IFB Research Foundation

FAMILY BUSINESS CHALLENGES

No. 16

MAXIMIZING PEOPLE CAPITAL

Practical guidance for family business owners and managers

SECOND EDITION

No.16 Maximizing People Capital

Section 1. INTRODUCTION

Unique relationship and human resource issues emerge in family firms. Non-family members can find themselves in complex and uncertain situations because they are part of the business system but not the family system: problem issues often focus on trust, fairness, integrity and justice. As a result, family businesses face challenges in attracting and retaining high-quality employees, and in relation to remuneration, performance appraisals and promotions.

Challenges may increase as family businesses grow. It can become harder to maintain positive engagement with non-family employees as the company expands and becomes more complex (moving from being an owner-managed to an owner-governed business), and as succession becomes an issue.

Family businesses are able to create a special and positive relationship with their non-family employees. IFB Research Foundation studies highlight how owner–manager links and long-term stewardship values help produce greater employment security, job satisfaction and worker loyalty, providing a source of competitive advantage for family businesses.

Family businesses need to work especially hard on recruiting and retaining non-family talent. Candidates may think twice before applying to work in a family business (see Exhibit 1). If they are recruited for the job, they sometimes end up resigning because they've run out of opportunities (or out of patience) if family politics, emotional cross-currents and a lack of clear accountability have interfered with their work.

Exhibit 1: Purpose and potential

Source: Adapted from Peter Leach (2015) Family Enterprises: The Essentials. London: Profile Books.

Bringing in non-family executives, especially in a leadership role, can cause cultural and integration challenges. The culture in family businesses is sometimes resistant to change, and families need to be sure about their objectives for the appointment and that there's a consensus behind it. Executives with previous experience working in a family company can provide guidance to a new non-family executive, helping them to carry out their role in a way that's sensitive to the family's emotional involvement (see Exhibit 2).

Exhibit 2: Contributions from competent, motivated non-family executives

"A manager with 35 years of experience working with three major family groups sums up what accomplished outsiders can offer a family firm: 'As regards shareholders, outsiders can foster the transition from a shareholder culture to a

stakeholder culture; recommend ways of balancing responsibilities, privileges and benefits; serve as coaches for the new generation; show how to motivate the entire management team. As regards the firm, outsiders can bring in new experience; encourage the development of method and discipline in dealing with problems; promote innovations, while respecting the company's history; help build a management team.'"
Source: Guido Corbetta and Carlo Salvato (2012) Strategies for Longevity in Family Firms: A European Perspective. Basingstoke: Palgrave Macmillan, p.128.

Family companies need to devise reward structures that motivate and retain top-performers. Non-family executives want to know that their efforts and achievements growing the business will be recognised (see Exhibit 3). Such recognition may be in salary and benefits terms, including a long-term incentive plan and possibly an equity (or equity-equivalent) stake in the company.

Exhibit 3: Making non-family employees full participants

"If all top positions in a company are held aside for family members, gifted, ambitious people will look elsewhere for a job. Similarly, if the family hangs on to all the tangible rewards of success, even the most empowered and dedicated employees will begin to feel aggrieved. By sharing their success with their employees, family business owners can increase their loyalty, motivate their future performance, and create a workforce that turns a contented, positive face toward the public – the business's clients and customers."
Source: Marshall B. Paisner (1999) Sustaining the Family Business: An Insider's Guide to Managing Across Generations, Basic Books, p.37.

Confining share ownership to family members could place the company at a disadvantage versus its competitors. Strategies available to address this issue cover a range of options, including:

• **Restricted voting shares** – identical to other equity shares, except they carry no rights (or restricted rights) to vote at general meetings.

• **Restricted transferability shares** – shares that must be offered back to the company, the family or an employee trust when the executive leaves (or before they can be sold).

• **Phantom share options** – a cash bonus plan where the amount of the bonus is tied to the increase in value of a notional share option.

• **Long-term bonus incentive plans** – not involving shares, real or phantom, but enabling executives to participate in any appreciation in company value.

The best family businesses engage and retain non-family talent by balancing a range of HR issues. Family firms' HR practices must provide non-family members with a sense of psychological ownership, develop employee capabilities and offer paths for career development.

• **Develop employee ability**: Set up a system by which both family and non-family are recruited and evaluated on merit. Adopt sophisticated recruitment and induction techniques, formal assessments of employee development needs, and increased education and training provision.

• **Motivate**: Look at all aspects of non-family executive rewards to ensure you are offering a competitive benefits package. Provide opportunities for employees at all levels to receive appropriate remuneration and financial rewards. Keep employees informed on financial matters and profits.

• **Assure career growth opportunities**: Regularly review job design and career development opportunities, promote family-friendly and equal opportunities policies, and work to instil a sense of responsibility, autonomy, merit-based achievement and fulfilment.

Section 2. ACTIONS TO CONSIDER

- How does our family business measure success in relation to people capital?
- Are we doing enough to ensure family members fully understand the value of talented and committed non-family managers?
- Are we making the most of our special ability as a family firm to build strong relationships with our employees, encouraging loyalty and maximising job satisfaction?
- As our business grows and the family may have less day-to-day involvement in management, what strategies should we adopt to maintain positive relationships with staff?
- Are there measures we should consider in developing our human resources strategy that are found in large, non-family owned businesses (e.g. sophisticated recruitment techniques and performance management)?
- How can we attract and retain the best people, and establish a strong employer brand that helps us to compete in the labour market?
- Have we a family consensus on whether employees can own shares in our company?
- Do we empower non-family managers to innovate and change business strategy in ways that break with tradition?

