External managers in family businesses

Recruiting and retaining top managers from outside the family

A joint study by
- Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft
- AvS – International Trusted Advisors GmbH
- Chair of Human Resource Management & Intercultural Leadership, ESCP Europe Business School Berlin

AvS International Trusted Advisors

ESCP Europe Business School

EY Building a better working world

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About the Ernst & Young Family Business Center of Excellence

Successful management of a family business is a balancing act that must reconcile the strategic interests of the family and the business, market forces and the family's objectives.

EY is an organization that focuses on businesses where the key issues are to preserve family traditions and strengthen the company from generation to generation, so we understand the concerns of family businesses and are well able to respond to them.

Our Family Business Center of Excellence – the first of its kind – aims to provide support for family businesses and their owners, no matter where in the world they are based. The Center brings consultants together from many parts of EY's global network to exchange and develop knowledge and experience about the challenges faced by family businesses. The aim: to provide a seamless service for family-led businesses across the globe.

The Ernst & Young Family Business Center of Excellence is based on our tradition of collaboration with private companies and family businesses. The Center coordinates research investments and passes on valuable practical knowledge to our clients.

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About AvS – International Trusted Advisors

AvS – International Trusted Advisors advises company managers and shareholders on key issues of governance and management, critical situations involving radical change and structural and staffing reorientations. AvS focuses on issues related to corporate governance and organizational development, owners' strategies, and mediation in conflicts among shareholders; it also focuses on identifying, analyzing and integrating management staff and appointments to supervisory boards and the evaluation of such bodies.

Our clients are often owners, advisory board chairs or managing directors of companies owned by a limited group of shareholders. Many of these firms are classical family businesses – but they also include portfolio companies or listed groups where an entrepreneurial family has a major influence.

Our work takes the form of customized projects where we work closely with our clients on a level playing field, always focusing on practical implementation. The aims is to create sustainable value and build up long-term relationships underpinned by trust. The human factor is a crucial element of our advisory approach: we support decision-makers as they reach consensus on strategic goals and principles, and as they develop the structures and teams that are needed to attain these goals.

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We are a multinational and multilingual team with our own offices in Frankfurt am Main, Hamburg, Geneva, Zurich, Paris and Bogotá, backed by a network of cooperation partners in Europe, North America, Asia and Australia.

Further information can be found on our website at:
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Andreas von Specht, Founder and Partner
Following his international studies, Andreas von Specht held management positions in family businesses for ten years before becoming a partner at Egon Zehnder. During almost 17 years of consulting work for Zehnder, he was a member of the German management team and he headed the global Consumer & Retail Practice Group from Paris, among other activities. He developed family business support as a personal focus. In 2011, he founded AvS – International Trusted Advisors with the objective of offering support on key governance and management issues to entrepreneurial families in particular. Consultants in several countries assist clients with developing corporate governance structures, owners' strategies and mediation in conflicts among shareholders. His personal focus in mandate work is on succession issues, the assessment of management executives and appointments to supervisory boards. Andreas von Specht himself serves on supervisory boards and, for example, has represented his own family for many years on the Board of Directors of Berenberg Bank in Hamburg.

Authors

About ESCP Europe

ESCP Europe, the world's oldest business school (founded in 1819) has operated its multi-campus model since 1973 with locations in Berlin, London, Madrid, Paris, Turin and Warsaw. With some 4,000 students and 5,000 executives from over 90 nations at its six European campuses, ESCP Europe actively fosters the European concept and turns it into a living reality. ESCP Europe in Berlin enjoys government recognition as an institute of higher education, and is the first business school in the Federal Republic of Germany to obtain recognition by all three major international accreditation agencies – AACSB, AMBA and EFMD (EQUIS) – an accolade known as the "triple crown". This enables it to confer bachelor's and master's degrees, and it also has the right to confer doctorates in Germany.

The institution's success is reflected in the rankings: ESCP Europe regularly occupies top positions in the FT European Business School Ranking.

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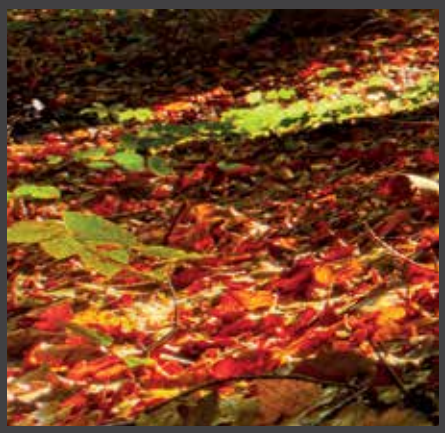

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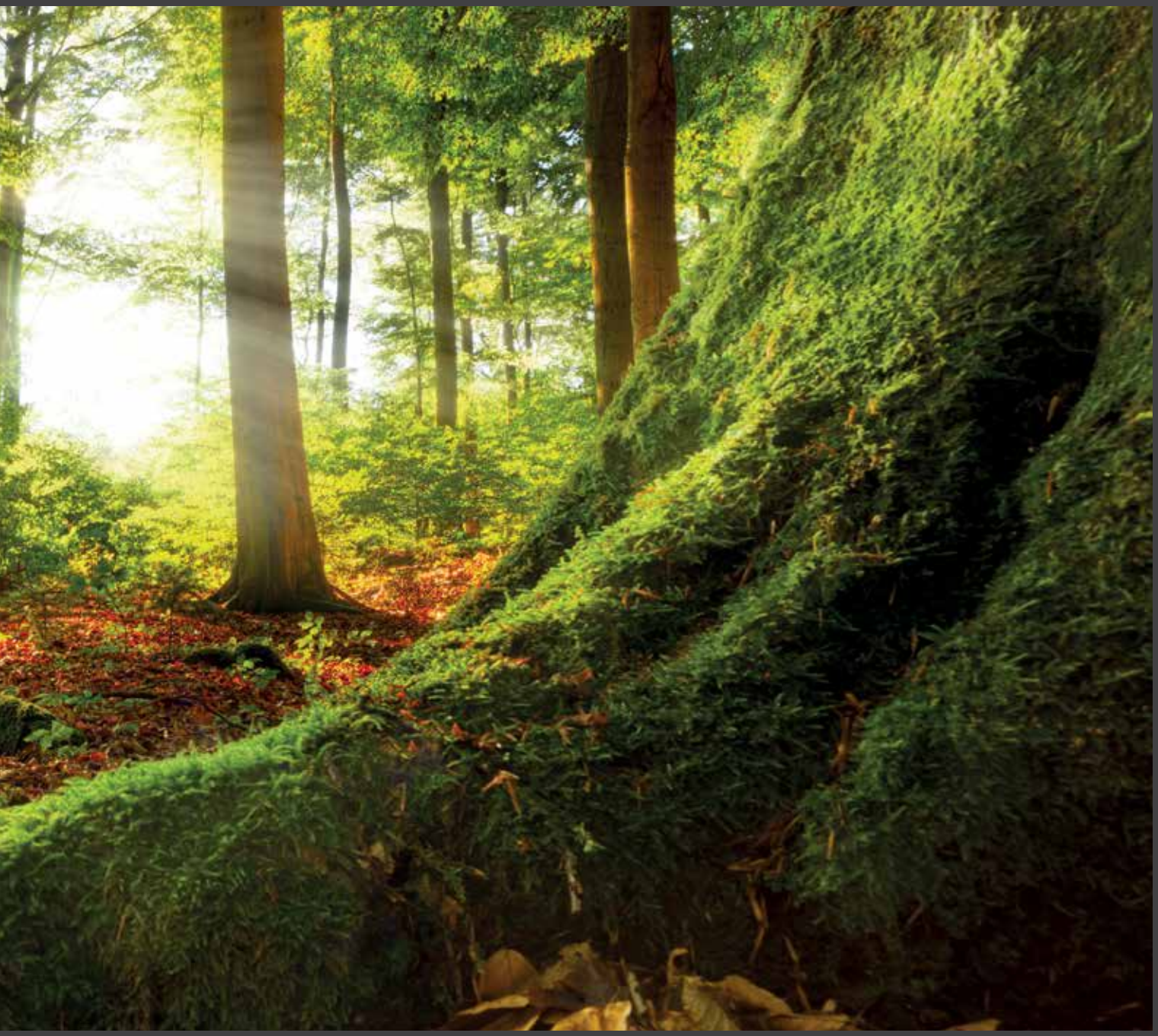


Summary

Most businesses are family businesses. In this context where business, family and ownership are united, there is a special "family business spirit" that manifests itself in the corporate culture, the relationships between owners and external managers, and in the working environment. Family businesses are geared to the long term; they are nevertheless dynamic and entrepreneurial, and they are characterized by a corporate culture of harmonious coexistence. Like their non-family counterparts, family businesses are currently confronting a very diverse range of challenges such as those posed by the advance of globalization and digitization, and the increasing complexity that these trends entail. Suitable top managers are needed in order to overcome these challenges. In most of the world's top 500 family businesses, at least one family member currently plays an active part in the top management team. This situation is likely to change in the future. The results of the GUESS Project[1] show that succession intentions on the part of the next generation of entrepreneurial families have dipped to an all-time low: only 20% of students from entrepreneurial families plan to continue the family business. Even so, there seems to be insufficient awareness of the growing risk caused by this lack of succession. This gap can be closed by a deliberate decision to recruit an external manager as an alternative to family members.

The results of the study titled "External managers in family businesses" show that in this context, family businesses seek not merely employees but "co-entrepreneurs" who are suited to the company and the family – so the aim is to find a good emotional and cultural fit.

The factors that count in making an employer attractive to top managers are, on the one hand, the company's economic potential, challenging assignments and extensive scope for development; and on the other, good family business governance. When it comes to retaining external managers, non-monetary incentives, such as an interesting job, extensive scope for development and a good working atmosphere seem to carry more weight than the level of monetary compensation. The results of the study also show that the family plays the most decisive part in controlling and monitoring external managers. According to the study, the special family business spirit pervades many different areas, providing external managers with a work environment that is interesting as well as challenging.

1 The GUESS Project is an initiative supported by the Ernst & Young Family Business Center of Excellence. GUESS examines the entrepreneurial intentions and activities of students all over the world, and also succession intentions in family businesses.

Key data: target group and survey methodology for the study

The results of this study are based on one qualitative survey and two quantitative surveys.

Qualitative survey

Owners and top managers from outside the family in large family businesses in Germany (7), Austria (3), Switzerland (8) and the Netherlands (2) were questioned during the qualitative survey. The objective of the interviews with owners of family businesses and external managers was to discover how family businesses recruit external managers for their companies, how they select suitable managers and retain them in the company over the long term, and how they exercise appropriate control over such managers.

A total of 20 businesses took part in the study. Except for one company[2], the respective families were the majority owners of the selected family businesses. The companies were relatively large, with annual turnover of between EUR 155 million and EUR 47,500 million, and with 600 to 88,500 employees. Of the 20 family businesses taking part in the study, 15 were managed by managers from outside the family, while five were managed jointly by the owners and external managers.

A total of 33 structured interviews with 13 owners and 20 external managers[3] were conducted in the course of the study.

Quantitative survey I

Additional data was collected from a survey of the top 500 family businesses in the Global Family Business Index. This survey aimed to discover what influence the owning family exerts on the business. For this purpose, respondents were asked whether the family is represented in the top management team or on supervisory boards; they were also asked to state other areas where the family's influence on the company is noticeable, for example, in connection with social commitments or in an advisory board function.

