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Family Firms and their Governance

Creating Tomorrow's Company from Today's

by Sir Adrian Cadbury

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Introduction

Family-owned firms are one of the foundations of the world's business community. Their creation, growth and longevity are critical to the success of the global economy. Although facing many of the same day-to-day management issues as publicly-owned companies, they must also manage many issues specific to their status.

Sir Adrian Cadbury's long and distinguished business career was built on his dual expertise in both corporate governance and family firms. A recognised authority on the former, he led the committee which laid the foundations for corporate governance in the UK. Thereafter, he played a crucial role in developing corporate governance standards in many other countries.

Sir Adrian also has a first-hand understanding of family firms. His career began with his own family's firm, the Cadbury company. Joining its board when it was still privately owned, he subsequently became its chairman. During his tenure, Cadbury was transformed into a public company and subsequently merged with Schweppes. His unique perspective of family firms and their governance is at the heart of this report.

To lend a global dimension to the topic, we have also studied five other family firms from around the world, focusing on the development and evolution of their corporate governance structures. These are presented in five short case studies.

This report seeks to highlight the very particular advantages and challenges of family firms in a highly competitive global economy. We hope it also helps family Boards everywhere to "create tomorrow's firm out of today's."

A. Daniel Meiland
Chairman
Egon Zehnder International

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Family firms have to strive to be as well-managed as the best of their competitors. The need for a professional business approach is in fact greater in a family than in a non-family firm. By building on their innate strengths, family firms should prepare for the future and continued growth by establishing logical organisational and governance structures.

The Distinctiveness of Family Firms

Strengths

Family firms have distinctive characteristics from which they can derive significant competitive advantage. A long-term perspective comes from building a business for future generations while the strength of most family firms' founding values give them a clear identity in an increasingly faceless corporate world.

Risks

But there are also risks associated with this type of firm, most notably the dissension that may arise within families, particularly between family members who are actively working in the business vs. those who are solely shareholders.

Consequences of Growth

As family firms grow, the owner/manager equation shifts and complexity grows. More generations of an increasingly extended family and growing numbers of non-family managers require more formal systems.

Organisational Imperatives

Three issues take on growing significance:

Recruitment and Promotion

The recruitment and career management of both family and non-family managers is a major issue in getting the talent needed to ensure a firm's long-term success. Establishing a clear open door policy that allows willing family members to be employed should be balanced with a performance-based promotion that is resolutely the same for both family and non-family managers.

Fairness

Fairness and transparency in financial and non-financial perks and reward systems, particularly within the family, is an essential tool in avoiding tensions over perceived injustices.

Organisational Structure

Most importantly, more formal organisational structures become necessary to clarify roles and to separate the day-to-day management from the strategic direction of the business.

Corporate Governance Structures

Successful family firms need to establish a board devoted to strategic business issues. The family needs to be involved and informed, preferably through dedicated channels, such as a family council.

The Advantages

A board allows a family firm to establish clear lines of authority for different areas of the business. It ensures the stability and continuity of the policies and values that distinguish the firm. It also makes a necessary distinction between matters of day-to-day management and issues of strategy – enabling strategic issues to be properly and objectively addressed.

Outside Directors

Boards allow the infusion of new ideas and a broader range of experience from having outside directors included. These members help on several fronts, simultaneously assisting with contentious internal issues, ensuring equal treatment between family and non-family executives and contributing external perspectives to strategic reflection.

In conclusion, an effective board, a logical organisational structure and fair and transparent recruiting and promotion policies are the key drivers to ensuring the longevity and success of family firms.

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The Distinctiveness of Family Firms

"For the family-owned business, good governance makes all the difference. Family firms with effective governance practices are more likely to do strategic planning and to do succession planning. On average, they grow faster and live longer." [1]

Professor John L. Ward.

