the interviews we have conducted, teaches us that the vast majority of successful outside CEOs in family companies have certain behaviour patterns and personal characteristics, the absence of which frequently leads to a break-up or to failure, regardless of how well the CEO has performed. As a general rule, these characteristics are basic personality traits; a prolonged period of working in a particular environment in the course of a career will serve to reinforce them and make them more noticeable.

The following list of the principal elements provides only a number of examples and lays no claim to completeness. It lies in the nature of things that there will be a number of similarities and overlaps with the way in which the CEO performs his duties (3.2.).

In all cases, the outside CEO will be expected to show moderation in the exercise of the authority vested in him:

Many of the people we spoke to on the owner side tend to use rather traditional descriptions of the role of the outside CEO, such as that of the steward (as opposed to the lord of the manor), or the major-domo, who has committed himself to the service of the company and the partners. Such expressions are somewhat inappropriate to the self-image of a CEO in the modern business world. But they do serve to make it clear to the CEO that he will be dealing with a set of attitudes which need to be considered carefully. This will best be managed by an intensive study of the interests of the owners and the value-set of the company and by strict adherence to the division of responsibilities agreed with the partners.

Modesty will be expected, including financial modesty. Unreasonable demands will not be tolerated. The type of public debate concerning excessive salaries or remuneration deals in some public corporations would be inconceivable in a family company.

The outside CEO should keep a weather eye on the work- and lifestyle of the family, and always take care to live somewhat more modestly himself. One owner partner reported how offensive it was when the CEO flew first class, while the family partners flew business class.

The content and the nature of communications with the owners should be characterised by restraint and diplomacy. Too brusque an approach may cause offence.

Integrity, honesty and predictability are highly esteemed; ties or interests in non-material affairs are often particularly well received; many owner families like to keep an eye on relationships within the family of the outside CEO.

Probably the key determinants of success or failure will be personal discipline and the ability to keep the ego in check. However, since most families are not looking for a shrinking violet, but for person with charisma and presence, this difficult balancing act calls for a certain type of personality:

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However successful he is, he must never believe that he can replace the owner or the family, and must never strive to shape the company in his own image. The outside CEO is simply not family; he must never attempt to outshine them.

The willingness and the ability to recognise borderlines and to accept second place are matters of survival; anyone with a marked inclination to self-aggrandisement or a craving for status symbols or personal recognition is probably not going to succeed.

This is especially true of behaviour or display in public, including dealing with the press or attending important business or social functions. Particular care is required at the location where the company is headquartered. Incidentally, these rules also apply to the CEO's spouse and children.

Non-family chairmen in quoted companies face a particularly delicate task in finding the correct balance between effective public presence and restraint. They have to represent the company in public with the appropriate degree of self-assurance, while keeping sight of the values and the sensibilities of family members.

It is not a good idea to aim at being an American-style CEO; family owners will usually want to see company goals being achieved by teamwork and acceptance of the majority view. A person who always insists on his own way is probably not going to make it.

People who devote most of their effort to bolstering themselves or their position will generally not be tolerated for very long.

Remote, self-absorbed, soulless technocrats rarely feature as CEOs in family companies; some signs of humanity will be expected.

“A manager with an over-developed ego and an autocratic style of leadership won't survive for long in a family company.”

Regardless of his ability and experience, the outside CEO must be prepared to recognise the role of the owner:

He must accept that he can never be the same as the previous family CEO; it would be a fatal mistake to attempt to copy him. The outside CEO may succeed the owner, but only chronologically, never in status.

It also means that the outside CEO must be prepared – to some extent, at least – to put up with the peculiarities and even with the foibles of the partners and other family members; if he cannot face this, then he should stay away from family companies.

The outside CEO has to accept that family ideas and interests will influence business decisions. Not all management initiatives will be accepted, even if they make good business sense and are persuasively presented, such as a recommendation to go for a public offering of shares.

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Growth, profit and financial stability are the primary business goals for family owners as well. Simultaneously, however, they will expect the CEO to adopt a business strategy designed to keep the company in the hands of the family, using the means available.