The Global Family Business Index comprises the world's 500 largest family businesses. It was compiled by the Center for Family Business at the University of St. Gallen in cooperation with the Ernst & Young Family Business Center of Excellence. It includes family businesses in Africa (2), the Middle East and North Africa (28), Asia-Pacific (80), Western Europe (227) and Eastern Europe (5), North America (117) and Latin America (41). For this purpose, family businesses were defined as follows: companies where the owning family controls more than 50% of the voting rights if the company is not listed, and more than 32%[4] if the company is listed on a stock exchange. The companies in the index post annual turnover of between EUR 2,000 million and EUR 476,000 million, and they employ up to 2.2 million staff.

2 In this case, the family only owns a 29% stake in the business.

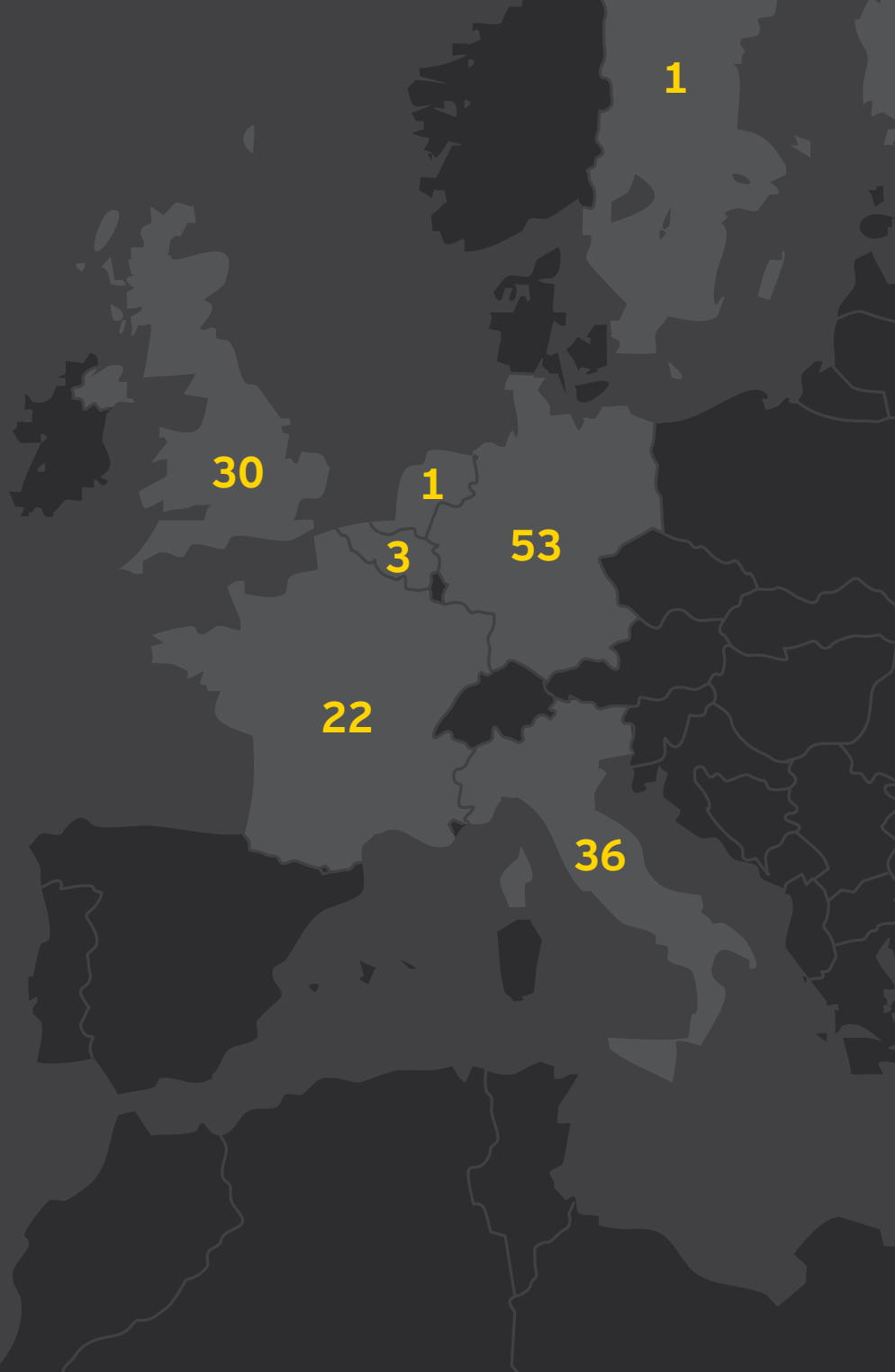
3 Ten CEOs, four CFOs, four board of directors members and two supervisory board or board of directors chairs.

4 This number was set because in OECD countries, it is usually possible to dominate the annual general meeting of a listed company with 30% of the voting rights. This is because on average, only about 60% of the voting rights are represented at the annual general meeting, so 32% is sufficient.

Key data: target group and survey methodology for the study

Quantitative survey II

In a second quantitative survey conducted by telephone, an independent market research institute (Valid Research, Bielefeld) questioned 150 external managers[5] in family businesses throughout Europe. The aims of this survey were to validate the results from the qualitative survey and to discover what challenges will confront family businesses in the future, which financial incentives the family businesses create for external managers, and which instruments they deploy to control their external managers. In this case, family businesses were demarcated according to the definition for the first quantitative survey. Of the 150 external managers surveyed, 144 serve on the management board; four serve on the supervisory board or the board of directors. The study includes family businesses in Germany (53), Italy (36), the UK (30), France (22), Finland (4), Belgium (3), the Netherlands (1) and Sweden (1). The selected companies are large family businesses with 290 to 11,000 employees.



5 39 CEOs, seven CFOs, 98 members of the board of directors, three supervisory board or board of directors chairs and two members (multiple answers were possible; no information was given in two cases)

4

Limitations

The results of the qualitative and quantitative surveys provide good insights into the issues of recruiting and retaining top managers from outside the family. Nevertheless, we would like to point out three major limitations of the study and its design here.

The aim of qualitative research is to explore unknown circumstances in depth. This approach is particularly suitable here because there is as yet no adequate discussion of the issues of recruiting and retaining top managers from outside the family in the practical or academic literature. At first glance, 32 seems a very small number of interviews for the qualitative survey. However, what is known as "theoretical saturation" had been reached here, i.e., the assumption was that additional interviews would not supply any new findings because the results from the individual interviews pointed in the same direction.

Another point that must be mentioned here is the risk that results could be distorted due to self-selection and social desirability. On the one hand, interviewees decided voluntarily to make themselves available for an interview; this could possibly mean that only those companies with few problems or none at all said they were prepared to be interviewed. On the other hand, although an assurance of anonymity was given, it is possible that the interviewees failed to address negative aspects adequately in order to avoid damaging the reputation of the company and the family. As a precaution against these limitations in the study, a consideration of the results by experts with lengthy practical experience of consulting for family businesses is appended after each section.

Experiences from consulting practice

To provide a clear practice-based counterbalance to the potential limitations of the study, the advisors at AvS – International Trusted Advisors have contributed the expertise they have accumulated over the years from advising international family businesses on the issues of succession, evaluation of external managers and governance. Each section therefore concludes with the advisors' own thoughts and comments to complement the results of the study.

6 Mandl, 2008

7 Global Family Business Index 2015

8 cf. Berrone, Cruz and Gomez-Mejia, 2012; Gomez-Mejia, Cruz, Berrone and Castro, 2011.

Introduction

Family businesses – drivers of the economy

Family businesses play a crucial role in Europe's economy. Between 70% and 80% of all companies in Europe are family businesses. They employ 40% to 50% of the workforce and they generate about 40% of all turnover in the private sector.[6] According to the Global Family Business Index, almost one half of the 500 largest family businesses in the world are domiciled in Europe.[7]

What is special about family businesses?

In many family businesses, the family exerts an enormous influence on the company. The survey of the world's top 500 family businesses in the Global Family Business Index reveals that in 73% of businesses, at least one family member is represented in the top management team. In Europe, the proportions of family businesses where this is the case are about 68% for listed companies and 76% for unlisted companies.

> *"We have extremely strong emotional ties with the company and the persons active within it."*
>
> *Florian Rehm, Owner, Jägermeister*

Latin America is the region where the family has the greatest influence. Family members are active in the top management team in 90% of businesses here. But irrespective of whether the family is represented in the top management team, family businesses are often influenced by the family's attitudes and values.

The family's influence – and hence the interaction between ownership, family and company – makes these businesses into something special. Families questioned during the qualitative survey often see the business as more than a mere financial asset. They have emotional ties to the company, they are interested in it, and they talk about the business with enthusiasm. The business offers the family a point of identity, and is more than a mere financial investment. The culture of these companies is shaped by the enormous importance of this "socioemotional wealth" (as it is known) and the strong desire to safeguard it; these factors also create a special working environment.[8]

> *"We have to ensure that we create and maintain an emotional bond between the family and the business – there has to be a 'tingle' factor. All members of the family should be filled with pride when they drive through the city and see the huge company sign, and say: that's our company!"*
>
> *Company A, Owner*

Current challenges

The environment in which businesses operate is complex. Family businesses are confronted by major challenges, starting with the advance of globalization and the resultant increase in competitive pressure; then there are demographic developments that are triggering a shortage of skilled personnel; challenges are also posed by Industry 4.0 and the growth of digitization that it entails. According to our quantitative European survey of 150 external managers, over 50% of family businesses rate the challenges of globalization, foreign economic developments and statutory regulation as significant to very significant. Especially in Germany, the majority of family businesses surveyed appear to take a critical view of the future, highlighting increased complexity in addition to the challenges already mentioned.

A series of challenges within each business also have to be overcome. About half of the family businesses identify development of returns (55%) and company development (49%) as major to very major challenges. Here too, it is evident that a majority of family businesses in Germany see more problems than similar businesses in other countries. For instance, over half of all German family businesses in the random sample consider that major to very major challenges are posed by innovation management (58%), risk management (58%), liquidity and cost control (58%), product development (53%) and capacity utilization (51%). Contrary to expectations, the businesses surveyed in Europe only accord minor to

moderate importance (on average) to the classical family-specific challenges such as relations with external managers, succession, maintaining family unity and the frequent lack of readiness for change. Based on this result, one may ask whether challenges in this area are underestimated. For example, some academic studies[9] suggest that only about one-third of family businesses are passed on to the second generation. Responsibility for this can often be traced to family disputes, which owners and external managers interviewed during the qualitative survey regard as one of the greatest risks for the business.

The importance of external managers

It is essential to have the right managers on board so that the challenges set out above can be tackled successfully. Family members will likely be unable to meet the future demand for junior managers at executive level. This is suggested by the results of the GUESS project titled "Coming home or breaking free? Reloaded – Career choice intentions of the next generation in family businesses"[10]. According to the results of this study, the next generation's motivation to take on the family business has dipped to an all-time low. Thus, barely 20% of all students from entrepreneurial families are prepared in principle to take over the succession of their own businesses. It follows that enormous importance attaches to top managers from outside the family. The larger and more complex the family business is, the more necessary it becomes to fill strategic positions with managers from outside the family, and then to retain them in the business over the long term – especially when there is no family member suited to such responsibilities, and specialist know-how is required.