Family firms form the basic building block for businesses throughout the world. The economic and social importance of family enterprises has now become more widely recognised. Internationally they are the dominant form of business organisation. One measure of their dominance is the proportion of family enterprises to registered companies; this is estimated to range from 75% in the UK to more than 95% in India, Latin America and the Far and Middle East. The manner in which family firms are governed (the way in which they are directed and controlled) is therefore crucial to the contribution which they can make to their national economies as well as to their owners.

For simplicity, I take family firms to include all enterprises that are owned, managed or significantly influenced by a family or families. This is the case when the family has the final say in whoever is responsible for managing it. In the same way, it makes sense to treat family firms as an international business form, on the basis that they face similar opportunities and problems and that those similarities outweigh the national and cultural differences between them.

The Distinctiveness of Family Firms

It is essential at the outset to recognise that the governance of a family firm is in many ways more complex than the governance of a firm with no family involvement. Family relationships have to be managed in addition to business relationships.

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The Distinctiveness of Family Firms

"Of all the special characteristics of the small family firm, the most outstanding is that it produces a distinctive style of business, a form of kith-and-kin involvement in which business, decisions and objectives are inevitably complicated by personal relationships."[2]

Philip Clarke

Strengths – Visions and Values

It is the 'kith-and-kin involvement' in family firms which marks them out from other types of business organisation and is a potential source of strength. It is the family commitment to building up a profitable enterprise that gives the family firm its competitive edge. When the enterprise starts, the family has a single goal to which all its members can subscribe. Since the family both owns and manages the firm, decision-making is straightforward, because the interests of the owners and the managers do not have to be considered separately. For the same reason, the firm can be run with minimum overheads drawing on the family's own resources. It is natural for the authority of the founder to be accepted at the outset and, provided the founder is competent, the firm has every chance of flourishing.

Long-term Perspective

Family firms do not only offer opportunities for commercial success, essential though that is for their survival. They usually see the family interest as a continuing one and so they tend to take the long-term view in coming to decisions. It is the best guarantee to those who work in them that the future will not be mortgaged for the present. It is this sense of building a business for future generations which underlies the policies of successful family firms.

Building for the future leads to a concern for the firm's reputation and to a regard for the interests of employees and the community. If a firm sees itself as retaining its home base and remaining in business over the years, it is sensible for it to take trouble over its relationships with employees, suppliers, customers and neighbours, because it

expects these relationships to be continuing ones. Thus this is why family firms have, on the whole, good reputations as employers and have often pioneered advances in conditions of employment.

A Clear Identity in a Faceless World

Family firms also have a clear identity in an increasingly faceless world. Family firms are built on a human scale and the people who work in them know for whom they are working. It is not, therefore, surprising that family firms generally win the loyalty of entire families of employees and that there is often a continuing family tradition of working in them.

Risks – Family Tensions

Family firms have much to offer to the community, but they can also face particular problems that may strain the relationships between members of the family and so affect the firm's ability to compete in the market-place.

Blurring Work and Family

The problems arise from two sources. The first is the reverse side of the coin of family commitment. Commitment derives from the family seeing the business and their family life as one, as a unity. There is no separation between family relationships and business relationships and no relief from the one in the other. Those who work for someone else can leave business frustrations behind them when they return home, or seek refuge from home problems in the office. If the family is the firm, its members are denied that safety-valve. One potential area of difficulty, therefore, is that personal relationships are unrelievedly important in a family firm and those involved cannot stand back and look at business issues separately from family issues.

Growth over Time

Other sources of difficulty are the growth of the firm and the passage of time. The founders of firms and their immediate family may well be able to manage their relationships successfully, because the business hierarchy will probably match that of the family. This straightforward

pattern of relationships may not hold when it becomes a question of bringing in the second generation of what by then will be an extended family. The continued existence of a firm as a family firm depends on maintaining relationships within a widening family circle.

Sharing Power

Equally important, if a family firm is growing it will have to draw in managers from outside the family. This will require management of the relationships between family and non-family members of the firm. The sharing of power, which the acceptance of non-family managers requires, is one of the hardest issues for family firms to come to terms with.