As a rule, the owners of family companies reserve to themselves the right to decide matters of strategy, and the outside CEO must accept this. In many cases the basic strategic orientation will be designed to cater for specific family interests and ideals – e.g. a conglomerate structure with a long-term distribution of risk, or a niche strategy. This means that the strategic freedom of the CEO is curtailed compared with public companies, where strategy is primarily the responsibility of the management.

Even in family companies covered by the companies act, the CEO, particularly in the two-tier model, should exercise restraint in claiming the powers to which he is legally entitled, in order to avoid friction. In this context, it is interesting to repeat Gerd Strehle's (majority shareholder of Strenesse AG) quotation from the Handelsblatt of 20 February, 2006:

“The non-family manager simply has to take this living organism as he finds it. He may be able to influence it in the long term; in the short term he has to accept it as it is. If, instead of this, he proceeds to look up the articles of the companies act, to see just what rights the CEO has and what rights all the others have now surrendered, and if he suddenly starts insisting on the letter of the law, then he is heading for trouble.”

This applies, however, to all decisions in the company, even those which appear trifling. Good corporate governance and pragmatic agreements between the family and the management will go a long way towards eliminating possible friction from the day-to-day business, but the outside CEO must never challenge the right of the owners to make the final decision.

Even at the risk of repeating individual points, we would like to list again the principal errors into which the outside CEO might fall:

Playing politics with individual family members, factions or cliques, in an attempt to get his own way; this would also include bypassing elected family representatives in the relevant committees.

Just as dangerous would be neglecting to communicate appropriately and promptly – especially where there are acute problems; or even attempting to shut out the family, under such circumstances.

Handling sensitive issues in an insensitive way, such as changes in strategy, manpower reductions, outside capital, etc.

Offending against the family's moral code, or breaking unwritten rules; this would include failing to show the proper degree of respect or loyalty to the family or to individual family members.

Insensitive use of status symbols or any overly flamboyant behaviour can be a very delicate issue. Above all, avoid mixing private and business interests.

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Laying too much emphasis on his own person or interests, either within the company or in public.

3.2 Special duties and conduct of office

The following courses of action have proved themselves of value in the daily running of the business:

The outside CEO should demonstrate a readiness to learn the business as quickly as possible, if the industry is new to him. He will be expected to acquire more than a superficial knowledge and to get involved at the level of detail – surface involvement and excessive recourse to delegation will not be appreciated.

While hard work and personal commitment will be taken for granted, we would advise caution before taking on additional duties outside the company (supervisory board or committee memberships, etc.). Always behave with moderation; unusual or eccentric behaviour could cause problems. An overly narrow pursuit of shareholder value could lead to conflict; do not focus exclusively on financial interests or on capital market issues.

Most of those who took part in the study would ideally like to have someone who is approachable, whose management style is effective and strong without being dominant, who can carry others with him and win their respect. He should establish his authority sensitively while, at the same time, having a recognisable personal style. In conflict situations, he should pursue the logical, unemotional solution and be prepared to present his opinions openly and confidently.

The outside CEO must never forget that he is dealing with the family's money. It is his duty to protect their property and he must appreciate the fact that capital may well be limited. A high level of openness opposite the family owners can be a good way of establishing trust. He will be expected to maintain a strict and unrelenting control over costs, even if the business is doing well.

Any necessary changes should be made with discretion, since radical measures can be harmful to trust, destabilise the business and lead to arguments with the family. Particular care should be exercised in matters of divestment, manpower reductions or closures. Do not insist on using every last bit of authority vested in you; some actions, while not expressly forbidden, may nonetheless be looked at askance.

The outside CEO is dealing with family members “above”, in whatever way they carry out their supervision role – whether as heads or members of committees, or directly as partners. Work at this interface can be politically very demanding, calling for a high degree of attentiveness and intuition.

From this circumstance we can deduce the following recommendations:

It will be very important to get to know the views and the emotional currents present in the family, beyond the extent possible in initial discussions, and to be aware of the interests of the family as well as those of the business (property and taxation issues). Whatever the calls of loyalty, the outside CEO should always preserve a healthy

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distance to the family and avoid any excessive intimacy. He will need to gain the trust of the whole family, not just that of the dominant member or individuals, factions or groups. This may mean making presentations when requested to do so. Dealing with such matters constitutes a delicate balancing act, particularly where there is a minority group among the owners.