> *"In companies with 500 or more employees, it certainly makes sense to introduce an external perspective. And it does actually happen that, in many companies, external managers handle the commercial functions such as controlling, finance and accounting. This is done to prevent the firm from stewing in its own juice and permit it to better develop."*
>
> *Dr. Wolfgang Blum, Chairman of the Board, Haberkorn GmbH*

But because of their special characteristics, family businesses are faced with a variety of challenges as well as opportunities when it comes to talent management of external managers. Although this is an important issue, not enough attention has yet been devoted to its theoretical and practical aspects, so there is a need to define the specific challenges and potential solutions.

> *"I took the radical step of installing external management because I wanted the business to be managed very professionally, and separately from family. The children of good entrepreneurs are not necessarily good entrepreneurs themselves. Of course, whether or not things will work better with someone else is always a matter for speculation. In our case, I have to say that it's working very well."*
>
> *Company B, Owner*

9 cf. Molly, Laveren and Deloof, 2010.

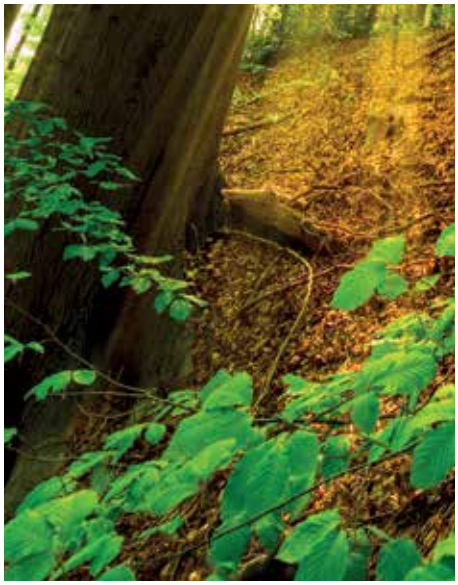
10 cf. Zellweger, Sieger and Englisch, 2016.

The study aims to answer these questions:

1. What are the decisive criteria for the choice of a suitable candidate? What makes family businesses attractive as employers for external managers, and what makes them unattractive? How do family businesses go about seeking and selecting a suitable candidate?

2. Which monetary and non-monetary incentives do family businesses use to retain external managers in the company?

3. Which monitoring and control bodies are present in family businesses? Which instruments are deployed to control external managers so as to ensure that they act in the family's interests?




2

The special family business spirit

a) Family business culture

The special family business spirit is at its most evident in the specific corporate culture of these businesses. This is influenced by the management and the employees but – principally – by the family.

> *"The family is present everywhere to some degree, and I believe most of the people concerned also see this as a very good thing."*
>
> *Owner, Harald Quandt Holding*

In many of the surveyed businesses, the families only exert indirect influence on the company and the management because they are merely represented on supervisory boards and are not operationally active; nevertheless, the attitudes, values and also (in many cases) the nationality of the company's founder and his descendants are reflected in the culture of the family businesses. The outstanding characteristic of this special family business culture is a long-term approach.

> *"As a matter of principle, the family tries to keep future generations in mind. Which means that I'm not really all that interested in what happens this year, next year or in the next three years – but the picture after five or ten years starts to be exciting."*
>
> *Florian Rehm, Owner, Jägermeister*

The primary objective is to hand the company over to the next generation in good condition; for that reason, short-term results are often not so critical. Continuity and stability are characteristic features of family businesses, and this frequently manifests itself in above-average employee seniority. Another feature is the appreciation shown to employees. A sense of solidarity prevails – a feeling of togetherness and a community where the human factor is very prominent.

> *"We create optimal working conditions for our employees in terms of workplace attractiveness, work content, compensation and safety and security. What we mean by that is not only safety at work but also job security."*
>
> *Company C, Manager*

The employees can rely on the company. Working conditions are good, and family businesses generally offer high levels of job security. People treat each other in a cooperative and open way; there is often a sense of family and, as our interviewees explained, the atmosphere is much more personal and not so anonymous or political as in non-family businesses. One sign of this is the use of informal modes of address (e.g., "du" in German) that is common in several businesses in our random sample. Family businesses also offer an entrepreneurial setting. Trust is shown in the employees, responsibility is delegated to them and there is scope for entrepreneurial activity.

> *"In our company, entrepreneurship is present down to the lowest levels. We put a lot of trust in people, and we train them so that they find recognition in the company. This conscious entrepreneurship is very important to us."*
>
> *Company C, Owner*

Rather than mere employees, therefore, family businesses often want "co-entrepreneurs" who tackle issues and make an effort of their own accord.

Although stability and a long-term approach are hallmarks of family businesses, they are also characterized by a degree of dynamism. The surveyed businesses place particular emphasis on their companies' capability of making fast decisions. Flat hierarchies and decentralized decision-making authorities in keeping with "co-entrepreneurship" allow the flexibility that is needed to adapt to changing market conditions.

Another characteristic of the family business culture is the major importance accorded to social responsibility and sustainability. The pronounced sense of responsibility in family businesses is evident not only in relation to employees, but also in dealings with customers and suppliers, and towards society and nature. As well as participating in regional projects, family businesses are also globally involved in social and ecological issues, especially if they operate

internationally. Furthermore, half of all the surveyed family businesses maintain one or more foundations that focus on such concerns.

> *"The owning family was very heavily involved with sustainability even before the word was invented. [...] And it's no coincidence that for six times in a row now, we've been the leading healthcare company in the world in the Dow Jones Sustainability Index. Of course, that's related to the importance our company accords to this issue."*
>
> *Company D, Manager*

Key learning

As the results of the analysis of the interviews show, the corporate culture of family businesses differs from that of non-family businesses. The term we use here is "family business spirit". The corporate culture is shaped principally by the influence of the family; it is characterized by positive aspects such as a long-term approach, entrepreneurship and the ability to make fast decisions, so it can very clearly be used as a competitive advantage. Classical negative aspects ascribed to the corporate culture in family businesses – such as the prevalence of nepotism or paternalism – were not addressed by our interviewees.

Experiences from consulting practice

The shareholder families' status as role models

The family business spirit is the positive side of the coin. But where branches of the family and shareholders are involved in lengthy conflicts that smolder on or become public, there is a substantially increased risk that external top managers will leave or that turnover in these positions will be high. Conversely, family shareholders act as role models by providing stability and good sense, and by advocating values – a function that is very important in retaining external managers. In positive cases, it is the external managers who then adopt and reinforce these cultural and ethical values that make up the family business spirit, integrating them into the operational business.

b) Family business governance

In contrast to the situation in non-family businesses, the governance structure of family businesses (known as family business governance) should consist of two systems: there is classical business or corporate governance on the one hand, and family governance on the other. In a family business, it is necessary not only to regulate the company's affairs but also those of the family – for example, in order to strengthen cohesion among the owners and consensus about a long-term vision for the family business.[11]

Business governance

Classical business governance comprises the top management team, a supervisory body such as the supervisory board or board of directors, and the meeting of shareholders. The top management team is responsible for operational management and is monitored by the supervisory board which is elected by the meeting of shareholders.[12] Good corporate governance calls for strict compliance with these responsibilities. According to the European Commission's Corporate Governance Code, this requires an independent and professional board of directors, foresighted shareholders with a long-term approach, and compliance with the principle of transparency in keeping with the principle of "comply or explain".[13]

Most of the surveyed family businesses take the implementation of good corporate governance very seriously, and they abide by the rules of play. In most of the businesses that took part in the qualitative survey, the family is not actively involved in the top management team but is merely represented on the supervisory board, staying out of operational management or daily business.

> *"Good corporate governance is much more important in a family business than in other companies. If we, as the owning family, act contrary to good corporate governance and assume powers that do not fall to us based on our company's structure and force the board to act in certain ways, then sooner or later we will no longer be able to find any good managers who are prepared to work here. It is really necessary to keep to the rules of play. We need the right people and we need to trust them. It doesn't work if the owning family is constantly interfering."*
>
> *Martin Wentzler, Attorney, Chairman of the Board of Partners of Freudenberg & Co. KG and Chairman of the Supervisory Board of Freudenberg SE*

In many companies, a careful selection process takes place to find suitable family representatives for the position on the supervisory board. This is particularly important so that the family's interests are represented professionally, in keeping with good corporate governance. The results of the survey of the world's top 500 family businesses show that a majority (51%) of them are stock corporations, so the appointment of a supervisory body is required by law.

Companies where a member of the family is allowed to take a position in the management team stress that the same selection criteria apply in this case as for candidates from outside the family, and there is no preferential treatment.

Key learning

Implementation of good corporate governance is especially important for family businesses. This makes it possible to clear up any preconceptions about nepotism or paternalism and preferential treatment for family members in family businesses.

Tip

If the family is not operationally active but nevertheless wishes to influence some of the company's transactions, this can be arranged, for example, by means of a list of transactions that require approval.

11 Koeberle-Schmid, Witt and Fahrion, 2010; Siebels and Knyphausen-Aufsess, 2012; Suess, 2014.

12 Siebels and Knyphausen-Aufsess, 2012; Suess, 2014.

13 European Commission, 2011.

Family governance

Unlike non-family businesses, a family business depends for its survival not only on the company's economic success but also on the family's cohesion and on how it exerts influence on the business.

> *"If families are spread across multiple generations, it's important for them to have a family constitution. Among other things, this should stipulate the precise conditions under which family members can play an active part in management and how a family can control a company if it isn't actively involved in the operational business."*
>
> *Dr. Wolfgang Blum, Chairman of the Board, Haberkorn GmbH*

For this reason, the voluntary system of family governance is extremely important. Commonly used instruments include the shareholders' committee or family council, the partnership agreement/articles of association (or the family constitution), regular family gatherings and events, or the family office. The purpose of family governance is to organize the family's affairs (mainly in the entrepreneurial context), to strengthen its unity and to focus its interests.[14]

This becomes particularly important as the size of the family increases and the ownership structure becomes more complex.

Most of the interviewed family businesses have recognized this need, and they make use of family governance instruments. Most frequently, contractual arrangements such as a partnership agreement/articles of association, a family charter or a family constitution are used to regulate and define the family's interests and concerns. For example, these contractual agreements include the family's fundamental values; they stipulate whether and how family members can become involved in the business, and they specify any age limits that may apply to positions, arrangements relating to matrimonial contracts and inheritance law, options for withdrawing, or the transfer of shares.

There are only a few cases where the family has a shareholders' committee or family council in place to focus its interests. Likewise, only very infrequent use is made of advisory boards that draw on their experience or expertise to perform a consulting function.

On the other hand, the majority of the interviewed families exchange ideas and experience regularly at meetings or events, thereby strengthening family unity. These exchanges range from informal family meetings to fixed sessions with the top management team at regular intervals. At such meetings, for instance, the family is briefed on the company, its business success or future projects. In many companies, the next generation is also included in such events so that they can be introduced to the subject of the family business.

Fewer than half of the family businesses that were interviewed maintain some sort of family office that deals mainly with the family's assets and ensures the separation between private and business assets.

Key learning

There is still some scope for developing family governance in several of the businesses that were examined. However, all family businesses should be aware of its importance because the family is – and will remain – one of the greatest risk factors for a family business. Developing suitable instruments for family governance can help to resolve conflicts of interest and avert disputes.

14 cf. Koeberle-Schmid et al., 2010. The literature also mentions other instruments such as family philanthropy, family education and conflict management systems.

