BRIEFING NOTE

Following a Founder—Issues of Transition and Continuity in Family-Owned Businesses

The Paradoxical Nature of The Successful Founder

Recent research suggests that within the next 10 years, 40% of business owners expect to retire. Because of its far-reaching strategic implications for business owners, this figure may appear staggering. However, recent research also suggests that approximately 31% of business owners have no plans to retire at all (American Family Business Survey, 2007). In fact, many founders when speaking about death will not say “when I die,” but “if I die.”

Although continuity of leadership is a key strength in businesses, Thomas Neff, chairman of the executive search firm Spencer Stuart U.S., notes that very few organizations—publicly or privately held—have more than one legitimate candidate, and an increasing number are caught without anyone properly groomed to assume the founder’s leadership role. Founders of businesses have a strong sense of invulnerability and immortality—it is this powerful belief in their ability and their vision for their business that has made them successful. Yet, these same characteristics present a paradox: the passion that keeps the founder closely connected to the business and drives success also blurs the distinction between the two, so that the founder and the business are seen and experienced as one entity. This melding of the identities between the founder and the business becomes problematic when considering the business’ future without the founder.

The long physical presence of a founder in a business, whether running the business directly or not, enables the articulation and dissemination of a consistent vision and strategy for the business. One remarkable aspect of successful family business continuity is a founder’s ability to embed strong core values and a clear vision, while also developing the managerial skills of key leaders, something not all founders are able to do. The viability of any business succession is inextricably linked to the organization’s preparedness in thoughtfully addressing leadership transition and sustainability long before the business is faced with this reality.

Preserving The Founder's Legacy—Pulling Yesterday's Success Forward

The same longevity of leadership that is highly valued by key internal and external stakeholders becomes a critical vulnerability when the founder is no longer physically present. At the same time, developing a succession plan can be anxiety producing for the founder and for the business as it surfaces worries about the organization's viability and the founder's vitality. However, as noted in Jim Collins' book Good to Great (1991), the characteristic of a great leader is one who sets up the company to succeed after he or she is gone. Businesses—from large, well-institutionalized businesses to smaller, less formalized ones—often falter when the founder departs. While many of these businesses recover, unfortunately, many others do not.

If a company has grown psychologically dependent on a founder with extraordinary authority and charisma, company executives, including the founder's own children or nieces and nephews, employees, and the market may have difficulty distinguishing those elements of the founder's characteristics and personality that matter to the business' future and those that do not. In fact it may not occur to them to ask this question. Furthermore, the founder's presence and power may crowd out, undermine, or under develop emerging leaders. As the old adage warns, "Acorns seldom flourish in the shade of great oaks," a new leader, attempting to replicate the characteristics of founder, may be seduced into focusing on superficial or inconsequential matters rather than honing in on the fundamental strategy for the business of today. We know that strategic adaptation is an essential element of continuity, and that at just the time adaptation may be needed, holding fast to a static view of what success entails can become an emotional pull that clouds real analysis (Drozdow & Carroll, 1997).

Failure to anticipate and create robust plans for the time when the founder is no longer leading the organization is common. Board members and the organization's leadership must dedicate time to think carefully about succession planning. Without planning, what may seem quite clear today—for example, mission, values, vision and strategy—can suddenly become less clear and open to interpretation without the presence of the founder as arbiter. Newly authorized executives that are not sufficiently immersed in the business' economic rationale and mission, values, and vision, may move too fast or too slowly in responding to marketplace signals. In either case, the business can be put at risk.

A Perspective on Continuity—Business Beyond the Second Generation

A well-known Mexican saying about family owned business is: "Padre noble, hijo rico, nieto pobre" ("Father founder, son rich, grandson poor"). Conventional wisdom of family-owned businesses supports this perspective; data from leading organizations that study family-owned businesses seems to draw the same conclusion. The vast majority of family-owned businesses fail to continue into a second generation—fewer family businesses make it as independent entities to the third generation. Research shows that no more than 30% of all family-owned businesses survive into the second generation; 12% will still be viable into the third generation, with 3% of all family businesses operating at the fourth-generation level and beyond (American Family Business Survey, 2007).

