The Family Business Client - Managing the Complexity

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Editor's foreword

This article and the following article provide an introduction by the Editors to the principal theories which have stood the test of time and practice in the field of family business consultation. The Editors have summarised ideas that are widely accepted in the family business field in order to provide a useful grounding for other articles to follow in this Journal, and for readers' own professional development. The key concepts identified by family business researchers are presented with the perspective of the family business professional adviser in mind. They allow readers to use these helpful frameworks when thinking about how to unlock the complexity inherent in family business clients.

Introduction

This article challenges two of the traditional views about family businesses. The first traditional view is that they are all part of the SME or owner-managed sector and should be advised accordingly, whether under family ownership or not. The second traditional view is one held by advisers: it assumes that all the family business client wants from professional advisers is technical answers to technical problems.

Applying these assumptions in practice can cause advisers to overlook the unique complexity posed by the family business system. This in turn often means that professional intervention in family businesses is less effective than it could be. The article introduces an internationally recognised model for family business ("the three circle model" [1]) which "is both theoretically elegant and immediately applicable".[2]

An ordinary family business?

The case presented here contains many variables that are to be expected in family business client cases:

- complicated family structures where reconstituted (step) families are involved;
- the politics of power when dealing with strong entrepreneurial personalities; and
- gender stereotyping.

The father built up this particular business and controls it through a combination of the family's shareholding, his management influence and his dominant personality.

He has soon to decide which (if any) of the three children from his second marriage (he has recently remarried for the third time) should succeed him, or if a professional manager from outside the family would be a better successor in the interests of the business. His daughter (the eldest) performs an increasingly significant role in the business but many have tipped the middle son as the successor. The youngest son works in the business but is generally thought to be too laid back to succeed his father. The daughter by his first marriage has not featured in the speculation.

There are many others who have a keen interest in the matter, although probably not much influence over the outcome. These include other investors and employees, suppliers, customers, banks, governments and the father's/managing director's/owner's recently divorced spouse and new wife.

The business in question is News International.

The economic significance of family businesses

The challenges faced by News International are not often portrayed as *family* business problems. The same point can be further illustrated by other well-known family dynasties such as Sainsbury, Marks & Spencer, Forte, Liberty, Great Universal Stores and the Daily Mail. In fact, it is estimated that 76% of the top 8,000 businesses in the United Kingdom are family businesses and that family businesses employ upwards of 50% of the private sector workforce.[3] At a more local level, many parts of the United Kingdom depend on family businesses to provide the majority of employment and wealth creation in their area.[4]

Effective advice to family businesses can be hampered by an insistence on classifying them by reference to trading vehicle (sole trader, partnership or company) size, (small, medium sized enterprises or listed) economic activity, in fact, in any way other than by reference to what they are; a business owned and controlled by a family. Since many of the challenges faced by family businesses stem from the fact of being a business family, this lack of recognition is a serious impediment to planning effective professional intervention.

The "traditional" approach

What are the "real" issues facing business families like the Murdochs? The tendency is to answer the question by identifying the technical issues and offering technical solutions. It is obviously important for every client to receive the best technical advice available, but is this all that the family and the business face: a series of technical problems? Do family business clients identify their lives and relationships as "a series of technical problems"?

Surely not. The client's concerns are far more complex and do not fit neatly into the traditional specialisms of different professions. Indeed, if clients find it difficult to understand their problems when they have been redefined by the professional specialist (even in plain English), how can they fully understand the technical solutions? If they have difficulty understanding the technical answers to the technical problems, which might not be the problems they thought they had in the first place, what has been achieved? And if this seems confusing to the adviser, how does the client feel?

Who is the client?

The answer could be an individual in the family, the family as a group, the business, or all of these. Answering this question is not as simple as it first appears. To put it in personal terms - which reflect the situation in many family businesses - is the client:

- Dad as *Dad?* or
- Dad as *spouse?* or
- Dad as *managing director?* or
- Dad as a *shareholder?* or
- *the board of the company?* or
- any or all of *the children?* and *their spouses, partners and families?*

The point is that *everyone* in a family business can occupy a number of roles at any one time in the family business "system".