Tips

- The instruments deployed for family governance must be matched to the family's needs, and their benefits must be subject to regular review.
- Family and business governance must be coordinated so that no overlaps occur.
- It makes sense to set up a shareholders' committee or family council in order to strengthen family unity.
- "Putting all your eggs in one basket" should be avoided, and a separation should be made between private and business assets.

Experiences from consulting practice

"Family business governance"
Outstanding candidates from the market take a very detailed look at corporate governance in family businesses, and they make it a condition of their long-term service with the company. The greater the dependency on pure goodwill, "grace and favor" and the emotional stability of individual shareholders, the greater will be the risk as seen from the perspective of external managers. Family businesses that have not defined their internal constitution and rules of play for shareholders, support and control, etc. (in keeping with professional family business governance) are less attractive when a long-term (or even lifelong) decision is being considered.

c) External managers in family businesses

The particular combination of business, family and ownership – and the great importance of socioemotional wealth[15] that bonds the owning family to its company – results in a very special relationship between the family and the manager from outside the family. Trust plays a crucial part in this relationship. The family hands over responsibility for the business – for its property, which means more to the family than its purely financial value – to the external manager. This frequently involves emotions, and these are reflected in the relationship between the two parties. According to our interviewees, this relationship is shaped by the profound trust that the family places in the external manager. The relationship is often personal and is characterized by open and honest relations between the parties. Interviewees describe these as amicable, close, trusting and respectful, or as a relationship of partners. Collaboration between the two parties is organized as follows: there are regular exchanges between the family and the external manager when the family is briefed on business results, strategic issues and future transactions. In most businesses, this exchange takes place several times a year or once a month. There are only a very few companies where it takes place every week. The external manager takes on the active role here, driving issues that are then approved by the family (usually on the basis of its governance position). But almost all the surveyed owners reserve decision-making powers on important matters, such as the strategic orientation of the company, major investments or personnel issues relating to top management.

> *"In a family company, there is always the unwritten rule that the company management must carry all family members along with it, regardless of the size of their stake in the company. If even a small proportion of the family members are not in agreement, this can poison the atmosphere. In everything they do, external managers have to make sure they have the owners on their side. This creates an interdependent relationship, which in turn requires a close and trusting cooperation between the board and the shareholders' committee. This is demonstrated in our trust-based culture: as the owning family, we have to trust that the company's management will operate within these limits, and will not embark on any adventures. And for its part, the company management must also trust that the family will support them in what they are doing, and not keep constantly interfering."*
>
> *Martin Wentzler, Attorney, Chairman of the Board of Partners of Freudenberg & Co. KG and Chairman of the Supervisory Board of Freudenberg SE*

> *"On very important strategic issues, the family has the last word. If the family says 'no, we don't want it' – then the issue is closed."*
>
> *Company E, Manager*

Challenges arise for the external manager in the course of collaboration with the family if the family is not in agreement, and the manager must attempt to accommodate the differing expectations of the family members. Implementation of appropriate family governance is critical in order to avoid such situations.

Key learning

All in all, the relationship between the owning family and the external manager is a special one in which trust plays a major part. In many cases, however, the family reserves the power to make decisions on specific matters.

15 "Socioemotional wealth" is the non-monetary value of a business for its owner. cf. Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson and Moyano-Fuentes, 2007.

Experiences from consulting practice

Communication as the key to success

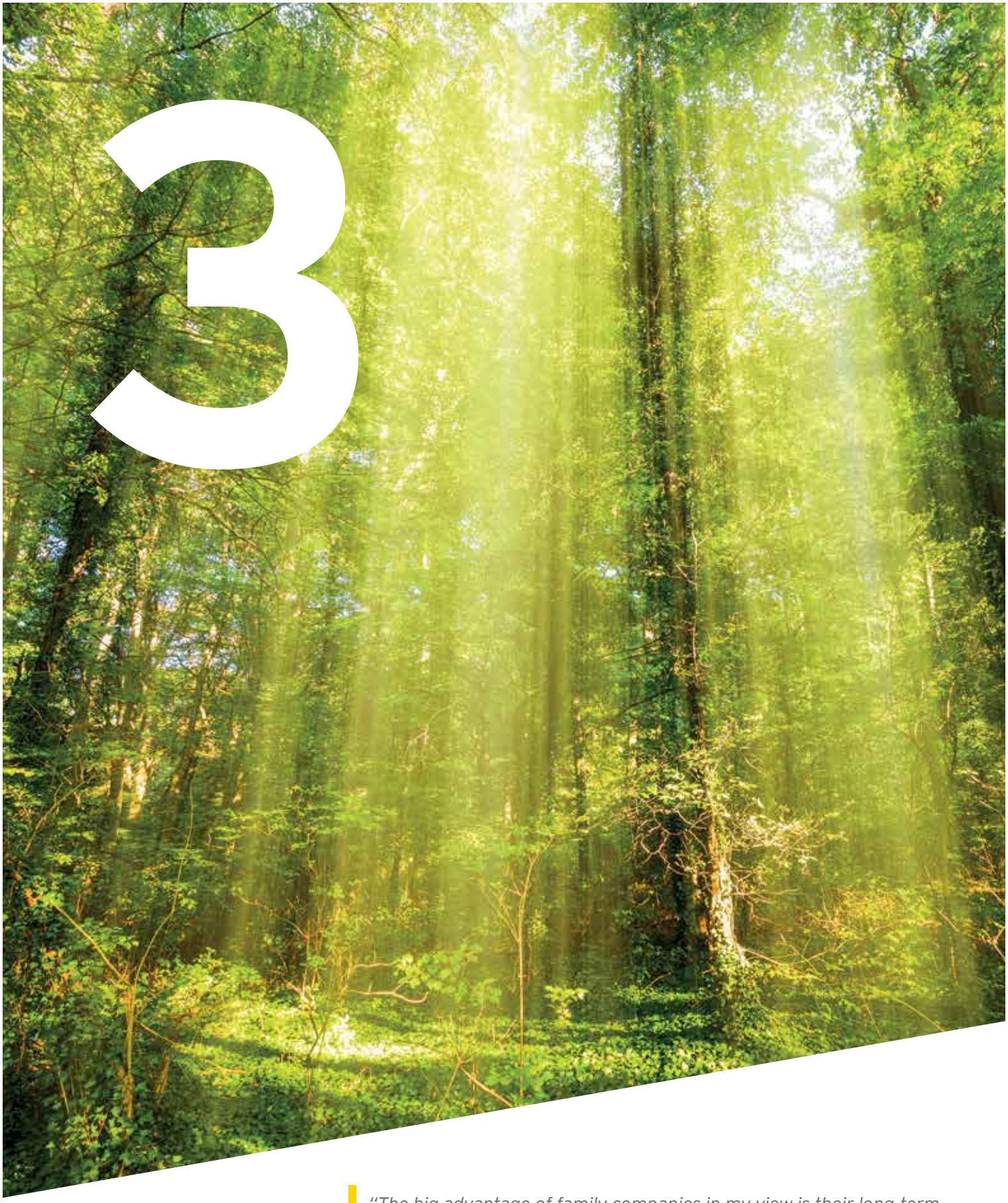
"Communication" – regular exchanges and reports by the external managers to the shareholder(s) – is fundamentally important in a very large number of family businesses. In this regard, there are critical obligations to obtain and provide information, and the very survival of external managers can depend on following these rules of play (which, in some cases, are unwritten).

Listed family businesses – "the best of both worlds"

External managers consider that the most professional family businesses are usually listed companies where, for example, the families hold a majority of shares in the company, so they have greater influence.

The "best of both worlds" can be found here – professional control and governance structures that are regulated by law, combined with the influence of the family, which often stands for the long-term mindset, predictability and consistency, etc. in the orientation (as opposed to quarter-by-quarter thinking).

3



"The big advantage of family companies in my view is their long-term perspective, the emotional attachment to the company, and the great ability to embrace people. But you have to be willing and able to handle and adapt to the downside of a sometimes emotional environment. I personally like it!"

Juergen Steinemann, former CEO of Barry Callebaut

Recruiting external managers

a) Challenges and opportunities

The special family business spirit throws up challenges as well as opportunities for family businesses when it comes to recruiting suitable external managers for top management positions. It is most important for family businesses to know the criteria that top managers apply when selecting an employer.

A challenge is posed by the negative aspects that are often associated with family businesses. Interviewees in the study regard the family as one of the greatest risks. It has emotional ties with the business that can impact decisions about the company and, in some cases, may hamper rational behavior.

If, in addition, no suitable governance structures are in place in the company or if they are not consistently implemented, further risks will arise. For instance, family members could interfere in the company's operational business, even if they are not actually authorized to do so. Disagreements within the family cannot be cleared up and they have a negative impact on the business, or family members may receive preferential treatment that is not justified. All of these factors can deter suitable top managers from working in a family business.

Moreover, some of the surveyed family businesses see even more challenges in recruiting external managers – due, for example, to an unattractive location, a shortage of specialized manpower or the low awareness levels of many family businesses and their advantages.

Even so, the special features of family businesses are not only a source of challenges; there are also opportunities that such businesses can exploit when recruiting top managers from outside the family.

One of the key positive aspects is that the surveyed external managers want a corporate culture of the sort that prevails in family businesses: one with a long-term approach, fast and clear decision-making processes and an entrepreneurial setting. The interviewees also consider it important to be able to identify with the corporate values and feel comfortable: in other words, there should be an emotional and cultural fit between the family, the business and the external manager. Furthermore, the surveyed external managers value the ability to tackle an exciting job where they see scope for development and can overcome challenges. The company and/or the product or brand should be interesting, should be crowned with success and – even more importantly – should have potential. Finally, good corporate governance should prevail in the company in order to minimize the potential risks in a family business as set out above. Some of the surveyed external managers also explicitly emphasize that the company should be a family business and not a major corporation.

> *"I based my choice of employer on three criteria: the company, its potential, and the people on the governing bodies – because I was certain that I wanted something where I feel comfortable."*
>
> *External Manager, Jägermeister*

Key learning

The corporate culture of the surveyed family businesses offers opportunities for recruiting suitable top managers from outside the family.

The particular features of family businesses are to be found in the special family business spirit; they often have strong brands, and they offer their external managers scope for influence and development in their entrepreneurial setting. This means that there are many overlaps with top managers' search criteria when choosing a suitable company.

Experiences from consulting practice

Potential concerns about family businesses on the part of external managers

"Hidden agendas"
There is fear of the hidden agendas that occur relatively often with/between shareholders – and also of a very widespread lack of transparency. External managers' experiences show that family businesses are far more difficult to understand from outside; also, family entrepreneurs very often fail to disclose existing problems, and in particular, the company's true economic situation. In very large numbers of family businesses, there are concealed or even open conflicts that can have a substantial impact on management. In the worst-case scenario, decisions are no longer made – or they may even be deliberately neglected or blocked.

Irrational, erratic behavior of family shareholders
Many family entrepreneurs and shareholders do not have or use any means of calibrating themselves. They do not "report" to anyone; they are not accountable to any board or body – and as time goes on, they risk slipping into behavior that is high-handed, irrational and difficult for others to tolerate. Some families/shareholders behave among themselves like "spoiled kids"; they lord it over the employees and/or argue with one another. Family shareholders often have a very narrow interpretation of what must be disclosed and approved, what should and should not be said, etc.

Lack of consistency
In some family businesses, employees who fail to perform as expected are inadequately sanctioned (or not sanctioned at all), due to a misconceived sense of protection , a desire for harmony, or similar reasons; business carries on as usual and things are left as they are. Promotions tend to be based on age or seniority rather than performance. The result is a loss of courage, entrepreneurial spirit (especially at downstream levels) and individual responsibility.

