Regent's Working Papers 2019
Working Paper 1902: RWP1902

Walking the tightrope between family and business; the owner-manager transition towards a sibling partnership.

Chris Swaffin-Smith
Family Business Reflections, Burnham-on-Crouch, Essex, CM0 8AJ, UK.
c.swaffinsmith@btinternet.com

Simon O'Leary
Regent's University London, Inner Circle, Regent's Park, London, NW1 4NS, UK.
olearys@regents.ac.uk

Abstract: Successfully transitioning a family business or enterprise across successive generations of family members can be a difficult balancing act on the tightrope of achieving both family and commercial goals. It is perhaps the initial transitions that are the most critical for the long-term sustainability of the enterprise. Often, what may in effect be a personal initiative or enterprise evolves, through business successes, to become a family business that sustains several close family members. Extending that owner-manager status into one that is an effective family or sibling-partnership presents several opportunities and challenges. This paper forms part of a series of case studies on such transitions, this first one illustrating what can go wrong if decisions are not made at earlier stages before age or illness catches up with the founders of a family business and suitable arrangements have not been anticipated and set in place.

Keywords: Family; Business; Owner; Manager; Sibling; Partnership.

Profiles:

Chris Swaffin-Smith is an experienced Family Business Advisor & Non-Executive Director who has worked with family businesses internationally for over three decades and been involved in teaching and research at the same time.

Professor Simon O'Leary is Director of the Centre for Entrepeneurship & Family Business at Regent's University London and has been publishing in these fields over the last decade following a previous two decades in industry.

Word count: 4,286.

1. Introduction

Family enterprises have a major economic impact across the globe and this paper builds upon the authors' direct experiences of such family enterprises over the last thirty years. A series of case studies are being prepared based on international experiences from across Europe, the USA and Asia, including specific challenges in Thailand, Laos, Singapore, Hong Kong and Hungary. These experiences are further supported through exchanges with the participants on family business courses at Regent's University London, many of those participants being members and directors of family businesses.

This is the first of three papers in which the authors explore how differences in the perceived roles, values and expectations of family members can impact the long term sustainability of the family enterprise. Each is based on anonymised actual issues. In each case, the authors outline the current situation within the business, with particular reference to the issues that the family and business are currently facing. Relevant family business literature is then used to set out the wider context. Of particular intrest are the issues and challenges that family enterprises face in moving through the ownership stages from being family-owned, to forming family, sibling and extended partnerships. The study includes the challenges that family members face during these transitional phases and one of the aims is to draw some conclusions about the ways that independent external parties could assist family enterprises move smoothly and effectively from one inevitable stage to another.

2. Family Enterprises in Transition

Family enterprises come in all shapes and sizes and are neither homogeneous nor static. They change and develop over time as do the families and individuals who own, manage and work within them. Some authors and commentators have identified different types of family enterprise, others have sought to define the different stages of development of the business and some have identified the issues and challenges that the family and business have to manage to ensure a smooth transition from one stage to another. For example, the Organic Model of family business evolution (O'Leary and Swaffin-Smith, 2016) outlines four categories of family business based on the relative importance that is placed on family and business values; those catergories being Personal, Livelihoods, Heritage and Bank family businesses. Transititioning from one category to another requires changes in emphasis on the goals associated with the business and with the family. For example, moving from Livelihoods to Heritage status requires the professionalisation of almost every aspect of the relationship between the owners, the family and the business. In a similar way, others (such as Cohen and Sharma, 2016) propose alternative conceptual models based on the emotional and financial goals of family enterprises, or make distinctions between family enterprises and enterprising families, the latter being a structure in which family members set up ancillary businesses under the umbrella of the core family business. Many authors distinguish between family businesses developing from being family-owned and managed, to family-owned and led, towards a final stage of being solely family-owned but not managed. Others (such as Lansberg, 1999) focus on the challenges involved in the ongoing involvement of the extended family as the family enterprise grows from from being owner-managed, through family-partnerships, to sibling-partnership to cousin-collaborations.

Though such models help appreciate the complexities involved in family businesses and enterprises, the authors' experiences suggest that no individual company will necessarily fit directly into one category or type, reflecting the fact that such entities are dynamic and ever-changing. Nevertheless, at any point of time, a business tends to be at one stage rather than another and the ability to apply theoretical knowledge or relevant theories and models helps to frame the dynamics of an individual company and highlight potential actions that owners may take to help the business move forwards.

In the following case study, a Family Business Adviser learns about the family and the business through dialogue with various family and non-family members of the enterprise, applies a variety of relevant models and concepts to the knowledge gathered, and develops some conclusions about the status of the business and the potential actions open to the owners.

