WOMEN'S ENTERPRISE CENTRE

Problems in Managing a Family Owned Business

1. Summary

Management problems in a family-owned business are somewhat different from the same problems in a non-family business. When close relatives work together, emotions often interfere with business decisions.

In some family companies, control of daily operations is a problem. In others, a high turnover rate among non-family members is a problem. In still other companies, growth is a problem because some of the relatives are unwilling to plough profits back into the business.

This publication discusses such problems from the viewpoint of the family member who is the company's manager. It offers suggestions that should help you to manage effectively and profitably.

When you put up your own money and operate your own business, you prize your independence. "It's my business," you tell yourself in good times and in bad times.

However, "It's *our* business", in a family company. Conflicts sometimes abound because relatives look upon the business from different viewpoints.

Those relatives who are silent partners, stockholders, and directors see only dollar signs when judging capital expenditures, growth, and other major matters. Relatives who are engaged in daily operations judge major matters from the viewpoint of the production, sales and personnel necessary to make the company successful. Obviously, these two viewpoints may conflict in many instances.

This natural conflict can be aggravated by family members who have no talent for money or business. Sometimes they are the weak offspring of the founders of the company -- sons and daughters who lack business acumen -- and sometimes they are in-laws who must be taken care of regardless of their ability or the company's needs.

Basically, the management problems that face the manager of a family owned business are the same as those that confront the owner-manager of any small company. But the job of the "family manager" is complicated because of the relatives who must be reconciled to the facts of the market place, the factory, and the counting house.

2. The Sparks Fly

Different opinions do not always produce discord, but sometimes they cause "sparks to fly" -- especially in a family owned company. Emotion is an added dimension as brothers and sisters, uncles and aunts, nephews and nieces, and fathers and children work together in such a small business.

For the individual who must head such a company, the important thing is to recognize this dimension of emotions and to make objective decisions that are difficult to come by in such situations.

Many times when members of a family are active in the business, it is hard to make objective decisions about the skills and abilities of each other. For example, one says about another relative, "He was lazy when we were kids, and he's still lazy." Or a disgruntled wife says about an aunt, "What does she know about the business? She's only here because of her father's money."

If such emotional outbursts affected only the family, the manager might "knock a few heads together" and move along. But often it is not that easy. The quarrels and ill feelings of relatives have a way of spreading out to include non-family employees. Then the manager's problem is to keep the bickering from interfering with work. You cannot afford to let the company become divided into warring camps. You have to convince non-family employees that their interests are best served by a profitable organization rather than by allegiance to particular members of the family.

Another aspect of the emotional atmosphere is that often non-family employees tend to base their decisions on the family's tensions. They know how their bosses react and are influenced by this knowledge.

3. Is the Manager Really in Control?

The president of a small company is not always necessarily the person in charge. In many family-owned businesses, the elder statesman of the family becomes president or chairman of the board of directors. But day-to-day management is in the hands of other members of the family.

In some cases, even the best hands are tied as the family member tries to manage the business. For example, the ceiling on the amount of money that can be spent without permission from the rest of the family may be too low for the situation confronting the company. Having to clear operating expenditures may mean missing opportunities for increased profits, such as taking advantage of a good price on raw materials or sales inventory.

In other cases, a manager may be in a bind because of emotional involvement. For example, you may feel that you have to clear routine matters with top family members because "Uncle Bill never lets you forget your mistakes." Personalities and emotional reactions create bottlenecks that work against an efficient operation.

Relatives who indulge in excessive family talk during working hours may also reduce efficiency. The manager should set the example and insist that relatives refrain from family chit-chat on the job.

In some family-owned companies, the day-to-day manager may be a bottleneck. You may be a bottleneck because you do not have the ability to delegate work and authority. You may be the manager because of age or the amount of capital you have in the business without regard to your qualifications. In other instances, you may hold up progress because you do not listen to others in the company.

One solution is for other members of the family to persuade such a manager to let someone else run the day-to-day show, perhaps a hired manager.

