IFB Research Foundation

FAMILY BUSINESS CHALLENGES

No. 8

FOSTERING RESPONSIBLE OWNERSHIP

Practical guidance for family business owners and managers

SECOND EDITION

Family Business Challenges

No.8 Fostering Responsible Ownership

Section 1. INTRODUCTION

Family business owners have special responsibilities. The typical shareholder in a listed, widely owned company does not feel responsible for the conduct of the business or even much connection to it. But a family firm is both a business and a source of personal identity for owners, and they often view it as an important part of the family's tradition and legacy. Owners often perceive their participation as a heritage on loan – something they need to cherish, develop and pass on.

"Conscripts", not volunteers. In older family businesses, ownership tends to expand and devolve to family members who are increasingly remote from day-to-day operations. These shareholders usually don't become owners by choice – they acquire their shares by inheritance or a gift – with a risk that they can feel "locked in" if there is no liquid market in the company's shares.

Role confusion. It is not the shareholders' job to manage the company, and the board of directors is appointed to provide corporate governance and to hold management accountable. Family owners often misunderstand these distinctions (see Exhibit 1).

Exhibit 1: Ownership defined

"Business owners have proprietary rights over the assets of a business, which entitles them to be concerned about the direction, performance and security of the business, but doesn't give them any implicit right to interfere with day-to-day operations.... For example, the family may require the business to produce a gross return on investment (assets employed) of 15%, or it could insist that the company only trades with suppliers involved in ecologically sustainable activities. It's then the job of the directors and managers of the business to decide how they'll achieve the family's desired results (and if it makes commercial sense to do so). The owners shouldn't interfere with this process."
Source: Jon Kenfield (2011) The Solutionist Guide to Family Business, The Solutionist Group, pp.35 and 149.

Branch politics. The different needs, expectations and ambitions of owners who work in the business, and those who do not, often cause conflict (see some examples of these in Exhibit 2). When shares pass down the generations within family branches, perceived unfairness due to numerical imbalance or alleged favouritism can undermine family unity and the effectiveness of family business ownership.

Exhibit 2: Family business "insiders" and "outsiders": How perspectives can differ

Owners 'inside' the business	Owners 'outside' the business
Have more access to knowledge and information.	Have less access to knowledge and information.
Are so steeped in the business that they fail to recognise what others do not know.	want to feel more connected to the business, or might prefer to exit.
Have power and status and can make important decisions.	Sometimes are confused and overwhelmed by the responsibilities of ownership.
Work hard and carry a heavy burden.	Often feel disrespected by owner-managers.
Sometimes view owners outside the business as an interference or as parasites	May suspect owner-managers of being greedy, receiving inflated salaries and perks.

Responsible ownership attitudes. Addressing these complex challenges involves recognising the hallmarks of "responsible family ownership", defined broadly as an active and long-term commitment to the family, the business and the community, and balancing these commitments with each other. Responsible owners:

• **have a common vision of the family enterprise**, as well as agreement about its long-term objectives.

• **are active towards the business**, visibly demonstrating their commitment to the family's values and the company's continuity and development.

• **provide "patient capital"**, taking a long-term view of investments and returns.

• **address the needs of multiple stakeholders** – the company, employees, customers and society at large, as well as the family and other owners.

• **understand "emotional ownership"**, as measured by factors reflecting care, psychological attachment and identification with the family enterprise.

Active family owners reinforce family values. Family firm culture is more likely to stay values-based when the family retains a strong influence in governing the enterprise. By fostering links and engaging in frequent communication with the business, the family's values can be reinforced across generations. Maintaining collaborative governance processes can enable family shareholders to promote business policies and practices that are consistent with their family values and culture.

Responsible ownership strategies. Successful families promote ownership group effectiveness by:

• **Articulating a clear and powerful vision** for the family and the firm. A shared sense of vision and values that becomes a guide for decision-making and action.

• **Planning ownership**, so family members have a unified stance on, for example, the rules for next generation ownership and the principles underlying the company's dividend policy (see Exhibit 3).

• **Educating for ownership**. Ensuring family owners understand their role and do not make inappropriate demands of board members and managers. (See the six-point framework for ownership education in Exhibit 4.) When owners are united, committed and responsible, they make it possible for board members and managers to do their jobs in an optimal way (see the "Enhancing Communication with the Board" Challenge in this series).

• **Preparing the next generation for ownership** – encouraging enthusiasm for the family enterprise, and setting up age-appropriate learning and development programmes.

• **Building governance structures** that help family members to draw up rules and policies to underpin a cohesive approach to the family's involvement in the business.

• **Defining a succession plan** that places the issue on the "family agenda" at an early stage. Succession must be a recurrent theme in communication between parents and children, leading to the development of a crystal-clear plan that's laid down in writing.

