

1.3: Chapter 3- Family Businesses

Family Business: An Overview

Learning Objectives

1. Explain what a family business is.
2. Understand the role that family businesses play in the US economy.
3. Explain the advantages and disadvantages of family businesses.

“Family businesses are different.”^[1]

There is no agreed-on definition of a family business. The percentage of ownership, the strategic control, the involvement of multiple generations, and the intention for the business to remain in the family are among the many criteria that experts use to distinguish family businesses from other types of businesses.^[2] For the purposes of this chapter, however, a *family business* is defined as a business that is actively owned and/or managed by more than one member of the same family.^[3] A family business can also be defined as the result of someone’s dream:

The story of every successful family business starts with someone who has the passion, confidence and courage to put his [or her] money where his [or her] mouth is...[These entrepreneurs] work incredibly hard, make things happen, are positive without being unrealistic and possess the resourcefulness to overcome all sorts of hurdles. They are also socially adept, capable of communicating effectively and good at inspiring others...^[4]

Family business owners know that their roles are different from that of shareholders in companies owned by many public investors. In addition, “[E]mployees in family businesses know the difference that family control makes in their work lives, the company culture, and their career. Marketers appreciate the advantage that the image of a family business presents to customers, and families know that being in business together is a powerful part of their lives.”^[5]

Market and Employment Presence

Because of the private nature of most family businesses, it is difficult to obtain accurate information about them.^[6] Complicating the situation is that most data sources do not distinguish between small family businesses, such as the local pizza parlor or deli, and large family businesses, such as Walmart, Mars, and Ford. “The reality is that family-based operations are represented across the full spectrum of American companies, from small businesses to large corporations.”^[7] Within this context, the following has been observed^{[8][9]}:

- Family businesses account for a staggering 50 percent of the gross domestic product (GDP).
- Although it may seem that this GDP contribution comes from thousands of small operations, 35 percent of the *Fortune 500* companies are family companies.
- Family businesses account for 60 percent of US employment and 78 percent of the new jobs created.
- Family businesses represent one of the fastest growing sectors of the economy because their new job requirements outpace their current employment rates when compared to other types of businesses.

What this means is that family businesses continue to be a powerful economic force, no matter what their size and no matter how they are defined. “Family firms are the most common form of business structure; they employ many millions of people; and they generate a considerable amount of the world’s wealth.”^[10]

The focus of this chapter is on the small family business.

Video Link 3.1: Mother and Daughter Partner in Family Business

A mother and daughter partner in a hair brush business.



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Advantages and Disadvantages of the Family Business

There are benefits to a family business, but there are disadvantages that must be considered as well. Starting a family business is not for everyone.

Advantages

A family business offers the following advantages:

- One of the popular misconceptions about family businesses is that they are unable to adapt easily to increasing competitiveness and technological progress. The reality is that family businesses frequently have the advantage of entrepreneurial spirit, flexibility, and opportunism.^[11]
- It is believed by some that family firms are “too soft” and rarely reach their potential. The reality is that family businesses actually outperform public companies. Oftentimes, the marketplace forces public companies to make short-term decisions, whereas a family business has the advantage of having more freedom to make its decisions. Family businesses can adapt to market fluctuations more easily because they can afford to be patient. They have common goals, shared values, and a commitment to brand building.^[12]
- Family-owned businesses are often seen as ideal because family members form a “grounded and loyal foundation” for the company, and family members tend to exhibit more dedication to their common goals. “Having a certain level of intimacy among the owners of a business can help bring about familiarity with the company and having family members around provides a built-in support system that should ensure teamwork and solidarity.”^[13]
- The culture of a family business is very different from that of a company you will find on Wall Street. “Family businesses frequently take a very long-term point of view. They’ll make investments that they don’t expect to pay off for 5 or 15 or 25 years...Culture in a family business is more frequently based on very personal and emotional values. It’s stronger because there are deeper roots and closer connections to the history of the company.”^[14]
- Family businesses are becoming more and more attractive to undergraduate business students who face a bleak job and salary outlook for new grads. These undergrads are choosing to return to their family businesses directly after graduation instead of trying to find a job in corporate America or on Wall Street.^[15]
- There is a common misperception that family businesses are less professional and rigorous in their behavior because of the relational nature of the businesses.^[16] However, like all other businesses, family businesses face global competition and rapidly changing markets. This creates more pressure on those who join to make sure that they produce. “This emphasis on professionalism has made family businesses both more daunting and more attractive—and has created new interest in them, from family members, outsiders, and business school students.”^[17]
- Many family-owned businesses tend to be stable and optimistic, even when economic times are uncertain. They seem to be better able to weather economic difficulties and stabilize the economy than their nonfamily counterparts.^[18] However, this is a function of the industry and the size of the business.

- In general, family businesses feel that they are stronger because family members are involved in their activities. Family owners believe that their family members can be trusted, will work harder, and care more.^[19] This can help create competitive advantage in the marketplace.
- Family businesses may be more open to flexible or part-time schedules or choosing your hours. This presents a very attractive work environment for people who need to tend to children, parents, or other family members in need.^[20]
- Family businesses tend to operate more ethically. In fact, many family businesses believe that their ethical standards are more stringent than those of their competitors. In addition, family businesses are often deeply embedded in their communities, and this proximity is seen as an important factor that increases the likelihood of ethical decision making and moral behavior.^[21] As members of the local community, any ethical problems with a family business will be quickly visible.
- Family businesses also exhibit more social responsibility than their competitors. This has been attributed to their concern about image and local reputation^[22] as well as their closeness to the community.
- Family businesses may incur lower costs because of the greater willingness of family members to make financial sacrifices for the sake of the business. Accepting lower pay than they would get elsewhere to help the business in the longer term or deferring wages in a cash-flow crisis are examples of family altruistic behavior.^[23]
- Family businesses, in general, have greater independence of action because they have less (or no) pressure from the stock market and less (or no) takeover risk.^[24]
- Family businesses tend to be more resilient in hard times because they are willing to plow profits back into the business.^[25]
- Family businesses are less bureaucratic and less impersonal, which allows for greater flexibility and quicker decision making.^[26]
- Family businesses offer the possibility of great financial success.^[27] This can manifest itself in interesting ways. "As the family of a media conglomerate once mentioned, 'The name I have has certainly helped me to get access to top executives of companies, persons who under other circumstances would have kept their doors shut.'"^[28]
- Family members have the chance to learn the business early. This extensive expertise can create an important competitive advantage.^[29] "One executive recalled how as a child he would take long walks with his father, during which they would visit stores to look at competitor's products. Afterwards, his father would ask him which products he liked most, and this would lead to lengthy arguments about each product's quality. This man felt that the expertise he gained during those informal outings proved invaluable later in life."^[30]

Video Link 3.2: Iron Horse Barbecue



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A family-owned business that is helping other business fire up businesses of their own.