"If the adviser only deals with one part of the system the result is too often sound technical advice that cannot be implemented by the family business client because it does not fit the overall needs of the business family and family business"

In addition, it is often necessary to take into account the interests and concerns of other stakeholders such as non-family managers and employees, banks and other investors. In fact it is necessary to take account of every part of a very complex family business system. If the adviser only deals with one part of the system the result is too often sound technical advice that cannot be implemented by the family business client because it does not fit the overall needs of the business family and family business. The overriding practical question is how to manage the complexity?

Models of family business

The starting point is to identify the range of interests and concerns that can exist at any time and in any family business (regardless of size, organisation or type of business). In the early days of family business research and practice, family businesses were treated as dual systems comprising two sub-systems: family and business (see figure 1).

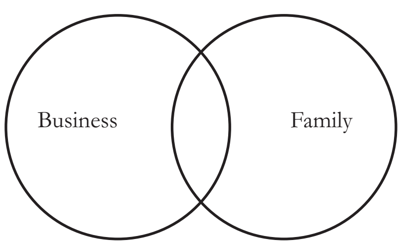

Figure 1: **Family and business**

The basic operating characteristics of the business system are coping with change and striving for profit. The values of such a system are competence and productivity. The flip side of the coin, however, is the family system. This is also a fully functioning system which has its own set of unique characteristics and values. Almost universally, the basic operating characteristic will be maintenance of the status quo. Change is to be avoided in the family system at all costs, for the family is the place to go to be buffeted from the pressures of coping with an ever changing outside world. The values of the family system are also different, for they are designed to promote not competence and productivity, but universal acceptance and unconditional love.

The impact of stress on the systems

Problems begin to occur when significant stress is applied to one system or the other. When this occurs, the system under stress will normally begin to dominate. If this is the family system, business perspective is lost as the focus of attention turns inward. Such enterprises frequently fail to assess adequately the competitive marketplace and seldom have a management structure professional enough to cope with rapid changes in the business, such as new technology, the sudden presence of a dominant competitor or serious employee strife. Such family dominated businesses often look like caricatures of the feuding family where personality strife is acted out every day on the business premises, much like it is over the kitchen table at home. Even when successful, such businesses seldom reach their potential as the non-family employees learn by experience to tune their actions and reactions to the temperament of the moment as displayed by the active family members. (See Figure 2, left.)

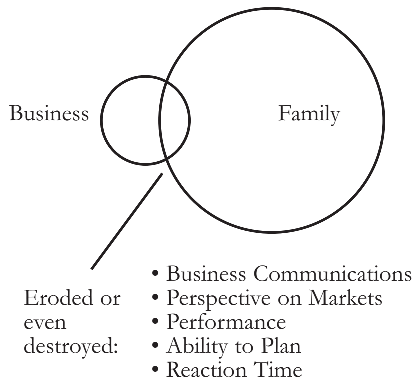

Figure 2: **Family and business**[5]

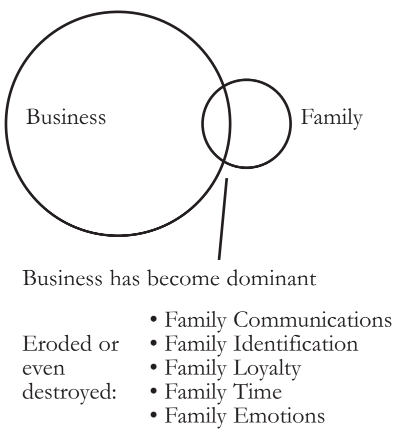

Figure 3: **Family and business**[5]

Similarly, the family enterprises that are dominated by the business system tend to be cold, even ruthless places to work, where expectations for performance are often unrealistic and constantly changing. Such businesses quickly impact on family intimacy as business problems dominate and replace family concerns. In this setting, the owner is often viewed as driven and while he/she may be highly respected for his/her hard work and dedication, such executives seldom involve themselves in wider community activities that are not business related and their family relationships invariably suffer. Employees in such a business may feel treated like machines and long-term loyalty is seldom rewarded when a crisis strikes the business. As a consequence, spouses of such entrepreneurs are usually very concerned about the well being of their families and may even see the business as the principal obstacle to a happy family. (See Figure 3 above.)

The "three circle model"

In their research at Harvard University in the early 1980s, Tagiuri and Davis [1] identified the importance of a third subsystem (ownership) which overlaps with the other two, but has a distinctly different purpose and agenda. Their "three circle model" helps to identify the range of self-interests inherent in family business systems by describing the family business as comprising three independent but overlapping subsystems; ownership, management and family (see Figure 4).