Growth – Patterns and Consequences

Family firms come in all shapes and sizes and experience every kind of success and failure. Those which never make the grade or expire with their founders will not reach the stage of forming a board and appointing directors. There will also be those which deliberately decide not to grow in order to retain their original pattern of organisation. I intend to focus on the issues faced by those family firms which need to formalise their structures in order to grow, but which aim to do so in ways which will both retain the family commitment and promote the business success of the firm.

The Owner/Manager Evolution

The relationships between the members of a family who depend on the family firm for employment, for income, or for both, are put to the test as time passes and the firm grows. One change which growth brings is that ownership is spread more widely among the family and the proportion of non-family to family managers increases. As a result there is no longer such a close identity between the family and the business. Family members still involved in managing the firm have more room to breathe and more outsiders with whom to discuss the firm's affairs.

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The Cadbury Case

In considering the stages through which family firms can pass it may be helpful to draw on the experience of the firm in which I spent my working life. The firm of Cadbury was founded by my great-grandfather, John Cadbury. He opened a grocer's shop in the centre of Birmingham in 1824 and sold tea, coffee, cocoa, patent hops and mustard. In 1831, he decided to concentrate on the manufacture and marketing of cocoa, so he handed the shop over to his nephew Richard Cadbury Barrow. The shop in its turn grew into a family grocery firm, Barrow's Stores, which flourished in Birmingham until it was taken over in the 1960s.

John Cadbury owned and managed the firm of Cadbury from 1831 to 1861, when his two sons Richard and George took over from him. So the simplest form of business structure, the owner- manager, gave way at that point to the next simplest - a partnership. Under the two brothers the firm grew rapidly, especially after the building of a new factory on a green-field site at Bournville in 1879. In 1899 Richard Cadbury died, and the firm was by then employing 3000 people. At that point the decision was taken to turn the business into a private limited liability company, Cadbury Brothers Limited, and a board of directors was formed to run it. The board of directors was made up of my grandfather George Cadbury as chairman, his two eldest sons, Richard's two eldest sons, and a company secretary who was also a member of the family.

The next change in structure came with the merger between Cadbury and Fry in 1919. In the 19th century, J.S. Fry & Sons, a family firm dating back to 1728, had been the leading company in the industry. It was overtaken by Cadbury in the early part of the 20th century, and by then the Fry family had become less directly involved in its management. The amalgamation of the two firms and the lack of members of the Fry family in the business meant that those members of the Cadbury family who were both executives and shareholders were outnumbered by Cadbury and Fry family shareholders who played no part in the management of the combined enterprise.

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The Distinctiveness of Family Firms

From this point on, it is understandable that there should have been differences of view between those in the family who were running the firm – whose aims were investment and growth – and those who were owners, but not managers, and primarily concerned with dividend income and the capital value of their holdings. In this situation, an inevitable point of contention became the price at which shareholdings could be transferred in the absence of an open market for the firm's shares.

The diffusion of ownership among the two families as the generations succeeded each other (my grandfather and his brother had nineteen children between them), the increasing proportion of family share-holders whose interests lay outside the firm and the pressures of taxation eventually made the move to obtaining a public quotation for the shares irresistible. In 1962, therefore, the firm became a publicly quoted company and ceased to be a family firm in terms of ownership, although a majority of the board were still members of the family and the family as a whole held more than half the shares. The family shareholders then had an open market for their shares and the directors had to take account of the general interest of a much wider body of shareholders than in the past.

The first non-family directors were appointed to the board in 1943, but when I joined the board in 1958 the firm was still effectively owned and managed by the family and all the directors had executive responsibilities within the business. The final change in the structure of the business came with the merger on a 50/50 basis of Cadbury and Schweppes in 1969.

The forces which brought about structural changes in the Cadbury business such as growth, family succession, deaths, taxes and amalgamations affect all continuing family firms. In particular, most family firms will want to find ways of continuing to grow while retaining the family interest.

