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Assessing a failed family enterprise:
Why a strong organizational structure is essential

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In late 2015, I sat in a conference room with my relatively new clients, the second- and third-generation executives of a 61-year-old manufacturing company, when they decided to sell. Fortunately, despite years of losses, the business was a strong strategic fit for the buyer, and the family was able to negotiate a price far in excess of what traditional valuation techniques would have supported. Unfortunately, they took the offer only when their company had fully depleted the financial resources needed to operate independently. Had they pursued this opportunity when first approached 12 months before, they could have walked away with about $3 million more.

The arc of this company's history is both common in my 30 years of experience and highly instructive. What were the underlying reasons for this company's initial success and eventual failure, and what strategies can help ensure sustainability and protect the value of a family enterprise?

Rise and fall of a family enterprise

When Harry started the company with his wife in 1954, he operated as a sales representative in the Midwest for a group of office supply manufacturers. (Names of the principals have been changed and the company name has been omitted because of the sensitive nature of the topic.) Through June 1970, the business never quite got "over the hump." Sales grew sporadically to about $700,000 annually, and cash flow problems were common. At that point, Harry brought his nephew Dan into the business.

Dan, the graduate of a "prestige" business school, was a smart, ambitious, dogmatic and domineering workaholic. He quickly identified a growth opportunity by observing that the company's customers were increasingly investing in advertising specialties to promote their businesses. Further, he learned that many suppliers in the industry were plagued by inconsistent quality and unreliable deliveries. The company began to manufacture a small line of rulers and letter openers that could be imprinted with a customer's name and logo. The service was marketed aggressively, with a promise of consistent high quality and shipment no more than three business days after receiving an order. Sales began to grow rapidly.

Within two years, Harry reduced his time commitment to the company substantially and Dan assumed the responsibilities, if not the title, of CEO. At the same time, Dan's brother Kevin joined the business. While also bright, he lacked Dan's drive and was passive by nature. Then, in 1982, Harry passed away. Harry, who had no children, left 75% of the company to Dan and 25% to Kevin.

By 2000, with Dan's driven, dogmatic and domineering style serving the company well, the business had enhanced its product line substantially and had about 110 employees. Dan began to import "blanks" that could be imprinted in his plant, developed a national network of independent sales representatives and purchased a 150,000-square-foot manufacturing facility.

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Volume grew to about $30 million annually, net profits averaged about 5% of sales and the company built a strong balance sheet.

In 2001, Dan's son Chris joined the business after spending five years as a financial analyst. At about the same time, Internet marketers that sold directly to advertising specialty customers began to gain market share. Initially, while real, the impact was considered moderate; growth slowed and profit as a percentage of sales dropped about 30% on average. By 2010, however, Internet-based competition had significantly disrupted the industry, and the company's sales began to plummet. Finally, after refusing for five years, in 2012 Dan reluctantly agreed to authorize the development of a website to compete with the established Internet marketers. The company invested more than $4 million in the effort through late 2015, but it didn't make a material impact on sales. Most significantly, the website investment along with ongoing losses had depleted the company's cash reserves. At that point, there was no choice left but to sell.

The family management team and company organizational structure

After Harry passed away in 1982 Dan assumed the CEO title and Kevin became the executive vice president. In his role as CEO, Dan held responsibility for the overall direction of the company as well as marketing, sales, finance and human resources. As EVP, Kevin oversaw manufacturing, buying and catalog development. In 2010, Chris became the third family executive and assumed full responsibility for day-to-day administration and information technology. Dan continued to be the dominant force in the business, profoundly influencing both how decisions were made and how the company functioned.

To more fully understand Dan's impact as CEO, it's essential to look at him as both a man and a manager. In many respects, he could best be defined as passionate. He had a great love for music and sports and reveled in talking about his favorite performers. At the same time, his greatest passion was the business. Regardless of the arena, he held strong opinions and had difficulty considering the thoughts or feelings of others. Complicating this, he lacked self-awareness and had little appreciation for how his behavior affected others, including his family. As a manager, he focused on building sales and profits but had relatively little interest in developing a strong organization.

