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Challenging succession issues

A researcher gives advice to family businesses

By Marsha Zapson

Mitigating or eliminating sibling rivalry to ensure the continuation of a family business has become for Frank Sulloway—lecturer, family business consultant and professor of psychology at the University of California at Berkeley—a topic on which he devotes much of his time. He advises business owners and family offices on how to prevent the dissolution of a family business due to sibling-sibling or parent-sibling rivalry.

Sibling rivalry is hard wired from the perspective of evolutionary psychology, says Sulloway. Sibling-sibling and parent-offspring conflicts are flip sides of the same Darwinian coin, and there's abundant research in animal biology on such conflicts, he says.

Sulloway notes that patterns of sibling diversity as well as conflict, for example, that are seen within the family are also seen in family businesses. For example, if siblings are hard wired to compete, then strife will ensue when succession is in the offing (just as it may do at an earlier stage when parental approval is at stake). However, says Sulloway, the opposite may also be true, namely, that siblings are hard wired to cooperate—with a potentially more benign outcome in the succession process.

"There are circumstances documented from evolutionary biology, under which siblings will cooperate," he says. "They'll cooperate when the costs of doing so are relatively low. But the benefits to be derived from helping a sibling, under those circumstances, are quite high."

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Altruism reinforced

If the owners of a family business want their offspring to run that business, says Sulloway, then the parents need to start a life-long education program focused on altering the balance between cooperation and competition. The goal is to maximize cooperative behavior, and parents can enact some fairly simple strategies to do so.

Siblings can be made to realize that pulling together and cooperating with one another is a win-win situation. In the family business, it's important to set tasks for the children that are not discrete or competing tasks. Rather the parent-owner assigns joint tasks, in which the sum of the project's various parts are considered, rather than individual contributions.

"The more you can convince family businesses to create joint projects and reward cooperative endeavors, the better off it will be when succession is being decided," says Sulloway.

Given that siblings will compete over just about anything, parents can direct their children into competing over being cooperative, he says. If parents create an atmosphere in which cooperation is seen as a highly desirable and valued trait by the parents and the family, siblings will attempt to gain parental favor by cooperating, he says. The only problem is implementation.

One solution is to hold regular family meetings, to place a major emphasis on those meetings and to begin them early on, when the children are six, seven or eight years old. "Family meetings foster an appreciation that the family is a democracy," says Sulloway.

"Essentially family meetings really do represent a kind of open-book policy. It's saying that we as a family value communicating information, and that everyone has input, and that all input is weighted equally. It's a democratic as opposed to a dictatorial spirit."

On a similar but slightly different note, succession may be further complicated by the chief executive himself. In many instances, says Sulloway, the person running the business believes that only one child can take over. "And they agonize over the decision, knowing that the appointment—whomever they select—will destroy the family by favoring one child above the others."

Sulloway proposes two alternatives to this.

Dual principals

One is sibling partnerships, which business theory used to say couldn't work but which actually do work. This kind of partnership defies an older theory that says only one head can wear a crown. "There are plenty of family business consultants who will show the family how to set up sibling partnerships with power sharing," he says.

But sibling partnerships don't work for everyone. They're much more successful if a family has spent a long time training the children to think and act cooperatively, he says. "But if you don't go that route, and you appoint one offspring and only one to the new CEOship, the best way to go about it is to use outside consultants."

Family business consultants can advise a business through that delicate transition period. They enter the family business, as well as entrenched familial dynamics, from the outside. Under a flag of impartiality, they conduct an evaluation of all the candidates, based on interviews with family members and other employees, regarding each candidate's strengths and weaknesses.

The candidates are told what the consultants learned, which includes how they're perceived in their family business and what employees think of 23▶

◀11 ners in its alternative groups, a majority are either those who have run businesses or have been significant principals in entrepreneurial ventures. These investors are comfortable with the risk associated with private equity, having been recipients of such investments themselves, and are very often first time or "early" alternative investors, as Hass describes them.

Many of these investors have had relationships with other Brown Brothers divisions, such as mergers and acquisition or commercial banking, to help them grow their business or sell it. Once the business is sold, the entrepreneur turns to the asset allocation group to manage the newly liquid assets in his portfolio.