Even though there may be little he can do to influence the situation, the outside CEO must have an interest in avoiding quarrels and schisms within the family. He should be on the lookout for danger signals and offer impartial support. The preservation of family unity and harmony is a major prerequisite for the future prosperity of the business.

“The outside CEO will seldom have strategic sovereignty in a family company.”

The CEO should accept strategic initiatives from the supervisory body or the partner group constructively and act on them promptly. Some suggestions from him will be accepted and welcomed, but they must not run counter to the wishes of the family or offend against established taboos. Some subjects will be particularly critical, such as approaching the capital markets or extending the influence of outside investors, whatever good sense these might make as ways of expanding the capital base.

Since the chairman of the supervisory board is an important channel of communication between the family and the outside CEO, it will be useful to discuss some key aspects of this relationship:

Close and regular communication, far beyond the levels of normal usage, is a must. It will serve to avoid unpleasant surprises, in that problems can be discussed and dealt with before bad news filters upwards from some other source.

Suggestions for strategic or conceptual change should be discussed informally in advance, in order to sound out the probable reaction of the partners. This will help to avoid an official disagreement or rejection.

Where the family representative was the previous CEO, his successor should avoid offending against his sensibilities, show understanding for the difficulty of severing the ties and refrain from reversing all previous policies or wanting to do everything better.

A special situation obtains where the family business is a quoted company with family shareholders having a controlling interest. The principal duty of the CEO is to demonstrate compliance with the Companies Act, which calls for even-handed treatment of family and external shareholders. However, unless he can also display sensitivity in dealing with the values and the culture of the family, he cannot hope to succeed for long.

4. What is required of the partners

There can be no doubt that the retiring family CEO or whoever represents the family will be called on to make a substantial contribution to the success of the tandem. The newcomer cannot be expected to shoulder the whole burden of the adaptation and change process, particularly if he is the first outside CEO. Without tact and good will from the family partners, the project will be doomed to failure. Professional and constructive cooperation between the owner or family representative on the one side and the outside CEO on the other is the key to the success in a move to non-family management. This means that there is a heavy burden on the family representative side of the tandem as well. Where the operational management of the company is completely in non-family hands, the chairmanship of the supervisory board or the advisory committee is usually held by a family member. In the case of the initial move to non-family management, this is almost invariably so, with the retiring family CEO assuming this position. This arrangement has the advantage of ensuring a smooth continuation in the business affairs of the company, since it ensures that knowledge of the business or the customers is not lost in transit. But it is only to be recommended where the previous family CEO satisfies the following criteria as well:

He must be a person in whom the other partners repose a high degree of trust.

He must be a good communicator and facilitator, capable of uniting a group and finding the right note when dealing with the family, the management, the employees and the public.

He must enjoy the respect of managers and partners in equal measure, able to reconcile differing and possibly opposing interests, even when the issue is hotly disputed.

He cannot have an inflated ego, placing his own prestige above the importance of finding the correct solution. He must be a strong personality, but capable of taking a back seat and serving the business.

He must be a dedicated guardian and developer of family values, but at the same time an uncompromising and determined champion of change when this is required to preserve the competitiveness of the company, whether it be a matter of business strategy or of the constitution of the company.

He should possess a well developed antenna for long-term social and economic trends.

In the interest of avoiding conflict, some family CEO's have, upon retiring, been prepared to

accept a position as an ordinary member of the supervisory board, leaving the chair to someone else. Alternatively, a family member might be elected, who has never been active in the management of the business, or an outsider might be appointed, in whom the family reposes a high level of trust.

“Uncoordinated interference by the family in the operational management of the business is the main source of conflict with the outside CEO.”

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The partner and previous CEO must be prepared to change to a very considerable extent in his new role as chairman of the supervisory board. Of primary importance will be the manner in which he clearly distances himself from his previous role. The major objective is to avoid interfering in the operational management of the business:

He must abide by the division of responsibilities agreed upon.

He must accept that important business issues are now decided by committee and that “his” decisions must now be filtered through a process of objective and detailed group discussion.

Attendance at meetings of the management team: certainly justifiable for the first six months, but thereafter only by way of exception.

He must be prepared to take a back seat and not to overvalue his own importance. Even as a partner he must rein in his ego and eliminate patriarchal elements in the management of the business.

