



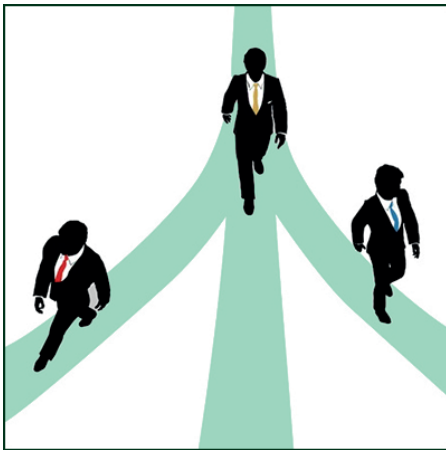
## THE TRUSTED ADVISOR

**THE TRUSTED ADVISOR** is our firm's regular publication, featuring not only articles and insights derived from our project work but also guest posts and interviews with leading business figures. They offer food-for-thought and practical advice on a variety of key topics in the leadership, ownership advisory, governance and strategy domains.

### TTA 02-2015 | PROFESSIONAL OWNERSHIP



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## Role Separation as the Key to Success in Family Business Management

### Recommendations for family business in the second and third generation

by Dr. Christian Bühring-Uhle

In order to be able to look back on a successful entrepreneurial life, one should not only have built a strong and valuable company but should also have created the basis for sustainable further development by means of a viable succession plan – great work outlives its creator. More than three quarters of companies in Europe are family owned. But only about a quarter of them manage to pass the business onto the third generation. This can be due to a lack of children or grandchildren, or nieces and nephews, who have the appropriate age, and who are “ready, willing and able”, in terms of education, experience and personality, to run the business. Sometimes, attitude is the problem: do the potential successors see themselves as destined to “serve” the company, its owners, its employees and the community in which it is located? Or do they feel entitled to rule due to a birth right?

In the founding stages of a company, the owner and manager are typically the same person. When the business is passed onto the next generation, this usually changes. In the second generation, you often find shareholders who do not work in the company, and equally family members who work in the company but who are not (yet) shareholders. But even if all owners are active in management, and all managers hold shares in the company, they do not simply work on their own account – they primarily work for others, they “serve” and are accountable to the other shareholders. A lot of tensions can arise from this situation, which can ultimately destroy a company if they are not adequately managed. Approximately 70% of successful entrepreneurial families lose control of the business, and suffer serious emotional damage, between the first and third generation. In 60% of the cases, these problems can be traced back to interpersonal conflicts (dysfunction in trust and communication).

The most important “neuralgic points” are:

- How to create appropriate, effective monitoring mechanisms for managers who are also (co-) owners?
- How to ensure that on fundamental issues, management obtains the timely, well-founded decisions that you would expect from a competent owner?
- How to ensure that family members working in the company are employed, developed, managed and remunerated according to their abilities?
- How to protect the interests of the shareholders who are not working in the company?
- How to avoid the phenomenon, observable in many hierarchies, that in the course of time managers are

promoted to positions they cannot handle – also known as “Peter Principle”? (Family businesses are liable to seeing employees that “belong to the family” or have been “loyal” to the family for many years, often benefit from special benefits and protection.)

- How can first-class talents be won, selected, integrated and retained in the company, regardless of whether they are external executives or family members?

The key to solving all these issues is to neatly separate the roles of owner and management. The goal must be to have both roles exercised in a professional and effective manner so as to secure and grow the business, and to maintain harmony in the family owning the business. This, however, typically requires a paradigm shift. Especially the second generation – born into a family of entrepreneurs, in which typically the owner, or often the owning couple, has run the business the way he or she liked – has to understand that “the game” is different in subsequent generations. Those who are active in the company’s management have to realize that they primarily serve the company and its owners in their entirety. In other words, they must act transparently, have to answer to critical questions and be accountable. This does not work with a mind-set rooted in a feeling of entitlement. And for the shareholders, whether or not they are involved in the management of the company, this means that they have to develop the courage and the competence to monitor the brother, uncle, cousin, nephew (or sister, aunt, etc.) and demand transparency and accountability. This is not only about exercising one’s rights as a co-owner, but also about the obligation towards the family fortune – and towards the family members who take on an often difficult and burdensome task and responsibility, and who have the right (and typically also the need) to receive feedback and to develop themselves further.

