Family Feud

When conflicts arise in family firms, learning to compromise helps ensure long-term survival.

by Raymond Bakin

Siblings fight. Best friends disagree. Spats bruise the happiest marriage. So it's no surprise that persona1 conflicts arise in closely-held family businesses.

However, conflicts in family businesses involve more than egos and emotions. Such conflicts can have serious financial consequences.

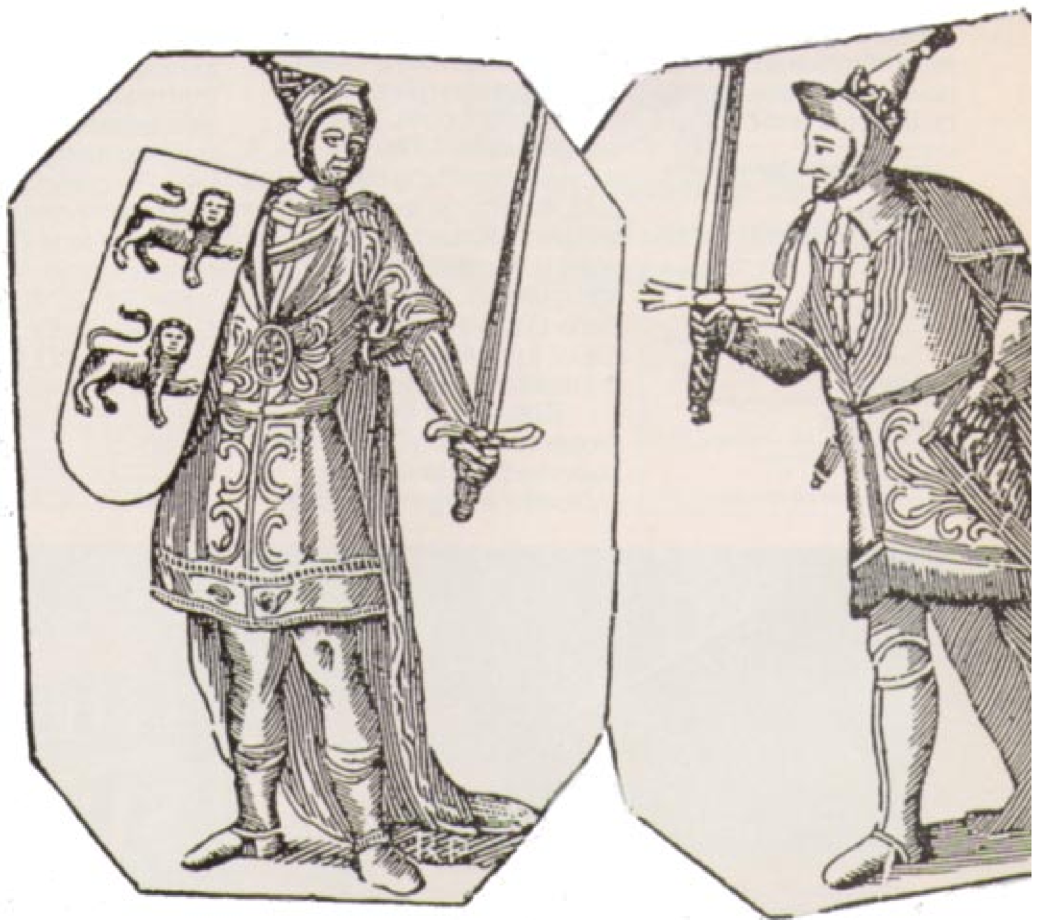
Simple family disagreements become distractions that absorb valuable management time and energy. More severe conflicts can disrupt sales and reduce earnings. In extreme circumstances, family conflicts can threaten a firm's survival. Being right can become more important than being successful.

No panaceas exist for avoiding conflicts in family businesses. And family disagreements often resist common solutions. But recognizing some basic considerations can help reduce the frequency and severity of family conflicts.

Potential conflicts in family businesses fall into the following categories:

- Non-business conflicts that affect the business.
- Problems arising from dispersed management control.
- Problems with inactive shareholders.
- Problems with non-family members in the business.
- Transition problems in replacing top management.

Problems arising from personal conflicts may be the most difficult to solve. Such conflicts often bear only an indirect relationship to business activities. Yet they often arise from deep-seated emotions that resist rational solutions.



