The success factor “external manager”

External filling of management positions in family-owned companies

by Andreas von Specht

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1. Recruitment challenges

Less than half of family businesses are likely to hand over the reins to a next generation of managers from within the family itself. Many owner families are simply running out of young talent. But even if there are children or grandchildren, this does not mean that they have the aptitude or experience to take over the business.

While the sale of the entire company may be considered by some family businesses without an internal successor, this option is still not desirable for many families. So, if a succession within the family is not possible, or a gap until the next generation is ready has to be bridged, the ‘external management’ option inevitably comes into play.

More and more family companies are deciding to hire managers from outside the family to take on the operational management of their companies. Yet for many there is still uncertainty as to how such a process should be professionally organised and in a way which does not simply rely on “gut feeling”. Mis-hirings of important management functions with external managers are frequent and can be very expensive. They can also lead to a damaged image in the eyes of customers, suppliers and employees. Experience with, or a cultural fit to, SME businesses, and especially family businesses, is crucial. In our consulting practice, we have heard of numerous external managers who did not really understand the values and objectives of the owning family – and were therefore unable to align themselves and perform accordingly.

In order to carefully prepare for the recruitment of an external manager, the shareholder group must first gain clarity about the tasks, distribution of competencies and responsibilities of the top management function. It will be difficult to win over a first-class professional manager for the

company if the family is not prepared to cede to the manager significant room for manoeuvre and decision-making authority. The definition of a role profile naturally also includes the question of which "critical competencies" an external manager must bring with him/her. Here it is not only a question of years of experience, but also of the development of certain fields of competence, for example: the ability to develop and implement strategies, to introduce change into the company, or to engender a strong "customer orientation" within the sales team. In order to be able to agree on this competence picture, the family should be guided by what specific results will be expected of the external manager in the coming years, and by how the success of his/her activity will be measured.

2. Success factors for external managers in family businesses

The successful "fit" of many external managers in family businesses is often decided after only a couple of brief meetings. There are a large number of family businesses that have been dissatisfied with the first appointments of external managers to their top team. In many cases, it turned out that the family had not devoted sufficient care and time to interactions with the new hire, either before or immediately after the appointment. Family businesses often have unique sensitivities or ways of doing things, which the newcomer inadvertently overlooks or transgresses – and which would not immediately lead to a conflict in large companies but send out an alert signal in the Mittelstand environment. For example, the choice of the "wrong" company car brand, office equipment that was perceived as "too expensive" or an "exaggerated self-portrayal" in public. Many family businesses also expect the outside manager to move to a (small city) location with their family at short notice; here too, misunderstandings and timing can cause problems. So, in addition to a good integration & onboarding process, close personal contact and continuous, open communication is of great importance. According to studies, personal conflicts between family members and the external manager are much more likely to contribute to the failure of the manager than a shortfall in his/her professional qualifications – and these conflicts usually arise at the beginning of their tenure.

A further, essential success factor hides behind the question of successful 'governance'. A careful definition and organisation of the owner function, for example supported by a competent advisory board, provides a necessary framework within which the external executive can manage – and be managed. Particularly during the transition from an owner-managed to an externally managed company, friction often occurs if the owner side of the equation is not appropriately and professionally set up. Non-family advisory board members, in particular the chairman of the advisory board, often play a key role, as they can act as 'bridge builders' ensuring mutual understanding between family and management.

The role of external managers in family businesses depends not least on their personal ties to the entrepreneurial family and their behaviour towards them. There seem to be some unwritten rules that clearly influence the success of outside managers in family businesses. For example, the advice to keep a certain social distance to the owner family and not to strive for the membership in the same clubs or associations. Or the requirement to treat shareholders of different tribes as equally as possible in order not to get caught between two sides.

3. The long-term commitment of external managers to family businesses

In solving the problem of non-family succession, there is also the challenge of motivating outstanding external managers to stay in the company for an extended period and to act in a long-term manner. Too often, bonuses are seen to be handed out according to ill-defined terms and "in the manner of a landowner", although there has been a professionalisation of the incentive systems in family businesses in recent years with quantitative values more often used as the basis for assessment.

In our consulting practice, we have seen cases where equity investments were considered as an element of the remuneration package – and then actually implemented. There are some major obstacles to overcome, especially the psychological barrier of many families to ever include an outsider in the circle of shareholders and to grant him/her corresponding rights. The structuring of a participation is difficult: the balancing of the participation relationships must be taken into account, the actual share valuation must be comprehensible and fair, and ultimately the details of the transfer of capital shares (e.g. inheritability of the shares or retransfer of the shares upon withdrawal) must be regulated. We recently advised a family business in which all these challenges proved to be surmountable after the family had made the – initially difficult – basic decision to transfer capital shares to an external manager. This fundamental choice was based on the fact that doing so would enable the attraction of a much higher calibre of CEO candidates. Executives who would certainly have wavered beforehand given the company's size and existing compensation systems, could now be interested in a long-term perspective of genuine entrepreneurial participation.

There are undeniable difficulties in implementing an external manager's equity stake, and the administrative and cost implications of implementation are not insignificant. However, this should not lead to a premature rejection of this option, as there are also enormous opportunities to win over real entrepreneurs for the greater long-term development of the company.

If family businesses can succeed in attracting and integrating well qualified and highly entrepreneurial professionals into their companies, these incomers can be the decisive factor in sustaining and improving business success.

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