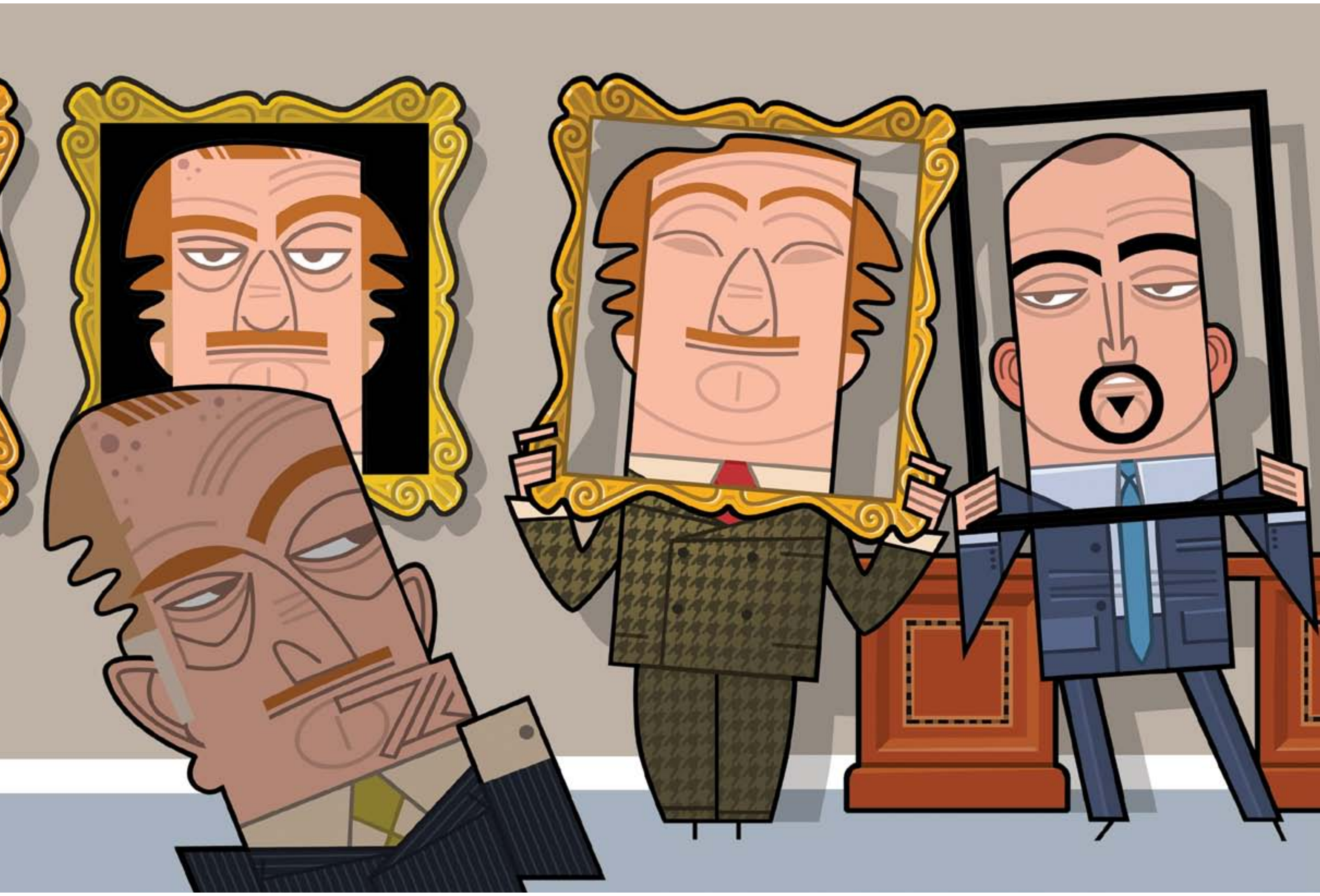


Chief (non-) family officer

More and more family businesses are hiring outside chief executives. *Attracta Mooney* asks whether a family or non-family CEO is better