3. Case study: Distress and Despair in a Language & Travel Experiences company

This company is a family business with a turnover of around £5m per annum and, although quite small in terms of businesses as a whole, it is relatively large within its industry. The enterprise was started around six decades previously by a husband and wife team and they developed the business progressively by reinvesting much of the earnings back into the business. The main assets of the business are the three properties, located in an attractive part of the United Kingdom (UK), that were purchased to form the foundations of the business. Clients come from abroad to study languages and to enjoy the local sites and relevant educational trips and experiences. Growth over the last few years has been relatively static and the business continues to be seasonal, with reduced turnover between the winter months from November to April. The company is now run by the youngest of four siblings as Managing Director (MD), owning 25% of the shares, the other 75% being retained by the co-founding parents, who are both in their eighties. The father was MD until he was 78 years old and the mother is still a non-working Director of the company. Three other members of the family, the siblings of the MD, work in the business; two brothers as Directors and a sister who is a Non-Executive Director. The two brothers have very busy management roles for eight months of the year but are less occupied during the slack winter months. The following outlines the content of interviews with several family members and a number of experienced employees.

3.1 The elderly parents; Co-Founders and 75% owners of the business

The father has a long-term illness and is living in a care home, while the mother is also in poor-health and living in their own bungalow about half-an-hour's drive from the business. She needs part-time care support which is quite expensive. She effectively owns 75% of the business, as her husband is unable to be involved, and receives a monthly dividend from it to pay for all of her outgoings. She had no other assets and, she and her husband's intention, has always been to build up the value of the business so that it could be passed on to their four children as a going-concern. She was particularly worried that, because of the current performance of the business, that she had let her husband and children down. A current valuation of the business showed that the value of the company's property assets were greater than the value of the business.

The father had been the driving force in the business and had always managed it in a relatively autocratic manner. All four siblings would contact or visit the parents individually regularly to discuss business issues, often complaining to their mother about the performance of their siblings in the business.

3.2 The four children; MD & 25% owner, two Directors and a Non-Executive Director.

The relationship between the eldest son and his other three siblings was very poor. This had been the case for the five years since the father had retired as Chairman due to ill-health. The brothers openly argued about the business in front of other staff and often tried to encourage other staff to take side in disputes. The three siblings were very critical of the way in which the MD ran the business and felt strongly that their role as Director obligated them to challenge and criticise how the business was being run., this because they they were very concerned about any implications for them if they were not seen to be as carrying out their statutory responsibilities There was constant bickering and personal verbal attacks being made on the MD and, yet, all of the family said they wanted the business to continue as a family business.

All three of the brothers were on the payroll, the eldest brother being close to retirement. The middle bother relied on the business for employment and felt it would find it very difficult to find another job if he was not employed by the family business. The youngest sibling, the MD, was the most likely to be able to find alternative employment and was also the company's main contact with the Bank, who were supporting the business financially. The sister lived abroad and came home occasionally.

3.3 The business and conducts within it

The conflict within the family was having a detrimental impact on the business and any potential future growth. There was no business plan, no agreed goals and no targets. The staff were not motivated and the business was finding it difficult to recruit and to hold on to staff. In addition, the Directors had just discovered that their finance company had just stolen £0.5million from the business. This had made matters worse, the MD being accused by his siblings that he must have been compliant in this act.

Finally, the company did not hold Board Meetings, although this had been tried six months previously with an outsider chairing the meeting, but it had ended in chaos. The company had developed legally-required contracts, disciplinary and grievance procedures but, although it was apparent that one of the brothers should have been disciplined for inappropriate behaviour, this had not happened. Sales had stopped growing and the management had some key decisions to make if the company was to survive in the medium-term.

The high level of conflict within the business was having a major impact on family members and their own families. The mother was being regularly contacted, by phone or in person, with complaints from all the members of the family about how their siblings were behaving in the business. This was making her distressed because she felt she had failed as a parent. She wanted to eventually pass on an equal share of the business to each of the children and it was this that had led her and her husband to make each of their children Company Directors. However, this also made the position of the youngest son, as MD, almost untenable as he was not consulted beforehand. From an outsiders point of view, the parents probably made the right decision as he appears to be the most capable member of the family to move the business forwards. His two brothers had each run unsuccessful businesses abroad and had, in essence, returned to the family business as a last report.