How did all of these factors affect the family management team and the overall organization? There were three key areas:

• First, while generally below the surface, family issues were ever-present. Kevin greatly resented Dan's 75% ownership interest and felt powerless. Moreover, Dan's working relationship with his son, Chris, was quietly strained. I'll always remember Chris's heavy sigh when I asked about his ability to work comfortably with his father. Chris, a product of the first of Dan's three marriages, talked at length about his feeling that Dan's current wife showed little interest in him or his two siblings. Importantly, and quite possibly because of their histories, Dan was incapable of holding either Chris or Kevin accountable when they performed poorly. As a result, Kevin and Chris's tendency to miss deadlines significantly hampered the company's ability to execute.

• Second, the organization had established little in the way of fundamental management practices. As a family management team, Dan, Kevin and Chris didn't meet regularly. They had no meaningful planning process and no consistent forum for discussing issues or implementing action plans. Almost as significantly, the family invested little time, effort or money in building a middle management team. Only the controller, whom the family refused to give the more appropriate title of CFO, played an important role, albeit one with no real authority. Finally, the

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family invested no meaningful time pursuing management training opportunities for either themselves or their employees.

• Third, given all the issues described above, Dan had unknowingly created a destructive culture, and there was a pervasive cynicism throughout the organization.

So what happened? From 1970 through 2000, the nature of the advertising specialty business had been relatively stable, and this served Dan's style well. When the industry began to change profoundly though, this was no longer the case. Dan wasn't equipped to change and had created a family management team and organization that was also incapable of responding effectively. For many years, Dan refused to go online and market directly to the customer, and his team, including Kevin and Chris, had neither the expertise nor the standing to influence that decision. Finally, when circumstances forced Dan to relent, he made the fatal decision of assigning Chris the responsibility to manage the project. No one -- not Dan, not Kevin and certainly not Chris -- realized that he lacked the training or experience to lead the effort successfully. As a practical matter, this decision eliminated any chance for the website effort to generate the sales needed to offset the decline of the company's core distribution channel.

Vital lessons to be learned

Sustainability has always been a central challenge for family enterprises. Dan successfully built sales and profitability for decades -- but he failed to build an organization with the potential to sustain the family business for generations. Furthermore, he also failed to understand that family enterprises face a series of threats to sustainability, and that these threats make it crucial to have an effective organization. The threats include an understandable inclination to place family members in high-level positions regardless of their qualifications; the tendency to become overconfident when performance is strong; the failure to be forward-lookng at all times; and the likelihood that family considerations will be allowed to compromise key business decisions.

This company's example offers lessons for other family enterprises:

1. Human capital must be continuously enhanced through professional training. Every family member, including the CEO, must be required to make a strong commitment -- perhaps a minimum of 40 hours per year in a classroom environment.

2. Organizational structures must be put in place: clear job descriptions; regular reviews; well-defined objectives, both individually and organizationally; consistent accountability; and the regular communications needed to ensure that all employees understand both the company's challenges and its progress.

3. A constructive culture must be created that fosters foresight and openness to change, supports individual career development and growth opportunities, provides compensation and bonuses that are aligned with corporate goals, ensures the ability to be heard and fosters a belief that management decisions support corporate sustainability and individual job security.

4. An effective, forward-looking planning process must be established. To that point, some larger companies now appoint a "Chief Change Officer." While most family enterprises may not be of a size to support a full-time person with that role, at least one family member should be tasked with tracking significant industry and economic trends.

5. The family must respond proactively when performance lags or serious threats to sustainability arise.

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6. The family must be able to make collaborative decisions, with all parties given a real opportunity to contribute to key discussions. In many cases, the use of a trained family clinician to facilitate these conversations should be strongly considered.

You could easily say that the steps presented above are simply common sense and, in fact, they are. A commitment to implementing these steps -- notwithstanding the complex interplay of personalities, capabilities and family history -- can help every family enterprise develop a strong foundation for sustainability. FB

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