Illustrations by *David Lyttleton*

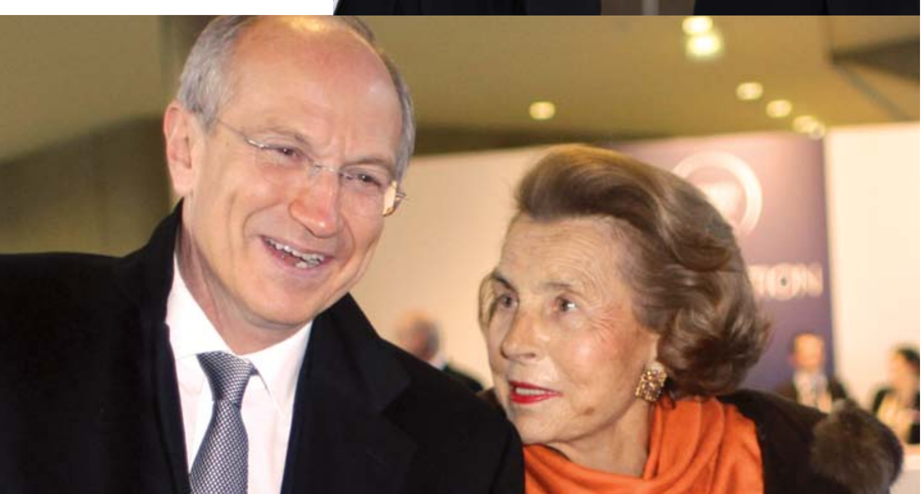
Tempted to promote your son or daughter to the chief executive position? You shouldn't, at least if you believe current research. Family-owned companies with a family member as chief executive are among the worst managed, says a 2012 international study. Another, by British academics at Leeds and Aberdeen Business Schools, found that a company's operating performance increased after a family chief executive left. Yet another found the stock prices of listed family-controlled businesses reacted favourably to the appointment of a non-family chief.

From top: Thomson Reuters president and chief executive James Smith (right) has worked at the company, headed by chairman David Thomson, for over 25 years;

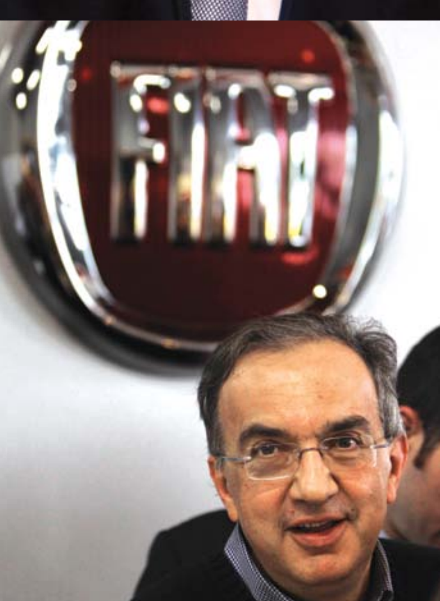
Jean-Paul Agon joined L'Oréal in 1978 and became chief executive in 2006, when family member Liliane Bettencourt sat on the French firm's board;

Non-family CEO Sergio Marchionne is credited with turning around the fortunes of family-owned Fiat

Reuters



Associated Press



Press Association

The reason family-run companies perform badly, says Nicolas Bloom, an associate professor at the Stanford Department of Economics, is simple – family members often don't have the right experience and ability. "Being a CEO of a large firm is hard and highly selective – CEOs are often literally selected from hundreds of employees – and often such a talented and experienced person may not exist amongst the sons and daughters of the current CEO," he says. "The obvious analogy is that none of the eldest sons of the 1966 England World Cup team played for England themselves – while they may have been great football players, they were not great enough to play for England."