According to the author, conflicts in family firms fall into five categories: non-business conflicts, problems from dispersed management control, problems with inactive shareholders, problems with non-family executives, and transition problems in replacing top management.

Shift the question of compensation differences away from emotional issues

Consider the example of a family firm in which the founder remains in control of the business. He has three sons active in the operation: one functions as sales manager, a second serves as controller, while the third is a plant supervisor.

Although all three sons receive generous compensation, their varying responsibilities still introduce differences in their pay and provide the seeds for discontent. Irrational jealousy takes precedence over reason. Demands for equal pay for unequal contributions create family discord that threatens the company's success. Irrational personal differences become a business problem.

One solution might be letting dissident family members assume responsibilities for specific profit centers. Their income then can be partially related to the profit center's performance.

The specific profit center may be oriented towards a new or existing market area. Or perhaps a new business can be established that moves the firm into a new field.

Whatever the approach, such moves shift the question of compensation differences away from emotional issues. Family members can't quibble as much when their measurable performance becomes an important influence in the compensation issue.

Of course, expansion into new markets or new fields may not be a feasible alternative. The firm may lack the necessary financing capability. Or the dissident family members may lack the ability to manage a separate profit center.

In other instances, personal differences may preclude a reasonable solution. Minor family disagreements can grow into bitter, irreconcilable disputes. In such circumstances, business survival should stand as the most prominent concern. That may require separating the dissident family members from the business.

If the dissidents lack any ownership interest the separation process is straightforward. The dissidents simply gain the opportunity to seek employment elsewhere. However, in many instances, dissident family members also own an equity interest in the business. So to avoid rekindling disputes in the future, the dissidents should sell their interests in the business.

If the dissidents can sell their shares directly to those remaining active in the business, that leaves the business entity uninvolved in the financial transaction. However, in many circumstances, the company must buy out the departing shareholders. The company may pay cash for the shares, or a long-term payout may be arranged. But in any event, the buy-out should not severely upset the firm's financial circumstances and thus threaten survival.

If a burdensome buy-out seems the only feasible settlement, selling the whole business to a third party may become more desirable. The business survives, and the family can enjoy the financial settlement, if not the continuing benefits from ownership.

Management Style

Another category of problems in family-owned businesses doesn't necessarily involve any direct personal conflicts. Instead, the problems center on efforts to effectively manage the business.

Conflicts in family businesses can have serious financial consequences.

In this instance, several family members may be actively involved in day-today management activities. Yet no single family member, nor any family group, enjoys majority control of the business.

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The family must develop an approach to managing the business successfully, while avoiding discord. Even though no one has majority control, one or more family members must assume leadership positions. Effective leadership then replaces the authority and influence typically exhibited by a controlling manager.

All the active family members must be involved in the significant business planning and decision processes, perhaps through various management committees. But whatever the form, active involvement encourages the teamwork necessary to work for the best interests of the business enterprise, which also serves the family's interests.

Open lines of communication must prevail among all the family members involved in management. Apparent secrecy of any kind plants the seeds of discontent. Not every family member can have his way, but every active member must feel involved.

Lastly, whenever possible, management tasks and responsibilities should be spread among family members in a manner that reduces the potential for disputes arising from overlapping concerns. Clear lines of authority and established responsibilities contribute towards that objective. Leaving responsibilities unclear increases the potential for unnecessary disputes.

Inactive Members

One set of problems that commonly arise in family owned businesses involves inactive members. Although inactive, these family members typically feel their ownership interests entitle them to share in the firm's earnings through periodic dividend payments. Knowing active family members enjoy generous compensation from the business only intensifies those feelings.

The demand for dividends may be complicated by the firm's own need to retain its earnings to fuel continuing growth. In such instances, the firm's best interests should prevail. Active members should try to prove the firm's need to retain earnings. Certainly, the longer-term prosperity of the business serves everyone's best interests.

Of course, the business may periodically pay stock dividends to the firm's shareholders. Those shareholders needing cash may find other family members willing to buy their dividend shares. The inactive shareholders then achieve their aims without draining cash from the business.

As another alternative, a business may spin off one or more profit centers into new corporations. Earnings from those corporations then can be dedicated to dividend payments to shareholders. Even modest dividends may placate the inactive shareholders.