Why Family Businesses Are So Special

"If family businesses are so common, how can they also be special? When Freud was asked what he considered to be the secret of a full life, he gave a three-word answer: '*Lieben und arbeiten* [to love and to work].' For most people, the two most important things in their lives are their families and their work. It is easy to understand the compelling power of organizations that combine both. Being in a family firm affects all the participants. The role of chairman of the board is different when the company was founded by your father and when your mother and siblings sit around the table at board meetings, just as they sat around the dinner table. The job of a CEO is different when the vice president in the next office is also a younger sister. The role of partner is different when the other partner is a spouse or a child. The role of sales representative is different when you cover the same territory that your parent did twenty-five years earlier, and your grandparent twenty-five years before that. Even walking through the door on your first day of work on an assembly line or in a billing office is different if the name over the door is your own."^[31]

Disadvantages

As attractive as family businesses are on many fronts, they have the following disadvantages:

- Family businesses tend to be stable organizations. Although this is a good thing in many instances, stability can also make it difficult to change. A new, younger family member coming into the business will find tradition and structure. Changing that is not simple. The key to changing a family business lies in defining tradition in terms of the company's core values, not in specific ways of doing things.^[32]
- Family closeness can lead to sibling rivalry or problems when both the parent and the child want control. By the third or fourth generation, with many cousins possibly sharing ownership, governance can become very complicated.^[33]
- There may be times when the interests of a family member conflict with the interests of the business. One family member may want to expand the business, but other family members may not share this person's desire. The needs of the business are not in sync with the needs of the family.
- Family ties have a downside. Family members will frequently be expected to work harder, make more of a commitment, and get paid less than other employees in the business.^[34]
- Family business owners may automatically promote someone from the family or give family members a job even if they do not have adequate skills for the job. A nonfamily employee may be better qualified.^[35] This can cause dissension and resentment among other employees.
- Relationships between parents and children or among siblings have a tendency to deteriorate due to communication problems. "This dysfunctional behavior can result in judgments, criticism and lack of support."^[36]
- The family business may be a breeding ground for jealousies, resentment, anger, and sabotage. Family problems may spill over into the workplace.^[37]
- The business may be plagued with managerial incompetence, the lack of exposure to other businesses, and the inability to separate family and work.^[38]
- Some family businesses may have difficulty attracting and keeping highly qualified managers. "Qualified managers may avoid family firms due to the exclusive **succession**, limited potential for professional growth, lack of perceived professionalism, and limitations on wealth transfer."^[39] Succession refers to passing the business to the next generation.
- Family businesses have limited sources of external capital because they tend to avoid sharing equity with nonfamily members.^[40] Having less access to capital markets may curtail growth.^[41]
- Not all children of owner-managers may want to join the business. According to one study,^[42] 80 percent of those who did not work in the family business did not intend to go into the business. This reluctance comes from several directions, such as the following:
 - My parents would not want me to join.
 - I could not work for my parents.
 - There are already too many family members in the business.
 - I am not interested in this particular business.
 - The business is too small for me.
 - The business would not allow me to use my talents.
 - The business would not allow me to use my training.
 - I can earn more elsewhere.
 - I am not interested in a business career.^[43]

In Their Own Words

Why Some Children of Owner-Managers Do Not Want to Join the Business^[44]:

I see the pressure my dad is under—this does put me off slightly. I want to enjoy my job as well as enjoying life outside work.

A larger factor when working under a relative is the problem of self-worth. It is hard to feel like you are worth something when your father is an MD.

A business relationship with your father makes your family relationship harder.

I do not look to go into the family business straight away, as I feel this is giving a commitment to work there for the rest of my life.

I would join only because I am genuinely qualified, not because I am the owner's daughter.

The difference in my father's education and mine is a factor affecting why I have decided not to go into the business. I have more choice over what I want to do as a career, and my personal interests would not be met by my father's company. I am sure it would not have been his choice had he had the same educational choices as me.

As much as the route into the family business is seen by outsiders as an "easy route to wealth and inheritance," in my case it was also a liability. At 17, was I to be the fourth generation after 100 years that could not keep the company going?

- The "spoiled kid syndrome" often occurs in a family business. The business owner may feel guilty because his devotion to the business takes away from the attention he should be giving to his children. Out of a sense of guilt, he or she starts to bribe the children, "a kind of pay-off for not being available emotionally or otherwise."^[45]
- Financial strain emanating from "family members milking the business and a disequilibrium between contribution and compensation"^[46] can have a significant negative impact on the business.
- Nepotism that results in the "tolerance of inept family members as managers, inequitable reward systems, [and] greater difficulties in attracting professional management"^[47] can easily lead to low morale among nonfamily members of the business, and it can ultimately result in business failure.
- Family businesses frequently have a confusing organization, with "messy structure and no clear division of tasks." Authority and responsibility lines are unclear; jobs may overlap; executives may hold a number of different jobs; and the decision-making hierarchy may be completely ignored, existing only to be bypassed.^[48] This can create a dysfunctional working environment.
- Family businesses frequently have paternalistic or autocratic rule that is characterized by a resistance to change, secrecy, and the attraction of dependent personalities.^[49]

Key Takeaways

- Family businesses account for 50 percent of the GDP, 60 percent of US employment, and 78 percent of the new jobs that are created.
- A family business offers both advantages and disadvantages. It is important to understand both.

