Principles of Founder Succession

Cambridge Institute for Family Enterprise

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The irony for a Founder is that what made the Founder successful will likely not make the enterprise successful in the second generation. The model must change for success to be perpetuated. Here are some principles for how to do this well.

Replacing a Founder-CEO is one of the most challenging tasks for a family business—and for good reason. Founders have enormous influence. They are central to decisions large and small. They hold the key relationships. They are emotionally committed to the organization. The company depends on them. People are loyal to them.

A generational transition from a founder can seem insurmountable. But there is guidance for how to do this well and where to begin.

THE MINDSET OF A FOUNDER

To effectively design a succession transition from a founder, one must first understand the mindset of a founder and what drives him/her. There are many varieties of founders, and most of them do remarkable things as individuals and with their companies.

First and foremost, successful founders are value creators; their dream is to create and build value. They wake up in the morning, restlessly aiming to answer: *How do I solve this problem?* Their company is a vehicle for them to create value; building an organization in and of itself rarely is enough to motivate a successful founder.

Successful founders see trends that others miss. They are effective at commercializing on their innovations.

They are craftsmen. They know their craft better than most anyone else.

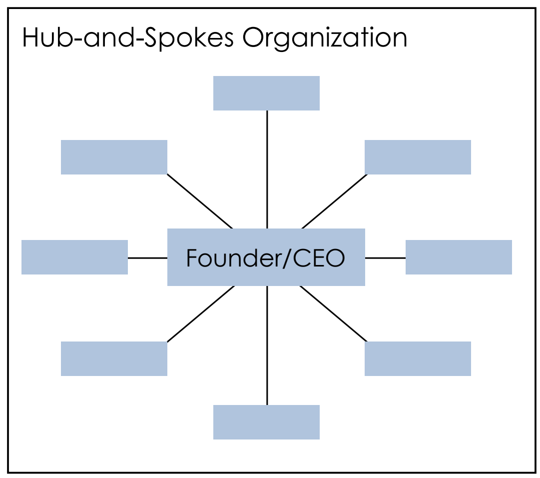
They are determined. Persistent. Convincing.

They are self-reliant. And they build organizations that wholly depend on them, where they remain absolutely central in the life and power structure of the company (a hub-and-spokes model).

Then, they reward loyalty for reinforcing this dynamic.

HUB-AND-SPOKES ORGANIZATION STRUCTURE

The organization structure of most early-stage and founder-led companies, by necessity, is the hub-and-spoke design: The founder is in the center of this organization; information flows into the center, and decisions from the boss flow out to be implemented. This can be a very efficient and effective way of organizing decision-making. In fact, most companies in the world are young enough and small enough to be organized this way.



This structure facilitates fast decisions. There is one person to ask, and that person can decide immediately. There are no layers of authority with which to check. It is quick. It is efficient.

It is also vulnerable. This structure is reliant on one individual who could make a mistake, have an error in judgment, or become impaired. Rarely do hub-and-spokes systems have a well-developed bench of talent that can step in and take over in the case of the founder's incapacity.

The hub-and-spokes organization structure allows founders to guide operations and make decisions whenever they want. It functions as the ultimate control mechanism where the founder decides what does and does not get addressed, prioritized, and implemented.

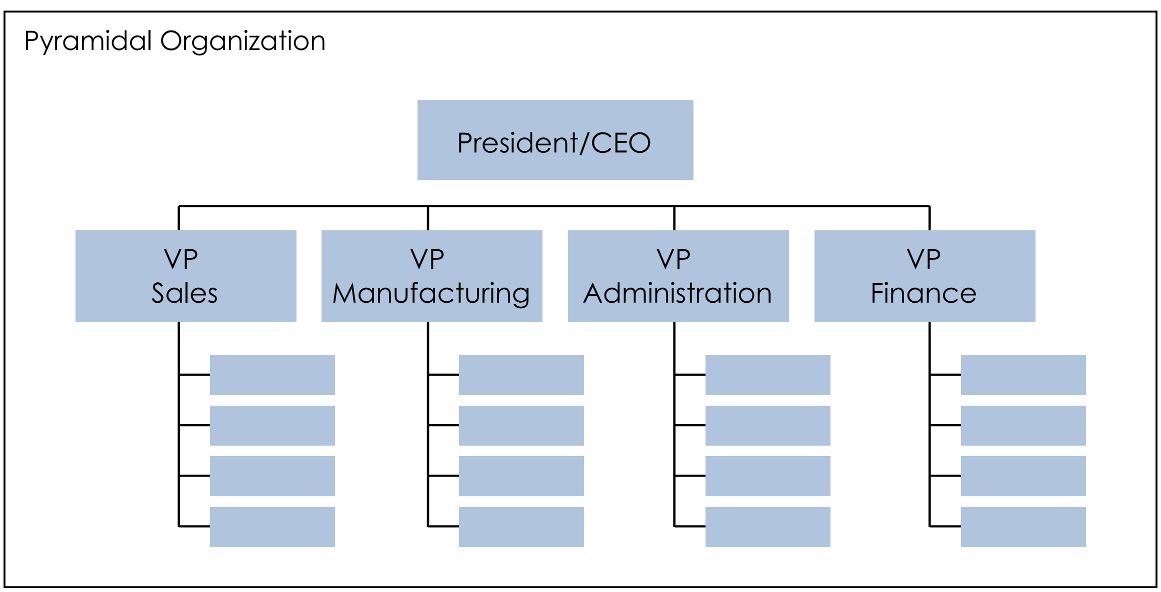
It can work well at the founder stage, and it often does. But it rarely works in the second generation, for a few reasons:

