

How Time Changes Everything
The Developmental Model
for
Understanding Change over the Life Cycle of Family Businesses

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Editor's foreword

The three-circle model featured in the previous article is an essential tool for every family business adviser – and their clients. It is, however, incomplete in the sense that it is a snapshot of a family business system at a moment in time. Family businesses, like any business, are always developing and so it is necessary to supplement an understanding of the family business system with a model that encapsulates the changes that happen in the ownership, management and family segments of the three-circles. This article gives a brief introduction to the developmental model of family businesses. Before embarking on providing advice to a family business it is essential to take account of their stage of development, The issues then become clearer – as do the tasks that the adviser has to tackle.

Introduction

The previous article describing the three-circle model conceptualised family businesses as “systems” or dynamic entities that strive to stay in balance by keeping the interests of owners, family and the business in balance. The three-circle model is an elegant framework for mapping the competing self-interests of those who inhabit family business systems. It shows how conflicting self-interests are built into the structure, and are therefore not necessarily a feature of personality clashes or other conflicts¹.

The three circle model helps those inside and outside the family business system to appreciate the complexity of the system, and to predict what the consequences may be if anyone in the system changes their role or place in the structure. It is inevitable that people will move around the structure. For example, when a founder retires he or she may move from segment seven (owner-leader-family) to segment six (family only) and the successor may move from segment five (manager-family) to segment seven, (taking over as the next owner-leader-family).

It follows, then, that the changes that will inevitably take place in people's roles and self-interests can be planned for. Planning involves the emotional challenges people face as their

lives change, as well as the technical challenges to construct efficient structures from a corporate, financial and legal perspective.

How time changes everything

Building on the concept of family businesses as systems which must be able to cope with and respond to change if the system is to survive, this article provides professional advisers who are new to the field of family business theory and research with a framework for understanding the pattern of predictable changes that will take place in family business systems. Family business researchers have been aware that changes taking place in the lives of individuals, families, ownership groupings and business profoundly affect the types of structures (organisational, legal, financial and family structures) that are used to hold the family business system together.

In the business circle or sub-system, a structure that is not suitable for doing business and surviving in the real world will eventually fail. Advisers may see this happen in cases where senior generation leaders are emotionally unable to let go and cling to their way of doing business, despite the reality that the world has moved on since their heyday.

In the ownership circle or subsystem, inappropriate ownership structures (including outdated partnership agreements, articles of association or shareholders' agreements) that keep family members' wealth and inheritance locked into the family business will eventually fail if shareholders feel that in order to achieve liquidity, they must refuse to support the strategy of the firm, or decide to sell out (see "the family effect" in Francois de Visscher's article in this issue).

In the family circle or subsystem, families who use the family business to keep the family structure together (for fear of family disintegration or fear that some family members may not be able to make it in the employment world outside the family business) will eventually place too high a strain on family members who feel their life is unsatisfactory or being subordinated to the family business. Often in these cases, family members who want to have their own lives become "cut-off" by their family for "rebellious".

The developmental model

Changes are going to take place, therefore, in the ownership, family and business circles as life goes on, and it will be helpful for anyone with an interest in the family business system to know in advance what these are and how they are likely to show up in family business systems. John Ward, (a contributor to this edition) was one of the first researchers to identify the changing needs of the family and the business over their life cycle, and to examine the implications of these for planning and strategic management purposes². In their book

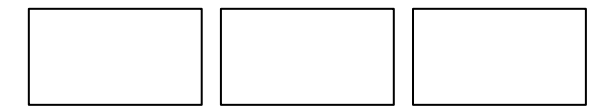
*Generation to Generation*³, Gersick, Davis, McCollom Hampton and Lansberg (all leading researchers and practitioners in the field of family business), provide a thorough review of the life-cycle stages to be travelled in each of the family enterprise subsystems: ownership, family and business. This article is based on their developmental model, shown in Figure 1 below.

With due respect to all the authors mentioned above, the rest of this article is a brief overview, based on their work, of the **ownership** life-cycle stages that a developing family business can expect to go through if it continues through the natural evolutionary process. This dimension is of particular relevance in this issue since other contributors refer to it (as will others in the future) and expect professional advisers to be aware of it as an “entry level” knowledge base. Readers of *The Family Business Client* who are serious about developing their family business skills are strongly advised to follow up the references given at the end of this article. Further editions of this journal will discuss the family and business dimensions in more detail.

[Insert Figure 1 Here].

The Ownership Life-Cycle

Figure 2 below describes the Ownership Axis of the developmental model. Although the ownership structure can take many forms, most fall into one of the three basic forms shown below if we think about ownership developmentally; that is, in terms of the ageing of key people in the system, and families’ tendency to expand in size and complexity. Not all families will move ownership along this axis, though; some may never get beyond passing shares on to a controlling owner in the next generation even if it means other siblings may “lose out”, and there are numerous other ways in which businesses can “re-cycle” their ownership amongst siblings and cousins.



[Insert Figure 2 here]

Controlling Owner (CO):

This is often the structure by which entrepreneurial owner-managed businesses start up. They may eventually become family businesses if and when more family members are

recruited into ownership and or management. CO firms are characterised by the ownership control (the right to veto) being concentrated in the hands and mind of one individual or couple. If there are other owners, they may not have real ownership authority.

The main challenges accompanying this stage are to do with how this power and control is managed, given that others are also likely to have a stake in the business (other family or non-family managers, and possibly other owners). Single-minded decision making has its pluses, but sooner or later the entrepreneur(s) will need access to other expertise and advice, but may not be willing to listen to it, or to risk implementing it.

CO stage firms may also be undercapitalised: the founders have invested “sweat equity” in the form of long hours and may not want to share the returns on this with others – even if it means growth or investment is curtailed.