The hopes and positive expectations that external managers associate with family businesses

Long-term mindset and behavior
Foresighted entrepreneurship (with a horizon of decades) – rather than thinking from one quarter to the next – makes it possible to pursue and implement a long-term strategy, even if there are setbacks from time to time. Stable, consistent thinking and behavior that does not depend on quarterly developments can be seen in many successful family businesses.

Flat hierarchies, short pathways
One particularly attractive feature of many family businesses – in total contrast to major corporations – is that organizational structures are generally flatter, with fewer decision-makers and much greater speed, adaptability and scope for action. When a small number of owners display boldness and hold decision-making powers, actions can be taken far more quickly and consistently, leading to benefits such as enhanced innovation.

The special family business spirit
Many external managers expect family businesses to offer value-based cultures, a distinctly stronger focus on people and employees, and no anonymity; unlike major corporations, family businesses have no "gray men" or "hired guns" who do not shoulder long-term responsibility for their behavior and decisions, or who even act in largely political or opportunistic ways. Quite the opposite is true: in these businesses, families often put their names at stake in the outside world – and they make sure that the special family business spirit prevails within the company.

Tips

- Family businesses should exploit the strengths of their corporate culture and project them to the outside world as part of their employer branding, so that they can recruit external managers.
- Also, an appropriate family business governance structure should be present and should be consistently implemented in the company, so that working relationships are made easier, and the company becomes more attractive as an employer.

We have clearly defined

the criteria that family businesses must meet in order to be attractive employers for top managers; the question now arises as to the criteria that family businesses apply when selecting suitable external managers.

b) Selection criteria: the cultural and emotional fit must be right

The socioemotional wealth that bonds families to their businesses shapes relations between the family and the external manager, creating a very special relationship in which trust plays a major part. Figuratively speaking, the family places its business in the hands of an outsider – and the family must trust that this individual will act professionally, and in its interests.

This situation also shapes the criteria that a candidate must meet for a position in the top management of a family business.

> *"It's not just a matter of specialist knowledge or management skills – the right 'chemistry' must also be there. In case of doubt, I think more emphasis is placed on human factors, or the attitude to the world of work, than on purely technical aspects. When deciding between two candidates who are relatively similar and comparable, one is more likely to ask 'Who is more loyal? Who will make the greater personal contribution?' instead of asking who is the better candidate in technical terms."*
>
> *Company F, Manager*

Specialist skills such as qualifications and know-how, experience in the sector, leadership skills and (in rare cases, according to the interviewees) prior experience in a family business are regarded as fundamental requirements. Social and personal skills are no less important and in several family businesses, they are actually decisive factors.

Accordingly, there should be an emotional and cultural fit between the family, the business and the managers – and this requirement is also expressed by top managers themselves. This means that the parties should understand each other well, and the values, standards and behavior patterns of the family (and therefore the company) should be shared by the external manager.

> *"Professional qualifications, sound training, experience, leadership abilities – all of these are important. But it is also necessary to have a good sense of the requirements of the family shareholders and the ability to deal diplomatically with people who don't only think in rational ways."*
>
> *Company C, Manager*

He should also have good social skills. As some interviewees explain, an external manager needs instinctive tact when dealing with the family; he must be trustful and loyal, and must also have the human touch. Co-entrepreneurship is another aspect.

An external manager ought to behave like an entrepreneur. He should show commitment and lead the company with passion. Some interviewees also think that it is important for him to fit in with the management team.

Key learning

The selection criteria for a top management candidate are slightly different from those that apply in non-family businesses. Trust plays a key part here, which is why high priority is given to an emotional and cultural fit between the family, the business and the external manager. Furthermore, family businesses want co-entrepreneurs rather than mere employees.

Experiences from consulting practice

External managers' ability to cope with families

If no suitable candidate is available in the family, a search is mounted for successors from outside the family: either among individuals already working in the business or on the open market. In contrast to the results of the study, lengthy experience of advising family businesses shows that skills such as the ability to deal with medium-sized enterprises or families, as well as previous experience of family businesses, etc. seem to be central. Many family businesses stress that the emotional and cultural fit is especially important. However, it seems that numerous external managers are not really able to understand – let alone accept – the owning family's special values and objectives.

c) Search and selection process

One critical factor in the success of a family business is the selection of suitable external managers for strategic positions – most often because family members in some of the surveyed family businesses are not allowed to be actively involved in the operation of their own companies, because they have no interest in doing so, or because they are not suitable for such positions.

There are two possible ways of finding a suitable non-family manager to fill a top management position: the family either recruits someone from its own company to take such a position, or they look for a suitable manager from outside the family on the external labor market. Several of the surveyed family businesses explicitly stress that they prefer junior management to be developed within the company. This makes it possible to build up trust in advance, and the individual to whom they are entrusting their own business is already known to them.

> *"We draw on our own resources wherever we can. If that's not possible, we of course resort to external support, preferably those we can watch for some time before handing over the relevant responsibility to them."*
>
> *Company G, Owner*

Also, internal candidates are familiar with the company and its values. Internal recruitment of managers for strategic positions in the company greatly minimizes the risk of making an incorrect choice as regards the emotional or cultural fit. But in most cases, the surveyed family businesses were unable to find suitable candidates within the company, so someone suitable had to be recruited from outside. Cases where this can be done through friends and acquaintances or business relationships are rare. The most frequent solution is therefore to engage headhunting companies to find a suitable external manager for the business.

> *"In our company, there is a committee for personnel matters, the Nominations and Compensation Committee, which first creates a search profile. We then contact a headhunter we trust to begin the usual processes with the long list, short list, interviews, references, and performance and media checks, which are becoming ever more intensive in today's social media environment."*
>
> *Dr. Andreas Jacobs, Barry Callebaut, Chairman of the Board of Directors, representative and member of the owning family*

Once candidates have been identified, the family, top management, the supervisory board, various committees and sometimes external advisors are involved in the selection process. The candidates are examined in more depth at this stage, and several interviews take place with the individuals involved. In most case, the family only steps in at the end of this process after a shortlist has been drawn up, and they usually have several interviews with the remaining candidates. These may be conducted very formally or they may be of an informal nature – for example, dinner together followed by a visit to a bar, or getting to know the external manager's family during a home visit. The important point is that the family gets to know the potential external manager to some extent so that they can assess whether he fits in with the company, the family and its values. Usually, therefore, the final decision for or against a candidate is left up to the family. The entire process of seeking and selecting a suitable external manager normally takes six months.

Onboarding – the subsequent process of the external manager's start in the company – is very unstructured in most of the surveyed family businesses. There is often an overlap with the manager's predecessor. This makes it easier for the external manager to get acquainted with the company and his responsibilities. Some companies enable their external managers to undergo a very intensive onboarding process. One interesting example of this is provided by a major chain store that gave its new CFO the

chance to get to know the business from the bottom up. Instead of spending the first month in his new position going over the books at his desk, the CFO spent time in the logistics section and individual branches so he could get to know and understand the corporate culture, the brand and the individual processes.

> *"In the end, it comes down to a gut decision, in which the candidate's social skills and values play a big role. We gain a clearer picture after seeing a candidate four or five times. I think that's important, too. With each conversation, we make progress and get to know the person better. This assures me that we share more or less the same values."*
>
> *Company C, Owner*

Only a very small number of businesses view support with the onboarding process for a new external manager as not relevant. A suitable program that is tailored to the company concerned can make it easier for the external manager to start out in the business.

> *"I implemented an onboarding process for the new member of our management board, because I felt that this could have helped me as well. I also think it could be helpful at different levels – even senior managers could benefit from a formal onboarding process."*
>
> *Dr. Mohsen Sohi, Speaker of the Management Board, Freudenberg SE*

For example, steps can be taken so that external managers can get to know the key players in the company ahead of time, giving them insights into the corporate culture and the company's values.

Key learning

Certain businesses prefer to develop candidates for strategic positions within the company. In many cases, however, this is impossible, and external managers have to be recruited from outside, usually with the assistance of headhunters. The final decision is then usually left up to the family. The subsequent onboarding process is unstructured in most cases.

Tips

- The search and selection process ought to focus on selection criteria that are specific to family businesses. The emotional and cultural fit is crucial here!
- As part of its talent management system, the company should set up a talent pool so that potential internal and external candidates can be identified, observed and (when appropriate) developed at an early stage.
- An onboarding process tailored to the business is better than it is made out to be; such processes make it easier for external managers to start out in a family business.

Experiences from consulting practice

Prioritization of candidates from the family
In the initial stages, succession candidates from within the family are usually given first priority provided that they are viewed as "suitable" and "adequately experienced". But there are two problem areas here: a) Growing numbers of succession candidates from the (family's) own ranks are refusing to enter their own family businesses on a permanent basis.[16] b) Even if they are prepared to do so, there is uncertainty as regards the definition and evaluation of "suitability" and "adequate experience". In Germany, it is estimated that fewer than half of family businesses can arrange their succession from their own ranks – and the downward trend is set to continue!

The importance of integration, and how it can be supported
Whether or not there is a successful "fit" between external managers and family businesses often becomes clear after only a few months. Many family businesses have been dissatisfied after employing external managers in their management team, especially when doing so for the first time. In many cases, the appointment was not preceded by intensive discussions or interactions with the company or the appointee. In family businesses, moreover, there are also special disruptive emotions and sensitivities that would not immediately lead to a conflict in a major corporation if they surfaced in the same way. (Examples include choosing an excessively large company car or over-luxurious office fittings, or an external manager who presents himself to the outside world in a way that is perceived as "over-confident".) Genuinely active integration of the external manager into the company with support from the shareholders does not usually take place.

16 cf. Zellweger et al., 2016.

4

Family businesses seem to be very successful at retaining external managers at their companies over the long term. One interesting example of this is supplied by an international manufacturer of technical components. Unlike many of their counterparts in non-family businesses, its top managers have held positions in the company for decades; seniority of employees at top management level is between 20 and 40 years. The average seniority of employees in the surveyed family businesses is also very long, according to interviewees' assessments. The incentives that are used seem to be effective.

Retaining external managers

a) Monetary incentives

Monetary incentives play a major part in retaining managers from outside the family within the company; examples include compensation or the option of acquiring a stake in the company.