- If you have a successful organization that grows in size and complexity, at some point the hub-and-spokes model becomes an inefficient way to get work done.
- It is rare that you could replace the founder with a successor clone who can "plug and play" into this model and have the organization be effective. The successor is unlikely to be a carbon copy of the founder, and rarely do you even want that.
- If the organization is owned by more than one sibling, which it often is in the second generation, it is not politically acceptable to have one of the siblings replace the founder in that central role where everything revolves around him/her. This model does not fit well with a sibling team.

When a group of siblings own and lead the family business together, it is often a mistake to keep the hub-and-spokes structure. To change from this model requires a multitude of talent, more independent thinkers, a hierarchy of authority, and the removal of the founder from the center.

THE PYRAMIDAL ORGANIZATION STRUCTURE

The goal is to move from the hub-and-spokes model to a pyramidal model. In this structure, following the shape it is named for, the CEO sits on top, with a small executive leadership team below, and tiers of managers and employees fill the organization down to the base of the pyramid.



In this structure, responsibilities are distributed. Information is shared and initiatives are implemented through systems and processes. Direct reporting relationships are clear, and therefore accountability is applied. Career paths are more evident. People see where they fit. Siblings can find roles in the organization that match their capabilities. The system can still function when one person is absent. This structure also permits a new CEO to better implement changes.

If your founder-led company is currently organized as a hub-and-spokes structure, and you want to perpetuate the family business into the second generation, we recommend shifting to the pyramidal model. To move from the hub-and-spokes model to the pyramidal model, follow these guidelines:

- Structure the company's organization and ownership to allow more than one voice to matter
- Build structures, systems, and processes for decision-making that are not highly reliant on one person
- Build and add key management talent, and delegate authority to them
- Reserve some decisions for the founder – and respect the founder's important objectives and values – but allow for change in practices
- Build a board that can guide the company (with or without the founder)

THE IRONY OF A FOUNDER'S SUCCESS

For a successful transition from the founder, it is not only the organization structure that needs to shift. Entire groups need to be transitioned including management teams, ownership groups, boards, committees, councils and family leaders. But they are not necessarily to be handed over in their existing form.

The irony is this: What made the founder successful will likely not make the enterprise successful in the second generation. The model must change, and that means many of the ways that the system functions under the founder's leadership. This includes aspects such as: power, leadership, governance, reward systems, ownership, family relationships, communication, purpose, and others.

Let's look at how each of these aspects of a family enterprise need to shift during a founder succession transition.

Power will no longer be concentrated with one individual. It will be diffused among multiple siblings, which can result in siblings seeking recognition, status, and authority in the system. This can lead to siblings being sensitive to, and observant of, fairness, or the perceived lack of fairness.

The *Leadership* model often needs to take a different form. One single leader of the business, ownership, and family is unlikely to be effective for a group of siblings. A partnering mentality among the siblings is needed because siblings generally have relatively equal ownership. Siblings often want to apportion leadership responsibilities of the business, ownership, family, investments, and philanthropy among them.

Governance is often carried out by the founder informally. The founder decides the company's and the family's direction and identity, and provides the stability and adaptability the system needs. The founder is often also the leader of the family, and in that capacity, resolves family disputes and sets rules. At the sibling stage, governance does not function effectively when it is so informal. Fairness needs to be managed through structure (rules, principles, and processes) to avoid ambiguity. Roles and responsibilities need to be formalized and transparent. Processes for decision-making and dispute resolution must be written down.

