Leadership Succession:

Best Practices from the World's Leading Family Businesses

EgonZehnder

FBN international
THE FAMILY BUSINESS NETWORK

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Preface

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Leadership succession is one of the most critical and daunting tasks a family business can face. Unfortunately, there are few resources that set forth in a concise way established best practices and then provide practical guidance on their implementation.

Leadership Succession: Best Practices from the World's Leading Businesses seeks to fill that need. This handbook outlines the five steps to success that enduring family businesses follow in their own leadership succession practices and is based on extensive interviews with the chairman and chief executive officer of such companies. Each element of success is described in detail along with diagnostic and implementation tools to help readers apply the principles to their own organization. The handbook is built on research conducted by Egon Zehnder and the Family Business Network, the world's leading family business organization, as well as guidance from Sabine Rau, professor of Entrepreneurship and Family Business at King's College London.

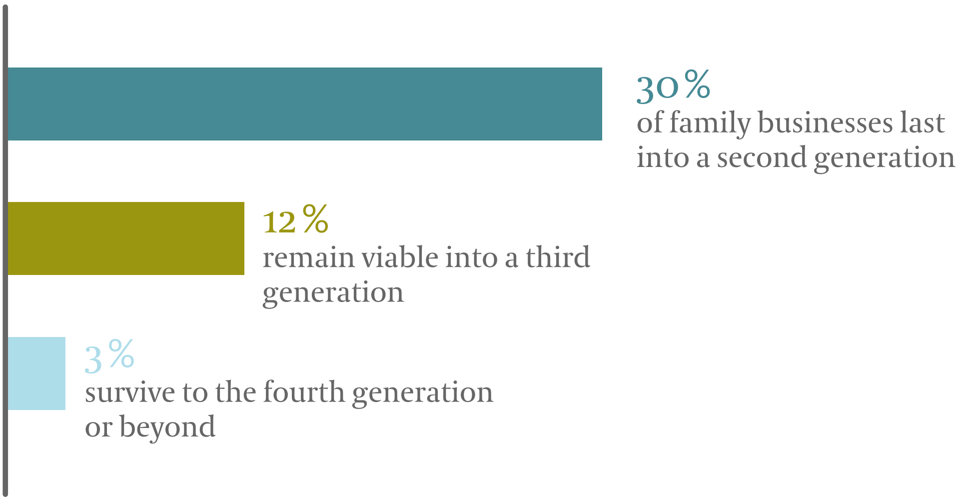
It is our hope that those responsible for succession planning in family businesses will find this handbook to be a useful guide in their endeavors.

Family businesses: Powerful but vulnerable

Family-owned businesses play a major role in the global economy. Family members control a significant share of:

- *One-third of Standard & Poor's 500 companies*
- *Forty percent of the 250 largest firms in France and Germany*
- *More than 60 percent of large corporations in East Asia and Latin America*

However, it can be difficult for family businesses to achieve long-term success. According to the Family Business Institute:



Just as with non-family owned companies, the ability to attract and retain the right chief executive officer and other senior executives is an essential component of long-term success and stability. But board directors of family businesses give themselves much lower performance ratings than board directors of non-family companies in the realm of talent management.

The Family Business Leadership Study

In order to better understand how family businesses can develop effective senior talent management, Egon Zehnder and the Family Business Network, with guidance from Sabine Rau, professor of Entrepreneurship and Family Business at King's College London, conducted extensive interviews with family members and senior executives at 50 leading family businesses. The interviews examined the most recent change in top leadership, including the method of identifying the successful candidate, the evaluation criteria, the family's role in the process, family members' perceptions of the successful candidate, the successful candidate's view of the family, the first 100 days of integration and the family's communication with the new leader.