He must respect the person and the role of the outside CEO.

The type of communication is of crucial importance for the transformation process and for the long-term success of the tandem:

Communication should be very close, particularly during the initial phase, with regular feedback to the outside CEO. The owner should always be available for a consultation.

Communication with the outside CEO could follow the form of “Encourage and Warn”, such as the British constitution prescribes for the monarch. While it is perfectly acceptable to make suggestions, the CEO must be allowed the necessary freedom to act.

It is better to allow the outside CEO a long lead in day-to-day business matters, but to set clearly defined targets and to supervise these within the agreed control framework.

Possible sources of conflict should be spotted early and cleared up before they develop. They should never be allowed to escalate onto the level of the supervisory body.

Solidarity and support for the outside CEO are indispensable for the success of the tandem. Some examples of recommended behaviour:

The performance of the outside CEO should be fairly recognised. Should there be grounds for criticism concerning the management of the business, then these should be addressed and cleared up in frank and confidential discussion.

The outside CEO should be defended against unfair criticism from within the family and measures should be taken to prevent defamatory statements concerning him, especially in public. Where the family is large, he should be given the opportunity to present himself to a selected group of family members and to win their trust. This is particularly vital where the chairman of the supervisory body is not a member of the family.

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The previous family CEO should refrain from using his sources of information within the company to the detriment of the outside CEO. Here once again it is important to follow the dictates of common courtesy and to exercise solidarity. Long-serving managers and employees may well be tempted to exploit their acquaintance with the owner to the disadvantage of the outside CEO. The owner must not allow this to happen.

If other members of the family have lines of communication into the company, these should be known to the chairman of the supervisory body and controlled by him, as far as possible. Otherwise they could undermine the position of the outside CEO.

Where the outside CEO, despite being a difficult character, is nevertheless valued by the partners and an asset to the business, then the owner should try to balance his negative aspects as far as possible. But the latter should bear in mind that he is filling two roles, that of supervisor and that of coach.

5. Point of view of the outside CEO in a family company

Parallel to the talks we had with representatives of the family owners, we also conducted a series of interviews with outside CEOs, who had served in this position for periods of varying length. To a large extent, the views they expressed were similar to those of the owners, particularly concerning the types of behaviour and the personality traits which determine success or failure. In the following areas the CEOs, while not differing in principle from the views of the owner group, did, however, see the matter slightly differently:

The term “outside CEO” is regarded as highly discriminatory, although most were unable to come up with a pithy title which would be more acceptable. This point illustrates very clearly that family representatives and supervisory bodies would do well to play down the element of distance in day-to-day contact, in order to foster the identification of the CEO with the interests of the family.

Our interview partners confirmed the experience we had ourselves gained as an executive search firm engaged in recruiting CEOs for family businesses: perceived undue interference by the owners in the running of the business is the principal bone of contention. It comes as no surprise, therefore, that the outside CEOs are more inclined to stress the significance of a formal framework of rules than are the owners. What they would really like to see is a professional manning of the supervisory body and a clear definition of its role:

CEOs expect to be controlled and guided – and this includes performance appraisal – by an independent and technically competent body with a majority of non-family members. The owner, particularly where he was the previous CEO, should be faced by a forum for discussion and decision, where his own views may well be moderated or even corrected. Some CEOs complained that members of these committees are not sufficiently impartial or are too weak.

Some interviewees intimated that they keep a careful eye on the composition of the supervisory body and have been able to suggest candidates for membership. The CEO would like to be dealing with qualified and challenging partners when discussing changes of strategic direction and other important business decisions. This is true regardless of whether the members of the supervisory body are family appointees or not.

It is a good idea to draw up the articles of the supervisory body along the lines prescribed by the Companies Act, even where the legal form of the company does not require this.

All outside CEOs are of the opinion that some external involvement in ownership (minority) is advantageous. The form of involvement is of little importance, whether public shareholders, long-term financial partner or private equity investor. The advantage they see is that this external involvement forces a degree of discipline on the family partners and encourages a commitment to professional financial criteria and management methods.

“Outside CEOs think the influence of non-family partners is positive – it encourages discipline in the family.”