The *reward systems* at the founder stage are decided by the founder. This often means that financial compensation and support to family members are unequal, not tracked, not transparent, and have no formal criteria. This lack of structure, and the perception of unfair treatment, can divide a family at the sibling and later stages, if they are not managed. Siblings benefit from evolving to a contribution-based (merit-based) compensation structure for jobs in the business and other roles in the enterprise.

Ownership will eventually transition from one controlling owner to a group of sibling owners. Ownership decision-making is then shared, with no one individual having a majority vote. Even if equity is divided equally, there will be greater diversity and inequality among the owners at the sibling stage: some owners will work in the business, and some will not. Some will have more capability to make ownership and investment decisions than others. Clearly defining the role of owners, and preparing owners for these responsibilities, is essential.

Family Relationships will change as individuals move from parent-child interactions to peer-to-peer or mentor-mentee relationships. This is harder for the senior generation than it is for the next generation to adopt. In the second generation, siblings need to interact more formally now as equity partners and not just sisters and brothers.

Communication needs to become more abundant, systematic, and transparent. Having business conversations at business meetings, and ownership conversations at owners meetings, and family conversations at family council meetings or at home provide needed structure and discipline.

The family's *Purpose* for staying together, and the values that guide their way, will require a collective buy-in from the second generation siblings. The next generation must take ownership of their mission (purpose) so it energizes them. They should not be saddled with inheriting a mission from the founder that they consider unmotivating out of duty.

With all that needs to change in a family enterprise during a founder transition, here are some practices to guide you:

- Clarify how the company/organization needs to evolve
- Prepare to move (or move) from the Hub-and-Spokes model to the Pyramidal Model
- Recognize the sensitivity of making substantial changes to the founder's "baby"
- Professionalize decision-making on complex issues (supplement family talent with non-family talent)
- Discuss family members' interests and job qualifications. Decide appropriate roles.
- Develop a **team** of capable next generation owners—with a shareholder agreement
- Help the founder develop a post-succession role that works for all

HAVE FAMILY CONVERSATIONS

Succession from the founder requires an abundance of dialogue, and many families restrict these to solely business discussions. Make space for family conversations too. As family members settle into new roles and learn to relate to one another in new ways, keep the foundation of supportive family relationships strong.

Remember that sons and daughters want their parents to be proud of them, and want their parents to support their growth and development.

Be mindful that parents want from their sons and daughters: respect; appreciation for their upbringing, inheritance, and opportunities; pride in their accomplishments; and to continue their legacy.

The successor(s) to a founder also need to appreciate what has been done well so far in the business, ownership, and family. When the incoming generation comes in believing that intelligent life in the enterprise starts with them, it is usually a derailer. Use family settings to express appreciation to one another.

THE ULTIMATE TEST OF A FOUNDER

The ultimate test of a founder is to relinquish the business that s/he created, built, and likely still loves. The mandate is not just to hand it over to the next generation, but to also invite the second generation to change it and make it their own. The founder is to encourage, support, mentor, and help the next generation to change the family enterprise.

This comes more easily to some founders, but for most, it is a painful detachment process. It requires substituting one's identity as the "founder of this business" for an identity as the "provider of a legacy." If one chooses to see it, there can be great pride and gratification in providing the next generation with a platform and a legacy, and then detaching from it.

THE NEXT CHAPTER

Some founders hand over the keys to the business and move on, opting for physical separation. They engage in new activities, sometimes running their philanthropic foundation, or serving on boards, or finding new acquisition opportunities.

Many founders move to the Chair of the Board role. This role is an important, part-time role leading the board of directors. It should not be a disguised title for hanging on to the CEO position or keeping a close eye on the new CEO. An effective board chair has a clear mandate that is supported by the board. The chair works symbiotically with the CEO, providing high-level aerial cover as the CEO changes the organization. If the chair does not support the new CEO, or undermines the changes that the new CEO is implementing, there is no reason for other people in the organization to treat the new CEO seriously.

The best scenario is a mutually supportive partnership between the founder, the chair of the board, the new CEO, the second generation owners, and the family.

ABOUT CAMBRIDGE INSTITUTE FOR FAMILY ENTERPRISE

The Cambridge Institute for Family Enterprise is a global research and education institute dedicated to the real issues facing family enterprises. It is a place where progressive members of family enterprises come to learn, exchange ideas, develop themselves and position their enterprises to be not only successful, but sustainable over generations. Its sister organization, Cambridge Advisors to Family Enterprise, advises multigenerational families around the world on strategies to sustain their success over generations.