RELATIVE RISK

Family businesses cannot afford to ignore their inherent complexities

BY SIMON HALLY

RUNNING A SUCCESSFUL business is difficult, time consuming and complicated. So is raising a happy, well-adjusted family. For people who run family businesses, these two demanding tasks become intertwined and even more complex.

When the psychological and emotional needs of family members interact with their company's business imperatives, the outcome can be strife. If not dealt with appropriately, such discord will endanger the future of the business as well as the harmony of the family.

"It's hard to maintain good family relationships while building a successful business," says Bill Northcote, partner and chair of the business law practice group at Shibley Righton LLP. "Every family dynamic is different and every family business is different, so there are many possible causes of friction. The trick is to try to divorce the family dynamic from the business dynamic, and some families are better at this than others."

In fact, most families aren't very good at it at all. Only 30 per cent of family firms survive into the second generation, according to a U.S. statistic that's widely thought to apply to Canada as well. Just 12 per cent make it to the third generation, and a mere three per cent into subsequent generations.

"I don't believe Canada has escaped the proverb about family businesses: shirtsleeves to shirtsleeves in three generations," says Michelle Osry, leader of Deloitte's family enterprise consulting practice, "and it's because not enough attention is given to succession planning." Two-thirds of family businesses have no succession plan, she says, and less than one-fifth have a shareholder agreement.

80 PER CENT OF BUSINESSES IN CANADA ARE FAMILY OWNED
— CANADIAN ASSOCIATION OF FAMILY ENTERPRISE

This is important because family firms are a major driver of the economy. The Canadian Association of Family Enterprise estimates that 80 per cent of businesses in this country are fam-

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ily owned. Collectively they account for roughly half of GDP (different sources put the percentage anywhere from 45 per cent to 65 per cent) and half of total employment.

A significant reason for the high attrition rate among family firms is a failure to confront the complexities that are inherent in every family run enterprise. That failure typically results from poor communication coupled with insufficient understanding of the various roles, responsibilities and rights of family members and others involved in the business.

Communication problems can often be traced back to an unwillingness to have difficult conversations, says Saul Plener, national leader in PwC's private company services group. "The members of the family have to get comfortable discussing very uncomfortable topics. For instance, who will head the business when it's not clear which sibling is the heir apparent? How will spouses be involved? Should extended family members have the right to work in the business? These are very difficult and emotional discussions to have. However, it's essential to address these questions for the business to succeed in the future."

Shying away from uncomfortable conversations will only make matters worse as time passes, adds Osry. "Families tend to avoid conflict, and they can end up with 30 or 40 years' worth of unspoken topics."

Some families find they cannot have these kinds of conversations without advice from an outsider, says Paul Coleman, national leader, succession and estate planning, at Grant Thornton. "It's not within the skill set of many firms to cope with these issues, so external support and assistance may be required."

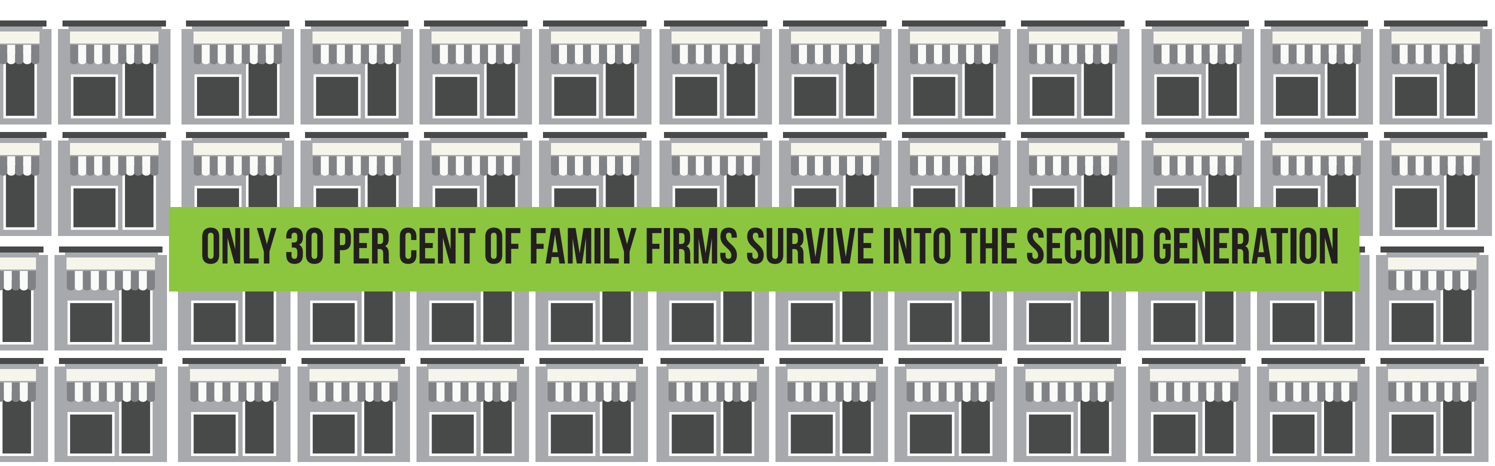
Coleman says every family firm will face certain paradoxes. For example, should they put the family first or the business first? Should they harvest profits or invest in the company? How should they treat family members in the business — is this an aristocracy or a meritocracy? Should they continue running the firm themselves or bring in professional management?