This task of the professional owner is not an easy one, but it is inescapable. And from a certain company size on, this task cannot be adequately accomplished without the help of competent third parties, typically in the form of a supervisory or advisory body. In the case of a public corporation, this role is typically performed by the Board, although it is sometimes complemented by a Shareholder Council or Family Council. However, in many family enterprises, this role falls to the Advisory Board.

Such a body can be the key to exercising the owner’s role in a competent manner, and thus to the neat separation of the roles of owner and manager – if its members are well chosen, and have the right mandate and the right attitude. The mandate can either consist of the delegation of certain shareholder rights – the competence to make fundamental decisions – or at least the obligation that the (advisory) board has to be consulted on important issues. The composition of this body is essential: the owning family with their values and strategic objectives should be adequately represented, but there should also be external directors with entrepreneurial expertise, relevant industry knowledge and experience in the management of companies, as well as a sufficient distance from the persons directly involved. The attitude is of great importance as well: apart from strict objectivity and impartiality, coupled with complete intellectual and material independence, advisors must also have the courage to ask uncomfortable questions and to express unpleasant truths in order to be effective sparring partners. They also have to be perseverant enough not to be satisfied with evasive answers or mediocrity. The Chairman of the Board naturally has a crucial role, giving guidance, “leading the leaders” in the interests of the owners, and acting as a bridge between owners and management, sometimes also among shareholders and among members of management.

It is not easy to bring about the paradigm shift mentioned above and to build a solid structure for the competent exercise of the owner’s role. Often this is not possible without competent and trustworthy external support. But the effort is worthwhile, since it is the key to preserving an entrepreneur’s legacy.



## In or Out?

### Perspective on internal and external CEO appointments

by Nick Harris

Appointing a new CEO is likely to be the single most important people decision that most Boards and owners will ever have to make. And the choice on whether to make an internal or external appointment is often a difficult, and sometimes a highly emotional, dilemma.

Below, we give some summary perspectives on the relative merits and considerations of internal vs. external candidates. We have deliberately not referenced the many published studies on this topic, but rather have drawn on our own observations from previous C-level succession projects.

#### Internal Appointment

- + Conveys a sense – particularly internally – of stability/continuity rather than disruption (i.e. ‘evolution not revolution’)
- + Sends a message that the company develops/promotes from within, up to the top level
- + Candidate is a well known commodity (i.e. you know exactly what you are getting)
- + Candidate already knows the organisation (therefore, no/little risk in terms of cultural fit)
- + Candidate’s learning curve is less steep (i.e. he/she knows what they are getting into; can be mentored ahead of time by the current incumbent)
- Less likely to act as a change agent; more likely to bring incremental – rather than breakthrough game-changing – improvement
- May be less likely to challenge and ‘stand up to’ the Board

#### External Appointment

- + Conveys a sense – particularly externally and to the markets – that the company is continually striving to out-perform and is not ‘resisting on its laurels’
- + Sends a message that the company is committed to recruiting the best-in-class, global talent
- + Candidate brings in new knowledge and best practices from other organisations

+ Candidate will bring a fresh perspective, likely spotting both weaknesses and opportunities more readily

- Steeper learning curve; candidate must learn about a new environment and adapt to the culture (a comprehensive onboarding & integration programme is indispensable to mitigate the risk)

- Risk that internal candidate(s) become demotivated or leave

Thus there are pros and cons to both kinds of appointment. Appropriateness is situational: dependent on the current and future/looked-for state of the company, and the type of mission (both the 'what' and the 'how') which the CEO must accomplish.

External appointments are, by definition, riskier... However, (successful) external appointees typically drive greater value over time... So, the risk with externals is higher, but so too is the potential upside.

In conclusion, considering both internal and external options – objectively and rigorously – is best practice. And ultimately, the 'right answer' is the 'right candidate'!