Exhibit 3: Shareholders' agreements

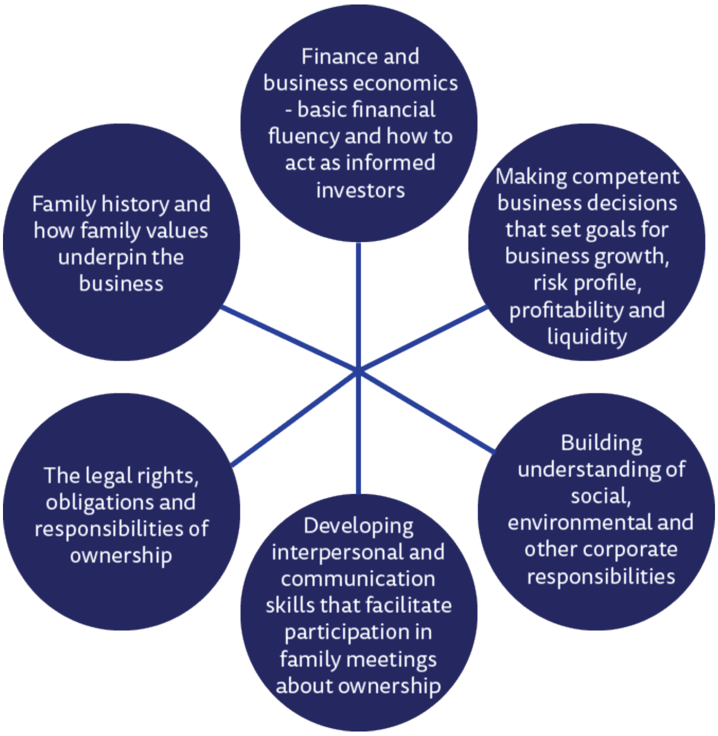
"Maintaining family control or influence while raising fresh capital for the business and satisfying the family's cash needs is an equation that must be addressed, since it's a major source of potential conflict, particularly in the transition of power from one generation to the next. Enduring family businesses regulate ownership issues – for example, how shares can (and cannot) be traded inside and outside the family – through carefully designed shareholders' agreements that usually last for 15 to 20 years.

"...To keep control, many family businesses restrict the trading of shares. Family shareholders who want to sell must offer their siblings and then their cousins the right of first refusal. In addition, the company may buy back shares from exiting family members. Payout policies are usually long term to avoid decapitalizing the business. Because exit is restricted and dividends are comparatively low, some family businesses have resorted to 'generational liquidity events' to satisfy the family's cash needs."

Source: Christian Caspar, Anna Karina Dias and Heinz-Peter Elstrodt (2010) "Organization

Organization Practice: The Five Attributes of Enduring Family Business", McKinsey Quarterly, January, p.4.

Exhibit 4: Key topics for an ownership education programme



A family business can only fully develop its potential if it has a group of capable and responsible owners. They need to play active roles as individuals and as a group in building effective ownership structures and in developing a consistently applied ownership vision and strategy.

Section 2. ACTIONS TO CONSIDER

• What work do we need to do in order to secure responsible, effective and stable ownership of our business?

• Do we have agreed positions on difficult and potentially contentious issues that will face the family in their capacity as owners?

• Are family members, and in particular the next generation, learning about family business and the rights and responsibilities of ownership, as well as about our company's operations and finances?

• Do we understand board member qualifications and participate, when useful, in the screening of new board members?

• Do we respect managers and avoid interfering in their operational responsibilities?

• Should we set up a mechanism to allow family members to redeem their ownership thereby facilitating "pruning" of the family tree?

• As the owning family, do we have regular family meetings to review our progress and objectives?

Add Your Questions

CASE STUDY: A.F. Blakemore & Son

Founded in 1917 by Peter's grandparents, Harriet and Arthur Blakemore, the business began life as a counter service grocery store in Wolverhampton. Over the past century, under the stewardship of Arthur's son Frank and grandson Peter, the organisation has grown into one of the largest privately owned companies in the UK. Annual turnover today exceeds £1 billion and the group employs some 8,000 people.

Food and drink have always been the lifeblood of A.F. Blakemore, and their business divisions now encompass retail, wholesale, distribution and shop-fitting. Peter joined the company in 1965 and pioneered the development of "cash & carry" wholesale self-service depots, as well as building up the firm's trading relationships with the "symbol groups". Having joined SPAR in 1975, Blakemore's has been a wholesale distributor for them ever since: as a family business, they feel well placed to understand the needs and values of their SPAR independent retailers. The group also owns 292 stores through its retail arm.

The family has always taken a planned and proactive stance when it comes to managing their ownership of the business. When Peter's father Frank died in 1986, the majority of the company's share capital was placed in trust for current and future generations. Private family ownership is seen as helping to ensure the company can be flexible and independent, able to make unpressured decisions that are not just about seeing a rapid profit. Three family members representing the fourth generation currently work alongside Peter in the business.

The family also believes they have a special responsibility as guardians of the company culture and values, and in 2006–07 both family and independent directors worked hard to finalise "The Blakemore Way", setting out the guiding principles underpinning their approach to business. The document explains the Blakemore's family values and includes a statement of core purpose – "to grow the family business in ways that are profitable and sustainable for the benefit of staff, customers and community."

