FINANCIAL POST

Don't let your firm burn like Rome

Leadership matters, especially in family-run companies

Brad Cherniak, Financial Post Published: Tuesday, October 13, 2009

Ancient Rome in part went off the rails because it moved away from being a Republic governed by rules, processes and well-established qualification requirements for choosing its consuls or leaders. This system worked well for centuries, but once Rome became an Empire, it was ruled by Caesars who arbitrarily choose their successors. Often, they would choose one of their children -- consider such notables as Nero and Caligula. This ultimately brought about the end of the Roman Empire.

Leadership matters: Empires or companies, even strong and successful ones, are not immutable blocks of stone, impervious to the actions of their leaders. Successful owner-operators often are lulled into a sense of invincibility that they impart to their children -- chip off the old block, cut from the same cloth, etc.

There is a growing professional practice focusing on these businesses and their transitional issues, which often can have devastating effects on everyone concerned. It is often rife with emotions and family bonds, pressures and perceived entitlements.

No wonder, as statistics show, there are few successful second-generation family-owned business. And with each generation, the odds of a successful transition fall drastically.

Here are some key issues to consider in a family run business:

Business is business It is a recipe for disaster, if the business -- literally or psychologically -- becomes the communal property of indifferent or uninvolved family members. The owner-operator should almost always retain control and keep a hard boundary between the company and their family.

Special care should be taken when shares are issued to family members as part of an estate freeze, where the value of the business is frozen in favour of the owner-operator, and future growth is transferred to other, usually younger family members to defer capital gains taxes, says Jordan Gould a partner at SBLR LLP, a Torontobased accounting firm.

"We often advise clients to ensure there are sufficient votes attached to the frozen shares of the owner-operator to maintain a majority of votes."

Spread the wealth, not the control It is fine to want to spread your financial success to loved ones, but there are ways to do this without polluting the governance of your company or creating swelled heads and feelings of entitlement.

One way is to create a pool of non-voting or "phantom" shares, which are joined at the hip with your shares. The recipients of these phantom shares has no voice at the company and doesn't attend shareholder or board meetings. The benefit of these is solely economic; and is realized at the time and in the manner of the owner's choosing.

"If you are concerned about the financial equity of what you are providing your family members, consider cash gifts to members not participating in the business, or ensure your will bequeaths other assets, such as real estate or stock investments of equal value to an interest in the business," Mr. Gould says.

Hire professional managers and empower them A sure-fire way to lose your best employees is for them to see there is no real structure of accountability; that they are likely to be pushed around by some wet-behind-the-ears type sporting a BlackBerry in one hand and a silver spoon in the other. It should not be assumed family members will follow in the owner's footsteps. But if they do enter the business, it should be on the same terms as any unrelated employee.

"The family member learns a great deal about how the business works, preparing them for a possibly more senior role in the future, and other employees appreciate the respect shown to the work they do, usually resulting in minimal or no resentment toward the family ownership group," Mr. Gould says.

The bottom line is performance should be measured and rewarded objectively and transparently. Business is a meritocracy -- if family members don't make that cut, so be it.

These notions should also extend to the senior governance of the company. If you have ever attended a meeting of a board of directors populated by uninterested and involved family members and other assorted familial hangers-on, you know what the downside is.

You call the shots Many owner-operators feel obliged to share control and ownership of their companies with their families, that they are somehow derelict or immoral by not doing so. Hogwash. No one is entitled to something they don't earn.

When it's time to go... When you feel age or health issues creeping up on you, or motivation lagging, don't lose your resolve in dealing with your company. It is at this juncture that the walls around your company should be strongest.

When money and emotion mix, the result can be volatile. The pressures may be particularly hard to resist if you are in declining health or your energy is waning. This is why it is particularly important to begin your exit planning well ahead of the event.

Mr. Gould indicates that many business owners bury their heads in the sand, refusing to contemplate what the business should look like once they are no longer at the helm, to the detriment of themselves and the business.

The steps you should follow at this critical stage should not differ materially from any other party who is contemplating selling a company.

- Brad Cherniak has spent more than 20 years as a principal, advisor to, and investor in private companies. He is co-founder and partner at Sapient Capital Partners, a Toronto-based advisory firm to companies from early stage to $50-million in revenues. His column appears monthly in the Financial Post. He can be reached at brad@sapientcap.com.