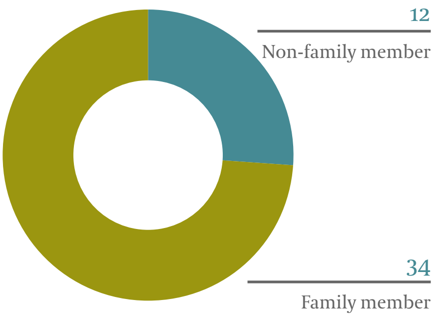
The companies that were surveyed:

- *Have at least 50 percent of voting rights controlled by family members, most of whom are in the third or fourth generation*
- *Have a minimum of €500 million in annual revenue*
- *Are among the top three companies in their respective industry and geographic market*
- *Are drawn from a wide range of industries and represent a truly global sample*

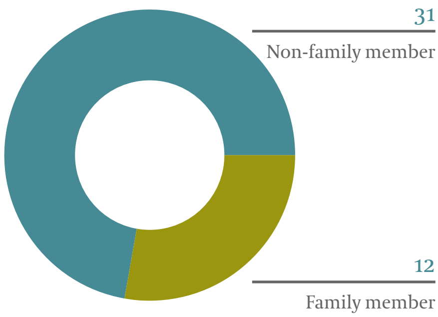
At most of the companies surveyed, a family decision maker and a non-family executive were separately interviewed. Interviews were conducted between January and August 2014.

Eighty-nine executives were interviewed, including:

46 Chairmen



43 CEOs



We gratefully acknowledge the many family and non-family chairmen and CEOs who generously shared their thoughts and experiences with us and contributed to the insights of this report.


Don’t rush.
Be precise.

Elements of success

Our study showed that successful family-owned companies followed five common steps in their approach to leadership succession:

1. Understand the organization's unique "family gravity"

2. Establish a strong and structured leadership succession process

3. Have a clearly defined corporate governance process

4. Understand what is needed in the family business leader

5. Carefully manage the integration process

1. Understand the organization's unique "family gravity"

One of the key characteristics that distinguishes family businesses from non-family businesses is what we call "family gravity": the values and priorities that endure across generations and how those values and priorities affect making strategic decisions and running the business. Understanding the family gravity is essential when evaluating the talent needs of any family business because the leader must have the capability to be effective in this environment.

Family gravity can be felt throughout an organization, but the ultimate source is a core of one to three family members who "carry the mantle." A family's gravity can be evaluated by looking at three characteristics:

The nature of the gravity. What are the non-negotiable values and legacy of the family business? Does the family have a particular connection with the location of its headquarters? Are there certain markets the family is committed to serving or avoiding? Is the business operating above expectations in how it treats its employees, suppliers and customers?

The strength of the gravity. How strong a pull those values exert on the organization is determined by how firmly the family's identity is linked with the family and how much cohesion there is among family owners.

The transmission of the gravity. A family's values and priorities affect the day-to-day operation of the business through the written and unwritten rules of family and business governance that determine how decisions are made. The level of identity and cohesion within a family often is reflected in its governance.

Questions to ask

What are the non-negotiable values and legacy of the family? How have these values shown themselves in business decision making, policies and relationships?

Is the family a cohesive unit or is there dissention or rival power centers? How strongly does the family identify with the company? What impact does this have on how the business is managed and the qualities successful leaders must have?

What are the written and unwritten rules of family and business governance? Are there aspects of that governance that need to be re-examined? Do both family members and non-family executives understand those rules in the same way?

2. Establish a strong and structured leadership succession process

The transition to a new leader can strengthen a company's vision and trajectory or expose discord and stalled momentum. Despite the importance of succession planning, many companies have failed to establish the process necessary for a seamless transition. Among the successful family businesses we examined in this study, nearly 30 percent had considered only one candidate for the role, and two-thirds had failed to follow a properly structured succession process.

Even if there is a clear front-runner, the choice of a new leader is not a coronation but rather a comprehensive process that begins with consensus on the company's position in the market and ends with an evaluation of the leader's performance.

