Professionalizing the Family Firm

By Morten Bennedsen and Brian Henry

To professionalize a family firm is to empower the organization at all important levels. To professionalize a family firm frees up precious time so that owner-mangers can think about strategy. It attracts and retains the best possible non-family employees. It attracts top family candidates. It attracts new investment. Empowering the firm means empowering the corporate board. It means establishing a competent leadership team, delegating authority to the right level and implementing a clear and transparent family dialogue.

What is Professionalization? We define professionalization as a process that aims to transform the firm from being dependent on a single key figure (the founder) to having an organizational structure where management resources at all levels are driven by a common vision and where owner-managers delegate real decision-making authority to a group of highly capable managers. Or, as is said in popular writing, *going from a solo performer to a symphony conductor*.

Why Do Family Firms Professionalize? Professionalization are often triggered by threats or opportunities:

- **External Threats**: These include lacklustre financial performance, loss of market share and a lowering of customer satisfaction, all of which can force family businesses to rethink their organizational model. The pressure to turn the company around often becomes the trigger to hire external CEOs and get experts into the board.
- **Internal Threats:** These include situations where the business family do not have talented and interested next gens or cannot agree on succession, ownership, strategy, day-to-day management or the roles of family members in the organization. In such a conflictual environment, a professional organization will often emerge as a pacification tool.
- **Opportunities**: These include events when the firm experiences new business opportunities, strong growth, need for outsourcing production or investment from outside investors. The expansion of the company may require more professional leaders that have experience in industry and are able to take the firm to the next level. It can also be a requirement for new investors to invest in the firm. In this context there will be a dual need to both introduce

professional management resources and to professionalize the board by adding experienced people who can help govern the firm in a sea of opportunities.

What Are the Benefits of Professionalization? Professionalization is about creating and implementing a flexible organization that is more relevant and transparent to all stakeholders, including employees, customers and shareholders. A well-executed professionalization process has several benefits:

- Next gens will find it more attractive to join professionally run family companies, where career plans and incentives are crystal clear;
- Outsiders will find the company more interesting as well. By eliminating the glass ceiling, external managers will no longer feel inhibited about joining the organization or pursuing more interesting projects and responsibilities within it;
- Family firms will be significantly less exposed to the key personal risk factors of their owner-managers such as sudden health problems or departures or even loss of life;
- Investors will be prepared to pay a higher price;
- Easier to attract good board members who feel comfortable contributing their expertise in family business and sound management skills to family members who want to listen.

What Are the Elements of the Process? When an owner-manager steps in to enlarge and diversify the control span of the founder, the typical elements of the process of professionalization are the following:

- To create and implement an organization that is relevant to all employees and managers and is transparent in relation to the mandate and power of an external CEO and individual family members;
- To build and implement a business strategy that is not based on emotions and feelings;
- To select the right chairman of the board of directors and, in conjunction with him or her, find the right composition of the board;
- To hire a leadership team and build a professional organization where there are several leaders that are accountable and able to make decisions and implement;
- To evaluate each family member and find the best possible role for him or her in the firm (including firing family members if they are not talented or do not contribute).

The six successful habits of external CEOs: For most family firms hiring the first non-family CEO is a big step in the professionalization process. And a risky one. Too often the family regret it and end up replacing the CEO with either a new non-family CEO or a family member. So what makes a good external CEO?

1. Strong business skills based on a wealth of experience
2. Solid business education;
3. Understands the dynamics of family firms;
4. Is a robust, tireless leader;
5. Knows how to build honest and transparent relationships within the family;
6. Accepts the rules and procedures, values and traditions, that have been passed down by the founders;

7. Avoids taking on the role of family advisor as this will create a dissonance preventing the family from speaking with one voice.

Hiring the right professional top manager can be a rewarding exercise. Jean-Louis Dumas (1938-2010), the fifth-generation family member to run Hermès, the French luxury firm, hired a non-family executive twice, first as the COO from 1989 to 1997, and then as his right-hand man in the executive suite in 2003. It was the right man at the right time, because Patrick Thomas saved the luxury firm from losing its independence in a hostile takeover bid. Following the death of Jean-Louis Dumas in 2010, Bernard Arnault, the head of LVMH, built up a stake of 24% in Hermès, with the intention of taking over the company and folding it into LVMH.

What Arnault did not count on was the determination of Patrick Thomas to keep the Hermès in family hands. The first non-family CEO of Hermès, Patrick Thomas was more like a member of the Hermès family, and unified family shareholders in the heat of battle.