Growth also leads to tensions within the family, because the interests of members of the family will tend to diverge: this is particularly so between those members of the family actively involved in the management of the business and the rest.

Those managing the firm may well feel that they are keeping the remainder of the family in the state to which they have become accustomed. They see themselves as doing the work and carrying the responsibility, while their relations enjoy the results and are free to criticise their efforts into the bargain. Equally, the members of the family who are owners but not managers may consider on their side that their interests as shareholders are being subordinated to the interests of those managing the firm.

One of the most difficult transitions for a family firm is the move from the owner/manager stage to the stage when ownership is to a greater or lesser extent separate from management. For shareholders that are not managers this requires an acceptance of the owner's role which may not come easily. Owners have their say in the election of directors but once those directors are elected, whether or not they are from the family, they have to be left to run the firm. It is often hard for family shareholders to accept that they have no say in the day-to-day management of what they still regard as 'their' firm.

In effect, the relationships within a family firm change through time from being essentially family relationships to becoming essentially business relationships. If the only business enterprise which the family knows is its own, it is hard for its members to judge what an arms-length business relationship means, let alone know when it has become necessary to establish such a relationship.

As a firm grows, what was once a single family management group splits into three:

– family owners

– family owner/managers and

– non-family managers

To complicate matters still further, some of the owner/managers may see themselves as having responsibilities of a trustee kind for their shareholding relations, in addition to their direct responsibilities as owners and as managers. Managing these new relationships depends on all of those involved being clear about their own roles and responsibilities and those of everyone else.

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Organisational Imperatives

There are three organisational requirements which need to be addressed if family firms are to manage successfully the consequences of growth. They need to be able to recruit and retain the very best people for the business, they need to be able to develop a culture of trust and transparency, and they need to define logical and efficient organisational structures.

Recruitment and Promotion

The family firm's policy on recruitment and promotion is crucial to its continued success. For a firm with no family links, there should be no difference of view between the shareholders and the managers on management succession. Both groups want the best people for senior posts. The family firm will have the same primary aim, but it may, in addition, have such secondary aims as maintaining a family interest in the management of the firm and holding a balance between different branches of the family. A particularly critical issue for a family firm is how to ensure that capable non-family managers are both recruited and retained.

There are two general points which are relevant to recruitment and training in family firms. The first is that family firms tend to value hands-on experience more than formal training. Members of the family are often well-trained in a practical sense, being brought up in a business atmosphere and working their way through all the activities undertaken by the family firm. But the very thoroughness of the practical grounding which the family members have received may make them sceptical of the capabilities of those who have not shared that experience and of the benefits to be derived from education and training of a less specialised kind.

The second point is that the recruitment and training needs of managers are ongoing, but recruitment from the family will be by generations, until there is a reasonable family spread to choose from. This may lead to the appointment of family managers and directors at a much younger age than would have occurred in a non-family firm. It is,

however, difficult to combine a promotional pattern for non-family managers based on increases in responsibility every three to five years with a cycle for family managers based on the twenty-five year gap between generations. One of the strengths of the family firm is that its strategic planning horizon is measured in generations, but the same time-horizon does not fit easily into the planning of management careers.

Family Appointments

The future of a family firm depends on its ability to pick and promote the right members of the family and, equally, to provide attractive opportunities to managers from outside the family. The problem with family appointments is quite straightforward: it is more difficult for the family to agree on their assessment of insiders (in the sense of members of the family) than of outsiders. It requires the family to come to terms with a business hierarchy which may be quite different from the family hierarchy. The first will be based, in a sense narrowly, on business competence, while the other takes account of seniority and all manner of other attributes. A consequence of the family overlay is that the insiders find it difficult to separate their knowledge of their relations as members of the family from their experience of them as managers.