Professor John Van Reenen, at the London School of Economics, agrees. "Usually, having a family member, particularly the oldest son or grandson, run a business seems to be a disaster," he says. This is because such children are typically less educated and younger than other chief executives. He adds: "If the son knows he's going to inherit the business, then he has less incentive to work hard at school and university as he knows he'll be boss – this is called the 'Carnegie effect'." The concept is named after the American tycoon who gave away most of his money and left his children to make their own fortunes, amid worries they would have no incentive to succeed themselves.

Even if the eldest son or daughter isn't the heir, a study by Bloom, Van Reenen and colleagues found that having any family member in charge negatively affects the management performance of a company. After looking at thousands of medium-sized companies in 20 countries they concluded that family-owned firms with a family chief have the second-worst form of management out of a list of eight business types, just above founder-owned and run. In contrast, family-owned businesses with a non-family CEO scored well above average. Management was most effective in firms owned by dispersed shareholders. Meanwhile, only 10% of family businesses in Germany – Europe's strongest economy – choose their CEO through primogeniture. This compares to about two-thirds in the UK and France, where growth is currently weaker.

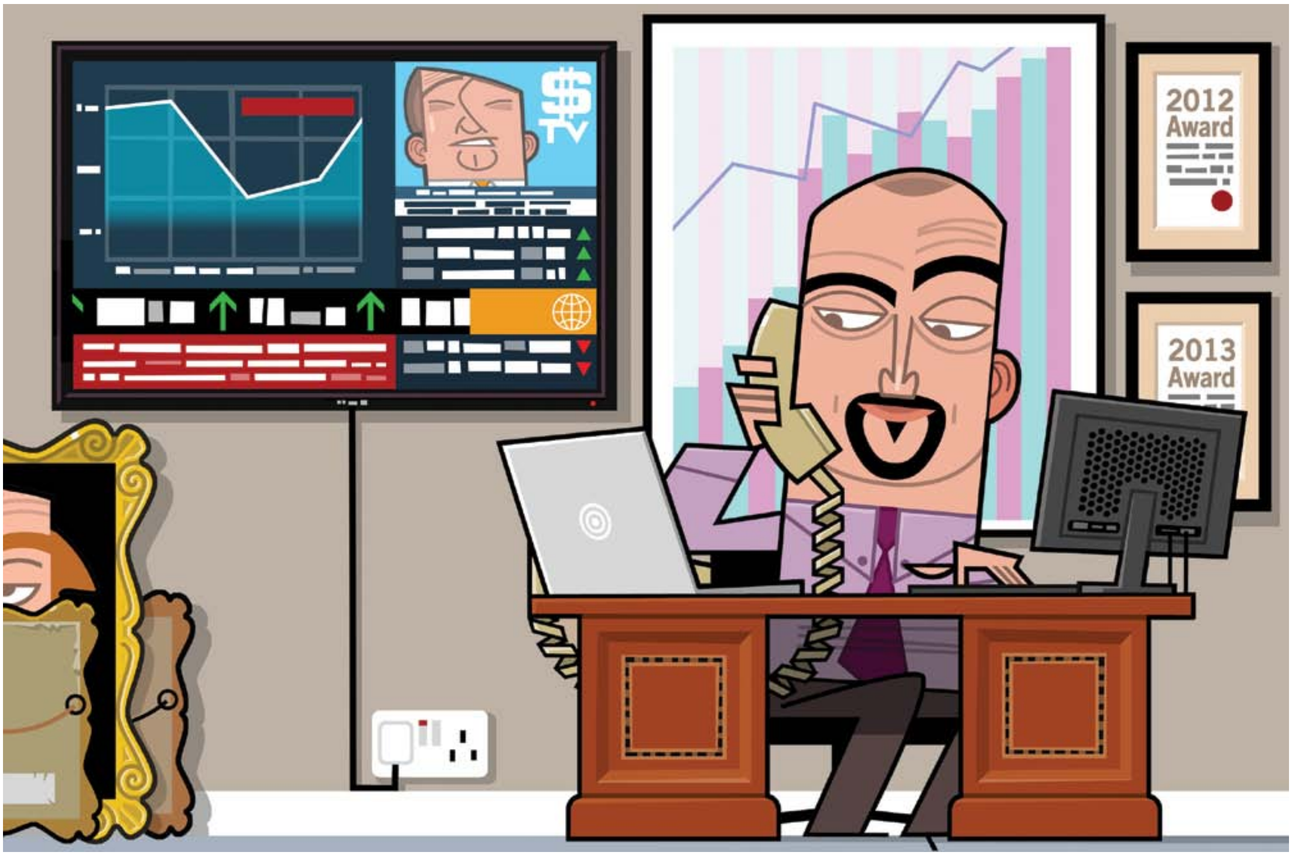
Another problem is that employees can feel they have few prospects. "No matter how hard they work, they'll never get the top role," says Van Reenen. There's also an emotional toll: the family CEO model can "put a lot of pressure on family relationships", leaving the business at risk, says Amy Schuman from the Family Business Consulting Group. All in all, it might be true in some cases a family member is the best person for the job – but it's rare.