Exercises

1. Jaret Coulson has returned to the family business and is very enthusiastic about expanding the business. He has identified four options: (a) expanding the antique store either at its current site or elsewhere in Charlottetown; (b) opening several similar-sized antique shops in nearby towns; (c) using the Internet to expand sales; and (d) expanding the sales of refinished chairs in a local store to a regional furniture chain. Any one of these ideas would represent a change from his father's Mr. Coulson's business model. Given that he had not expressed any interest in the management of the business, how should he go about approaching his father with these ideas? If the company expands, should Jaret approach his sister and her husband about taking a more active role in the business? What should their roles be?

Family Business Issues

Learning Objectives

1. Explain why communication, employing family and non-family members, professional management, employment qualifications, salaries and compensation, succession, and ethics are important issues for all family businesses.

Looking at the vision and hard work of the founders, family businesses "take on their unique character as new members of the family enter the business. At best, the environment can be inspiring and motivating. At worst, it can result in routine business decisions becoming clouded by emotional issues."^[50]

The owners and managers of family businesses face many unique challenges. These challenges stem from the overlap of family and business issues and include communication, employing family and non-family members, professional management, employment qualifications, salaries and compensation, and succession.

Communication

Communication is important in any business, but the complexities of communication in a family business are particularly problematic. Experts say that communication is one of the most difficult parts of running a family business.^[51] The approach to communication needs to include commitment, the avoidance of secrecy, and an understanding of the risks of bad communication.

Commitment

In a family business, it is critical that there be a commitment to communicate effectively with family and non-family members of the business. "Business leaders should be open about their awareness of the potential for communication issues to evolve and their willingness to accept feedback and input from all employees about opportunities for improvement and areas of concern."^[52]

One important issue is whether there should be a line drawn between family and business discussions. Some suggest that setting up strict guidelines from the start that draw a clear line between the different types of discussions is a good approach.^[53] By contrast, the Praxity Family Business Survey^[54] found that it is considered OK to talk about the business anywhere and at any time, whether at work or at home:

- Nineteen percent of the family businesses in the survey reported talking about business at home.
- Thirty-seven percent talk about it in the workplace.
- Forty-four percent talk about it when and wherever.

Secrecy

In family businesses, it is particularly important not to convey the impression that family members are more in the know than other employees. "...Even when this is not the case, the potential for the perception of exclusivity may exist. Steps should be taken to address any issues that may arise openly, honestly, and without preference for family members."^[55]

Risks of Bad Communication

If good communication channels are not in place, the following can occur:

- "Family members assume they know what other family members feel or want."
- "Personal ties inhibit honest opinions being expressed."
- "The head of the family may automatically assume control of the business even if they don't have the best business skills."
- "One family member ends up dominating the business."
- "Family-member shareholders not active in the business fail to understand the objectives of those who are active and vice versa."
- "Personal resentments become business resentments and vice versa."^[56]

These difficulties can be overcome if the family business makes a concerted effort to create and maintain an environment of open communication where people feel comfortable voicing opinions and concerns. It is important that family and non-family members have an equal opportunity to express their views.

Employing Family and Non-family Members

It is natural for a family business to employ family members, especially in management positions. Family members tend to be the first people hired when a small business gets started, and as the business grows, so do their roles.^[57] There are both pros and cons to hiring family members. Both need to be considered carefully. Who to hire may well be the biggest management challenge that a family business owner faces.

Pros

On the positive side of things, several advantages can be identified for hiring family members:^{[58][59]}

- Improved customer relations through family contact
- Intergenerational continuity
- Long-term stability
- Shared values
- Loyalty and commitment
- Inherent trust
- Willingness to sacrifice for the business
- Emotional attachment to the business; more willing to contribute to its success
- Share the same culture

“A family whose members work well together can also give the business a welcoming and friendly feel. It can encourage employees who aren’t in the immediate family to work harder to gain acceptance by those employees who are.”^[60]

Cons

There are also quite a few disadvantages to hiring family members:^{[61][62][63][64]}

- Families are not perfect, so a dispute among family members can spill from home into the workplace.
 - There is always the possibility of managerial incompetence
 - It may not be possible to separate family and work
 - Patterns of conflict will be rooted in early family experiences
 - Communication may break down
 - Sibling rivalry may create problems
- Newly hired family members may feel that they do not have to earn their positions; their success will be seen as linked to their name instead of their abilities.
 - The company may be subject to charges of discriminatory hiring practices if job openings are not published.
 - Non-family members of the business may feel that family members get hiring preference.
 - Non-family members may feel that they will be automatically outvoted in decision making.
 - Hiring primarily family members for management positions may lead to hiring suboptimal people who cannot easily be dismissed. This could lead to greater conflict because of promotion criteria that are not based on merit.

Hiring Non-family Members

There will be times when the better decision may be to hire a non-family person for a particular job. Experience has shown that a family business is less likely to be successful if it employs only family members; bringing in the fresh thinking that comes with external expertise can be valuable at all levels of a business.^[65] In addition, non-family members can offer stability to a family business by offering a fair and impartial perspective on business issues. The challenge is in attracting and retaining non-family employees because these employees “may find it difficult to deal with family conflicts on the job, limited opportunities for advancement, and the special treatment sometimes accorded family members. In addition, some family members may resent outsiders being brought into the firm and purposely make things unpleasant for non-family employees.”^[66]

Because it is likely that a growing family business will need to hire people from the outside, it is important that the business come to terms with that necessity. Policies and procedures can help with the transition, but the most important thing is to prepare the family culture of the business to accept a non-family member. Not surprisingly, this is much easier said than done.

Professional Management

The decision to hire a *professional manager* is likely one of the most important and difficult hiring decisions that a family business owner will have to make. “A typical argument...is that professional non-family managers should be brought in to provide ‘objectivity’ and ‘rationality’ to the family firm.” There are several problems with this way of thinking. First, it perpetuates the outdated notion that family members are not professional, that the smartest thing for a family business to do is to bring in professional management—as quickly as possible.^[67]

Second, professional managers are not always prepared to deal with the special nature of family-owned businesses. “The influence of families on businesses they own and manage is often invisible to management theorists and business schools. The core topics of management education—organizational behavior, strategy, finance, marketing, production, and accounting—are taught without differentiating between family and non-family businesses.”^[68] This does an injustice to the unique workings of a family-owned business.