CLOSING REMARK

The experience of the companies which have participated in this study confirms that it is quite possible to manage a family business via an outside CEO, and to develop it in accordance with the long-term goals and values laid down by the partners. A professional and well planned approach will serve to minimise the risks of this recruiting decision.

Almost all the owners who have had outside CEOs for several periods of office emphasise the advantages of this solution: things bed down after a while and the choice of the right candidate becomes easier. And the family partners are spared the emotional discussion over the most suitable successor from within the family.

Nonetheless, many companies keep the option of a resumption of family management open, in case they should someday have a suitable candidate within the family, who will be accepted by the partners and the supervisory body.

Where the company remains under non-family management for a prolonged period, the partners are faced with the difficult task of grooming suitable candidates from the next generation to serve on the supervisory body. This is essential in order to avoid the danger of estrangement between the owners and the business and to ensure professionally qualified owner representatives to interface with the company management.

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List of interviewees

Owner partners and members of supervisory bodies

Baumhauer, Jon	Chairman of Partner Committee Merck KGaA
Binz, Prof. Dr. Mark	Chairman of Supervisory Board Fielmann AG
Brenninkmeyer, Dominic	Part-owner of C&A Group
Freudenberg, Dr. Reinhart	Chairman of Partner Committee Freudenberg & Co. KG (until 2005)
Dürr, Dr. Heinz	Chairman of Supervisory Board Dürr AG
Geidel, Horst H	Chairman of Supervisory Board Behr GmbH & Co. KG
Haniel, Franz	Chairman of Supervisory Board Franz Haniel & Cie. GmbH
Hennekes, Prof. Dr. Brun-Hagen	Member of Supervisory Board Berentzen AG
Hilti, Michael	President of Board of Directors Hilti AG, Liechtenstein
Heraeus, Dr. Jürgen	Chairman of Supervisory Board Heraeus Holding GmbH
Hoffmann-Becking, Prof. Dr. Michael	Chairman of Advisory Board Felix Schoeller Holding
Kärcher, Johannes	Chairman of Advisory Board Alfred Kärcher GmbH & Co. KG
Kühne, Klaus-Michael	President of Board of Directors Kühne & Nagel International AG, Switzerland
May, Prof. Dr. Peter	Member of Supervisory Board M. Dumont Schauberg GmbH
Mohn, Liz	Member of Supervisory Board Bertelsmann AG
Oetker, Dr. Arend	President of Board of Directors Hero AG, Switzerland

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Pöllath, Reinhard	Chairman of Supervisory Board Tchibo Holding AG
Porsche, Dr. Wolfgang	Member of Supervisory Board Porsche AG
Quandt, Stefan	Vice-Chairman of Supervisory Board BMW AG
Rogowski, Dr. Michael	Chairman of Supervisory Board Voith AG
Schwanhäuser, Götz	Chairman of Advisory Board Schwanhäuser Industrie Holding ("Schwan-Stabilo")
von Koerber, Dr. Eberhard	Chairman of Advisory Board Wilh. Werhahn KG (until 2005)
Weiss, Dr. Heinrich	Chairman of Supervisory Board SMS Demag AG
Weiß, Dr. Karl-Heinz	Chairman of Supervisory Board Wacker Chemie AG
Woeste, Albrecht	Chairman of Partner Committee Henkel KGaA
Würth, Prof. Dr. Reinhold	Chairman of Würth Foundation
Zumtobel, Jürg	Chairman of Supervisory Board Zumtobel Group, Austria

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List of interviewees

Outside CEOs in family companies

Baschera, Pius	Hilti AG, Liechtenstein
Flik, Dr. Markus	Behr GmbH & Co.
Friedmann, Robert	Adolf Würth GmbH & Co. KG
Herms, Klaus	Kühne & Nagel International KG, Switzerland
Jaeger, Dr. Walter	Adolf Würth GmbH & Co. KG (until 2005)
Joos, Harald J.	Stihl Holding AG & Co. (until 2003)
Kormann, Dr. Helmut	J.M. Voith AG
Lehner, Dr. Ulrich	Henkel KGaA
Mayland, Dr. Kay	SMS Demeg AG
Römer, Dr. Michael	Merck KGaA
Scheuble, Prof. Dr. Bernhard	Merck KGaA (until 2005)
Winter, Berndt-Michael	Delton AG for Holdings (Quandt family company)

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