If a member of the family has to be in charge of operations, he or she should be capable of using efficient management techniques and be thick-skinned enough to live with family bickering and tough enough to make his or her decisions stick.

One way to obtain objective control in a family-owned business is to hire an outsider to manage the day-to-day operations, when the company can afford it. Any manager may become as biased as any other family member. With a hired manager, the family members will have their hands full in setting policies and in planning for growth. An efficient hired manager will see to it that all employees -- family and non-family alike -- know to whom to report at all times.

Such definite lines of authority are even more important when a member of the family manages operations with other relatives filling various jobs. The responsibilities of family members should be spelled out. "Family employees" should discipline themselves to work within the bounds of these lines of authority. Even then, it is wise to have a non-family employee high in the organization so that he or she can be involved in operations and help sooth out any emotional decisions that family members may make.

The manager's authority to suspend or discharge flagrant violators of company rules should also be spelled out. Management control is weakened if special allowances are made for "family employees".

An important question connected with authority is: Who takes over when something happens to the family member who heads the business? A position may be "up for grabs" if the family hasn't provided for an orderly succession. This need is especially critical when the top family member is approaching retirement age or is in poor health.

4. Your Brother-in-Law Needs a Job?

One of the most common problems in a family business is the hiring of relatives who do not have talent. But what are you to do when your sister or another close relative says, "Bob needs a job badly"? The emotional aspect of such family relationships is hard to fight. But try to go into it with your eyes open. It will be hard to fire Bob if he turns out to cost you more money than his presence is worth.

The main thing is to recognize the talent or lack of it. Suppose your brother-in-law, for example, has little or no ability as far as your company is concerned. Perhaps you can put him in a job where in spite of his weaknesses he can make a contribution and not disturb your employees.

The major concern is not necessarily the relative but how he or she affects other employees. In some cases, a relative can demoralize the organization by his or her dealing with other employees. For example, he or she may loaf on the job, avoid unpleasant tasks, take special privileges, and make snide remarks about you and other relatives.

If you are stuck with such a relative, try putting him or her in a job where he or she will have minimum contact with other employees, out of the mainstream of decision-making. For instance brother-in-law Bob might be placed in a sales office in another city some distance from the company's headquarters where he will be under the supervision of a top producer. Another alternative is to change his attitude by formal or informal education.

The key is to see that the non-talented relative does not affect the relationship that you, the manager, have with other members of your staff. Other employees will respect you for keeping relatives in line. Strange things sometimes happen. There is always the chance that the non-talented relative may be under your direction and turn into an asset for your company.

5. Is Non-Family Turnover High?

Some family-owned companies are plagued with a high turnover among their non-family executives. In other cases, top-notch managers and workers leave because promotions are closed to them because they see your relatives being pushed into executive offices.

The exit interview is a useful device for getting at the root of this type of turnover. A key employee who has decided to leave may be eager to tell you the true story -- or at least enough of the facts to help you develop a course of action.

When a manager has the facts, he or she may have to confront the trouble-causing relative with an unpleasant story. What comes out of the confrontation is anyone's guess. Rare is the owner-manager who can fire a troublesome and close relative and make it stick. One way to remove such a thorn from the side of key executives is to help the relative start a business in a non-competing line -- provided he or she has the management ability that is necessary for success. Another way is to "exile" him or her to a branch office or find a job with another company.

6. Spending to Save Money?

Many times, as the owner-manger you feel that you must make an expenditure to improve efficiency, yet other family members oppose the expenditure because they view it as an expense rather than an investment. They feel that funds spent for items, such as more efficient equipment, encroach on their year-end dividends.

One way to help these relatives see that "you have to spend money to make money" is to base your arguments for the expenditures on fact and figures that non-family employees have gathered. Suggest to the opposing family members that the matter be settled on a cold dollar basis; for example, "by spending money for this machine, we can increase profits and get our money back in four years."

If the opposing relatives refuse to accept your projection, try calling in outside business advisors. Relatives will sometimes believe advisors, such as your banker, accountant, or attorney, when they won't accept your judgment. But keep in mind that outside advisors who are personally close to other family members, should not be included among your counselors.

