The Family Business Advisor

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Succession Planning in Family Businesses: The Power of Sibling Partnerships

By: Nicole Bettinger Zeidler and Tom Emigh, The Family Business Consulting Group

Thinking about a future sibling partnership can be daunting for many family businesses. You may have questions, such as:

How will we structure leadership?

Will our titles be the same?

Are we going to split ownership equally?

Who will make what decisions?

Do we really need a board of directors?

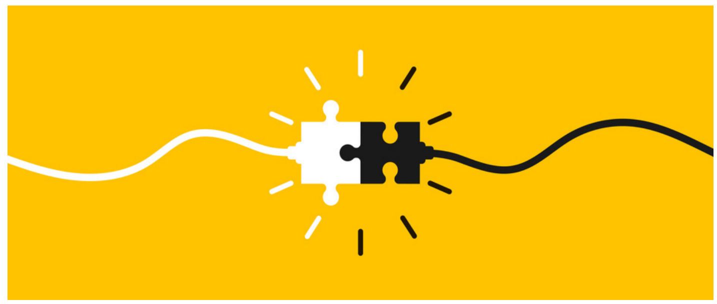
Who is Mom's favorite? (a little humor, based on reality)

But sibling partnerships in the family business don't have to be scary. In fact, we have worked with many successful sibling partnerships that are both immensely rewarding for all involved and deeply impactful for the business.

Let's consider how the Johnson* family prepares to lead their distribution business into the future. Jenny Johnson founded the company in her early thirties and has been its sole CEO for the last 40 years. Now, Jenny is preparing to retire within the next three years, while many of the company's key executives indicate that they also plan to retire within 12 months of Jenny leaving.

The second generation of the Johnson family includes three children: Sam, Sally, and Sarah. Sam and Sally work in the business, while Sarah does not. Sarah appreciates her family's business, though she has never felt a pull to work in it. Sam and Sally have worked their way up through the organization, becoming well-acquainted with all its aspects and serving in a series of roles with increasing leadership responsibility.

With Mom's retirement fast approaching, the Johnson siblings need to have focused conversations about how they will structure their family business's leadership, ownership, and governance.



Co-leading vs. Hierarchical Leadership

Two leadership models could be proposed to help Sam and Sally lead together: a co-leading model and a hierarchical model. Each model has merits and challenges, but either would create a structure where the siblings could work jointly to continue their family business.

Model 1: Co-Leading

In a co-leading model, Sam and Sally would equally share leadership of their family business. This requires a high level of self-awareness and communication, with the siblings continuously checking in with one another to ensure they do not undermine each other's authority. Sibling co-leaders will benefit from personal development and an understanding of one another's personality types. This can be achieved through tools and assessments, such as the Enneagram, which can aid in improved self-awareness, communication, decision-making and conflict management skills.

Clearly defined roles in a co-leading structure are a must-have to clarify authority and decision-making responsibilities. Sam and Sally may become co-CEOs or co-presidents in the Johnson family business. However, if Sam has more of an operational role and Sally has more of a financial focus, they may become COO and CFO, respectively. Or they could divide the business based on its domestic, regional, and international interests. There could even be a division of responsibilities based on the department: manufacturing vs distribution.

While the siblings' roles in a co-leading model do not have to be identical in function, they are at the same hierarchical level in the organizational structure. Sam and Sally would receive equal compensation, ideally developed and monitored by a compensation committee of a board with independent directors.

Co-leading situations can result in power struggles when communication breaks down and trust erodes between siblings. This can be alleviated with communication skills and conflict resolution systems.

Model 2: Hierarchical Leadership

In a hierarchical leadership model, Sam and Sally would each take roles that are not necessarily equal in responsibility or compensation but appropriate for their respective abilities, interests, and business needs. For example, Sally could become the sole CEO while Sam becomes the COO.

Once again, self-awareness and clear communication are key to this leadership model. Individuals must know themselves and their skills to lead well. Clearly defined roles with specific responsibilities allow everyone in the organization, including the siblings themselves, to understand who to report to and who handles what. With hierarchical sibling leadership, Sam and Sally must align with each other before communicating with their employees or the board.

In a hierarchical leadership model, unresolved family dynamics can seep into the family business. When there is inequality among the siblings working in the business, resentment, lack of trust, and other family issues can arise — even more reason for a well-structured leadership selection process and fair compensation policy.

Closely related, we often observe that a cadre of senior leadership provides longstanding, faithful service alongside the founder. And when she leaves, they often leave as well. So, the strategy of ongoing leadership development and succession/continuity planning at all levels of the organization is important, even though we are focusing here on sibling partnerships.

Helpful Tools in a Sibling Partnership, No Matter the Leadership Model

- Strong and ongoing personal and leadership development
- Dispute resolution policy
- Clear decision-making and accountability processes
- Agreed-upon communication standards/expectations

Equal vs. Proportionate Ownership

Let's consider how ownership can be structured in the Johnson family business, where two G2 siblings work in the company, and one does not.

Model 1: Equal Ownership

In an equal ownership model, Jenny Johnson would pass her sole ownership equally to her three children, giving them each a third of the business ownership. There are many pros to this ownership structure. First, the second generation will share the risks and rewards of the family business equally, honoring their mother's wishes and continuing her legacy. It also balances conversations about dividends, distributions, and reinvestment. There is high potential for engagement and alignment in the business, as equal ownership encourages collaboration and consensus-building amongst the siblings.