Third, a professional manager from the outside is not always prepared, perhaps not even most of the time, to deal with the special nature of family companies. The dominant view on professional management downplays the importance of the social and the cultural context. “This is a problem in family firms where family relations, norms, and values are crucial to the workings and development of the business.”^[69] It is argued that the meaning business families attach to their businesses is guided by family values and expectations—so much so that “anything or anyone that interrupts this fragility could send the business into chaos.”^[70]

The hiring of an outside manager, therefore, should include an assessment of both *formal competence*: formal education, training, and experience outside the family business and *cultural competence*: an understanding of the culture of a specific firm. Although it is certainly helpful and appropriate, formal competence is not sufficient for managerial effectiveness. It needs to be supplemented with cultural competence, an understanding of the culture of a specific firm. Interestingly, most family businesses look only to formal competence when selecting a CEO.^[71]

Culture and Non-family CEOs

It is extremely important to understand the culture of the family firm. It means that as a leader you have to be sensitive to the organization’s reactions on the things you say and do. I have a long-term employee on my management team, and she is my guide in these issues. She can tell me how the organization will react and how things are likely to be received. We have to build on the past even though we have to do a lot of things in new and different ways. But because of the culture, this might be very sensitive (*The words of a non-family CEO in a family business*).

As a non-family CEO, you have to have in-depth respect for the invisible forces among the employees in the family firm. You cannot escape the fact that there will always be special bonds between the family firm and the owner. Always (*The words of a non-family CEO in a family business*).^[72]

One concern of family businesses may be that the hiring of a non-family manager will result in the loss of their “familiness.” However, one study found that, even with non-family managers, bringing non-family management activities, styles, and characteristics, “[T]he special and unique aspects and forces of the system of the family, its individual family members, and the business itself provide a synergistic force that offsets the outside influences of the [non-family managers].” This same study acknowledged, however, that their research did not focus on understanding at what point, or percentage of non-family members, the feeling of “familiness” will begin to erode.^[73]

Employment Qualifications

One of the more difficult challenges that a family business must face is determining employment qualifications for employees, both family and non-family. The lack of a clear employment policy and process can lead to major conflicts in the company. Unfortunately, it would appear that, despite their benefit, most family businesses have a family employment policy.^[74] As a result, many family businesses may end up with more employees from the family than the company needs, and some of these people may not even be qualified or suitable for the jobs they have been given. “Some family

businesses even find themselves acquiring businesses that have no relationship with their original business or keeping some unprofitable business lines just to make sure that everybody in the family gets a job within the company.”^[75] This kind of situation benefits no one.

A written family-business employment policy can solve a myriad of problems because it spells out the specific terms for family and non-family members with respect to recruiting, hiring, promoting, compensating, and terminating. One recommendation is that an ideal family employment policy should include the following:^[76]

- “Explain the family employment policy’s purpose and philosophy.”
- “Describe how family members will apply and be considered for positions.”
- “Cover the general conditions of employment, including compensation and supervision.”
- “Outline the approach to be taken in developing and promoting family business members.”
- Make clear that family members will be completing the same applications that other candidates will complete.
- Include an inspiring and upbeat reminder that the policy’s purpose is to help the family business succeed and to support, develop, and motivate family members to lead successful and productive lives.
- Have all family business owners sign the policy, indicating they have read and agreed to it.

Others have recommended “that family members meet three qualifications before they are allowed to join the family business on a permanent basis: an appropriate educational background; three to five years’ outside work experience; and an open, existing position in the firm that matches their background.”^[77]

There are no rules that dictate the content of a family business employment policy, so differences from one family business to another can be expected. However, it is very important “to set employment conditions that do not discriminate against or favor family members. This would help establish an atmosphere of fairness and motivation for all employees of the family business.”^[78]

The benefits of an employment policy notwithstanding, the idea may be met with resistance. There may be the feeling that hiring decisions for family members should be separate from the hiring decisions for non-family members because being a family member provides special qualifications that cannot be matched by someone outside the family. How to proceed will ultimately fall on the shoulders of the family business owner.

Salaries and Compensation

As difficult as hiring decisions may be for the family business, decisions about salaries and compensation are probably even worse. No matter how well intentioned and well designed the company’s compensation plan may be, there will still be jealousies, hard feelings, severed sibling relationships, and even lawsuits, particularly among those family members who feel they have been treated unfairly.^[79] This presents a daunting challenge: how to develop a compensation plan that will be fair to family members and good for the business:

One of the greatest struggles of operating a family business is separating the family from the business. Oh yes, there are many great benefits to having family in the business and to being a family member in a family business, but the most difficult problems result when “family values” and issues take over, leaving business values and needs wanting. There is no greater source for family business problems—nor more fertile ground for their cure—than the family business compensation systems.”^[80]

Some of the Problems

Family businesses often make several common mistakes when developing their compensation plans.

- They consider fair compensation to be equal compensation for all family members, sometimes even for the owner. This creates a very sticky situation because all family members are not created equal. “It is sometimes difficult to assess and compare the talents of family members who are also employees. Nor do all family members contribute equally to the business. As a result of the stress that this causes, many family business owners ignore the problem and let compensation become a breeding ground for dissension in the family.”^[81]
- They do not compensate wives for the work they do. The reason often given? It saves on taxes. Not surprisingly, this approach leaves wives isolated from the business, invisible in the decision-making process, and unappreciated. This problem extends to the compensation of sons and daughters as well. A survey by Mass Mutual Insurance Company^[82] reported a big discrepancy among the salaries of sons and daughters in family businesses across America. The average salary of the typical son in a family business was \$115,000, while his sister earned only \$19,000. This may be due to the tendency of sons being groomed for leadership, while daughters are groomed for the supportive roles that command lower salaries.
- The compensation for family members is higher than that for non-family members, but the differential is not tied to the actual job requirements or performance. This situation can lead to anger, reduced motivation, resentment, and eventual departure of the non-family member from the firm.
- The business overpays family members—for a variety of reasons:^[83]
 - “Guilt, because mom & pop were so busy working when the kids were young.”
 - “Fear of conflict, because someone’s wife threatens not to come to the family picnic.”
 - “Resistance to change, because ‘That’s the way we’ve always done it.’”
 - “Inability to confront family members who feel ‘entitled’ to inflated salaries.”
 - “Determination to minimize estate taxes by transferring wealth through compensation.”
- Emotional pressures are allowed to determine compensation policies. What this means is that compensation is not correctly determined by job requirements and performance in those jobs. When this happens, small problems develop centrifugal force:^[84]
 - “Fighting between sibling/cousin partners increases.”
 - “Hard-working family members and employees lose morale.”
 - “Well-motivated competent employees leave the company.”
 - “The company loses its competitive edge and growth potential.”
 - “Family harmony decreases.”
 - “The value of the company declines, or it is sold—for the wrong reasons.”