Peter is convinced that responsible ownership strategies grow out of having such a clear and powerful statement of values and vision: "It helps stakeholders to understand where we're coming from," he explains, "and it makes it crystal clear that we're a committed family in business for the long term."

Section 3. RESOURCES

Articles and reports

Responsible Ownership: Perspectives on Best Practice

A briefing guide (2007) published by the IFB Research Foundation in association with the Family Business Network.

The guide aims to help family shareholders (and family members expecting one day to become shareholders) achieve a more effective and successful approach to the ownership of their business. The main stresses and strains of family business ownership are examined, as are some attitudes and behaviours associated with "responsible ownership". The guide concludes with a discussion of key aspects of family governance, called "the building blocks of responsible ownership" – practical steps designed to promote a more unified, constructive and productive approach to owning shares in a family business.

Emotional Ownership: The Critical Pathway Between the Next Generation and the Family Firm

Åsa Björnberg and Nigel Nicholson (2008), published by the IFB Research Foundation.

This report analyses the sense of closeness and belonging to the family business that helps family firms create their unique competitive advantage. The authors explain many of the psychological complexities that make building family capital a rewarding and sometimes a challenging task, and they provide practical frameworks and ideas to help families develop effective strategies to manage generational transitions and to ensure the success and sustainability of their firms.

What it Means to be an Investing Owner and Why it's so Important

Jennifer Pendergast (2015), published by Family Business Consulting Group (available at: www.thefbcg.com/what-it-means-to-be-an-investing-owner).

Because of their disparate interests and perspectives, ownership groups in second generation and beyond family businesses often shy away from direct discussion about their expectations as investing owners, preferring to focus instead on their role as operating owners or family members. The author makes a strong case that owners have both a right and responsibility to ensure their investment performs well: "if perpetuating the business across generations is the family's aspiration, then owners need to ensure that the business will not only survive but thrive."

Are You an Owner by Choice?

Craig Aronoff and John Ward (2017), published by Family Business Consulting Group (available at: www.thefbcg.com/Are-You-an-Owner-by-Choice).

For most family business owners, ownership comes to them via inheritance or as a gift. The authors argue, however, that it is critically important that remaining an owner be a matter of choice: "Nothing could be worse for a business than having uncommitted, unhappy owners." They go on to recommend that business-owning families provide shareholders with the opportunity to exit from ownership via the establishment of share trading or redemption policies.

Pruning the Family Tree: An Unexplored Path to Family Business Continuity and Family Harmony

Johan Lambrecht and Jozef Lievens (2008), Family Business Review, 21(4), pp.295–313.

By the time a family enterprise reaches the third generation there may be dozens of family stakeholders. The potential for friction and dysfunctional behaviour arising from this increasing complexity is significant, and it is usually recommended that families counteract these negative effects by using family and corporate governance methods. The authors of this research paper explore pruning the family tree (i.e. reducing the number of family shareholders) as an alternative method of handling family complexity, concluding that introducing simplicity by pruning can be a worthwhile path to family harmony and business performance, and that it is compatible with family and business governance methods.

Books

Next Generation Success: Reflections on a Decade of Dialogue Between Senior and Junior Generations at Harvard Business School
John A. Davis, Maria Sinanis and Courtney Collette (2014), published by Cambridge Family Enterprise Press.

In Chapter 3 (pp.33–46), entitled "Developing the Next Generation as Owners", the authors explain that in family companies the ultimate decision-making power lies with the owners. For this reason, families need to learn what it is to be responsible and capable owners of their company, and to pass ownership to the right people in the next generation. The chapter is divided into two sections (each supported by checklists and practical advice): 1. What the junior generation should do to develop as effective owners; and 2. What the senior generation can do to help the junior generation become effective owners.

Family Business Ownership: How to Be an Effective Shareholder
Craig E. Aronoff and John L. Ward (2002), published by Family Enterprise Publishers.

A short but comprehensive guide for family shareholders based on the premise that ownership ought to be interesting, challenging, profitable and spiritually enriching. The authors focus in particular on creating greater harmony between two sets of owners with disparate interests and perspectives – those who are employed as managers in the family business and those who are not.

Family Business Challenges

The Family Business Challenges second edition series includes 18 guides overing three areas:

Family business dynamics
No.1 Understanding Family Business
No.2 Maintaining Family Values
No.3 Developing Stewardship
No.4 Engaging the Next Generation
No.5 Planning Succession

Family business governance
No.6 Building Family Governance
No.7 Managing Differences
No.8 Fostering Responsible Ownership
No.9 Strengthening Family Communication
No.10 Professionalising the Board
No.11 Enhancing Communication with the Board
No.12 Employing Advisers

Family business management
No.13 Fostering Entrepreneurship
No.14 Embedding Long-term Orientation
No.15 Promoting Sustainability
No.16 Maximising People Capital
No.17 Branding the Family Business
No.18 Selling the Family Business

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Simon Perry, Author. Simon is a law graduate and trained as a barrister. He moved into publishing in the early 1990s. His work focuses on family businesses, writing academic and practitioner analyses and family enterprise histories.

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