Equal ownership, though, is not without its potential cons. Family harmony and relationships can struggle if there are significant differences in the perceived motivations of the different owners. Sarah may just want distributions since she does not work in the business, while Sam and Sally may want to reinvest in the company as a growth strategy. Equal ownership can also complicate things if Sam and Sally follow a hierarchical leadership structure. How would it feel if the CEO and Vice President of Marketing had the same ownership stake?

Ownership can complicate leadership because if everyone is an equal owner, how does this affect decision-making? A simple and clear way of heading off this potential confusion and conflict is to be very clear on the role differences, related decision-making and accountability, and when each person is fulfilling which role. If Sam and Sally are in a meeting with other executives, it's helpful for them to understand that they are functioning as executives, not as board members or shareholders in that conversation. When one sibling interrupts an executive team meeting by shouting: "Well, I'm the majority shareholder and we are going to do it my way!" there is a breakdown and misunderstanding on several levels.

Model 2: Proportionate Ownership

Another way the Johnsons can distribute ownership in their family business is through a proportionate model, in which ownership is split up based on various factors, including operational involvement and engagement of other business areas, such as governance. One way this could look is that Sally, as CEO, gets 40% ownership of the business, while Sam, as COO, and Sarah, a non-operational owner, each gets 30%. Or Sally could receive 50%, with Sam and Sarah each receiving 25%. The distribution of ownership in a proportionate model will vary from family to family and should reflect each family's needs and situation.

A proportionate ownership model can present challenges down the road, as it can create a trend toward greater ownership inequality in subsequent generations. Additionally, suppose majority ownership only goes to those who are currently operationally involved in the business. In that case, members of G3 born into non-operational branches of the family may face an uphill battle if they want to work in the family business one day.

No ownership model is free from the potential to reveal or exacerbate family dynamics that can lead to a lack of cohesion, lower family participation, and possible disharmony. As with leadership, a clear governance structure, as well as decision-making and accountability processes are essential in clarifying the ownership structure of a family business.

Leveraging Effective Governance for Generational Transitions

Both research on family business and our repeated experience have shown that a governing board with independent directors can provide important oversight and insight into its operations and strategy, thus reducing pressure on the family and helping guide them through leadership decisions, exit strategies, and strategic planning accountability.

With a generational transition like the Johnsons, a board of directors can reduce stress on the new leadership team's decisions. Furthermore, the independent board members can provide objectivity on various topics, including:

- Family and non-family leadership roles
- Compensation
- Performance reviews
- Strategic planning and decision making
- Succession/continuity planning

In our experience, the founding generation often struggles to fully exit the business operations promptly. An engaged and robust board of directors can provide guidance and accountability to help the founder transition while honoring their legacy. In the long term, the board can guide the next generation as they make their own unique contributions to the business's future.

Often, the founder assembles a board of close, trusted advisors. As the business transitions to second-generation leadership and ownership, establishing a board with independent directors is a valuable gift—to the next generation, the family, the business, and the succession process. Long-standing advisors may struggle to provide the level of accountability and constructive push needed to keep the plan moving forward, including encouraging the founder to transition the business to the next generation. A poorly functioning board may result in:

- Unclear decision-making at all levels of the organization
- A lack of succession/continuity planning
- Poor communication and trust between the board and the family

Ultimately, a board exists to protect shareholder value, provide guidance and oversight to a business's leadership, and communicate with the ownership group. A board with independent directors can be crucial for ensuring a seamless transfer during leadership and ownership transitions, and success going forward into the future of the business.

How Generations Can Support Letting Go and Stepping Up

While transitioning from the founding generation to the second generation can feel intimidating, it is a natural part of the lifecycle of family businesses. The founding generation can help support the future sibling partnership by:

- Implementing strategic planning
- Building a board with independent directors
- Emphasizing leadership and personal development
- Creating programs to support rising generations
- Delegating decision-making responsibilities to the rising generation well before the complete leadership and ownership transition

The founding generation can help immensely by developing a succession/continuity plan, leveraging the board for accountability, and then sticking to the plan. Recognize that even if the next generation chooses to do some things differently, they can still be effective and carry on your legacy. You are leaving your business in good hands, even if they differ from the ones that founded it.

The rising generation of a family business can also be proactive regarding their role in the succession/continuity planning process. It's never too early to start having conversations with your siblings about how you think you would work best together. You can discuss topics such as specific interests in the business and long-term ownership structures while familiarizing yourselves with what it feels like to engage with your sibling in a professional environment. Planning and clarity regarding the various roles in the family – shareholder, executive, board member, and family member – and the related decision-making and accountability processes, can forge a successful path forward.

We have seen many times that while establishing a sibling partnership can be challenging for any family business, thoughtful advance planning, development, structure, and good communication can make this a fantastic experience for both family and business.

**We value confidentiality. The examples mentioned in this article are composites based on our client experiences.*

Nicole Bettinger Zeidler, consultant, and Tom Emigh, principal consultant, are with The Family Business Consulting Group.

To learn more about our firm and how we serve families like yours, call us at (773) 604-5005, email info@thefbcg.com or visit www.thefbcg.com. There is absolutely no obligation.

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