The frequently heard opinion that compensation for top managers in family businesses is lower than in non-family businesses is apparently not true. For example, a study dating from 2010 shows that the total compensation for top managers in German family businesses is 35% lower than in non-family businesses. However, this is because these companies are smaller. If this factor is taken into account, there are apparently no major differences in per capita compensation for top managers.[17]

> *"At the management board level and the level immediately below, we determine compensation based on comparative studies. If the compensation is too low, we at Freudenberg notice this relatively quickly, as we no longer attract talent."*
>
> *Martin Wentzler, Attorney, Chairman of the Board of Partners of Freudenberg & Co. KG and Chairman of the Supervisory Board of Freudenberg SE*

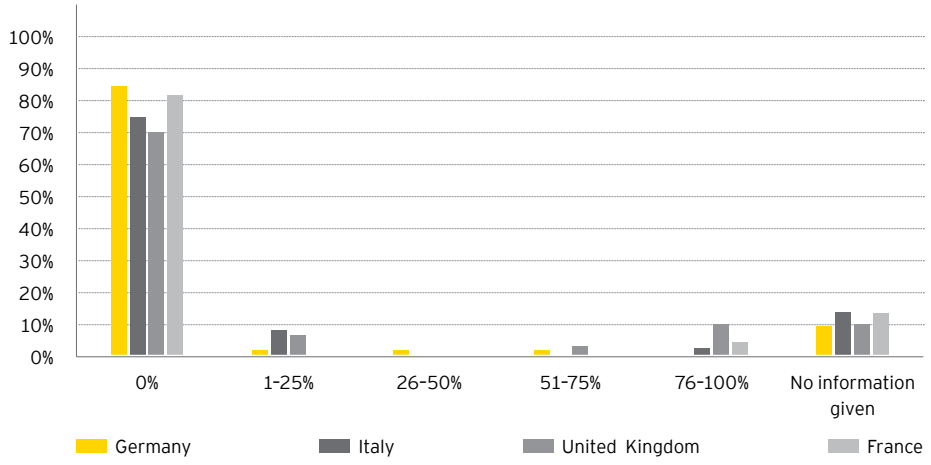
This is also confirmed by the results of this study. In the surveyed family businesses, compensation levels are very evenly balanced below or slightly above market levels, so – as several interviewees also emphasized – compensation does not appear to be a decisive factor in retaining external managers over the long term.

Compensation for top managers usually comprises a fixed and a variable component; in family businesses, higher priority is given to the fixed component (at least in Germany).[18]

The results of the quantitative survey show that the fixed salary accounts for a relatively high proportion of external managers' compensation in many European countries. For the family businesses surveyed in Europe, for instance, the proportion of fixed compensation averages about 81%. If we consider companies that offer no variable compensation at all to their external managers and pay 100% fixed salaries, minor differences are apparent between individual countries. The list is headed by Italian family businesses (58%), followed by those in the UK (40%), Germany and France (36% each).

The proportion of variable compensation for external managers averages about 19%. The respective percentages for short-term and long-term variable compensation make for interesting reading. Although the long-term orientation of family businesses is a defining characteristic of the family business culture, it is surprising that this is not reflected in the variable compensation for external managers. Only 6% of the surveyed European family businesses use

Fig. 1: Proportion of long-term variable compensation



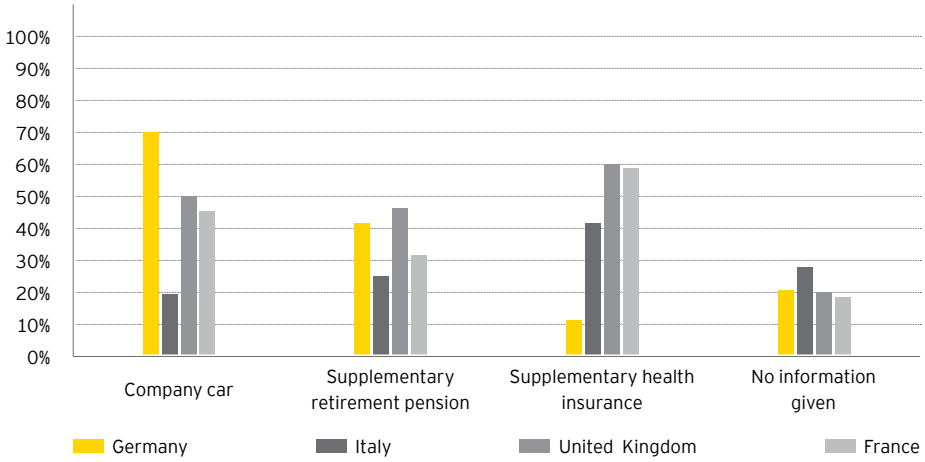
17 Achleitner, Rapp, Schaller and Wolff, 2010.

18 Achleitner et al., 2010.

long-term variable compensation components. Figure 1 shows the ratio of long-term variable compensation to total compensation for external managers in Germany, Italy, the UK and France. It can be seen that most family businesses in these countries do not make use of long-term compensation components for external managers.

In many cases, external managers in family businesses receive benefits in addition to fixed and variable compensation. For instance, over half of the external managers in European family businesses have a company car. On the other hand, only a little more than one-third of managers from outside the family benefit from occupational retirement pensions or supplementary health insurance. The country rankings reveal a varied picture (see Figure 2). In Germany, it is more or less usual practice for external managers to be given a company car (70%), whereas in Italy, for example, it is quite rare (19%). There are also differences among the various countries as regards occupational retirement pensions. In this regard, it emerges that German and British family businesses provide occupational retirement pensions for their external managers more frequently than their Italian and French counterparts. Supplementary health insurance benefits also vary substantially. In France (59%) and the UK (60%), about two-thirds of external managers receive supplementary health insurance from their companies; but in Italy, not even half of them (42%) receive this benefit, and in Germany, the figure is only about one in ten (11%). To some extent, the differences are due to the different structures of the healthcare systems in these countries.[19]

Fig. 2: Benefits: country rankings



Another monetary incentive used to retain external managers over the long term is the option of acquiring a stake in the family business. Possibilities for this range from employee loans in the form of profit-sharing rights to silent participations, virtual stock options or employee shares; they may even include the acquisition of shares in the business with the associated rights of information, control and co-determination. These options can be structured according to the company's requirements.

If external managers acquire a stake in the business, they may feel a stronger emotional bond with the company and adopt a longer-term perspective. Nevertheless, the majority of family businesses surveyed in Europe do not choose this method to retain external managers over the long term. Only 18% of the surveyed family businesses enable their external managers to acquire a direct stake in the company, and 14% allow limited or indirect participation in the company.

19 cf. Bjornberg, 2015; Federal Agency for Civic Education (FACE), 2016.

Fig. 3: Possibilities of acquiring a stake – international average

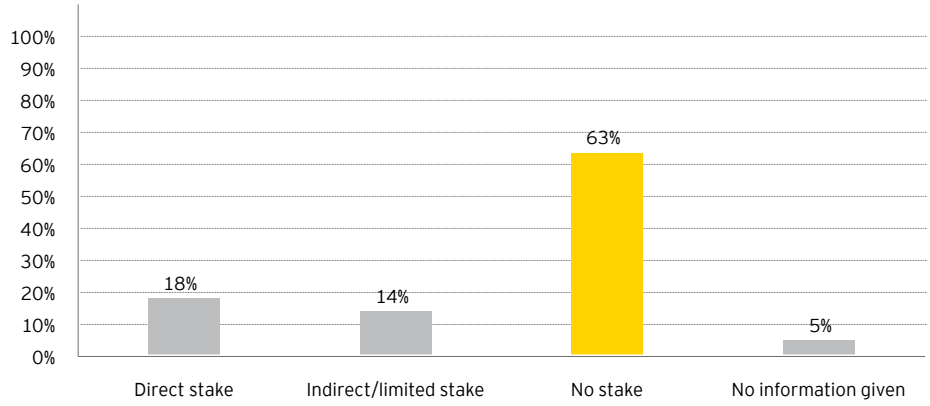
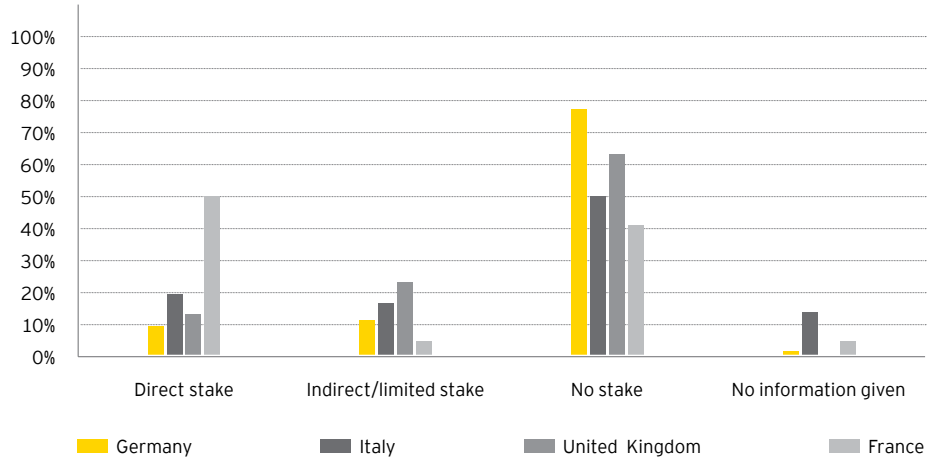


Fig. 4: Possibilities of acquiring a stake – country rankings



The country rankings show a varied picture. Half of the French family businesses that took part in the study offer their external managers the option of taking a direct stake in the company, whereas in 77% of the German family businesses, it is not even possible for them to acquire a stake. Figure 4 shows the differences between the various European countries that were examined.

Key learning

Overall, the surveyed family businesses offer their external managers a range of different monetary incentives to retain them at the company. Fixed compensation ranks as very important here. On the other hand, it is surprising that long-term variable compensation components are very unusual. Likewise, it is only possible for external managers to acquire a stake in the company in rare cases.

Tips

- Market-oriented compensation as appropriate for the sector, company size and seniority, etc. is an important factor.
- Higher priority should be accorded to long-term variable compensation as a way of encouraging a long-term approach.
- Stakes in the business should be designed so that both parties can benefit from them.

Experiences from consulting practice

Monetary compensation
Family businesses differ in three significant ways from non-family businesses and especially from larger listed corporations:

a) There are far fewer pension arrangements, and they are much less attractive.

b) There are still very many family businesses that do not differentiate between short-, medium- and long-term components for bonuses/profit sharing.

c) Non-monetary incentives (large cars, driver, first-class transatlantic travel, luxurious office fittings, expensive club memberships, etc.) usually turn out to be far less lavish than in large-scale industrial firms.

Compensation is not the only factor when it comes to retaining external managers in the business over the long term. Other aspects such as an interesting job or possibilities for development seem to be accorded more importance in this context.

> *"Money is not all that counts. It is also the pleasure you have in doing your work and the colleagues you work with. It just needs to feel good when you go to work – to be fun."*
>
> *Company H, Manager*

b) Non-monetary incentives

It is often difficult for companies to grasp what (apart from monetary incentives) motivates employees and keeps them in the company in the long term. Non-monetary incentives, such as a good work atmosphere, the management culture, a good work-life balance or stimulating work content, are very varied, often difficult to measure – and frequently difficult to develop.

> *"For me, it plays a big role that I have plenty of freedom as regards development in my area of responsibility. That's really one of the most important things. And, of course, that I can make an existing success story even bigger."*
>
> *External Manager, Jägermeister*

External managers interviewed during the study attach particular value to freedom. The opportunities for development that family businesses offer them provide motivation and enjoyment of their work

> *"What motivates me is a steep learning curve for my own experience and drive – really changing a company and making it future-proof again."*
>
> *Company I, Manager*

In keeping with the spirit of co-entrepreneurship, there is plenty of freedom for action in family businesses;

> *"Being able to really steer the culture, the strategy: that is really a rewarding job to do."*
>
> *Company I, Manager*

external managers are free to act and influence the company and its development, albeit usually within strictly defined limits. They see it as important to make a positive contribution, to leave a legacy behind and to lead the company successfully into the future. The ability to tackle an interesting job is also important to them. They seek challenge, they want to get things moving, and they don't want to be bored.