Phase 1: Discussion and commitment by shareholders

In family companies, the leadership succession process naturally has the potential to unleash a great deal of emotion, especially among decision makers. Because of this, it particularly is critical to agree in advance on the type of leader needed, how candidates will be evaluated and how a selection will be made:

- Discuss the possible paths of succession based on family involvement, the needs of the business and the talent pipeline
- Examine the company's competitive environment, strategic vision and industry disruptions
- Accelerate family alignment regarding firm strategy, family involvement and financial investment
- Translate company goals into a profile of the next leader, including required experience, competencies and values
- Develop a succession process to identify and evaluate candidates and select a finalist

Phase 2: Identification, evaluation and selection

Success of this phase depends on a search strategy that looks beyond obvious choices to ensure a thorough selection process:

- Identify the pool of internal and external candidates and build a dossier on each one
- Develop a long list of suitable candidates who meet all requirements
- Create a short list of the six to eight most desirable candidates
- Obtain references and conduct interviews with short-list candidates; select one or two finalists
- Hold and conclude contract negotiations

Phase 3: Integration and development of the successor

Succession does not end with the selection of a company leader but includes a detailed integration process that helps identify and remedy any challenges that occur:

- Establish an agenda for the first six to 12 months encompassing the family, the new leader and other stakeholders
- Analyze the senior management team and identify any changes to be made
- Conduct 360° feedback of the new leader and create a development plan, if necessary
- Evaluate performance at the two-year mark against previously agreed-upon benchmarks
- Discuss and make decision on renewal or non-renewal of contract

The hierarchy of talent sources for family businesses

When the successful family businesses in our study sought to identify possible leadership candidates, they followed a clear hierarchy:

Tier 1: Family members

Family members who have been effectively groomed for leadership offer the best opportunity for sustaining both the business' and the company's unique family gravity

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Tier 2: Internal candidates

Non-family internal candidates will have a clear track record on their performance and alignment with the family's values

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Tier 3: External candidates

External candidates can bring a much-needed fresh perspective and approach to the company's challenges and opportunities, but these potential leaders must be evaluated carefully for fit with the family and its culture

Successful family businesses know that family members must be proactively developed if they are to provide a reliable pipeline of leadership talent. More than 40 percent of the companies in our study include members of the next generation on their board and committees with the objective of nurturing appropriate business and management skills.

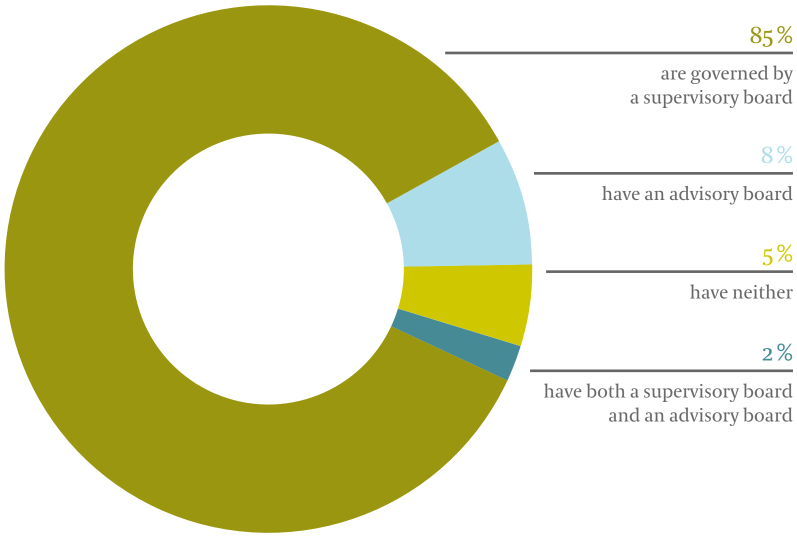
Stay involved.

Create space for interaction.

3. Have a clearly defined corporate governance process

A strong succession process must be supported and enforced with well-defined corporate governance. It is telling that in our study, one-quarter of the non-family executives interviewed report having had governance concerns when they considered joining the family business. It is difficult to recruit top non-family executives into a family business that is not professionally run because executives cannot count on the level of independence needed to do their job. Likewise, executives from the family find that their ability to lead is hampered without the clear boundaries that good governance provides.

Having either an advisory or supervisory board is central to good family business corporate governance. Of the firms we studied:




Own the decision.