Add your questions

CASE STUDY: William Jackson Food Group

Nicholas Oughtred, Group Chairman of sixth generation William Jackson Food Group, believes this is a time of great opportunity for family businesses seeking to attract non-family talent. "The short-termism of PLCs and private equity stands in stark contrast with the family business world," he explains, "where we're able to offer longer-term perspectives and a special sense of stability and support delivered by our ownership structures."

But family business people tend to be conservative by nature, and they sometimes worry that "outsiders" won't be sensitive to the family's emotional involvement. Nicholas accepts the concern, but urges us to look at the other side of the coin: "As family businesses, we need to recognise that it's not all about us taking them in, but just as much about them entrusting us with a portion of their career."

Nicholas Oughtred, Group Board Chairman

"These are professional, talented people who have lots of choices," he says, "and business to a large extent is fighting a 'war for talent'. If you've got really good people, they can make a massive difference to your family business. In particular, I think we can often attract clever people from matrix management in larger groups – people who yearn for autonomy and the chance to take responsibility for a whole business, backed by supportive family owners."

Of course, non-family talent can be put off by frightening stories of where family conflict has undermined a business, and where commercial priorities have taken second place to family politics. "So there needs to be evidence that family governance is in good order," says Nicholas, "to convince people that you're as good as you say you are. One of the things that attracted our current CEO was the family's efforts over 15 years to upgrade family governance, plus, bizarrely enough, the fact that we'd sold something. In 2004 we decided to dispose of our Jackson's Convenience Stores division, and that was seen as an indicator that we were commercially minded, that we'd taken a firm grip on governance, and that it was the board leading decisions at William Jackson's with the support of the family owners."

Section 3. RESOURCES

Articles and reports

Family Business People Capital
Nick Bacon, Kim Hoque and Stanley Siebert (2013), published by the IFB Research Foundation with Cass Business School (available at: www.ifb.org.uk/media/1353/people_capital_report_june_2013.pdf)

People capital – defined as "the strength of knowledge, skills, behaviours, energy, loyalty and commitment which exist within the non-family members of a family business" – is shown in this report to represent a cornerstone of family firm success and sustainability. The authors highlight important differences in people capital in family businesses compared with non-family owned businesses, and conclude that family enterprises are able to create a distinct and positive relationship with their staff in the workplace. The research findings include recommendations for improving family business human resources practices.

Managing the Complexity of Human Resources in Family Firms
David Ransburg, Wendy Sage-Hayward and Amy M. Schuman (2016), published by Family Business Consulting Group (available at: www.thefbcg.com/managing-the-complexity-of-human-resources-in-family-firms-).

The authors propose a broad definition of HR that includes all activities related to the HR "life cycle" within a company, along with the values-based cultural features that inform the stages of that cycle. They explore five components – recruiting, selection, onboarding, development and exit – and offer guidelines on establishing and maximising the effectiveness of HR systems and practices in family firms.

On the Theory of Psychological Contracts in Family Firms
Stephanie Ward, Brooke Envick and Margaret Langford (2007), Entrepreneurial Executive, 12, pp.37–50.

A discussion of the nature of reciprocal obligations between non-family employees and family firms, called "psychological contracts". The authors argue that studying these contracts possesses potential for developing a more comprehensive understanding of the complex human resource issues within family businesses. Although academic in flavour, the article represents a readable introduction to the special issues encountered by non-family employees.

Executive Pay in Family Firms: A Principal–Agent Model
Joern Block (2010), Chapter 9 (pp.176–196) in Long-Term Orientation in Family Firms, published by Springer.

The author analyses the optimal compensation contract for non-family executives using principal–agent analysis. He sets out how the compensation contract of a non-family executive should be designed if the business-owning family wants to pursue a long-term strategy.

Books

The Critical Role of Non-Family Managers
Chapter 7 in Family Business by Ernesto J. Poza, published by South-Western (2004).

This chapter highlights research findings that owners' pride in what has made the business successful can support the status quo and create a barrier to change, causing potentially damaging disengagement of non-family managers. To counter this challenge, a discussion is presented of the most productive ways to manage relationships between family and non-family managers, including guidelines and suggestions on ways to create a beneficial environment for non-family managers.

Rewarding and Incentivising Non-Family Directors and Employees
Paul McGrath and Jason Ogelman, in Part III of Business Families and Family Businesses: The STEP Handbook for Advisers, edited by Ian Macdonald and Jonathan Sutton, published by Globe Law and Business (2009).

Written by professionals with direct experience of the topic, this chapter reviews the challenges of providing effective rewards and incentives for non-family managers, and offer a technical analysis of the main instruments and schemes available. There is a particularly useful section on controlling equity and providing liquidity.

Developing Successors and Mentoring
Chapters 7 and 8 in Succeeding Generations: Realizing the Dream of Families in Business, by Ivan Lansberg, published by Harvard Business School Press (1999).

These chapters include perceptive sections on the role that can be played by non-family senior managers in coaching and mentoring the next generation and leadership candidates in family businesses.

Working for a Family Business: A Non-Family Employee's Guide to Success
Christopher Eckrich and Stephen McClure, published by Palgrave Macmillan (2011).

A discussion of people capital issues written from a non-family employee's perspective. The book provides a framework for non-family members working in family enterprises, helping them to recognise, evaluate and react to situations that may cause tension and conflict, including tables entitled "Traps to Avoid". Non-family employees are encouraged to get to know the business-owning family, to understand their values and the family business dynamics, and practical advice is offered on how they can be empowered to be more effective for the family and for their own careers.

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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The IFB Research Foundation's vision is to be the UK's centre of excellence for practitioner-oriented family business research. The IFB Research Foundation works closely with its parent organisation, the Institute for Family Business, a not-for-profit membership association.

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