"Having a family member, particularly the oldest son or grandson, run a business seems to be a disaster

Many families are also coming to this conclusion and opting for outside management – high-profile names include James Smith at Thomson Reuters, Jean-Paul Agon at L'Oréal, Greg Page at Cargill, Zafer Kurtul at Sabanci Holding, Mike Duke at Walmart and Sergio Marchionne at Fiat. In most cases, non-family chiefs are "brought in when there is a generation gap or a generation transition". It is also common when there is a need for a "dramatic shift in strategy", says Jane Hilburt-Davis, the Family Firm Institute's Global Education Network academic director, such as recently in order to cope with the financial crisis. "The last four or five years have forced the evolution of family businesses," says Clarke Murphy of Russell Reynolds Associates, an executive search firm. In turbulent times non-family chiefs have come into their own.

The evidence is compelling, but many family businesses are reluctant to change to the outside CEO model. Why? Often because families can't imagine a non-family member "being able to fully own and fully express the values" of the business and the family, says Schuman. One solution is to hire non-family employees from within the business. "[Often] there are folks within the family business that grew up with the family who can be tapped and promoted because they get the culture," she says. "Many times it's better to promote from within because they have the family's trust and they understand the values and the culture of the family."

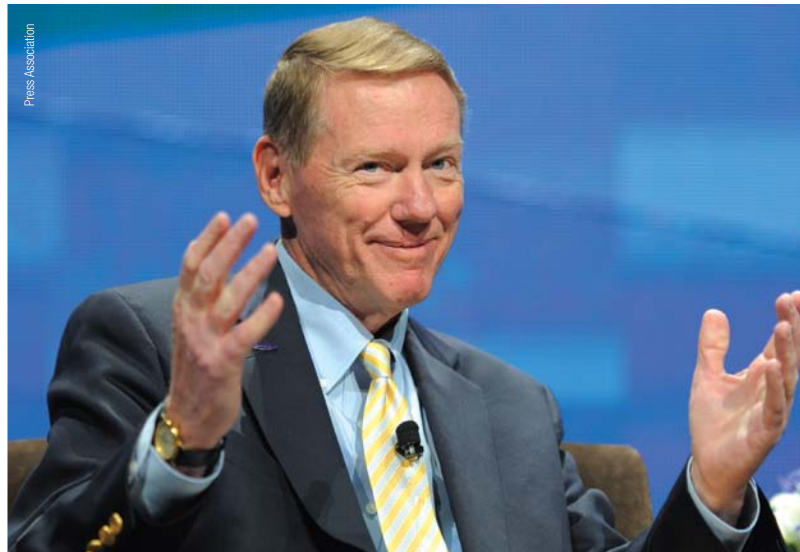
But it's also possible to find external candidates who understand the company's culture and values – it just takes time, says Andrew Wates, the former chairman of British construction company Wates Group. The Wates family first appointed a non-family chief in 2000, after Andrew's brother and cousin decided to retire. At the time, the family "had a review" and felt with the "growing size and complexity of the business", an outside CEO was their best option. "It was quite a laborious process – we took our time and tried to get our thinking right," says Wates. The new