4. Understand what is needed in the family business leader

Whether he or she comes from inside or outside the family, the successful leader of a family business combines three important qualities:

Shared values: The critical factor for long-term success

CEOs of large corporations typically spend six to 10 years in the role. Most successful family businesses—which think in terms of generations—would regard so short a tenure as a failure. Because long-term leadership is the goal, family businesses regard alignment with the family's values as non-negotiable. Family members know that a less-than-perfect fit with values will have negative repercussions that cannot be repaired.

While candidates who also are family members obviously have an advantage over non-family internal and external candidates in this regard, alignment with the family values for the business should not be assumed; no candidate should be exempt from assessment in any area. In our study of successful family businesses, family members have this to say about the role of values when choosing senior leaders:

"He did not have all the operational requirements the board had asked for, but he had so much else. He is the kind of person who just fits into our culture, and that is more important than the role spec."

"His value system as a person … was a very, very key factor in the decision."

"Can I imagine working closely with this person for 10 or 15 years?"

Key competencies: The right tools in the leadership toolbox

The specific competencies a leader needs depends on that company's vision, challenges and market position. But in addition to the range of traditional business competencies, the leader of a family business must have strong command of three competencies specific to the family business environment: family business awareness, ownership dynamics and sustainable entrepreneurship. For each of these family business competencies, it is especially helpful to evaluate executives and potential leaders along the following scales measuring their current level of readiness.

Family business awareness
An understanding of the organization's values, traditions and history and the ability to translate those attributes into how the business is run:

Deficient

Level 1: Knows company values, traditions and history

Level 2: Uses knowledge of company values, traditions and history to inform leadership behavior

Level 3: Works to keep company values, traditions and history alive and relevant

Level 4: Engages current and future generations of family leadership to embed company values, traditions and history in company culture

Level 5: Takes a leadership role in ensuring family business continuity

Level 6: Leads the evolution of the company's traditions

Exceptional

Level 7: Continually refines company values and traditions for long-term alignment between the family and the company

Red flag: Has little awareness of the company's values, traditions and history

Ownership dynamics

The ability to mentor next-generation family leaders and act as a trusted advisor on ownership and governance issues as they relate to the family's legacy:

Deficient → *Exceptional*

Level 1: Understands that next-generation family members must be taken into account

Level 2: Is aware of the perspectives of next-generation family members

Level 3: Responds appropriately to governance changes and requests for involvement from next-generation family members

Level 4: Proactively engages with next-generation family members regarding their involvement in the firm

Level 5: Proactively supports the development of next-generation family members

Level 6: Integrates next-generation family members into succession planning

Level 7: Proactively mentors next-generation family members

Red flag: Has little awareness of next-generation family members

Sustainable entrepreneurship
The ability to manage both the commercial and social-impact aspects of the business to allow the family business to be sustained over generations in a way true to the family's values:

Deficient

Level 1: Understands the concept of sustainable entrepreneurship

Level 2: Is able to articulate areas of tension in the family's sustainable entrepreneurship vision that need to be addressed

Level 3: Actively engages family members in a constructive discussion about sustainable entrepreneurship tradeoffs and opportunities

Level 4: Is able to help the family set sustainable entrepreneurship goals

Level 5: Proactively develops and implements sustainable entrepreneurship strategies

Level 6: Engages with family members to seek out and capitalize on sustainable entrepreneurship opportunities

Exceptional

Level 7: Serves as trusted advisor on sustainable entrepreneurship issues

Red flag: Ignores the inherent tension that value creation, preservation and social change can cause

Potential: The key to leading in today's dynamic world

Competency assessment provides an essential evaluation of a candidate's leadership tools. But basing an assessment solely on competencies assumes that future success can be predicted from past performance—an assumption that does not hold when the business environment is as volatile, complex, uncertain and ambiguous as it is today. No industry is immune from the changes brought by digital transformation, and ongoing globalization continues to create new markets but also additional competitors. Novel business models require a rethinking of conventional assumptions and risks.