Some of the Solutions

Developing a fair compensation plan for the family business is not easy. It requires good faith, trust, and good business sense. The dollar amounts offered to family members will be critical, but the more pressing issue is fairness.^[85] Unfortunately, fairness is often construed as equality. This must be avoided.

There is no template for designing a compensation plan for family businesses, but there are several recommendations:^[86]

- Develop accurate job descriptions for each employee that include responsibilities, level of authority, technical skills, level of experience and education required for the job, and goals for an annual performance review. In a performance-based company, the amount of stock owned by a family member will not be related to his or her compensation.
- Develop a clear philosophy of compensation so that everyone understands the standards that are used to pay people. The following is a sample of a written compensation plan philosophy that was developed by one family.

Family members employed in the business will be paid according to the standards in our region, as reported by our trade association, for a specific position, in companies of our size. In order to retain good employees we will pay all employed family members and other managers within the top quartile of our industry’s standards. Additional compensation will be based on success in reaching specific company goals, with bonuses shared among all members of the management team. Individual incentives will be determined according to measurable goals for job performance determined each year, and reviewed by the appropriate manager.^[87]

- Gather information about the salaries of similar positions in the industry of the family business in the applicable region of the country. Look at companies that are similar in the number of employees, revenue, and product. If possible, obtain salary and benefit information.
- Have the base salary for each position be consistent with the salaries and wages paid for comparable positions at similarly sized businesses. Paying at this market value will have an excellent effect on non-family members because they will feel that they are on an even playing field. There will be a positive effect on business morale.
- The family business owner might consider seeking outside help in determining compensation levels for individual family members. However, this assistance must be seen as truly objective, with no reason to favor one viewpoint over another.

Oh, Those Sleepless Nights!

A recent family business survey reported that the following things keep family business owners awake at night. ^[88]

Table 3.1 Top Factors Business Owners Lose Sleep Over

Rank	The Nightmare	Percentage Citing as a Significant Concern (%)
1	Family members can never get away from work.	18
2	Business disagreements can put strain on family relationships.	17
3	Emotional aspects can get in the way of important business decisions.	16
4	Transition to the next generation is more difficult than a third-party sale.	10
5	There can often be conflicts regarding the fairness of reward for effort.	9
6	The business rewards are not necessarily based on merit.	8
7	Family members find it difficult to be individuals in their own right.	5
8	Difficulties arise in attracting professional management.	5
9	Children can be spoiled through inequitable rewards.	4
10	Outside shareholders do not contribute but take payouts from the business.	3
11	The family is always put before the business and therefore can be less efficient.	3
12	Past deeds are never forgotten and are brought up at inappropriate times.	2

Other urgent issues identified by a different family business survey included, in order of importance, the following: ^[89]

- Labor costs
- Health-care costs
- Finding qualified employees
- Foreign competition
- Labor union demands
- Domestic competition
- Oil prices
- Availability of credit from lenders
- Estate taxes

Succession

Another important issue that is particularly difficult for family businesses is **succession**. As mentioned earlier in this chapter, succession is about passing the business to the next generation. Decisions have to be made about who will take over the leadership and/or ownership of the company when the current generation dies or retires ^[90]. Interestingly, “only a third of all family businesses successfully make the transition to the second generation largely because succeeding generations either aren’t interested in running the business or make drastic changes when they take the helm.” ^[91] There are family businesses that manage the transition across generations quite easily because the succession process chooses only the children willing and able to join and work with the prevailing family, business values, and goals. Unfortunately, there are also instances in which children have had to leave school as soon as legally allowed, not equipped to manage either the business, their lives, or their family. These children spend many resentful years in the business until it fails. ^[92]

Passing the family business to the next generation is a difficult thing to do, but succession is a matter of some urgency because 40 percent of US businesses are facing the issue of succession at any given point in time. ^[93]

This urgency notwithstanding, there are several forces that act against succession planning: ^[94]

1. Founder
 - Fear of death
 - Reluctance to let go of power and control
 - Personal loss of identity
 - Fear of losing work activity
 - Feelings of jealousy and rivalry toward successor
2. Family
 - Founder’s spouse’s reluctance to let go of role in firm
 - Norms against discussing family’s future beyond lifetime of parents
 - Norms against favoring siblings
 - Fear of parental death
3. Employees
 - Reluctance to let go of personal relationship with founder
 - Fears of differentiating among key managers
 - Reluctance to establish formal controls
 - Fear of change
4. Environmental
 - Founder’s colleagues and friends continue to work
 - Dependence of clients on founder
 - Cultural values that discourage succession planning

These are powerful forces working against succession planning, but they need to be overcome for the good of the founder, the family, and the business. It will be tricky to balance the needs of all three and fold them into a good succession plan.

The Succession Plan

Voyager Transportation, a company in London, calls its successful succession planning program, “If you got hit by a beer truck, what would happen to your department?” ^[95] As a family business owner, you should pose this question in terms of yourself and your business. Hopefully, this will provide the impetus you need to develop a succession plan.