## **Traditional values: a benchmark for start-ups?**

**On the importance of 'traditional values' for modern entrepreneurs**

by Andreas von Specht and Felix B. Waldeier

Particularly in Germany, the outstanding position of family businesses, which have been successfully built up over several generations, is repeatedly emphasized. If one asks the family managers concerned, one can learn a lot about the importance of flat hierarchies, quick decisions or long-term thinking. In the same breath – often in contrast to rather anonymous corporate structures – there is talk of the great importance of “values”. Loyalty, trust, honesty, integrity, justice and reliability – these values are often associated with Germany’s family businesses. And in many cases, rightly so. However, we were also interested in how today’s entrepreneurs / founders of start-ups think about the significance of such values. Do traditional values fall by the wayside with start-ups, rapid growth and permanent change? Are they even affordable? In the Berlin start-up scene, we met the successful founder of Thermondo, Philipp Pausder.

**Mr. Pausder, entrepreneurial values are often closely related to the type of company. Therefore, first of all the question: In which area is Thermondo active?**

Thermondo is a technology-driven heating engineer. We have fundamentally optimised the processes of changing the heating system, revolutionising the trade and opening up the possibility for the energy industry to enter into small-scale energy services. Thus, our customers come more easily and faster with good prices to a new heating service.

**What significance do classical, traditional values such as loyalty, trust and honesty have for your entrepreneurial activities?**

A very high significance – especially in the relationship with our employees. In today’s world of work, talent and human capital are the scarcest resources. These must be secured and promoted by a solid framework of values within the company.

**And what about an aggressively growing company in the context of corporate values?**

It is of paramount importance for us to attract the best and brightest minds. People who have a great passion for their job and who – often due to valuable experience and a good education – often have their pick of the jobs on the market. Fairness towards each individual employee, and reliability in agreements and in deeds are therefore the core elements of the entrepreneurial integrity experienced by the employees.

**How do you lure the “best and smartest minds” into your company?**

Younger top performers naturally want to earn well, conduct dialogues at eye level, and quickly feel extensive freedom and responsibility. But they also want to be part of a company for which it is worth working 50-60 hours a week. Our values and the meaningfulness of the company's content are extremely important here. For me, values thus become, in addition to other functions, a pillar of intrinsic motivation.

### **What role do these values play in the relationship with your business partners?**

Of course, values are also extremely important in the relationship with our business partners. We are transforming an entire economic segment and are thus in the role of the change driver and innovator. It is important to understand exactly how much change we can expect from our business partners and other market participants. We have to challenge them, but we must not overburden them. In doing so, it is crucial that we prove to be a reliable, value-oriented business partner despite, or precisely because of, our differences.

### **Are there other values or maxims that characterise your company?**

The freedom to think, to question and a very high degree of willingness to change! As a small, young and very fast-growing company we simply have to be better, faster and smarter. We can only do this if we attract the best people, as already explained. At the same time, these top talents must be given real freedom to think and act. And finally, we have to align the whole team to a common corporate goal.

### **Do you see a difference between the value system of traditional family businesses and that of start-ups?**

For me, the values just mentioned are not always "typical" of traditional family businesses. Rather, for me they generally represent values for "good entrepreneurship".

### **What do you see as the main differences between traditional family businesses and start-ups?**

In my view, the biggest difference between traditional companies and start-ups is not the canon of values, but the uncompromising focus on productivity. Without productivity and the associated growth, a start-up will not reach the next round of financing. Every day is precious, and any standstill is a step backwards. Formally and informally, we set ourselves goals on a weekly and monthly basis and define clear milestones that we want to achieve during this period. There are no rigid job descriptions, but priorities and job content must be constantly and flexibly adapted to our goals and needs.

### **To what extent do you combine entrepreneurial values with the "uncompromising focus on productivity" you describe in order to achieve your entrepreneurial goals?**

Of course, the management of a company must not only take place at the level of key figures and milestones. Employees in start-ups especially need orientation, esteem and a high degree of proximity to management due to the incredibly high dynamics and flexible job design. Only then is it possible to commit to a common goal.

### **When do you see a common goal or entrepreneurial success achieved?**

For me, the yardstick for entrepreneurial success means having created something that no longer disappears and thus makes a lasting contribution to the prosperity of our society. To have significantly changed a market, or to have spotted an upcoming development early and then consistently implemented it, is entrepreneurial success for me. We are often told that what we are planning at Thermondo is actually impossible. That we

cannot change the sector sustainably or even to digitize it. But we show that it is possible after all!