By analyzing the data on thousands of executives it has assessed, Egon Zehnder has identified four key traits that are indicators of the potential to succeed in the face of the unknown:

1. Curiosity: A penchant for seeking out new experiences, knowledge and candid feedback and an openness to learning and change
2. Insight: The ability to gather and make sense of information to suggest previously unseen opportunities and threats
3. Engagement: A knack for using emotion and logic for communicating a persuasive vision and connecting with people
4. Determination: The wherewithal to fight for difficult goals despite challenges and to bounce back from adversity

Hiring the non-family executive

Non-family executives play a major role in the success of most family businesses. Indeed, among the family businesses we studied, 59 percent employ a CEO who is not a family member—and that figure rose to 79 percent among companies where the family owns less than 76 percent of the voting shares.

The company's succession and assessment process may determine that the right executive for the job is one outside the family, but no matter how good the fit, that person still is an outsider. To maximize his or her chance of success, it is important to understand the type of relationship that is needed between the executive and the family.

Questions to ask

Is there any dissention among family decision makers regarding the candidate? If so, are these divisions recent or do they represent pre-existing fault lines within the family?

Does the candidate have the competencies to manage the family, given its dynamics?

How have previous appointments from outside the family unfolded? If there were lessons to be learned, have the appropriate changes been made?

Aside from business considerations, is the candidate genuinely liked by the family? Would it be pleasant to spend a weekend with the candidate and his or her significant other?

The three relationship archetypes that occur with non-family leaders

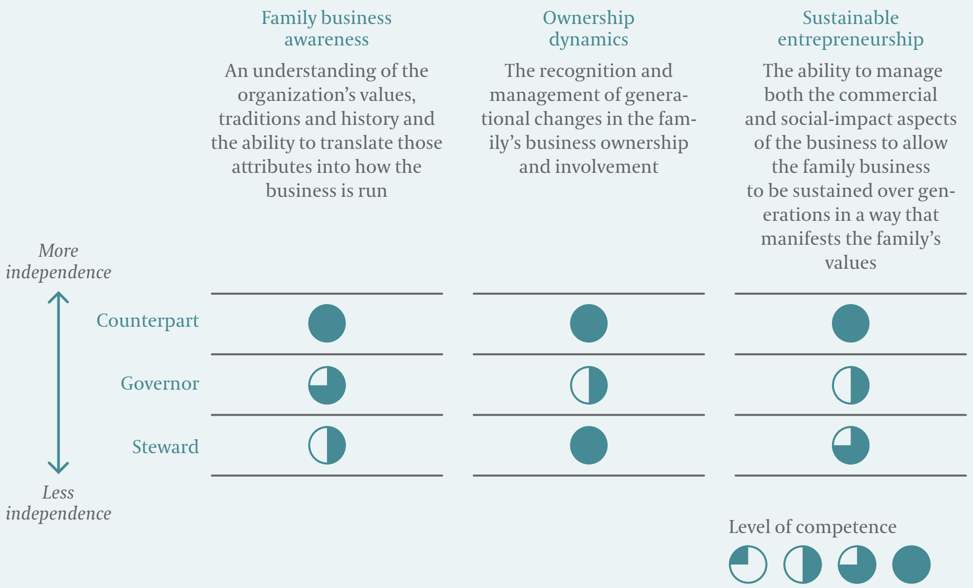
When appointing a non-family member to a leadership position, it is not enough just to have a clear definition of the role being filled. The relationship between the family and the non-family leader also must be defined. In examining the companies in our study, we identified three archetypes that occur in this relationship, which we discuss in terms of the non-family leader's role in the relationship:

Counterpart: A true peer to the family owners. The counterpart's appointment signals a shift to (or confirms a continuance of) non-family leadership. A counterpart works as an equal partner and creates his or her own momentum within the business while preserving the family's values. This type generally is seen in the chairman, CEO and chief financial officer positions.

Governor: A pragmatic leader who leaves strategy to the family. The governor is given leeway for implementation within well-defined boundaries. Usually found in conglomerates or companies with low family equity, this is the least common type of non-family leader.

Steward: A manager who is subordinate to the family but who adds significant value by executing the family's vision in an effective, professional manner. A steward generally is found in situations where family owners are looking to maintain their legacy and keep existing operations running smoothly.