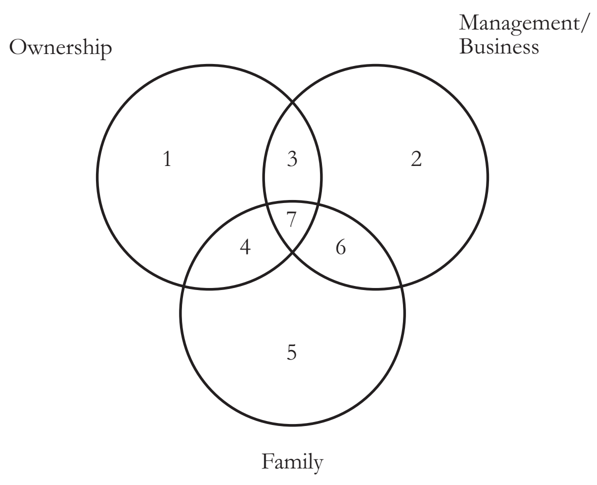

Figure 4:
The three circle model

Any individual in a family business can be placed in one of the seven segments in the model which can help to explain (and even predict) their motivations, fears and expectations. It also helps to explain why conflict is built into the structure of the family business: if everyone sees the world differently and has different needs, conflict is inevitable.[6] Owners, family and the business all naturally want different things and need access to resources the business generates to have meet their needs. Future articles in *The Family Business Client* will explore the ways and means by which this inherent structural conflict can be managed.

1. External investors

Those who own part of the business but who do not work in it and are not members of the family, (venture capitalists, banks and business angels) will be mainly concerned with return on their investment and they will expect business decisions to be clearly separated from family dynamics. However, surely this is expecting the impossible? Those in this segment may need to take a more active interest in family issues (including succession planning) than is often the case.

2. Management and employees

This group, who are neither owners nor family members, will have similar concerns to the external investors over the "threat" of nepotism. In addition they will be concerned about career prospects and job security. Many family businesses recognise the problems created by these uncertainties, including how to recruit and retain the best employees, but they still feel that sometimes family has to come first. Indeed if family strife occurs, the business can be overlooked and what appears to be irrational and emotional decision making can leave the business in crisis. Family businesses may then struggle to find and retain the right calibre of managers and directors required to sustain and grow the business.

3. Owner managers

Sometimes the response to the problem of recruiting and retaining key non-family employees is to give them shares or equity linked rewards. However these are usually small stakes and in private companies they are strictly controlled and not easy to realise. In addition the value of the investment is inevitably going to be affected by what happens elsewhere in the system.

4. Inactive or passive owners

The ownership of a family business that survives the first generation often passes from a controlling owner to family members who do not work in the business - the inactive owners. Their interests tend to be a mixture of the expectations of external investors tempered by a sense of family responsibilities.

The family stake in Sainsbury (which no longer has a family member on the board) is an example of this situation. No doubt the Sainsbury family members feel a considerable emotional attachment to the company, but given the company's recent performance, at what point will they want to realise some value from their investment? Their decision might be affected by whether family members view their shares primarily as a source of wealth or whether the inherited family values include a responsibility to pass these holdings to the next generation.[7]

5. Family

Every member of a business family has an investment "stake" in the family business, whether or not they are actively involved in ownership or employment. They all have "sweat" equity (the price of the family's sacrifice to keep the business going). They may be interested in the business for lifestyle reasons and because the business has an impact on the rest of the family such as the health and happiness of the present generation and the possibility of future career prospects for children.

With this in mind, why is it ever suggested that the first step in helping a family business is to leave the family out of it? The "let's deal with the business as a business" approach might work in some cases, but on most occasions the business family cannot be left out of the family business.

6. Family employees

Family who work in the business but do not own shares will be concerned with career development as much as the non-family employees in segment 2, but they might have different expectations about the future. After all they could have grown up in the atmosphere of "one day my son/daughter all this will be yours".

The model illustrates one area of potential conflict in family businesses: between family employees in this segment and the inactive family owners in segment 4. The family employees' hard work and determination to grow the business might be tempered by the fact that their efforts will reap financial rewards for the inactive owners/relatives. Those in segment 6 might be expected to argue the case for profits being retained for reinvestment in the future growth of the business, whilst the inactive owners, who would not want to stifle growth, at the same time would expect to see a healthy dividend.