While the process of continuity is a complicated and risky one, there are many companies in their second, third, fourth, and later generations creating value for their shareholders, great products for their customers, and work satisfaction for their employees. The first requirement for successful continuity is an overriding commitment to continuing the business and subsuming other goals under that overarching objective. Then the company's leaders (either those running the company or those owning the company, and hopefully both together) can deliberately attend to those areas that require attention (see chart on next page). Often, some areas are higher priority than others. Typically, if the business has been successful, all of these areas have had some attention.

It is important for leaders to view each of the areas of the business from the unique perspective of continuity: what do we have to think about, pay attention to, take action on in the area of leadership, for example, to ensure this business continues for another generation? What do we have to think about, pay attention to, and take action on in the area of governance so that this business continues for another generation and so on? With this perspective and commitment, great companies can thrive, building on what the founder created, but not being bound by it.

Attending to What Matters—Managing Transitions for Successful Continuity

To successfully transition from a founder to the next generation, the continuity process requires significant attention along multiple fronts, including:

- **Plan for business leadership succession.** Succession should be thought of as a mindset rather than an impending, dreaded future event. A founder can support the development of strong leadership well before he or she considers leaving the business. This leadership development should not only focus on business acumen, but should also work to develop an appreciation for and adeptness at the particular interpersonal demands on leaders following a founder.
- **Use strategy to preserve the core values of the business.** A departing founder creates a vacuum where misguided initiatives can potentially be swept into the business, or good ideas that don't fully align with how the business viewed itself in the past may be overlooked. With a departed founder, this type of situation can seem difficult to navigate. Develop a business strategy that adapts to the changing environment and organizational context by clarifying values so that business leadership knows what to pull into the organization and what things they will say "no" to doing.
- **Develop sufficient cohesion among the ownership group to collectively determine an ownership strategy.** Ownership must support the business; that is, an appropriate capital structure coupled with appropriate returns to owners. Typically this also means attending to the tax and liquidity issues of shareholders without letting this drive the ownership strategy.
- **Strengthen shareholder governance and leadership skills.** Shareholders play a critical role in the success of an organization by adhering to governing processes that clearly define roles and responsibilities of its members and the organization's leadership. Furthermore, the board, embodying the mission and values of the organization, helps to provide guidance and leadership to the business by holding it accountable to its strategic goals through evaluation and assessment.
- **Develop the organization and its culture.** Creating the environment for a nimble and innovative business means directing leadership and board attention towards employees and communicating to them in a manner that evokes loyalty to the fundamental strategy of the organization—a loyalty that translates beyond their allegiance to the founder. This openness presents opportunities for both loosely- and tightly-held authority in roles and responsibilities (not too much hierarchy and structure, but not too little either).