Each archetype works at a different level of independence from the family and thus needs to possess the three family competencies in different amounts:



5. Carefully manage the integration process

Managing the three dimensions of integration

Given the care that must be taken in the leadership succession process, selection committees can be forgiven for feeling that after deciding on a candidate and successfully recruiting him or her to the company, the job is finished. But the fact is that the leadership succession process must extend to cover the on-boarding and integration of the successful candidate into the organization.

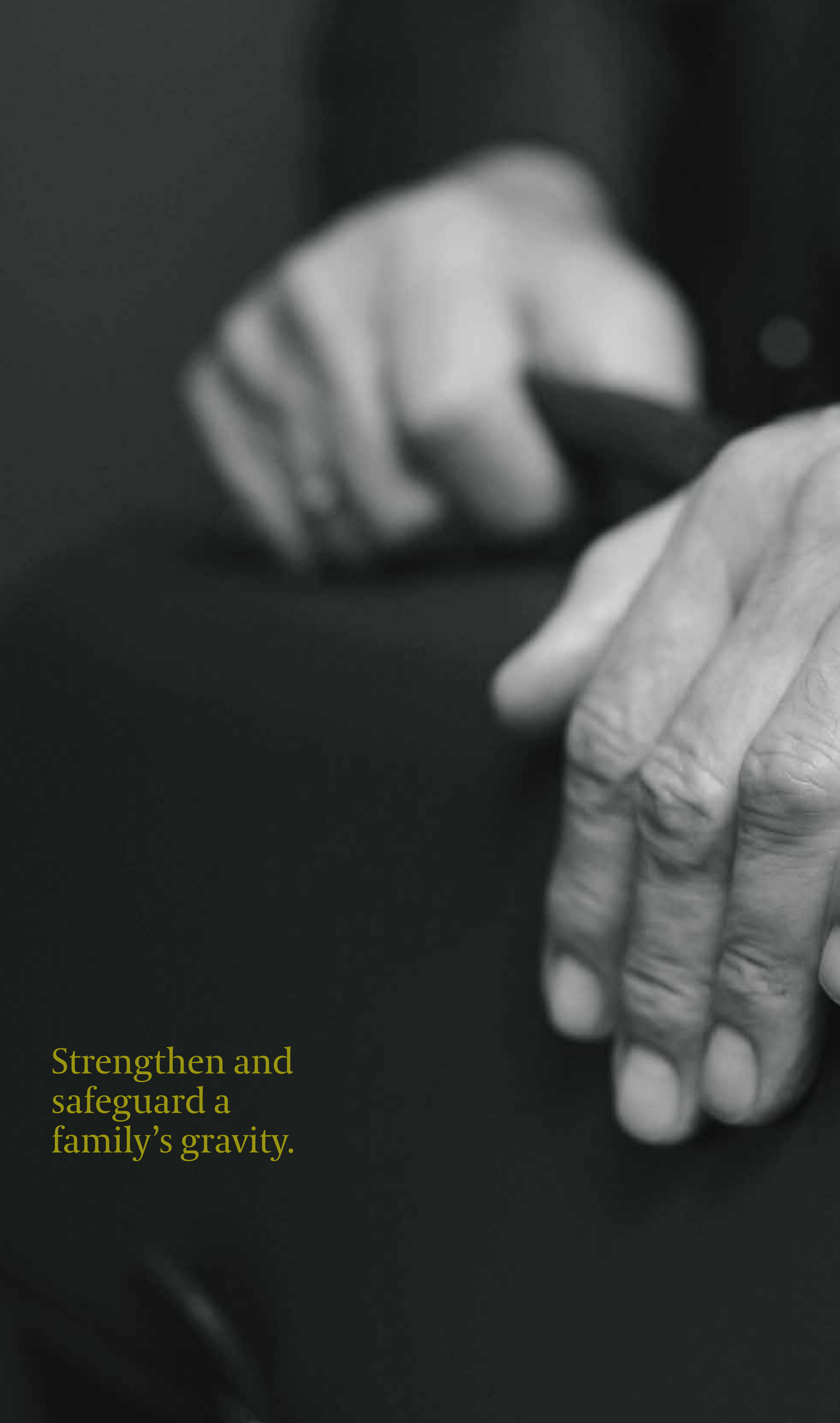
Unfortunately, this step often is omitted in both family and non-family companies. In a 2013 Egon Zehnder online survey of senior executives from around the world, only 30 percent reported receiving integration support for a new role. Survey respondents also said that when a new executive struggles in a role, the most likely cause is a poor grasp of how the organization works — precisely the sort of pitfall that a thorough onboarding process can counter.