A good succession plan outlines how the succession will occur and what criteria will be used to judge when the successor is ready to take on the task. It eases the founder’s concerns about transferring the firm to someone else and provides time in which to prepare for a major change in lifestyle. It encourages the heirs to work in the business, rather than embarking on alternative careers, because

they can see what roles they will be able to play. And it endeavors to provide what is best for the business; in other words, it recognizes that managerial ability is more important than birthright, and that appointing an outside candidate may be wiser than entrusting the company to a relative who has no aptitude for the work.^[96]

A good succession plan will recognize and accept people's differences, not assume that the next generation wants the business; determine if heirs even have enough experience to run the business; consider fairness; and think and act like a business. The plan should also include a timetable of the transition stages, from the identification of a successor to the staged and then full transfer of responsibilities, and a contingency plan in case the unforeseen should happen, such as the departure or death of the intended successor or the intended successor declining the role.^[97] It would also be helpful to get some good professional advice—from company advisors who have expertise in the industry as well as other family-run businesses.^[98]

Although each succession plan will be different, the following components should be seen as necessary for a good succession plan:^[99]

1. **Establish goals and objectives.** As the family business owner, you must establish your personal goals and vision for the business and your future role in its operation. You should include your retirement goals, family member goals, goals of other stakeholders (e.g., partners, shareholders, and employees), and goals relating to what should happen in the case of your illness, death, or disability.
2. **Family involvement in the decision-making process.** If the family and stakeholders who are involved in the decision-making process are kept informed of the decisions being made, many of the problems related to inheritance, management, and ownership issues will be alleviated. Communication, the process for handling family change and disputes, the family vision for the business, and the relationship between the family and the business should be addressed. The surest path to family discord is developing the succession plan on your own and then announcing it.^[100]
3. **Identify successor(s).** This section of the plan will address the issue of who takes over ownership and management of the business. Identification of the potential successor(s), training of the successor(s), building support for the successor(s), and teaching the successor(s) to build vision for the business are included here. Working with your successor(s) for a year or two before you hand over the business will increase the chances for success.^[101]
4. **Estate planning.** Estate planning is important if you are planning to retire or want to take precautionary measures regarding the future of the business in the event you are unable to continue operation of the family business due to illness, disability, or death. You should consult a lawyer, an accountant, a financial/estate planner, and a life insurance representative so that your benefits will be maximized. You will need to consider taxation, retirement income, provisions for other family members, and active/nonactive family members.
5. **Contingency planning.** Contingency planning is about unforeseen circumstances. It is about strategizing for the most likely “what if” scenarios (e.g., your death or disability). By thinking in terms of the unforeseen, you will be taking a proactive rather than reactive approach.
6. **Company structure and transfer methods.** This section of the succession plan involves the review and updating of the organizational and structural plan for the organization taking into account the strengths and weaknesses of the successor. The following needs to be identified: the roles and the responsibilities of the successor, the filling of key positions, structuring of the business to fit the successor, the potential roles for the retiring owner, any legal complications, and financial issues.
7. **Business valuation.** This section is relevant only if the business is being sold. Passing the business to a family member would not involve a business valuation.
8. **Exit strategy.** With any succession, ownership will be transferred, and you will remove yourself from the day-to-day operations of the business. Alternatives will be compared, and a framework for making your final choices will be developed. The transfer method and the timelines are decided. The exit plan should then be published and distributed to everyone who is involved in the succession process.
9. **Implementation and follow-up.** The succession plan should be reviewed regularly and revised as situations change. It should be a dynamic and a flexible document.

As difficult as the planning process can be, the goal should be a succession plan that will be in the best interests of all—or most—of the parties involved. Business interests should be put ahead of family interests, and merit should be emphasized over family position.^[102]

The Family Business and Technology

In 2008, when R. Michael Johnson—Mikee to everyone who knows him—took over the pressure-treated lumber company his grandfather founded in 1952, he had a great idea: laptops for all managers and sales staff.

“You would have thought the world was coming apart,” says Johnson, CEO and president of Cox Industries in Orangeburg, South Carolina. One salesman—convinced that the computer would be used to track his movements outside the office—up and quit. A buyer who had been with the company for thirty-five years said he would like a fax machine but could not see why he needed a computer when he had managed just fine without one for so long.

And that was just the beginning. In an industry where some businesses still write delivery tickets by hand and tote them up on calculators, Johnson recently led the company through an ERP (enterprise resource planning) software conversion and distributed iPhones to the sales team so they can use the company's new customer relationship management (CRM) system.

“Let's just say I have spent quite a few Sunday lunches after church explaining technology acronyms to Granddad and Grandmom,” Johnson says.

The resistance to new technology quieted, however, after Johnson was able to point to market share growth of 35 percent at the \$200 million business in the past year. “The numbers are starting to resonate,” he says. “Five years ago, I couldn't even say what our market share was because we didn't have the technology to figure it.”^[103]

Key Takeaways

- Important family issues include communication, employing family and non-family members, professional management, employment qualifications, salaries and compensation, and success. Each issue can create conflict.
- It is very important to understand the culture of the family business, especially by non-family CEOs.
- Succession planning is critical to the success of passing a business to family members.

Exercises

1. Select a family business in your area. Make arrangements to speak with three members of the family who work in the business. Develop a list of ten questions that cover a broad range of issues, such as the approach to compensation (but do not ask for specific salary or wage numbers), the process for hiring family and non-family members, and the plans for passing the business to the next generation. Ask each member of the business the same questions. Pull the answers together and compare them. Where did you find similarities? Where did you find differences? Did everyone know the answer to each question? Where were people reluctant to answer? Prepare a three- to five-page report on your findings.
2. The family business is looking to expand, and some members of the family, but not all, feel that it might be worth bringing in someone from the outside to fill one of the new management positions because the family talent has been pretty much exhausted. Design a process for hiring an external manager. What things should be considered? How might you get buy-in from all family members?

Conflict

Learning Objectives

1. Explain what conflict is.
2. Explain why positive or constructive conflict can be helpful to a family business.
3. Explain why negative or destructive conflict can damage a family business.
4. Identify sources of negative conflict in a family business.
5. Identify some ways in which negative conflict can be avoided.