Non-Family Members

Involving non-family members in management creates another category of problems for family businesses. That involvement is unavoidable since few businesses can fill every important management slot with talented family members.

At the same time, retaining talented

executives in a family business often becomes a problem. Non-family executives remain outsiders, involved in the family business, but unable to become part of the family. The potential for moving into the chief executive's role—a natural ambition for a talented manager—may be stymied by the presence of a family member with the same objectives and similar talents.

Moreover, talented managers typically want to gain an equity interest in the business that enjoys the fruits of their talents. That also can become a problem if the family members are reluctant to dilute their ownership positions.

Despite the obstacles, a conscientious effort can help a family business retain valuable executives brought in from outside. Make him part of the team,

with responsibilities and authority appropriate for his position and ability. Then, allow him to exercise those responsibilities without undue interference.

Ensure the executive enjoys compensation appropriate and competitive for his position. However, compensation also should include visible benefits that boost the executive's ego. A company car, a large and comfortable office, and other niceties can make up for many of the limitations the executive finds in the family business.

If desire for an equity position remains an issue, the family business may spin off a profit center or enter a new market with a separate corporation. The non-family executive then may be rewarded with a share of the separate entity. With the support of the existing business, a separate corporation has a larger probability for success than typical new ventures.

If no potential for equity interests exists, the business should develop some deferred compensation plan that pro-

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vides important non-family executives with long-term financial security. That security can allow executives to confidently pursue his own ventures as sidelines, yet devote the bulk of his talents to the business.

Transitions

Problems in family firms can arise from the need to make transitions at the top management level from one generation to the next. Under the best circumstances, the senior executive recognizes the need to turn the reins over to a younger family member. Ideally, one member—perhaps an only son—stands out among his peers. All recognize his succession as most beneficial to the business.

Then under these ideal circumstances, the senior manager turns the reins over gradually. The successor is allowed to make his own mistakes while the departing executive gently provides guidance when necessary. The successor grows into the job and gains the confidence of his peers and himself. And the senior executive backs out of the business in an orderly way to happily pursue avocations previously set aside in favor of the family business.

Unfortunately, these ideal circumstances are uncommon. For example, complications can develop when more than one potential successor exists. When the father elects to retire, the succession decision easily can create a family furor.

However, the top executive still should select his successor. Leaving the decision to the next generation inevitably creates dissension that may be painful to those concerned and damaging to the business.

In some instances, the retiring executive can make his choice known early, and then proceed through the "ideal" transition outlined above. But when the choice among peers isn't obvious, the top manager should consult with objective observers familiar with the firm's circumstances. Bankers, accountants, attorneys, suppliers, and even customers may provide insight that isn't obvious to the one responsible for the decision.

In any event, upon selecting his successor, the retiring executive should take steps to prevent conflicts among family members. Here, the expedient use of titles can help appearances and sooth some damaged egos. For example, the business may have (or form) subsidiaries that each have a president's title. Ultimate responsibility may rest in the hands of the president of the parent firm, but the titles can help avoid family dissent during a transition period.

The most difficult transition problem arises when the managing founder fails to see the need for turning the firm's reins over to the next generation.

That need may be apparent to those inside and outside the firm. The founder may be an obstacle to further expansion or critical changes necessary to keep the business competitive. Or the founder simply may rely on archaic management methods that are cumbersome in a modern era of electronic communication. Or the founder simply may be out of touch with a rapidly changing business environment.

Obviously, encouraging retirement in such instances is a delicate task. After all, the executive undoubtedly played an important role in the firm's past successes, and naturally expects due credit and respect. Raising questions about a successor can do more to raise the manager's ire than encourage his retirement.

What is the solution to this delicate problem?

Try reasoning with the executive, but proceed carefully and hope one approach or another eventually will prevail.

What alternatives exist if all efforts fail and the founder persists in office? Probably none. Forcing the issue will make the executive even more steadfast in his commitment to stay. The only solution may come from backing off and letting time prevail.

Waiting may not serve the firm's immediate best interests, but a workable compromise often takes precedence in this or any other family business problem. Although it may not maximize the firm's earnings, compromise may be the key to a family firm's long-term survival.