**How important are sustainability and the long-term nature of success to you – and how would you define them?**

Sustainable, long-term success is very important to me and for our company. We always tell our employees that we want to create a new type of company: a digital, nationwide, vertically integrated business, the gatekeeper in a small-scale energy landscape. That does not exist so far, and my incentive is it to prove that we are not a temporary phenomenon, but a pioneer. I would like people to look back in ten years and say: "Thermondo was the pioneer, others copied it." In order to be able to say this one day, we must have sustained success. For me, sustainable success means profitability with sustained sales growth.

**Do you see a certain responsibility of young entrepreneurs towards society?**

I consider social responsibility to be very important – and of course young entrepreneurs like us also bear it. Our activities at Thermondo, for example, contribute to the reduction of CO<sub>2</sub>. In addition, we create jobs and train our employees for tomorrow's jobs, for which there are currently no formal courses of study. We have already created 150 jobs, by Christmas it will be just under 180. This achievement is very important to me! Large companies generally cut jobs due to their lack of innovation. Our society therefore needs the small, innovative units because they create the jobs.

**Are traditional values increasingly losing their importance in the course of globalisation and the internationalisation of companies?**

Not at all! But from my point of view, the past has no universal claim to the existence of values. There are numerous examples of companies from the time before globalisation and internationalisation that did not live these traditional values at all. Basically, I do not see any signs that values are in retreat in the context of globally operating companies, but rather that they are gradually becoming more important again.

**Mr. Pausder, thank you very much for this interview!**





## **AvS News**

### **Recent news and developments at AvS – International Trusted Advisors**

The past months were marked not only by interesting client projects, but also by exciting developments within our firm that we are delighted to share with you in this edition of THE TRUSTED ADVISOR.

#### **New consultant and new office in Geneva**

At the beginning of the year, we opened our third international office, in Geneva. Geneva is an important hub not only for the European headquarters of various consumer goods companies, but also for a large number of family businesses and family offices. It is of strategic importance for the worldwide support of our clients.

Nick Harris joined our team at the beginning of the year. Nick, who has lived in Geneva for many years, has been with Egon Zehnder for the past decade, including as a Leadership Team Member of the firm's global Consumer Goods & Retail Practice. In his new role, he will focus on establishing our Geneva office and, in particular, strengthening our international client relationships. In addition to his industry specialisation, Nick has experience in talent management and supporting succession processes, particularly in family-run companies.

#### **New Partner / Senior Advisor in Bogotá**

In spring, we held several events at our office in Bogotá, which was opened last year, to further expand our activities in South and Central America. Since then, our partner in Bogota, Dr. Christian Bühring-Uhle, has quickly succeeded in strengthening the team:

Ricardo Sala moved from Spencer Stuart to join us in the summer of this year and will in future advise our South and Central American clients as a partner. Ricardo, who was Colombia's ambassador in Bonn in the 1990s, has many years of experience as a CEO and supervisory board member in family businesses, among others. At Spencer Stuart, he was responsible for the industrial and board practices in Colombia and other Latin American countries.

With Nelson Echeverría, the former CEO of BASF Colombia, Venezuela & Ecuador, we have gained an outstandingly well networked Senior Advisor for building client relationships. He will provide us with close advisory support and, on a case-by-case basis, will also work on challenging consulting projects. Nelson has decades of experience in international top management and is involved in various supervisory boards, advisory boards and foundations. Together with Christian Bühring-Uhle, he is a member of the Executive Committee of the German-Colombian Chamber of Commerce.

### **Expansion of our network of cooperation partners**

In the past two years we have succeeded in establishing close relationships with cooperation partners in countries where we do not yet have our own offices. We are now able to carry out international projects with the support of highly experienced consultants in the UK, the Czech Republic and Italy, as well as further afield in New York, Atlanta, Montreal, Singapore and Sydney. In the long term, AvS – International Trusted Advisors aims to establish at least one office on each continent.

Please feel free to share any articles or entire editions you feel may be relevant with your colleagues or clients. All articles and editions can be found here:

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