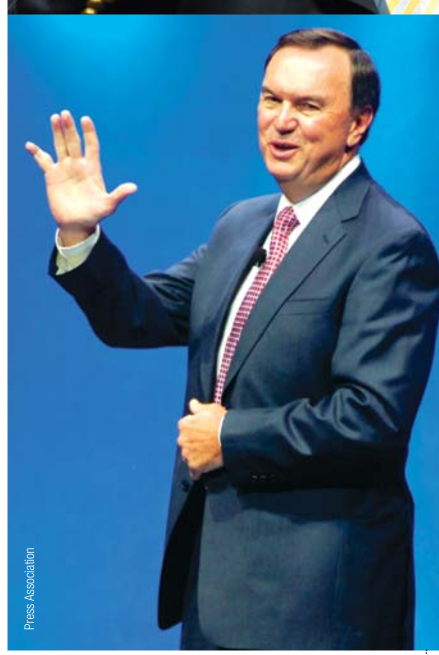


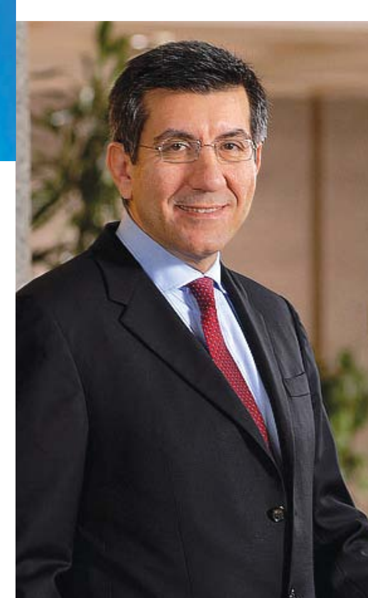
appointment, Struan Robertson, stayed for three years – Wates credits him with stabilising the business, but the family also realised it wanted more of a focus on its values and strengths. "We learnt a lot about how to relate to an outside chief executive," he says.

Families looking to hire a non-family chief need to think very clearly about their values and what they want from the business, says Annika Hall from Sweden's Jönköping International Business School. "Often the owners and their family – especially if they've had a business for a long time – take for granted that they know each other and have the same opinions and want the same things. But that's not necessarily true," says Hall. She adds that getting the relationship to work is "a joint responsibility" between the chief executive and the family. Family members have to discuss what they want, but the CEO must also take time to understand the family's plans. The family also needs to make it clear how and why "they do business" – owners are often unaware that they have a unique way of working until an outsider points it out, says Hall.

Usually, if the relationship isn't working out, the external chief executive will be gone within 12 to 18 months, says Hall. "In the beginning everyone is happy, but then all these challenges start to appear. Unless you start to take that seriously and start to handle them at once, everyone will get frustrated," she says. An example of what happens if the CEO's and family's cultures don't mesh is Bettys & Taylors of







From top: Alan Mulally took a tough stance at Ford from the beginning;

Walmart's chief executive Mike Duke has faced backlash from non-family investors over recent months;