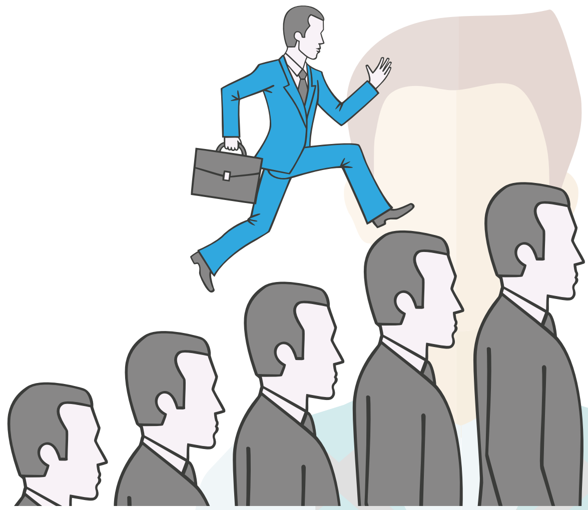
He advises turning "or" questions like these into "and" questions: rather than thinking about whether the family or the business should come first, consider how to ensure both the family and the business get the attention they deserve.

The issue of how to deal with family and non-family employees on matters such as promotions and compensation is especially thorny, and can be phrased as a question of fairness vs. equality, says John Hughes, senior vice-president in MNP's private enterprise practice. Parents are naturally inclined to treat their children equally, but if one is contributing more than another to the family firm, whether because of ability, education or interest, equal treatment is clearly unfair. If there is no agreed policy on this matter, not only will it cause antagonism within the family, it will also be a disincentive for non-family employees of the firm.

"Transparency around skill sets is necessary," Hughes says. "It's inescapable that family members will be treated differently, but good managers will recognize the role and contribution of non-family employees in some manner."

Entrepreneurs Elliott and Brian Greenberg agree with that assessment. A father-and-son team who have created several successful online businesses, including True Blue Life Insurance and Greenberg Enterprise Group, they have identified a





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> GREENBERG ENTERPRISE GROUP

number of common pitfalls for family businesses. First on their list is not respecting family hierarchy.

"Every family has a pecking order and not respecting this order within the business will cause friction," says Brian. "A big problem for a lot of family firms is they try to treat family members the same way as regular employees. We treat family like lifetime employees. Other employees understand the difference between family and non-family."

Non-family employees can still be treated fairly, adds Elliott, through compensation or similar incentives.

Other pitfalls on the Greenbergs' list include neglecting to define roles, not allowing enough leeway for family members to take risks, excluding some family members from business decisions and not having a conflict resolution plan.

Their own plan for dealing with conflict includes prenuptial and succession agreements within the family and written agreements signed by all employees that any disputes will be settled by mediation or arbitration, never by litigation.

One benefit of having formal agreements among family members, says Northcote, is that the process of developing them helps everyone address the issues and avoid potential misunderstandings, such as what the parents have promised their children.

The amount of formality required depends on the size of the business. "For a large family firm, a formal governance structure is essential," says Plener, "but one of the mistakes we make as professionals advising smaller clients is that we tend to jump to formality. We need to consider the nature of the business."

A valuable tool for helping family firms unravel their internal complexities is the Three-Circle Model of the Family Business System, developed at Harvard Business School in the 1970s. It is based on a Venn diagram whose intersecting circles represent the three key elements of a family enterprise: family, business and ownership of the business. Everyone involved in the family or the business appears in one or more of the circles. It's where the circles intersect, where people wear two or more hats, that problems usually arise.

"For example, a firm may hold board meetings but they turn into chats about family matters," explains Coleman. To prevent

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that, "there should be proper meetings for the three groups in the circle model. Only those matters relevant to that group should be discussed at that meeting. Having the right communication at the right level is critical to preventing undue conflict."

Each group needs to develop its own protocols, says Osry, around questions such as who has a voice and the right to make decisions, how are decisions made, and how are they implemented? The answers will be different for the three groups. In family matters, for instance, the aim should be to accept differences of opinion but develop a shared vision and shared values, and use consensus wherever possible to arrive at decisions.

Family firms that survive past the first generation also need to be aware of the differences between the generations.

"The dynamic changes when the patriarch or matriarch dies," says Northcote. "In the second generation, spouses and in-laws have a greater impact. And if the founder has remarried, there will be further complications between the second spouse and the stepchildren."

The differing perspectives and attitudes of the generations need to be appreciated as well, says Osry. The first generation has the dream, takes risks and starts the legacy. The second generation has to work with siblings; they want to make their own mark but tend to be risk-averse and afraid of failure. In the third generation, cousins are now involved; they have to live up to the legacy while developing a new vision. After that, the complexities continue to multiply.

Ideally, "some kind of structure will be introduced at the first-generation level," says Coleman, "maybe by giving the children a seat at business or owner meetings. It might be too late to introduce it at a later generation."

If Canadian family firms paid more attention to succession planning, they would improve their chances of long-term survival. European family businesses seem to last longer than North American firms, says Northcote. The reasons are hard to pin down, although he suspects tradition plays a role.

But the real experts at family business succession are found in Japan, where 40 generations of the Kongo family in Osaka have been building temples since the year 578, and 46 generations of the Houshi family have been operating a hotel in Komatsu since 718.

It will be a long time before any Canadian family businesses can match those records, no matter how hard they try.