All businesses have conflict. It can be a good thing or it can be a bad thing. **Positive conflict or constructive conflict** can be beneficial to a family business when it increases opportunity recognition, produces high-quality decisions, encourages growth, strengthens groups and individuals, increases the learning necessary for entrepreneurial behavior, and increases the levels of commitment to the decisions being made.^{[104][105][106]} An example of positive conflict is a disagreement between family members on the strategic direction of the family business, the result being a much-needed rethinking of the business plan and a new agreed-on vision for the company.^[107]

By contrast, **negative or destructive conflict** can hurt a business by damaging the harmony and relationships of family members in the family business, discouraging learning, causing ongoing harm to groups and individuals in the business, frustrating adequate planning and rational decision making, and resulting in poor quality decisions.^{[108][109]} “The absence of good conflict makes it that much

harder to accurately evaluate business ideas and make important decisions...But conflict does not mean browbeating.”^[110] An example of a negative conflict would be arguments over the successor to the business. Ultimately, the failure to adequately control negative conflict may contribute to the high mortality rate of family-owned businesses.^[111]

Because of the clash between business and emotional concerns in a family business, the potential for negative conflict can be greater than for other businesses.^[112] The tension that exists among the personal lives and career pursuits of family members creates an **interrole conflict**. A situation when a family member has simultaneous roles with conflicting expectations (occurring when a family member has simultaneous roles with conflicting expectations) in which the role pressures from work and home are incompatible.^[113] This conflict is difficult—if not impossible in some instances—to resolve. “Due to the interconnection and frequent contact among family members working in the business with those who are not but may still have an ownership stake, recurring conflict is highly probable in family firms.”^[114]

Sources of Conflict

The specific causes of conflict in a family business are many. Because the typical understanding of conflict in family businesses is that conflict refers to negative conflict that is unhealthy and disruptive, negative conflict is the focus of this section.

The PricewaterhouseCoopers Family Business Survey^[115] identified a core group of issues that are likely to cause tension.

Table 3.2 Factors Causing Tension in Family Businesses

Issue Causing Tension	Causes Some Tension (%)	Causes a Lot of Tension (%)
Discussion about the future strategy of the business	25	9
Performance of family members actively involved in the business	19	8
Decisions about who can and cannot work in the business	19	7
Failure of family members actively involved in the business to consult the wider family on key issues	16	7
Decisions about the reinvestment of profits in the business versus the payment of dividends	15	7
The setting of remuneration levels for family members actively involved in the business	14	7
The role in-laws should or should not play in the business	14	7
Decisions about who can and cannot hold shares in the business	13	6
Discussions about the basis on which shares in the business should be valued	12	5
Rejection of chosen successor by other family members	10	5

Add to this the fact that “[F]amily firms are prone to psychodynamic effects like sibling rivalry, children’s desire to differentiate themselves from their parents, marital discord, identity conflict, and succession and inheritance problems that non-family businesses do not suffer from,”^[116] and it’s easy to see how the family business is a fertile field for negative conflict.^[117]

Several other sources of conflict can occur in a family-owned business. A sampling of those sources is discussed here. All have the potential to adversely impact family relationships, business operations, and business results.

- **Rivalry.** Harry Levinson from the Harvard Business School maintains that, “the fundamental psychological conflict in family businesses is rivalry, compounded by feelings of guilt, when more than one family member is involved.”^[118] This rivalry can occur between father and son, siblings, husband and wife, father and daughter, and in-laws with members of the family that own the business.
- **Differing vision.** Family members will often disagree with the founder and with each other about the vision and strategy for the business. These differences “can create fear, anger, and destructive attempts to control decisions that are divisive and counter-productive to making and implementing sound decisions.”^[119] Rivalries that spill into the workplace can get nasty, leading to destructive behaviors.
- **Jealousy.** There is always the potential for jealousy in the family business. It can arise from feelings of unfairness in such things as compensation, job responsibilities, promotions, “having the ear” of the business founder, and stock distributions. It can also arise with respect to the planned successor when there is a difference of opinion about who it should be. If it is not resolved, jealousy has the potential to divide the family and destroy the business.^[120]
- **Succession.** Succession is always a big obstacle for a family business. In some cases, the founder may feel that his or her children are not capable of running the business. This will cause obvious tension between the parent and the child/children, such that the child or children may leave the business in frustration^[121]. This, in turn, becomes problematic for succession. “Who gets what type of equity, benefit, title, or role can be major sources of explicit conflict or implicit but destructive behaviors.”^[122] It is also true that while the founder of the business wants to continue family ownership and leadership of the business, this may not be true of his or her immediate family or later-generation family members^[123]. This can create substantive conflict during succession planning.
- **Playing by different rules.** This cause of negative conflict “often presents itself as a form of elitism or entitlement that exists simply by virtue of being in a family that owns a business. Examples show up in allowing one or more family members to exhibit deficient standards of conduct or performance that violate sound business practices or important requirements that all other employees are expected to follow. Such behaviors can be divisive and demoralizing to all employees and customers as well as harmful to the reputation of the business.”^[124]
- **Decision making.** If roles and responsibilities are not clearly defined, conflict will arise over who can make decisions and how decisions should be made. This will lead to confusion, uncertainty, and haphazard decisions that will put the company at risk.
- **Compensation and benefits.** “This is one of the most frequent sources of conflict, especially among members of the younger generation.” A person’s compensation is inextricably linked to his or her feelings of importance and self-worth. Compound that with the emotions associated with being a member of the family that owns the business, and you have the potential for explosive negative conflict. Clearly, this is not in the best interests of the business.^[125]

Avoiding Conflict

Some measure of family squabbling is expected in a family business. Some of the arguments will be logical and necessary. However, “it’s important that they remain professional and not personal, because squabbling among family members in a work environment can make the employees and customers feel extremely uncomfortable, and can give them grounds for legal claims against the business.”^[126] The negative effects of family squabbling are as follows:^[127]

- **Unprofessional image.** Family squabbling conjures up images of children—immaturity and pettiness. This sends a signal to customers and other employees that they are not in a professional environment that focuses on the right things.
- **Uncomfortable environment.** It is embarrassing to witness squabbling. No one likes to be in an awkward atmosphere; squabbling can cost you customers and employees, and it may result in expensive and unpleasant lawsuits. This can affect your bottom line very quickly.
- **Discrimination.** Nepotism is one of the biggest dangers of working in a family business. Arguing with relatives will only reinforce to other employees that they are in a family business. This can quickly lead to feelings of disparate treatment which, in turn, can lead to discrimination charges.
- **Legal troubles.** In the worst cases of family squabbling, disagreements over business can lead to lawsuits. If one family member’s role is minimized and his or her authority is restricted, this is violating the person’s rights as a shareholder. This can lead to an oppressed minority shareholder suit against the family business. This would be expensive, it would be ugly, and it could lead to the demise of the company.