The MD had tried a number of ways to improve the situation in the past, generally asking for advisory and facilitatory support. These had failed because, generally, his siblings simply did not trust him and discounted such help or advice because they felt it was loaded in favour of the MD. The other siblings often asked individual friends who were accountants for advice and they seemed to use this to confront their brother. The Articles of Association outlined that the only way that a Director could be dismissed was if this was the decision of the shareholders and, although they had agreed to remove one of the brothers from the Board as this would restore the authority of the MD and help the business move forwards, the mother withdrew her approval late on and that son remained in post. This significantly increased the bitterness between the MD and his siblings.

These types of behaviour were also having a majorly negative impact on the morale and stress levels experienced by other non-family members of staff.

4. The Analysis

This analysis focuses on what has happened within the family and the business that has led to this very difficult situation, one in which the relationships within the family have deteriorated to the point where the very sustainability of the family business is threatened.

4.1 The current status of the family business

The business is still family-owned and run. It is a family business and the family does not own any other businesses. In terms of the four business types identified by O'Leary and Swaffin Smith (2016), it is still primarily a Livelihoods Family Business. The business was started by the original owners to provide an income for the family and, over the last thirty years or so, the owners have tended to plough profits back into the business rather than build-up their own personal wealth. One of the main concerns has been to ensure that all members of the family can work in the business if they wish to do so, regardless of the potential impact on costs or efficiency. So, both the sons came back to the business after relatively unsuccessful careers elsewhere. Furthermore, the mother was unwilling to take disciplinary action on one of the sons by removing him as a Director and this decision appears to be against the best interests of the business. So the parents appear to have traditionally put relatively more emphasis on the family-angle rather than business goals and values. However, the sons have indicated that they would like the business to be passed down to future generations and, therefore, appear to be expressing aspirations for it to become a Heritage Family Business in the long-term. To achieve this though, they would need to make significant changes to the way the business is managed and to regularise the relations between the family members and the business. There is no clear family-agreed vision or strategy for the business and nor is it clear what each family member wanted out of the business.

Other family business models, such as Landsberg (1999) on owner-manager, family and sibling-partnerships, indicate similar findings. The four children and the mother are the active Directors and the business it is therefore a family-partnership as it ceased to be an owner-manager business when the father retired. However, the business is struggling to become a sibling-partnership because of the open warfare and lack-of-trust between the children. This model identifies a number of issues and challenges that the owner-manager has to deal with to ensure a relatively smooth transition from owner-manager to family-partnership. These include sharing his vision of the business with the family; staying connected with the family; developing a plan for the business; and exploring financial options. Once the business is establishing itself as a family-partnership, other challenges and issues emerge, including sharing control with the children, mentoring the new MD, creating liquidity for the founder, holding family meetings and setting up a Board Structure, agreeing the family vision, transferring ownership and choosing a successor.

In family businesses, the family need to be clear on the distinction between transfer-of-ownership and transfer-of-management; a complex set of of decisions and actions need to be initiated by the older generation and discussed and agreed with other members of the family. In this case, the parents had also not assessed whether the children were able to collaborate as a team.

4.2 The prior owner-manager phase

One of the authors had previously met the father when he was actively managing the business. Then, the mother and younger son were the only members of the family working in the business. At that time, the son was feeling very frustrated as he felt he had very little influence on the business as his father appeared to be very dogmatic and autocratic, with no particular long-term plans for either the business or retirement. The parents were expecting to be financially supported by the business through dividends until they died. However, the only potential management successor was the youngest son so, when the father became ill, the decision was made to transfer management responsibility to this son and to give him a 25% stake in the business, without reference to the other three siblings.

At about the same time, both the other two sons returned to the UK and as they did not have a job and asked to join the business as they both had some experience in the language school business. The parents, without reference to the youngest son, made them Directors of the business and also made the daughter a Non-Executive Director. It seems that the younger son had little or no mentoring support from his father and the older children appear to have resented their younger brother being given this role, especially as they had each run their own language school, though not necessarily successfully. This created a potentially difficult situation and it had clearly become even worse.

4.3 Current challenges

These initial transitional phases have had a major impact on the businesses' ability to create a successful partnership. This disruption has continued because the youngest son has not had the full support from his mother and, as they are the current owners of the business, they could exercise some control over the behaviour of other Directors. However, the mother finds it hard to make such decisions because it makes her feel that she is not treating her children equally. Her main concern is to be part of a happy and integrated family and she still intends to leave her 75% shares shares to her other three children so that each sibling has 25% of the business. She also feels guilty that her and her husband have not built up a substantial amount of private wealth. She also suffers stress through allowing all of her children to discuss the business individually with her.

Alongside this, the youngest son does not feel that his contribution within the business is valued and he feels that he lacks the support from the previous generation in helping him and the family move the business forwards. He would like to develop an effective sibling-partnership that leads towards Heritage status by professionalising the business.