Assessment

The problem of assessing the abilities of family entrants is compounded when it involves an older generation judging a younger one. To some extent, the younger generation will be judged by their parentage, a test which could not be applied to outside recruits. In addition, all the usual tensions between the generations can be expected to surface – modern methods versus accepted practice, qualifications against experience, new ventures as opposed to sticking to the core business, and so on. It is never easy to promote juniors over their seniors, and this is especially so within a family. Making the most of what two different generations of a family have to offer to a business is an issue that is peculiar to the family firm.

In practice, there are two distinct policies that apply when bringing family members into a family firm.

- **Selective** - Some firms take the view that they will only recruit those members of the family whom they regard as likely to reach senior positions.

- **Open Door** - Others will take on any recruits from the family who are prepared to work hard, provided that they accept they will have to find their own level with no guarantee of promotion.

Either way, there are advantages in encouraging prospective family entrants to qualify themselves for executive posts, before joining the firm, both through study and through experience in other businesses.

The Open Door

In my view, the open-door policy has merit from both a business and a family point of view. In the first place it is hazardous to judge whether someone at the start of their career is likely to have the qualities required for a top job in, say, twenty-five years time in what will no doubt be a quite different business environment. Firms following this approach are likely to turn down some good family entrants and appoint some who do not make the grade or should not have been allowed to do so. From the family angle, turning down a member of the family who is keen to join the firm is bound to put a considerable strain on family relationships.

While the open-door policy may leave some family members in not particularly senior positions, lack of promotion is not as drastic as non-employment. It is also easier to justify why certain individuals have not progressed as far as they, or their relations, think they should have done than to explain why they were refused entry in the first place. Progress can be related to track record which provides a more objective basis for argument than recruitment tests and interviews. There is also a real advantage in having some family members not occupying top jobs. It counters the myth that the family name is a passport to promotion regardless of competence.

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Organisational Imperatives

Bringing in Outsiders

The family firm, however, needs not only to make the right family appointments but to attract non-family managers of the required calibre as well. The objective of the family firm, as it grows, is to ensure equal opportunities for all, family and non-family alike. To establish this objective, family firms may well demand more of their family entrants than they do of outsiders.

Unless the family interest in the management of a firm can be maintained, it ceases to be a family firm. But family firms need to succeed commercially as well as to maintain the family connection. To do so, they will have to recruit from outside the family. The introduction of capable non-family managers into the organisation is an essential step in the development of a family business.

Barriers to Entry

The fact that the family managers think of the firm as theirs is a powerful source of motivation for them, but can, equally, be a deterrent to able outsiders wondering whether to join a family firm. What kind of reservations will career managers have about taking a post in a family firm and how can they be overcome?

– The first is that a number of the top jobs will be held by family members, limiting the prospects for promotion.

– Another is that they are unlikely to be able to become shareholders as well as managers, unlike their family counterparts, so long as the firm remains in family ownership.

Both are real limitations, but they are ones that can be assessed reasonably objectively and taken into account by those contemplating a career in a family-owned business.

More difficult to assess could be their feeling that their standing in the firm will never be the same as that of the family managers, however competent they may prove to be. In effect, that power will ultimately lie with the family and power can be abused or used arbitrarily. If this

sense of where power lies is generally held in a firm, then it is bound to limit to some extent the authority of the non-family manager.

Such reservations have to be recognised and dealt with if the family firm is to recruit outsiders of the calibre it needs. The essential first step is for the family firm to appreciate that it is going to have to try harder than competing firms, if it is to attract able non-family entrants. It will only succeed in doing so if it can offset what outsiders may see as the inherent disadvantages of joining a family firm.

Equal Opportunity

The next step is for the family firm to be demonstrably even-handed in the way it trains and promotes family and non-family managers. In practice this may mean that family contenders for top jobs have to prove themselves even more thoroughly than their non-family rivals. After all, it is easier for the outsider who is passed over for promotion to find another job than it is for the member of the family. Even-handedness in everything – in giving equal weight to the views of non-family managers and in ensuring that the family network is not used to bypass the professional management approach to making decisions – requires considerable self-discipline. Provided that self-discipline is exercised, the career opportunities for outsiders should be little different from those they would have found in a non-family business.