Turkey's Sabanci Holding is headed by non-family Zafer Kurtul

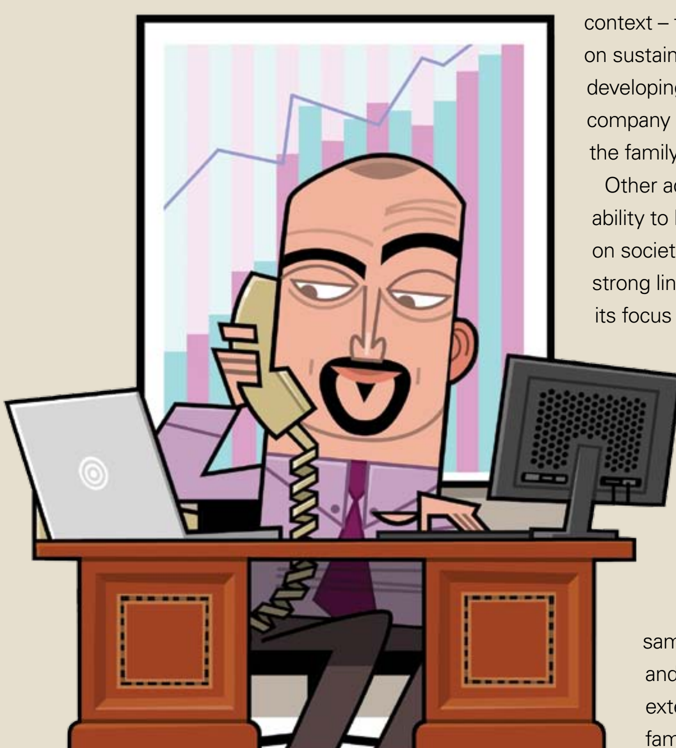
> "Often the owners and their family – especially if they've had a business for a long time – take for granted that they know each other and have the same opinions and want the same things. But that's not necessarily true

Pros and cons

While research shows that non-family chief executives improve management and operating performance, families may also find there are other advantages. "Many of the intra-family disputes can be avoided by having a non-family executive heading the operations," says Kavil Ramachandran from the Indian School of Business. Also, it becomes easier to outline "clear responsibilities for performance while retaining the freedom to hire and fire as per their need, which is not the case with a family member", he adds.

But this works both ways, and a big concern among families appointing a non-family chief is tenure. "While a family member will not run away in the normal course, a non-family executive can leave and look for a different job or profession without much problem," says Ramachandran. But some, like Jørgen Vig Knudstorp, Lego's chief executive, hope to spend the rest of their working life at the company. "I am aware that maybe someday the owners or the board will come up to me and say that they want a fresh pair of eyes. But I hope that doesn't happen. My ambition is to keep reinventing myself because I want to spend my life here," he says.

For chief executives, one of the biggest advantages is the ability to work long-term, says consultant Amy Schuman. Rather than working quarter to quarter, it's generation to generation. This was a big attraction for Wates' chief Paul Drechsler, who had spent 35 years working in non-family firms. "In a family business, certainly in Wates, it's very different in terms of the strategic context – this is very much focused on sustainable business and developing a bigger and better company for the next generation of the family."



Other advantages include the ability to have a lasting impact on society through the family's strong links to communities and its focus on philanthropy, says Drechsler. However, he also admits the advantages and disadvantages depend on the business and the family. "No two family firms are the same, no two families are the same, so the advantages and disadvantages to a great extent are unique to the family," says Drechsler.

"While a family member will not run away in the normal course, a non-family executive can leave and look for a different job or profession without much problem

Harrogate, a British tea and coffee specialist. The company's first non-family chief executive, Andrew Baker, only lasted from April to September 2011. The business said that its "longer-term ambitions and cultural direction" needed a different approach. The family is currently still looking for a new CEO.

At Wates, the family placed more emphasis on its values the second time round. "When it came to recruiting [current chief executive and chairman] Paul Drechsler, we spent a lot more time talking about the family's values and vision. We convinced him that they were good and he convinced us that he believed in them too," says Wates, adding this meant there was a "much stronger base" from the get-go. Drechsler, too, is convinced that values will determine how successful the relationship will be. "If there isn't alignment with values, it's destined to fail," he says.

Aside from shared values and strong business acumen, good people skills are priceless, says Hilburt-Davis. Non-family chiefs are usually appointed at a time of change, so having someone who can communicate effectively with the family, staff, suppliers and customers can make the transition easier, she says. "It is a lot about interpersonal relationships," adds Hall.