Avoiding conflict is no easy feat. However, there are several things that a family business should consider. First, there are consultants who engage in conflict resolution for a living. The possibilities should be checked out. If the budget can handle the costs of a consultant, it could be the best choice. A consultant, having no reason to take one side or the other, will bring the necessary objectivity to resolution of the conflict.

Second, emotional reactions should be differentiated from problem-solving reactions. Family members need to take a professional perspective rather than that of an irritated sibling, parent, son, or daughter.^[128] It will probably be difficult to do this, but it is important that it be done.

Third, focus on the professional role instead of the family role. “Make sure it’s clear what the expectations and attitudes of all your employees are...Because you’re a small business, you might not have as strict a policy as a large corporation, but it would still be helpful to put it in writing, such as in an employee handbook, which carries legal responsibilities to both family and outside employees.”^[129]

Fourth, encourage honesty from the beginning. When first starting to work together, it is important that family members sit down together to talk about potential conflicts that might arise. Acknowledging that it will be more difficult to work together because of being family is a good beginning. Treating family members and the professional environment with respect and expecting honesty when someone steps over the line should make for a smoother process.^[130]

Last, the founder should try to keep the conflict constructive. This means stimulating task-oriented disagreement and debate while trying to minimize interpersonal conflicts^[131]. This will require a fair decision-making process. For people to believe that a process is fair, it means that they must:^[132]

- “Have ample opportunity to express their views and to discuss how and why they disagree with other [family] members”;
- “Feel that the decision-making process has been transparent, i.e., deliberations have been relatively free of secretive, behind-the-scenes maneuvering”;
- “Believe that the leader listened carefully to them and considered their views thoughtfully and seriously before making a decision”;
- “Perceive that they had a genuine opportunity to influence the leader’s final decision”; and
- “Have a clear understanding of the rationale for the final decision.”

Key Takeaways

- Conflict can be either positive or negative. Negative conflict can potentially harm the business.
- There are many sources of negative conflict in a family business. The fundamental psychological conflict in family businesses is rivalry.
- It is important to avoid negative conflict. In particular, family squabbling that is witnessed by others can cause damage to the firm. Employees and customers will feel uncomfortable, and there may ultimately be grounds for a lawsuit.

Exercises

1. The founder of Carson’s Dairy Farm in Springfield, PEI has decided to retire. He wants one of three children to take over leadership of the business—and he knows exactly who it should be. Other members of the family have their ideas as well. One segment of the family wants the oldest son, Michael, to take over, but the founder thinks Michael is a melon head. The second son, Christopher, is a well-meaning and hard-working part of the business, but he just does not have what it takes to be a leader. Nonetheless, he is favored by another group of family members. Samantha, the youngest child, is as sharp as a tack, with solid experience and accomplishments under her belt. On an objective basis, Samantha would be the best choice for the business. She is the founder’s choice to take over the company and has other family supporters as well, although not as many as for Michael or Christopher. This is a situation tailor-made for conflict. How does the founder finesse the selection of Samantha and minimize the conflict that is bound to occur? Can he win?

Westbrook Lobster



Source: Used with permission, Michael Larivere, manager, Westbrook Lobster, Wallingford, CT.

In 1957, Westbrook Lobster opened in Westbrook, Connecticut, as a specialized lobster and fish market. As time went on, the company expanded to offer a comprehensive range of fish, shrimp, and prepared foods. In 1989, Larry Larivere, who grew up near the docks of New Bedford, Massachusetts, bought the business and had a dream of expanding the business with a seafood restaurant.

Fast forward to 2004. Larry and his two sons, Michael (an environmental science major) and Matthew (a business major), opened up their second restaurant in Wallingford, Connecticut. It overlooks the Quinnipiac River in the historic Yale Brother’s Mill built in the late 1670s. Originally a grain mill, later converted to a German and Britannia silver spoon factory, and finally converted into a restaurant, the building was rich with history.

Michael speaks easily about the value that Westbrook Lobster offers its customers: high quality food, great service...and visiting the tables while people are dining. He sees these visits as an important part of the relationships that he has built with his customers over the years. Westbrook customers eagerly await the monthly postcards that are sent out that feature dining specials, discounts, and coupons. He tries to get the postcards out early and actually receives phone calls if they are not received early. Many people have come to depend on them. Michael says that these postcards definitely give the restaurant its greatest return. The restaurant has a presence on Facebook, but that is geared to the bar crowd—a younger crowd.

Technology plays an important but mixed part in the restaurant’s operations. Michael says that it is tough to run a restaurant these days without technology tools like POS (point of service) systems. These systems include touch screens for placing orders and paying for food items. Interestingly, however, most food vendors still do their business face to face (or telephone to telephone), choosing to stick with personal relationships. Only a few suppliers, such as liquor vendors, accept orders online.

The current Westbrook Lobster website was created by Michael and Matthew using services from intuit.com. They built the site themselves and are proud to note that restaurant gift cards can now be purchased directly from the site. This is a perfect example of Web 2.0 capabilities.

As far as running the business, currently fifty employees strong, Larry Larivere (Dad) is brought in on the big decisions. Otherwise, Michael and Mathew run the restaurants on their own. There are currently no other family members in the business.

Westbrook Lobster continues to provide the freshest seafood available at competitive prices. The daily selection includes everything from locally harvested shellfish to fresh fish from waters up and down the East Coast. They also offer several “healthy” options that are made without butter or bread crumbs. These menu items are very popular and are especially attractive for people with food allergies or people who just want to eat a bit lighter. All their efforts continue to pay off. Westbrook Lobster was voted “Best Seafood Restaurant Statewide” in *Connecticut Magazine* 2009 and “Best Seafood in New Haven County” in *Connecticut Magazine* 2009 and 2010.

Larry, Michael, and Matthew invite you to Westbrook Lobster when you are in the area. Once you are there, you are family.

Source: ^[133] and ^[134]

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