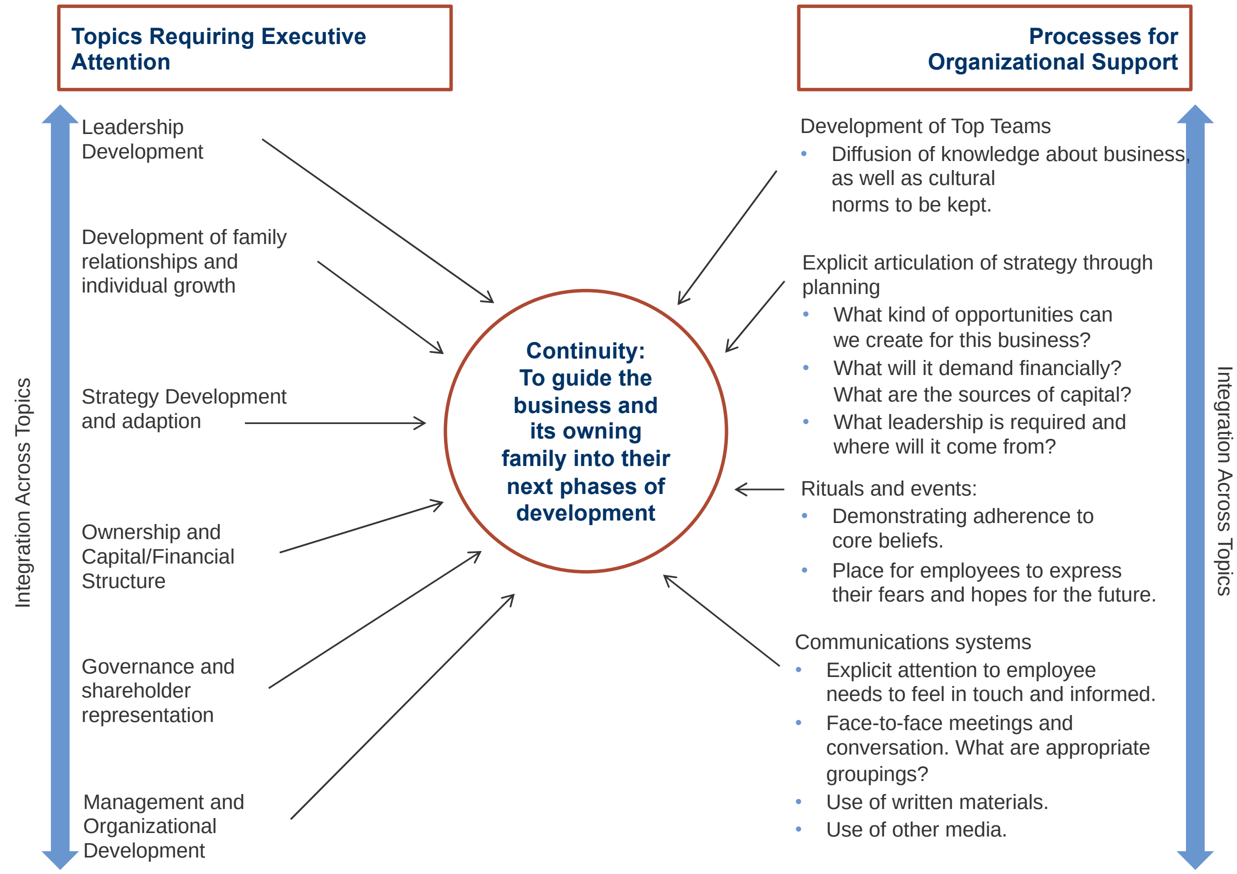

Figure 1. Managing Continuity and Growth in Mission-Driven Organizations

It is challenging to manage all of these streams of activity simultaneously, although this is often what is required. The technical business challenges are often complicated in themselves: competitive pressures, financing or investment issues, for example. When these are accompanied by the deep feelings people have about the loss of the founder and the uncertainty and anxiety produced by the loss, many firms and their leaders are simply overwhelmed. When in distress and mourning, most people are least able to harness their most positive and enlightened selves.

The Complex Reality of Leadership Transitions: Three Cases of Founder Succession

The cases summarized below are drawn from a variety of public sources. The illustrations are not necessarily meant to provide a detailed first-hand account of the organization's succession; rather, these stories are meant to offer a glimpse at issues of founder transition and continuity when a long-time leader is no longer at the helm of the business.

Disney—A Small World of Conflict—Embedded family tensions between founders, and the lack of a viable succession plan, created many leadership struggles over Disney's 85-year history.