However, the ultimate challenge faced by the CO structure, when there is to be a next generation of family ownership, is how to choose the right ownership structure for the *next* generation: one that will be workable for those who are to be involved in ownership and \ or management of the business.

A major challenge for professionals advising people and firms with this structure is to convince the client to look ahead to the time when power may have to be shared, and to encourage clients to look outside for advice and resources.

Sibling Partnership (SP)

If the business is passed to more than one sibling in the next generation, it becomes a sibling partnership. This is a fundamentally different ownership structure to the CO stage because, for the first time, power and control are to be shared by a group of relatives, some of whom may or may not actually work in the business.

Siblings in ownership have to learn how to share effective control of the business, and to establish how non-working owners are to be treated, given that they are investing their inheritance in the business under their siblings' leadership. It is inevitable that some siblings may wish to exit ownership, so proper systems for liquidity are needed, to ensure the business is still capitalised properly if equity is being cashed out.

Finally, not everyone wants to be in business with their siblings. Often they find themselves in this structure as a consequence of their parent's wish to ensure equal division of their estate, and for tax considerations. As the lives of siblings take their courses, it is inevitable

that some or all who are involved in the firm as owners or managers may seek out roles in the firm for their offspring. If this is the case, sibling factions can develop and these cause big problems if and when the offspring (cousins) take over.

A major challenge for professionals advising this type of ownership structure relates to the previous article: it requires a view of the needs of the whole family business system and the development of flexible processes to accommodate siblings who want in or out of ownership and employment. This requires a mature standard of communication amongst siblings and advisers, and needs a careful approach to planning liquidity and equity in the business. Some families achieve this by creating a family constitution or other protocol (this will be addressed in future issues). Most often, advisers only see the most powerful person in the system and therefore only receive data from one source in a complex system. If only one self interest in the system is being served, sooner or later the system will have adjust itself to regain balance, or it will disintegrate.

Cousins' Consortium (CC)

This is the most complex of family business ownership structures. It is inevitable by this stage that ownership has been considerably diluted. It may be in the hands of many minority shareholders, each with a different view on the security of their "investment" depending on whether or not they work in the business and on the extent they feel connected to and are kept informed about the business's progress and prospects. CC structures may by this time be led by non-family chief executives, so issues may emerge about how family control can be retained, and how non-family senior personnel can be motivated if ownership is not a realistic prospect.

Because of the numbers of cousins who may be involved (it is not unheard of for there to be hundreds of cousins participating in ownership), it is vital that the right organising mechanisms are in place to manage the expectations of family, ownership and business stakeholder groups. The family can meet to create a family council so that the family can be educated and prepared for ownership, employment or exit, depending on what family members want. Even more so than is the case with the sibling partnership structure, it is very likely that some owners will want to cash out, so planning should involve the early creation of redemption funds to create an internal family business capital market.

By this stage of development, the inherent complexity of the family business means that many professional advisers are involved in some discrete aspect of the system and no-one has the whole system in view. Many different professionals may be advising family members, and the business will have its own representation; accountants and corporate financiers will have a role, as will specialist consultants, insurance experts and possibly therapists. At some point, those in the CC structure will have to plan their own succession, leading to further

complexity. A major challenge for professionals under these conditions is to collaborate in the interests of the family business system as a whole entity, in whatever shape or form that may become.

The business and the family

This article has outlined the ownership axis of the family business developmental model. This is only one axis of the model: at the same time that changes are underway in the ownership structure, the “business family” is going through its own evolutionary process, and the business is going through the changes in structure needed as it grows, matures, and hopefully re-generates itself over its life cycle. Development in the business family dimension means that the family structure has to adapt to changes taking place in the parents’ “marriage enterprise”. Changes will take place in the marital relationship as the founders or owners mature, and as parents they will see the physical, emotional and social maturation of their offspring as they grow up within the context of being a member of a business family.

As they grow up, enter the business and work together with the senior generation, the next generation develop into people with different needs, opinions and outlooks. This can be difficult for parents to accept, and the major challenge they face is learning how to relate to their offspring as adults. There is a school of thought that says some parents may recruit their children into the family business, consciously or subconsciously to stall their development into independent autonomous adults⁴.

Conclusion

As editors, we had two aims in mind when presenting a summary review of the three circle and developmental models in this opening issue of *The Family Business Client*.

Firstly, we wanted to ensure that no one underestimates the sheer complexity inherent in family business client systems. The three circle model shows this by illustrating the many competing self interests to be served at any snapshot in time, and the developmental model shows it by defining how family, business and ownership structures will inevitably change over single and multiple generations.

Secondly, we wanted to provide some frameworks for conceptualising this complexity so that advisers need not be overwhelmed by it. Your client base should be assessed using the terms used in these frameworks so that you can appreciate better their current needs and can get into discussions early enough about their future needs. Without proper use of these models, family business client case analysis can be no more than a series of war stories, often with advisers nonplussed as to why their excellent advice is never fully implemented.

For further information:

¹ Lansberg, I., (1983). Managing human resources in family firms: the problem of institutional overlap. Organisational Dynamics, Vol.12, No. 1, pp.39-46.

²Ward, J. L., (1987) Keeping the family business healthy: how to plan for continuity, growth, profitability and family leadership. San Francisco: Jossey Bass. See Chapter 2

³ Gersick, K. E., Davis, J. A., McCollom Hampton, M. and Lansberg, I., (1997). Generation to Generation: life-cycles of the family business. Mass: Harvard Business School Press.

⁴ Kaye, K., (1996). When the family business is a sickness. Family Business Review, Vol. IX, No. 4, pp.347-368.