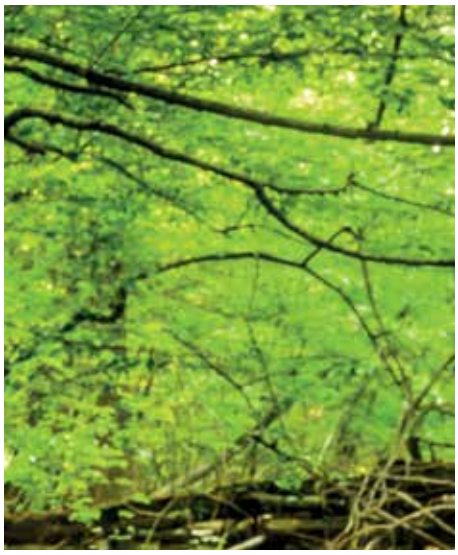
> *"You want to empower people and get them interested – then get them involved. I think that is very important. Make them part of the decision-making process. If you provide all those things in combination with a reason to operate, then I think in a company that is moving and where things are happening, you have 80% of your retention right there."*
>
> *Company H, Owner*

Another key factor in retaining external managers over the long term is that they must be able to feel comfortable in the company, and therefore in their work environment. A cultural and emotional fit between the business, the family and the external manager is critical in order to achieve this. In this regard, the surveyed external managers describe how they appreciate aspects such as the company's long-term approach, good relationships with colleagues, the family's respect and the family business culture, which is typified by greater familiarity rather than "politics in the negative sense".

> *"So during the week, I am fully focused on my work, 24 hours. At the weekend, I don't work at all unless it's necessary, of course. But in my case, I really manage it like that."*
>
> *Company J, Manager*

As regards the work-life balance, the surveyed external managers believe that private life should be accorded high priority, but because of their position, work often receives more attention. Anyone employed in a top position – in a family business or elsewhere – has a very heavy workload. Nevertheless, the special corporate culture in family businesses can have a positive impact. One manager describes this as follows:

Perhaps this is why the vast majority of surveyed external managers seem to be satisfied with their work-life balance despite their heavy workloads.



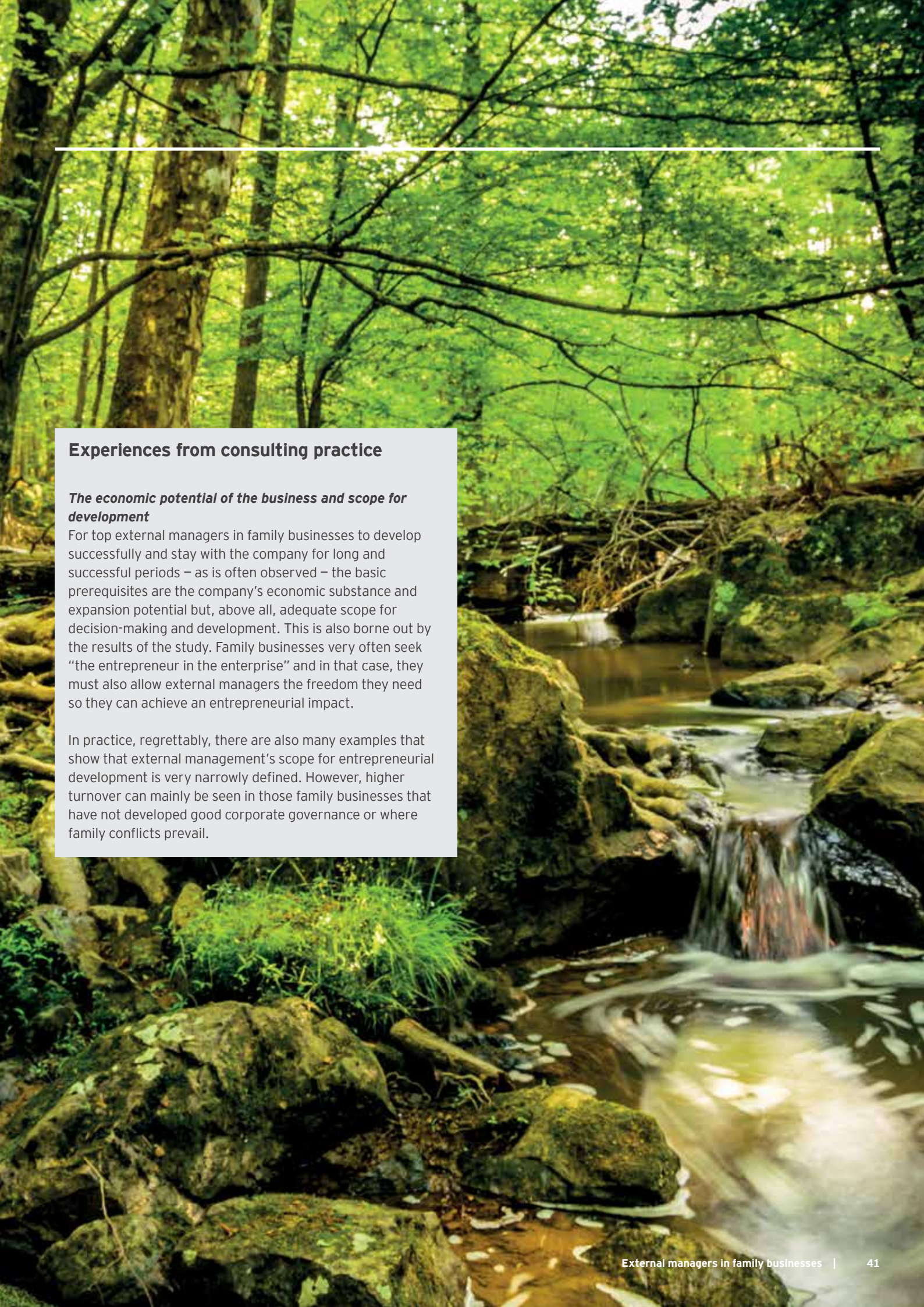
> *"It's not good to be controlled from afar. Long-term thinking and substantive convictions, as well as respectful interaction, serve to reduce stress."*
>
> *Company K, Manager*

Key learning

A balanced ratio of work and leisure does not appear to be a decisive factor in recruiting and retaining external managers in top positions in family businesses. In fact, the decisive factors are interesting jobs, scope for development or feeling comfortable.

Tips

- Possibilities for development are very important to external managers, and they can be created by implementing good corporate governance.
- A good work-life balance does not seem to be rated as very important. Nevertheless, this is an important issue – not only in order to prevent negative consequences, such as burnout, but also to achieve better performance and maintain performance capability over the long term.



Experiences from consulting practice

The economic potential of the business and scope for development

For top external managers in family businesses to develop successfully and stay with the company for long and successful periods – as is often observed – the basic prerequisites are the company's economic substance and expansion potential but, above all, adequate scope for decision-making and development. This is also borne out by the results of the study. Family businesses very often seek "the entrepreneur in the enterprise" and in that case, they must also allow external managers the freedom they need so they can achieve an entrepreneurial impact.

In practice, regrettably, there are also many examples that show that external management's scope for entrepreneurial development is very narrowly defined. However, higher turnover can mainly be seen in those family businesses that have not developed good corporate governance or where family conflicts prevail.

5

If external managers are engaged in the top management team, the family transfers responsibility for managing the business to them and then hopes that they will fulfill this responsibility in the family's interests. Control and monitoring measures can help to reveal potential irregularities at an early stage and steer external managers in the right direction where necessary. Below is a more detailed examination of the bodies and instruments that the surveyed family businesses use to control and monitor external managers.

Controlling and monitoring external managers

a) Monitoring and control bodies

External managers in family businesses are controlled and monitored mainly by the supervisory board, the family or also by family governance bodies. The pan-European quantitative survey shows that the owning family handles the control and monitoring of the external manager in the majority of family businesses. 51% of the surveyed external managers state that they conclude goal agreements with the owner; only 35% do so with the supervisory board or the board of directors. Family governance bodies appear to play a subordinate role in this context.

> *"The results are discussed at the supervisory board meetings each quarter. And then of course, we have an internal risk management system, which means that we continuously control and monitor the company's risks. To this end, an external auditor prepares an audit report and a management report, which we also discuss in supervisory board meetings. These checkpoints are very important for the company."*
>
> *Dr. Wolfgang Blum, Chairman of the Board, Haberkorn GmbH*

Fig. 5: Goal agreements with monitoring and control bodies

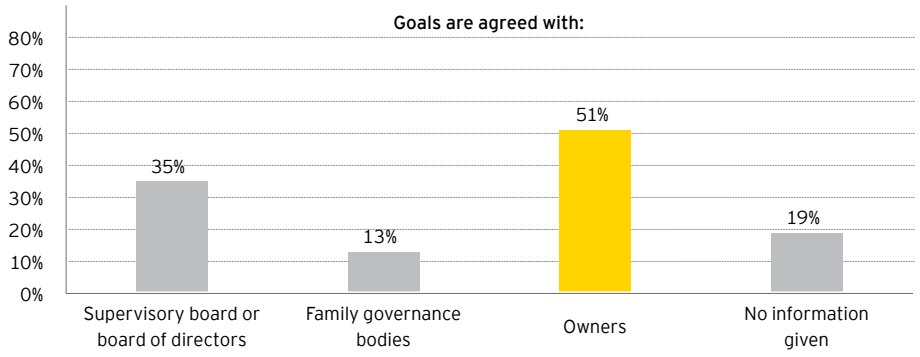
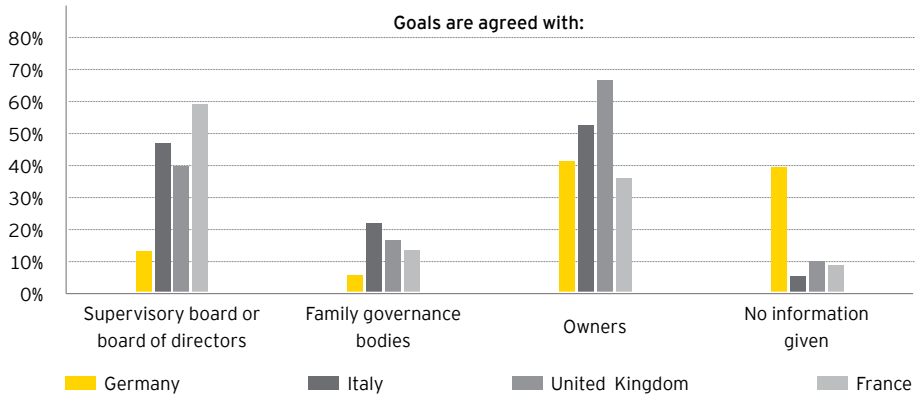


Fig. 6: Goal agreements with monitoring and control bodies — country rankings



Differences are evident between Germany, Italy, the UK and France. Especially in the German family businesses that were surveyed, it is surprising that agreement of goals with the supervisory board seems only to play a subordinate role.

Only 13% of the German external managers who were surveyed stated that they agree their goals with the supervisory board.[20]

In contrast, the figure in France is almost 60% of the surveyed external managers. In the UK, the owning family is particularly important as regards control and monitoring. In that country, a total of 67% of surveyed external managers agree their goals with the owning family. A similar

20 It should be noted that a total of 40% of surveyed external managers in German family businesses gave no information on this issue.

picture also emerges in Italy. The majority of external managers in Italian family businesses (53% in all) agree their goals with the business owners. Figure 6 shows the parties with whom surveyed external managers agree their goals in the various countries.