Walt Disney and his brother Roy started the Disney Company in 1923. Walt was the creative genius while Roy handled the money. Over time, minor resentments between the brothers grew into coalitions in the business. Although Roy became Disney's chairman upon Walt's death in 1966, he was, in fact, only a third of a ruling troika—the other two members of the power team were Walt's chosen right hands. Having no sons, Walt had selected his daughter's husband as his true successor. This cemented the difficulties between the two sides of the family, since Walt's son-in-law had neither experience nor skill in running the business.

Between 1966 and 1984, the value of Disney stock plummeted. The leadership team made strategic decisions by asking the question, "What would Walt have done?" In 1967, Roy E. Disney (son of Roy Disney) was elected to the Board and given the daunting task of protecting the family traditions within Disney. By 1984, the company had dropped from number one in the box office to number 12 and Roy E. Disney's holdings alone lost $30 million in market value.

By 1977 Roy E. Disney had resigned his job at the company but retained his board position until 1984. He had witnessed the decline of the company, but had been unable to affect any change from the inside. Company insiders who retained a cult-like admiration for the deceased Walt Disney called Roy "the idiot nephew."

Now, however, the business faced a new threat as corporate raider Saul P. Steinberg attempted to buy up enough of Disney's stock to pose a takeover challenge. Alarmed, Roy E. Disney rejoined the board. He and his team defeated Steinberg and was instrumental in recruiting new leadership for the shaken company, including a new CEO, Michael Eisner, in 1984.

Under Eisner's leadership, Disney successfully expanded its business reach into new areas such as retail and network media, while sustaining and affirming the original core of animated films. However, according to Roy E. Disney and his allies, despite his successes, over time Eisner himself seemed to lose his connection to the core of the Disney brand. Roy came to dislike Eisner's management style and strategic direction, saying in a letter explaining why he quit the board, that the company had become "rapacious, soulless, and always looking for the quick buck." It is the lost heritage he decries, not lost money (USA Today; McCarthy, March 3, 2004). An epic clash over the soul and direction of company ensued with Eisner ultimately leaving and Roy returning as an emeritus board member, continuing to advocate for the core values of the business founded by the brothers Walt and Roy Disney.

Versace—An emergency leadership transition and subsequent shift in strategy eventually produced stability and renewed success.

Gianni Versace grew up in Calabria, Italy with his sister Donatella, his brother Santo, and their mother, who owned a dressmaking business. In 1978, Gianni founded the Gianni Versace Company with the help of Santo, who had more business expertise, and Donatella, who designed accessories and later created a children's line. Gianni Versace quickly rose to fame for his distinctive cuts linked with high art and contemporary culture. Over the next 20 years, Gianni became a fashion icon and head of a multimillion-dollar fashion empire.

In 1997, Gianni was murdered by a serial killer at his home in Miami, Florida. Without its leader and icon, the company seemed headed for demise. Finances fell dramatically, and the firm wallowed in debt.

Remarkably, Gianni's siblings managed to keep the fashion house afloat, and the end of its founder proved the beginning of a new era for Versace. Donatella, at the time better known for her drug addiction and infamous nightclub antics, went into rehab and emerged to become the creative director of the fashion house. Santo became CEO and worked to right the company's finances. Together they restructured the company and rethought its strategic direction.

Several years after Gianni's untimely death, the Versace name still retained some of its cachet, adorning stars like Jennifer Lopez, Madonna, Gwyneth Paltrow and other dignitaries at major high profile events. However, despite Versace fashion's continued visibility, sales in 1999 of $374M and in 2000 if $392M remained significantly lower than the $560M in sales generated the year of Gianni's death (New York Times; Kaufman & Sorkin, April 16, 2002).

The company farmed out design responsibilities to another famous design house, and recruited Giancarlo Di Risio from LVMH's Fendi label to revive the Versace brand. When Di Risio join Versace in the summer of 2004, the house was drowning in more than $146 Million in debt and heading to a net loss of $124 Million for the year, on revenue of $416 Million. High-end retailers such as Bergdorf Goodman had stopped carrying the brand.