In July 2012, Patrick Thomas filed a lawsuit against Bernard Arnault, alleging that he had indulged in insider trading, collusion and price manipulation during the takeover fight. In the end, Patrick Thomas won the case, forcing Arnault to stop the hostile takeover bid and pay a fine of $11 million to the French financial authorities for not disclosing his stake. Following years of protracted struggle during which the courts threatened to conduct a full investigation of Arnault and the banks that loaned him the money to acquire his stake, Bernard Arnault quietly decided to sell most of his Hermès shares in 2014. In the end, Arnault made a €3.4 billion profit from the sale of his stake in Hermès, but Patrick Thomas kept the company under family control. A few years later, Patrick Thomas retired as CEO of Hermès and was replaced by Axel Dumas, a direct descendant of the founder.

Once an external candidate has been selected, those seven intangible qualities of leadership should manifest themselves at the beginning of the relationship. It is precisely at the start of tenure that the family needs to sow the seeds of success. The family's presence and long-term engagement to the management team is critical.

This commitment starts off with an onboarding process. A typical onboarding process can last between three and six months, as business families need to tailor the process to the specific needs of the candidate. If the candidate already knows the people, culture and values in the family business, they can start making their own decisions soon after their recruitment. But some may need more time depending on the size of the company, the number of employees and scope of their responsibilities. Without adequate time for the onboarding process, the new CEO may feel out of their depth and start making wrong decisions.

While a successful transition is never guaranteed, family owners and board members can improve the probability of its success by agreeing to set milestones. These can include a contingency plan in case of failure or a more aggressive growth plan to take advantage of quick wins. In addition, once the onboarding process is over, the family and board need to involve the new CEO in board meetings and social activities with the family and its stakeholders. A strong commitment to communication promotes trust in the management team and enables family members and stakeholders to stay abreast of the priorities and challenges facing the business.

Cultural differences can play a big role in whether family firms choose to professionalize or promote from within the ranks of the family. In Singapore, the majority of family businesses choose family members who have experience running firms. In a 2016 survey of family businesses conducted by PwC and the Singapore Chinese Chamber of Commerce & Industry, only 32% of owner-managers in Singapore said they would consider bringing in professional managers, compared to nearly 54% of owner-managers globally. Taiwan, China and India are other countries where the majority of business families hesitate to hire non-family CEOs, often because they fear losing control over the firm. In Western countries, business families are more inclined to hire outside managers as CEOs.

In many Asian family firms, the family will often use non-family CEOs as placeholder CEOs who run the family firm until future family members are ready to take over the management control. In the corporate culture of Toyota Motors, the role of the so-called salaryman is critical for the controlling Toyoda family. Founded by Kiichiro Toyoda in 1937, Toyota Motors was almost always run by family members until 1995, when the then CEO Tatsuro Toyoda suffered a stroke from high blood pressure, an event which brought his tenure to an unexpected end.

At that time, his nephew, the 39-year-old Akio Toyoda, was still too young to be considered for the top job; a salaryman was brought in to run the company. In the 14 years between 1995 and 2009, the year when Akio Toyoda's appointment in 2009 was officially named the CEO of Toyota Motor, three successive salarymen held the CEO position.

Hiroshi Okuda was the first of the three salarymen to be run the company, at a time when it was losing market share and focus. After four years of running Toyota from 1995 to 1999, Hiroshi Okuda brought the company back from the brink. However, he was replaced by Fujio Cho, the second salaryman who ran the company for the next six years from 1999 to 2005. One of the most trusted salarymen, Fujio Cho became a mentor to Akio Toyoda and eventually became honorary chairman of the board in 2013, a post that had never been held by a salaryman before.

Katsuaki Watanabe took over from Fujio Cho in 2005 and held the CEO position for the next four years. Under his leadership, Toyota expanded its operations with lightning speed to become a world leader, but the 2008-2009 global economic crisis wreaked havoc on the auto industry. To make matters worse, a recall scandal involving the Lexus line of Toyota vehicles put the reputation of the company based on strong quality controls at stake. During this period, the company's share price fell by over half, as shareholders dumped their holdings on the news of the recall crisis affecting mainly Lexus cars, the marque brand in the Toyota portfolio.

In January 2009, Akio Toyoda was named CEO of Toyota Motors. The family name thus became a major asset as he tried to restore the company's reputation for high-quality vehicles. To avoid embarrassment, Katsuaki Watanabe was quietly removed from his CEO position and shifted to a new vice chairmanship position without any power. By 2012, Toyota Motor became the largest automaker in terms of the number of vehicles sold worldwide. Furthermore, investors began buying up shares in the company once again, tripling its share price on the Tokyo Stock Exchange between 2012 and 2015.

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