These feelings are sometimes caused by a blurring of the distinction between rewards for employment and return on investment. If arguments ensue about this issue, they may become personalised and attributed to personality, when in reality, those in each segment of the system are merely expressing their entitlement and rightful expectations.

7. The controlling owner

Someone who owns a business and who also occupies a senior role in management and the owning family will face many conflicting choices during their business and private life, especially when it comes to succession. Should Dad or Mum do what is best for the business even at the expense of family discord? Can the future of the business and everyone who has a stake in it be imperiled by decisions that are based on family sentiment or expediency? In any event, when the family dimension is ignored by advisers, or when, at best, it is seen as the problem rather than as part of the solution, it does not help the controlling owner with his or her dilemma.

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The above can be summarised in the following table:

Self-Interests of Constituents in the Family Enterprise System[8]

Constituent segments in the family business system	
Position in the structure	**Self interest associated with this role**
1. Owner only	Return on investment; liquidity
2. Manager only	Security; appreciation of family culture (i.e. reward/nepotism); career goals; satisfied with family direction of firm
3. Owner and manager	Return on investment plus security and some autonomy
4. Owner and non-working family	As 1 plus being informed; rules on access to jobs; entry/exit rules for owners
5. Family only	Family life in balance with business; prospects for jobs, ownership, wealth
6. Non-owning family and manager	As 2 plus appreciation of rules for entry to ownership; career/succession prospects. Reinvestment of profits (not liquidity)
7. Owner, manager and family member	All of the above; how to manage the conflicting interests and keep focused

A new approach

As well as illustrating the wide range of views and opinions that can exist in any family business, the three circle model helps everyone involved in a family business (including advisers) to realise that these views may be as much to do with the position of individuals within the family business system as they are to do with their personalities.

It also highlights that it is virtually impossible and perhaps even dangerous to advise one part of the family business system without taking into account the impact and likely consequences this will have elsewhere in the system. If this is accepted, it follows that it is essential for the family business adviser to remain neutral and not to be, or be seen to be, biased in favour of any one person or any one part of the system. This is impossible if the condition for technical help is that the family has to be separated from the business. Even if this mistake is rectified, it can still be very difficult to avoid the trap, especially if the instructions come only from the business rather than the family (or vice versa).

There are no family business experts

This in turn shows that advising family businesses and business families needs a collaborative effort among professional advisers There is and can be no such thing as a "family business expert". What family businesses need is a range of expertise, provided by professionals who can understand the unique problems they face.

From principle to practice

The three circle model offers the following themes relevant to practice:

- Family businesses - whatever their size, organisational structure or type of business - represent *families in business*. Do not try to take the business family out of the family business: it cannot be done.
- Use the three circle model to enhance your understanding of family business clients and to avoid becoming trapped in one part of the family business system (the "I only advise the business/the family" mistake).
- Realise that family business conflicts can naturally be expected to occur between people who are unaware that they are in different parts of the system and that these problems are not necessarily rooted in personality clashes.
- Technical expertise is important but family businesses are more demanding and expect their advisers to help them find solutions that achieve a balance between the business family and the family business.

Notes

1. Tagiuri, R and Davis, J A, (1982). "Bivalent attributes of the family firm." *Family Business Review* Vol. IX, No. 2, pp.199-208.
2. 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. (Page 7). See page 35 of this edition of *The Family Business Client* for a review of this work.
3. Stoy Hayward. *Staying the Course. Survival Characteristics of the Family Owned Business.* London: Stoy Hayward. 1989.
4. Dunn, B, "Success Themes in Scottish Family Enterprises: Philosophies and Practices Through The Generations." *Family Business Review*, 1995 VII (1).
5. Ayes, G R, and Carter, M, "Family Businesses in Transition: Why traditional tools fall short", Family Firm Institute 1995 Annual Conference.
6. Lansberg, I, (1999), *Succeeding generations: realizing the dream of families in business*, Mass: Harvard Business School Press.
7. See the views on the family effect in the article in this edition by François de Visscher - "Seven Habits of Highly Effective Companies".
8. Dunn, B, (1999) *Emotional and Developmental Influences on the Management of Generational Transitions by Business-Owning Families*, Unpublished Doctoral Thesis, University of Stirling, p. 32 (adapted from Davis and Tagiuri, 1982; Ward 1987, and Gersick *et al*, 1996).