"The key to building a successful private equity platform is earning the trust of a group of private investors who, for the first time, will invest in someone else's privately held business, rather than one they control themselves," says Hass.

To offer access to its alternative investment products, Brown Brothers generally wants investors to have $10 million of inevitable assets, he says. "We want them to have an understanding that these investments are illiquid and volatile. Even with a diversified fund-of-funds, for example, on an individual basis, the underlying portfolio companies are likely to experience greater swings in performance than those in a conventional large cap equity portfolio."

In 1989, the firm formed its first proprietary private equity fund. Today it offers one fund of funds (which has invested in 18 subfunds), and four private equity funds that have invested collectively in 49 private companies or mostly controlled public companies. The multistrategy private equity fund of funds is jointly managed by Brown Brothers and Wilshire Associates. All the products are sponsored by Brown Brothers' private equity team.

The first three funds—the 1818 Fund, the 1818 Fund II and the 1818 Mezzanine Fund LP—were organized exclusively for large institutional investors who were willing to commit $10 million or more per subscription.

The fourth, the 1818 Fund III, is a little unusual. It too was initially organized with that large institutional investor in mind, but for the first time, "the firm built a bridge between its investment management business and its private equity business, enabling clients with less capital to invest in the fund," says Hass.

While the 1818 Fund III retained its $10 million minimum, the bridge—which took the form of a subpartnership called BBH&Co Private Equity Partners—created a venue for investments of $1 million or greater. As a result, Brown Brothers aggregated 84 subscribers with some $118 million. This pool then subscribed as one large limited partner to the 1818 Fund III, which currently has about $530 million under management.

Recognizing the appeal of private equity for those who can't afford a $10 million minimum, the firm launched a distinct unit within its investment management group that will, on an ongoing basis, create similar aggregation vehicles for smaller investors.

The second instrument to come under that rubric was the fund of funds. It was designed with a minimum of $500,000 and attracted 134 investors; its assets are about $102 million. The third vehicle, organized early this year, is another subpartnership called BBH Mezzanine Partners II LP. It was designed for the firm's most recent fund, the 1818 Mezzanine Fund II, to permit $500,000 minimum investments.

Hass attributes some of the appeal of the firm's funds to the BBH culture: "Even though private equity can be perceived as high octane, many investors take comfort that Brown Brothers has what I would call a risk-sensitive investment culture." ✦

◀19 them. All the sibling-candidates then come together in one room, and a discussion led by the consultant encourages communication among them.

What generally emerges from these meetings is a clear indication of, and agreement on, who ought to be the new CEO, says Sulloway. In this scenario, the decision is not necessarily made by the incumbent CEO, but rather by the siblings collectively.

Once the decision is removed from the parents and given to the children, under controlled circumstances, the chances of the family business surviving into the next generation are greatly improved, he says. One of the highest hurdles in this example is wresting control away from the CEO and convincing him to abdicate the decision-making process. "For him, it's almost counterintuitive," says Sulloway.

And finally Sulloway makes other suggestions that are standard family business advisor fare, such as recommending that children work outside the business. Leaving the family, entering the world and achieving a success that is not family dependent helps break niche sibling stereotypes that may cripple individual performance and perhaps jeopardize the business's future.

A child's going off on his own can challenge patterns and expectations within the family dynamic that have been reinforced over decades, and allow siblings to interact more as equals.

While many different factors ultimately make a family business successful, much of what Sulloway suggests depends on early intervention. If that has not occurred, then the survival of the family business may be more precarious.

Yet, some family businesses ought to be sold, says Sulloway: those in which early intervention was not practiced, the siblings are contentious and the CEO is autocratic. In these cases, it's best to sell, divide the proceeds, and allow the siblings to go their separate ways.

"Family business consultants are very skilled in dealing with these issues," says Sulloway. "Many times I say: 'This is what I think you should do, here's the phone number of the best consultant in your area. Call him up, see if I'm right, and see if he can come in and set up the legal mechanisms that implement these broad solutions.'" ✦