5. Conclusions

The conclusions focus on the future options for the business and the general lessons to be learnt from this case study.

5.1 Future options for the business

The current situation within this business is very serious and difficult to resolve. To better understand conflict in family businesses, Collette and Davis (2016) identified four different stages that can escalate conflict:

- Stage one is characterised by minor levels of disagreement which could be reasonably managed through discussion and compromise.
- Stage two where the disputes become more serious because issues have rumbled on without resolution; these disputes can generally be resolved with strong leadership.
- Stage three is characterised by the existence of serious conflicts which potentially destabilise the business.
- Stage four is warfare and, as here, individuals are entrenched in their positions and become aggressive; trust is practically non-existent; and emotions run high, with gossip and over-reaction prevalent.

This situation has reached the final stage and a possible solution was for an independent adviser to facilitate a family discussion that could lead towards an agreed vision and plan of action for the future. This approach was in principle agreed by all family members and a family retreat was set up; however, it never actaully took place because the level of trust was so low. This now leaves the family with four realistic options, each of which is difficult and could impact on the future viability of the business.

a) Continue as now and potentially destroy the business.
b) The youngest son buys the remainder of the shares from his mother so that he could restructure the business and take back authority.
c) Employ someone else to run the business and move away from a sibling-partnership model.
d) The youngest son could resign and find another job.

5.2 The major lessons from this case study

There are at least four major lessons to be learnt from this case study:

1. First, there is a significant responsibility lying on the shoulders of the senior generation to think through and initiate plans for the future ownership and management of their family business. This is particularly so if there is a possibility that it will move from a Livelihoods status to that of a Heritage family business This process cannot start too early as family illness can occur at any time. Starting this process is particularly difficult for individuals who cannot differentiate the business from themselves and essentially feel that they are immortal.

2. Second, a differentiation needs to be established at a very early stage between the needs of the family and the needs of the business. For example, equality is not the same as fairness and the younger brother in this case was probably the most suitable successor but the decision to bring the other siblings into the business as Directors has proven, in retrospect, to undermined his authority. Although the parents did give the youngest son 25% of the shares of the business, this did not improve his ability to exercise control because he was not able to rely on the support of his mother who is still reluctant to take any decisions that conflict with her view that her children should be treated equally. The other siblings who were made Directors were not given shares and it is still not clear what happens when the parents die; this ongoing issue clouds their trust in terms of what might happen next.

3. Third, the situation has become increasingly volatile because issues that were not resolved at the initial phases of succession continue to fester. In retrospect, the new MD needed to have made it clear under which terms he would take over, especially his levels of authority and the support he could expect. For example, he had no say in the appointment of his siblings as Directors and, although he tried to move things forward by bringing in outside help, there has never been the full commitment of all family members to resolve issues. This conflict has been extended by the contradictory advice provided by the personal lawyer and accountant friends of the MDs' brothers.

4. Fourth, an awareness of the overall context in which a family business operates can help understand what is happening within a family. Models and theories that identified different types of business and highlighted issues that need to be managed on moving from one stage to another. However, it is still quite uncommon that owner-managers develop that awareness at the right time; they are often simply too busy running their business and are not thinking about the future enough. Decisions relating to succession need to be made with a full consideration of how this might impact on the future relationships between the business and the family. Issues that could have be resolved through discussion and compromise can fester if they are dealt with early on. Succession is a process and not an event and a key part of this process often involves owner-managers changing their management style and the parents developing a business relationship with their children which is different from their family relationship.

This case highlights a family and business in a state of distress and despair. The balance between the needs of the family and those of the business has not been achieved because, for too long, the parents have not seen that they are different. It is primarily a Livelihood Business but it is unlikely to progress to a Heritage Business unless significant changes are made. It is also a dysfunctional family-partnership and unlikely to progress to an effective sibling-partnership The conflict between the parties is at a stage of open warfare and the Ihe level of distrust between the parties means that a facilitating approach to bringing everyone together could be very difficult. This case study is unfortunately not untypical of what happens to many family businesses - a salutary tale!

References

Cohen, A. and Sharma, P. (2016), How *Successful Family Business Develop Their Next Leaders*, Berrett-Koehler Publishers.

Cohen, A. and Sharma, P. (2016), How *Successful Family Business Develop Their Next Leaders*, Berrett-Koehler Publishers.

Lansberg, I. (1999), *Succeeding Generations: Realizing the Dream of Families in Business*, Harvard Business Review Press.

O'Leary, S. and Swaffin-Smith, C. (2016), Organic Model to reflect the transitional nature of family firms, *The Marketing Review*, Vol.16, No.3, pp.285-297.