These results are surprising, given that good corporate governance requires the top management teams to be controlled and monitored by the supervisory board, which should act independently. Nevertheless, there is a special relationship between the owning family and the external manager, and regular exchanges about business results and future plans are customary in most of the family businesses that were interviewed. Even so, family businesses should keep to the rules of play here so that they can recruit qualified external managers for the company and retain them in the company over the long term.

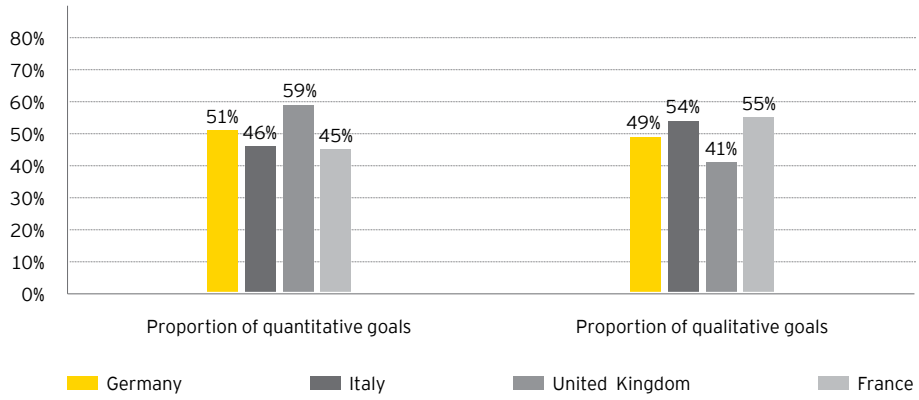
b) Instruments to control and monitor external managers

Family businesses use different instruments to control and monitor the top management team. For example, strategic planning, the budget or KPIs are agreed with the monitoring and control bodies and are defined as goals. The level of goal attainment can then be reviewed on the basis of reports, at meetings of the supervisory or the board of directors, or at special review meetings. In many cases, goal attainment is linked to the variable compensation paid to external managers. The goals set for this purpose vary greatly within the individual family businesses, and they include both quantitative and qualitative targets. The results of the pan-European quantitative survey show a very even balance between the proportions of qualitative and quantitative goals on which variable compensation for external managers is based. Therefore, target variables that cannot be measured quantitatively are also taken as the basis for incentives offered to managers from outside the family.

"We gave some thought to a multiplier that we use to measure performance: quantitatively, based on the budget, and qualitatively using various goals that are mostly linked to research; but there are other goals as well, such as a larger quota of women or a reduction of CO_2 consumption per employee. And we use this multiplier to calculate how bonuses are distributed at the end of the year."

Company D, Owner

Fig. 7: Proportion of quantitative and qualitative goals



Qualitative goals relate to subjects ranging from strategy, leadership and talent management to corporate culture, and they may be of many different types. In relation to the special family business spirit, appropriate qualitative goals, such as long-term orientation, co-entrepreneurship or focus on sustainability and fulfillment of social responsibilities, are also important. Figure 8 shows the importance accorded to the respective goals that are specific to family businesses in the surveyed European family businesses, in connection with control and monitoring of external managers.

It is surprising that the issues of value identification and culture are only rated as moderately important by European family businesses, even though the family business spirit is so important.

In connection with quantitative goals for controlling and monitoring external managers, the target variables used mainly comprise success factors (such as annual turnover, EBITA or EVA), profitability indicators (such as return on equity, ROCE or ROI) or growth rates (such as increased profit or turnover, or customer growth). This topic seems to be sensitive, because 35% of the external managers surveyed in Europe provide no information about the basis for their short-term quantitative goals; this figure is as high as 46% for long-term goals. Nevertheless, some statements about this subject can be made. The majority of surveyed family businesses in Europe use profitability indicators to set short-term goals to control their external managers. Alongside profitability indicators, growth rates are the most frequently used criterion for long-term goals. Figure 9 shows the respective proportions of quantitative short- and long-term goal types in the European family businesses in the random sample.

Fig. 8: Goals specific to family businesses

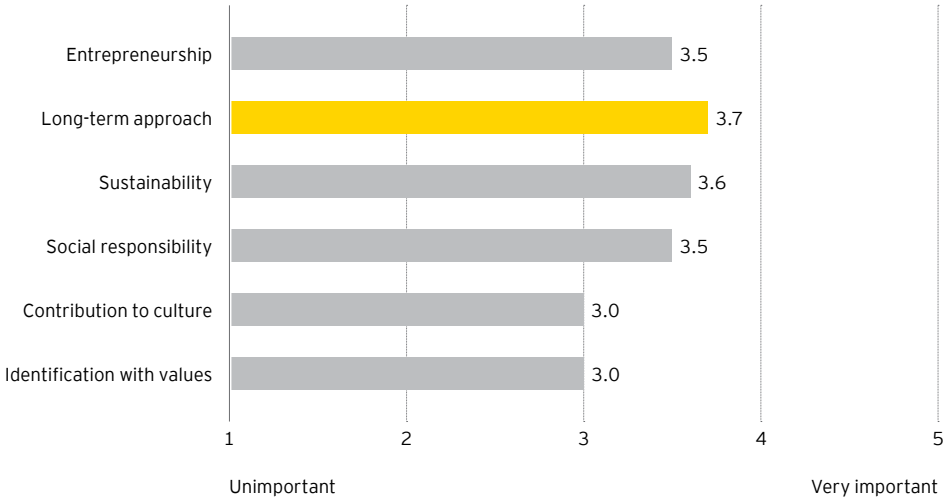
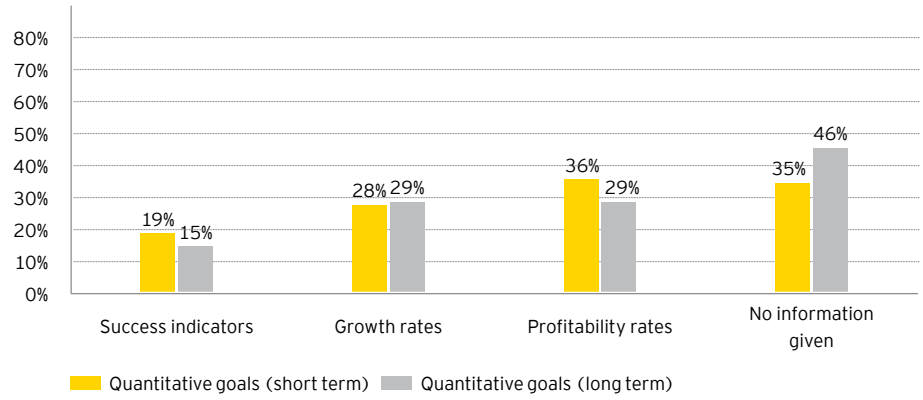


Fig. 9: Basis for determining quantitative goals



Key learning

In the European family businesses that were surveyed, the owning family plays a major part in the control and monitoring of managers from outside the family. The instruments used for this purpose include quantitative and qualitative goal agreements with managers from outside the family. In most of the surveyed businesses, however, only moderate importance is accorded to goals that are specific to family businesses.

Tips

- Despite the special relationship that exists between the business owners and the managers in family businesses, good corporate governance should also be implemented consistently for control and monitoring purposes.
- Furthermore, there should be a greater focus on goals that are specific to family businesses in order to strengthen the special family business spirit and exploit it as a competitive advantage.

Experiences from consulting practice

The advisory board as a bridge-builder

Many family businesses have now set up an advisory board as an additional body to offer advice and carry out monitoring. In Germany, more than half (54%) of the largest family businesses (> 1,000 employees) have set up an advisory board. However, there are major differences between these boards, depending, for example, on whether or not they "have teeth", because there are no statutory regulations for their constitution. Some families delegate extensive responsibilities and decision-making powers to the advisory board and also confer real power on the chair in this way; very many families explicitly refrain from doing so, and in these cases, the advisory board has a supportive or emergency function at most (e.g., in case of the family entrepreneur's total absence). If there is an advisory board with powers, a very important role in control and monitoring is assigned to it and – in particular – to its chair. In such cases, many (good) advisory board chairs also play the part of a key "bridge-builder" between family shareholders and external management.

6

The unity of business, family and ownership differentiates family businesses from non-family businesses and makes them into something special. As the results of the study show, the family does not merely see the company as something in which it has a financial stake; it has an emotional bond with the company, identifies with it and also wishes to safeguard it for future generations. It is the desire to preserve not only the financial assets but also the company itself for the family in the long term that shapes the special family business spirit. Long-term orientation, trust-based collaboration, dynamic behavior, the entrepreneurial setting and the major importance of sustainability and social responsibility are the positive aspects that characterize family businesses.

To safeguard them and to avoid negative aspects such as nepotism or paternalism, it is important to implement good corporate governance consistently and make use of family governance instruments to strengthen the family's unity, and also to facilitate cooperation with external managers. Accordingly, the implementation of family business governance tailored to the company is an important factor in recruiting suitable external managers and retaining them over the long term.

Suitable external managers are critically important for family businesses so that they can overcome the internal and external challenges that confront them; this enables them to ensure the long-term success and continued existence of the company — especially as size and complexity increase, and also if there is no family member as a candidate to fill a vacant strategic position. To respond to this challenge, external managers should not only have technical skills, but there should also be a cultural and emotional fit between the external manager, the family and the company.

To recruit suitable external managers for the family business, it is advisable to exploit the positive aspects of the special family business spirit and to project them as part of the company's employer branding. Furthermore, management of a talent pool could help identify and observe potential internal and external candidates ahead of time, opening up the opportunity to prepare them for a strategic position in the family business. This could minimize the risk of failing to achieve an emotional and cultural fit between the external managers, the family and the business.

21 cf. Caldwell and Karri, 2005; Zahra, Hayton, Neubaum, Dibrell and Craig, 2008.

22 cf. Davis, Schoorman and Donaldson, 1997; Zahra et al., 2008.

23 cf. Henssen, Voordeckers, Lambrechts and Koiranen, 2014; Hernandez, 2012.

Findings and recommendations for action

Once it has been possible to fill a strategic position with a suitable manager from outside the family, the objective is to retain the manager at the company over the long term. The results of the study show that in this regard, extensive possibilities for development – in keeping with co-entrepreneurship – are helpful, and non-monetary incentives play a decisive role. Nevertheless, monetary incentives should not be neglected and should conform to standard market practice in order to show appropriate appreciation of the external manager. A stake in the company (in direct or modified form) is another conceivable alternative to secure the external manager's long-term loyalty to the business.

The desirable characteristics for an external manager that were identified during the study accord with the stewardship concept. Stewards identify primarily with the company's objectives and values, and they take a long-term approach. Their motivation is not based on monetary incentives, but rather on realizing their own potential and giving something back to the community. The special family business culture can also be combined with this concept.[21] Behavior of this sort, for instance, is encouraged by the extensive scope for development within the entrepreneurial setting that prevails in family businesses.[22] Because external managers act like entrepreneurs in the business, showing commitment to the company with little regard for their own work-life balance, and because they gain profound insights into the business and exert great influence on it, they are likely to act as if the company were their own. The scientific term for this phenomenon is "psychological ownership" and it ranks as a major influencing factor that favors stewardship behavior.[23] Accordingly, the results of the study show that family businesses endeavor to recruit individuals who behave as stewards to fill strategic positions and retain them in the long term. An appropriate setting for this purpose is created by the special family business spirit, provided that suitable family business governance is taken into account.

Figure 10 gives another clear summary of the results from the study in the form of a model.

Fig. 10: The family business spirit – recruiting and securing the loyalty of external managers – stewardship behavior

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