Paid consultants can also be useful in proving the worth of expenditure. Such help is particularly valuable on specialized projects that require more research than you or your regular advisors have time to do.

7. Status Quo Blocks Growth

When some of the relatives in a family-owned business grow older, they develop an attitude of status quo. They don't want things to change and are afraid of risk. With this attitude, they can, and often do, block growth in their family's business.

The solution to such a problem is to urge or suggest that the status quo members slowly disappear from the scene of operation. One way to do this is to dilute their influence in management decisions. For example, the status quo relatives might be given the opportunity to convert their stock in the corporation to preferred stock; or they might sell some of their stock to the younger relatives.

It might also be possible for the status quo relatives to think in terms of gradual retirement. Their salaries can be reduced over several years, and they can relinquish some of their interests. With the proper legal advice, it might be possible for a small corporation to re-capitalize. A new partnership agreement might be drawn up when the company is a partnership.

Such action can take into account all the growth of the business to that particular point and can enable the retreating members to recover their equity. Meanwhile, the manager and active relatives can renew their efforts toward expanding the business.

8. How Is the Pie Divided?

Paying family members and dividing profits among them can also be a difficult affair. Many persons feel that they are underpaid, but what about relatives who comment as follows:

- "Uncle Jack sits around and gets more than I do."
- "Aunt Sue goes to Europe on the returns of money her husband put into the business before he died ten years ago."
- "Your brother goofs off and rakes in more than you do."

How do you resolve such complaints? You don't entirely; but if the business is a small corporation, certain equalizing factors can be accomplished by stock dividends. By re-capitalizing the company, some stockholders can take preferred stock with dividends.

Salaries are best handled by being competitive with those paid in the area. Find out what local salary ranges are for various management jobs and use these ranges as a guide for paying both family and non-family personnel. When you tie pay to the type of work that the individual does, you can show disgruntled relatives the value that the industry puts on their jobs.

Fringe benefits can also be useful in dividing profits equitably among family members. Benefits, such as deferred profit sharing plans, pension plans, insurance programs, and stock purchase programs, offer excellent ways to placate disgruntled members of the family and at the same time help them to build their personal assets.

How the pie is divided is vital to growth in a small business. Profits are the seedbed for expansion, and lenders are influenced by what is done with profits. What banker wants to lend a company a substantial amount when relatives drain off its earned surplus?

9. Where Do You Go for Money?

Another major problem in managing a family business is that of obtaining money for growth. Generally speaking if the company is profitable, you can get funds from your bank; but when the growth is substantial, a company often outgrows its local bank. When you see the prospect of expansion looming ahead, the managing relative should begin to plan for it. You will need to consider techniques for planned financing which may be a combination of these items:

- taking out a mortgage on the company's building;
- asking suppliers to extend credit on purchases;
- factoring the company's receivables and inventory financing;
- borrowing on a note basis from friends;
- borrowing the cash surrender value of relatives' life insurance policies;
- contacting an insurance company for a long-term loan.

If the business is a small corporation, the following techniques also offer possible sources of money:

- selling a portion of the stock to another company for cash - in a merger, you can use the credit of the larger company;
- contacting a regional investment banker who may privately find a lender, using some of the company's stock as collateral;
- contacting a national investment banker who would underwrite some of the company's stock.

Effective budgetary controls are important in seeking growth funds. Such controls help the managing relative to determine the company's needs. Lenders also regard them as evidence of good management.

10. Exchange Information

Fortunately, in most communities, the manager of a family-owned business is not alone. Other individuals operate small companies for their families and may provide a source of information and help.

The managing relative should seek out and cultivate counterparts. You can exchange ideas with them and learn how they solved problems in which their relatives were involved.

In a small corporation, the thinking can be stimulated by having outsiders on the board of directors -- directors who are not relatives and who are from other types of businesses.

National trade associations are also good sources of information and help. Through them, the managing relative can get facts from non-competitors