For family-owned companies, a conscientiously executed integration process is essential whether the new leader comes from the ranks of the family or not. Non-family executives clearly benefit from intensive mentoring and support from key family decision makers. But even when the person taking the reins is the family's 'heir apparent', he or she needs to be thoughtfully transitioned into the role. In our study of leading family companies, we identified three best practices to help ensure the success of a new leader.

Organizational alignment: The successful candidate must be affirmed in the new role quickly so that he or she can tackle the business tasks at hand and so that there is no time for dissent or doubt to fester. Successful family companies make sure that, when possible, the outgoing leader or other senior family member frequently is at the side of the new leader so that essential knowledge can be transferred in person and in real time.

Family bonding: The integration process should include many formal and informal opportunities for the successful candidate to work and socialize in his or her new role with both family and key non-family members.

Stakeholder acceptance: Family decision makers need to send a strong signal that the successful candidate has their full support. Watch carefully for any poorly defined roles or boundaries that may cause friction as company ownership and management adjust to a new leader.



Strengthen and
safeguard a
family's gravity.

Key lessons from successful family owners

Don't rush. Succession planning and management of senior talent are the most critical responsibilities of family business leaders. The need for care is heightened when the process involves non-family candidates.

Be precise. Finding the right candidate for a leadership role is an exacting task, and it is essential to have both a clear job description and a rigorous process to guide the decision. For non-family candidates, assess their ability to manage current family dynamics and determine how well they match the needed non-family archetype.

Stay involved. Adapting the selection process to the company's governance structure is a major consideration. Companies with basic governance should push themselves to look beyond their own backyard when searching for talent. Decision makers of companies with effective governance structures need to remember that strong governance demands continual high involvement.

Create space for interaction. Objective measures of a candidate's fit with a role are important. But particularly in family businesses, subjective judgment also must be considered. Create opportunities for formal and informal interactions to get a true sense of the person.

Own the decision. In the talent management process, family decision makers can benefit from outside expertise in profiling, pre-selecting, consulting and systematically evaluating. However, the final decision must rest with the family.

Strengthen and safeguard a family's gravity. A family's values, cohesion and identification with the business are unique and make the business distinct from non-family businesses. Live the family's values consciously and conscientiously.

The Egon Zehnder Leadership Succession Interview Team

The 89 interviews that formed the core of the study were jointly conducted by the Family Business Network and the following Egon Zehnder consultants:

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About Egon Zehnder and Its Family Business Advisory

Egon Zehnder is the world's leading privately held executive search and talent management consultancy with more than 400 consultants in 69 offices across 41 countries. The firm provides senior-level executive search, board search and advisory, CEO succession and family business advisory, as well as leadership assessment and development to the world's most respected organizations. Egon Zehnder's clients range from the largest corporations to emerging growth companies, family and private-equity controlled entities, government and regulatory bodies, and major educational and cultural organizations. For more information: www.egonzehnder.com.

Egon Zehnder's Family Business Advisory assists families, owners and managers in navigating the challenges of leadership, succession and governance across generations. Based on decades of experience serving many of the world's finest family companies, we know that the critical first step in this journey is to build alignment among family members around the family's philosophy and approach to business and ownership. With this in mind, our Family Business Advisors work closely with family members and owners to create an environment conducive to driving the best people decisions in their specific context.

About the Family Business Network

The Family Business Network (FBN) is the world's leading family business organization, a not-for-profit international community that is run "by families, for families" with the aim of strengthening successful and sustainable enterprises across generations. FBN's International Network was developed in 1989. Today, with more than 8,500 individual members from more than 2,900 family businesses across 57 countries, FBN is continually increasing its ability to help family businesses grow, succeed and prosper through the exchange of best practices, new ideas, and the peer-to-peer learning activities in a safe and trusted environment.

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