Di Risio and Donatella negotiated their respective roles. As Di Risio put it, "Donatella is here to create. My mission is to turn her work into business. Fast." By 2007, the fashion house was back on track. Donatella's restrained styles had changed significantly from the glitzy Gianni years, and they were winning rave reviews. Revenues buoyed and Gianni and Donatella's niece, Francesca, was poised to become the new heir apparent. The fashion business of the formidable and resourceful Versace family lived on, long beyond its founder, using the family's resilience and adaptability as key strengths.

Estée Lauder—Long-term vision and succession planning can create continuity and growth in a family business.

Founded in 1946 by the legendary Esther Lauder and her husband, Joseph Lauder, the Estée Lauder Company at first produced only four products: a super rich all-purpose crème, a crème pack, a cleansing oil, and a skin lotion. The company began with sales to New York City's Saks Fifth Avenue in 1948. It quickly expanded to sell to other leading department stores in the U.S. and, later, internationally. Estée Lauder bought a number of other cosmetic companies, and product lines grew to include fragrances.

Meanwhile, the Lauders developed leaders within the family. Esther and Joseph's oldest son, Leonard, joined the company in 1958 and was groomed for leadership early in his tenure. In 1972, he became president; a decade later, he was also named CEO. Leonard took a strategic approach to selling. He also took care to maintain relationships with store buyers. Faced with increasing competition during the 1970s, the Lauders' private ownership of their business allowed them to remain flexible and respond quickly to changes in the market.

Many other family members were involved in leadership of the family business as well. Ronald Lauder, Leonard's brother, served as executive vice president and later chaired the company's international operations. He also ran Clinique Laboratories, a major subsidiary of Estée Lauder. Leonard's wife, Evelyn, supervised new product development and began to take on Esther's role as company spokesperson. Co-founder Joseph managed production at the Melville, Long Island plant until his death in 1983. Esther became chair of the board and started to step back, working mornings from home and coming into the office only in the afternoons. In 1995, she stepped away completely, assuming the honorary title of founding chair. Leonard then became chair of the board, remaining CEO as well, while COO Fred Langhammer took on the presidential duties. Leonard once summarized the philosophy behind the company's success saying, "We think in decades. Our competitors think in quarters" (Women's Wear Daily; Born, July 13, 1990).

This long-term vision has indeed served the family business well. Today, the company employs more than 20,000 people and sells products in over 100 countries, generating revenues of $4.7 billion. Esther passed away in 2004 at the age of 98, Leonard, now 74, is Chairman of the board, and his son, William, now serves as CEO. The family has managed to retain a majority of its company's common stock and nearly all of the voting stock.

Conclusion

Successful founders can present a paradoxical dilemma for the businesses they found. The founder's larger-than-life persona and a belief (within the business and/or within the external marketplace) in his/her eternal leadership, can give an organization a strong sense of stability and consistency. However, this characteristic also suggests that the founder may cast a long shadow over the organization, inhibiting emerging leaders and blending the founder-business boundary. This leaves a successful business vulnerable when the founder is no longer available to lead.

The founder can perpetuate his or her success by positioning their business for growth and sustainability by explicitly emphasizing transition and continuity to support the next generation of leadership. This work requires proactive initiatives by the founder to plan beyond the business' current success. The strongest indicator of an organization's future success lies in how it plans today to follow future initiative made by the founder.

While considering a future without the founder can raise anxieties, businesses that take up this work early are positioning themselves to continue to drive business value and success beyond the founder's tenure. These businesses are thinking strategically about their future by attending to what matters:

- Leadership succession by investing in emerging leaders.
- Clarifying and preserving core values to give business leadership guidance.
- Developing cohesion among the ownership group to determine ownership strategy.

- Strengthening shareholder governance and leadership skills.
- Organizational management and growth by creating the right organizational culture.

Organizations that effectively manage transitions for continuity begin by addressing the interdependent transition issues that impact success.

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