A big concern for some candidates applying for chief executive positions in family-owned companies is whether they will genuinely be in charge. "There are still family businesses where the executives don't have the decision-making power," says Murphy. Families need to be prepared to step aside and let the chief executive make their mark, says Hall, adding they need to remember "they want change, otherwise they wouldn't have hired an external CEO". Jørgen Vig Knudstorp, the non-family chief executive of Lego Group, says that although he discusses all major decisions with the Kirk Kristiansen family, the owners trust him to act on behalf of the company. In most cases, families are willing to concede power, says Drechsler, so long as the chief executive develops a strategy "that is consistent with the family's values but has the executive's influence on the vision and direction of the strategy".

Once the strategy is in place, it's a question of hard work, says Alan Mulally, the well-regarded chief executive of family-controlled Ford. "The key for any well-run company, regardless of ownership structure, is to align all the stakeholders around a compelling vision and a comprehensive strategy, and then for everyone to pull together to relentlessly implement the plan," he says.

If the appointment proves unsuccessful, the advice from consultants, family business leaders and academics is to go back to the drawing board, fully discuss the family's values and the skills needed at that time, and then consider all candidates – whether they are family members, employees or outsiders. Don't automatically assume a family or non-family chief is best for your business, says Kavil Ramachandran, from the Indian School of Business. At the end of the day, as Schuman says, "you want to have the very best qualified individual directing your business". FB

"If there isn't alignment with values, it's destined to fail

The businesses that embrace outsiders...

Fiat

Working closely with family member and chairman John Elkann, Sergio Marchionne has managed to turn Italian carmaker Fiat around. In 2006, within two years of taking the helm, he returned the company to profitability. He's also worked his magic on Chrysler – which Fiat majority owns – taking the US automotive group from bankruptcy to profitability. "Family businesses have the capacity to attract great managers, persons of talent and great value," said Elkann last year.

Press Association

Ford

Alan Mulally was named Ford's chief executive in 2006 and took a tough line immediately, leading the firm's restructuring programme called The Way Forward. This included cost-cutting measures, while dividends to shareholders were suspended. It paid off and by 2010 Ford reported a $6.6 billion (€5.21 billion) profit. During the economic downturn in 2008/2009, Ford was the only one of the Detroit Three – Ford, General Motors and Chrysler – not to seek US government funding. Mulally regularly features on top businessmen/chief executive lists.

Press Association

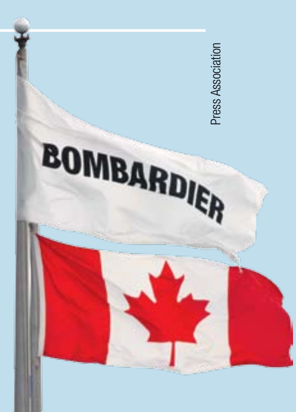
...And the ones that returned to the family model

H&M

In 2009, H&M appointed its first family chief executive in more than 10 years. Karl-Johan Persson took over from non-family Rolf Eriksen, who had headed the business since 2000. Before him, Fabian Månsson was at the helm. But H&M was convinced Persson, the grandson of the founder, was the right man for the job – family or no family – saying he had the "background, qualifications and experience" needed. Under Persson's leadership, sales reached 128.81 billion Swedish kronor (€14.36 billion) in fiscal 2011, up 24% from 104.04 billion Swedish kronor in 2008.

Bombardier

Over the last 25 years, Bombardier, the Canadian train and plane-maker, has made good use of both family and non-family chief executives. Laurent Beaudoin, grandson-in-law of family patriarch Joseph-Armand Bombardier, took the helm in 1979 and later non-family chiefs Robert Brown and Paul Tellier headed the business. Laurent also returned for a brief period in the 2000s, before his son, Pierre Beaudoin, was named chief in 2007. Since taking the helm, revenues have increased by about 23% to $18.3 billion.



Press Association