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How to stop the breakup of family firms

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Fotolia *Shifting from a founder patriarchy to many family members can lead to confusion about where power rests.*

Family-owned companies make up a large component of the private business landscape in Canada, and it is well-documented that not all survive past the first or second generations, let alone thrive.

But how even the thriving ones deal with changing family dynamics can determine the continuity of ownership and ongoing success, while avoiding the very public family quarrels some family firms have experienced.

On the positive side of the ledger, successful family firms tend to have a long track record of growth and profitability; are often a household name in their industry or space, and have decades of tradition and pride built in the business and the family.

On the opposite side of the ledger, however, these companies often have no formal shareholder agreement in place; are governed informally, gradually shifting from a founder patriarchy to a more heterogeneous group of family members; and can experience increasing confusion about where the power rests, and even who owns the company.

Even more confusing can be the range of interests and motivations shown by the family members: Some are loyal to maintaining or growing the business; others, in taking cash out of it, or even selling it; and others who are largely quiet or indifferent.

There is often someone who feels entitled to inherit the parents' shares; another who feels he or she should have a voice in the business, having already inherited shares; and still others, who feel time spent working in the business entitles them to a voice and even an ownership stake.

This situation can short-circuit the family's decision-making ability, and, in turn, the company's future. The most common and conventional rules of family business and exit planning can stop working well, or at all.

Family members often are afraid to discuss the situation for fear of disrupting the business, or the family. And the alternative — selling the business — is out of the question without a consensus of owners.

The following recommendations can help family businesses in this situation get back on track:

Start with what is This isn't always well-documented, but hopefully it is the most objective part of the process. Determine who are the current legal shareholders of the company; what percentage each own on a fully diluted basis (ie. after allowing for exercise of outstanding share options); and what rights each holds, including voting and veto rights.

Then what should be This is key to maintaining or re-establishing harmony. Consider whether there are family members who are important to the business who don't own shares and make them a part of the discussion. Also, determine what promises or established family practices have created reasonable expectations of having a voice in the process.

Establish a new decision-making/governance process Do not underestimate how difficult re-establishing control will be. A family business is not a perfect democracy, and decisions won't always be considered fair to everyone at all times.

The decision-making group should start with the current shareholders, especially the largest and most active and well-versed in the business, and expand to include enough of the family stakeholders to be considered legitimate. It is sometimes necessary to also involve influential non-shareholder family members.

The first steps in re-establishing control should be taken by this core group, assuming they recognize the need to change how things are being done, and are seen as credible within the family.

To have broad support across the family, you need to build momentum and have calm, private discussions. Admittedly, this can be difficult if there is distrust or open hostility, but trying to get everyone in a room from the get-go to resolve all the issues at once, will never help untie the Gordian Knot.

Stop when you have critical mass, not unanimous agreement At this point, you should have a body of individuals, shareholders and non-shareholders, who are seen by the family as opinion leaders. This body will not yet have a specific mandate or priorities, and its decisions may be binding or non-binding depending on the circumstances. The important thing is it is a new, strong and clear voice amid a cacophony.

Now comes the agenda It often helps to have an outsider chairing the proceedings or at least facilitating discussions and shaping the agenda. Look for the low-hanging fruit — the least-controversial decisions — to get started on growing the value of the business.

Starting small will increase everyone's comfort in the process, and mend family fences. At its own speed, the group will up the ante and tackle the harder decisions, such as growth strategy, raising capital, stakeholder payouts, or exit and succession planning.

What to expect The result of this process should be a more cohesive family decision-making mechanism that removes the shackles holding the company back from moving forward in a competitive and challenging economy.

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