The question of the power of the family remains. That is not something which the family can set aside of its own volition, because it is a question of perception as well as of substance. What the family has to demonstrate is that its influence will be used to the benefit of the enterprise and not to frustrate the efforts of non-family managers. The family's concern for the future of the firm gives an assurance of continuity of purpose. This, in turn, enables managers to pursue their long-term goals within a stable framework.

What outsiders will be looking for is evidence that a family firm will prove a rewarding place in which to work. They will want to assess the firm's record in innovation, in encouraging everyone in it to make the most of their abilities and in discouraging office politics – all of which are features of successful family firms. The advantages which family firms have to offer lie mainly in the character of their companies and their ability to provide a

good working environment. Family firms have to make the most of their strengths, which derive from their standards and values, if they are to be successful in attracting and retaining able outsiders.

Perceptions of Fairness

For both family and non-family members, it is essential that rewards, whether financial or non-financial, are distributed fairly and transparently and accounted for in a clear and precise way.

Financial Returns

For members of the family, there is the question of how they are to be rewarded for their contribution to the business. When a firm is still run by the original family group, the income of the firm is the income of the family. There is no call to separate return on capital from pay for work done. Family members will receive whatever reward the founder regards as appropriate and payment may be in kind, as well as in cash.

Once there are members of the family who have a share in the ownership of the firm but are not involved in its management, it becomes essential to differentiate clearly between

– return from ownership and

– reward for management

Unless this is done, relationships within the family will come under strain. The family owners are likely to be concerned that the family managers are taking too much out of the business, while the family managers may well feel that their contribution is being under-rewarded.

Even if the members of the family directly involved understand and accept the split between pay and dividends, their spouses may be less convinced. As the family circle expands, the links between the centre and the circumference become weaker and the fairness of the way in which the financial returns from the firm are divided becomes more likely to be called into question.

Other Benefits

When the family and the firm are one, it is not essential to cost out and control whatever benefits the family receives in kind, such as discounts on purchases, access to transport, use of the firm's facilities, and so on. Such benefits can, however, become major matters of contention, when some members of the family have access to them and others do not.

At the heart of the management of relationships in a family firm lies the concept of fairness. Divisions and ructions within the family can be caused only too easily through suspicion that some family members are benefiting at the expense of others, or that the contribution which some are making to the firm is not being properly recognised. The problem is to separate family judgements from business judgements and to be seen to be so doing. This is where independent, outside counsel is invaluable.

Family Produce
The Cadbury Case continued

Paradoxically, the less important some established family benefits are, the more trouble they can cause. I was once involved in a dispute in a family firm over the produce from a vegetable garden. The family home, factory and garden were all on the same site and the garden was cultivated for the benefit of those members of the family who lived on the spot. When this apparently modest benefit came to be costed out, it was clear that it was a totally uneconomic way of keeping some members of the family in fresh fruit and vegetables, quite apart from the development value of the land tied up in food production. Any change in the traditional arrangement was, however, seen by those who benefited from it as an attack on the established order and the beginning of the end of the family firm. Eventually, the fate of the vegetable plot was satisfactorily settled. But the sooner a family firm regularises the relationships between the family and the firm, the less time will have to be spent on matters of allocation between them, which can create trouble out of all proportion to their economic significance.

Formalising Structure

If family firms are to manage their growth successfully, they have to adapt their structure to cope with it. At the outset, major decisions are probably arrived at by the family as a unit, taking their lead from the founder. Tasks are allocated as they arise. When the firm becomes larger, a more formal pattern of organisation is required if there is not to be confusion, overlap and the danger of matters requiring attention falling through cracks in the structure.

Defining Roles

It becomes particularly important to define jobs and the responsibilities which go with them more clearly when non-family managers are appointed. Referring back also to the previous section, unless jobs are reasonably defined there will be no objective basis for determining how they should be rewarded. It is not, however, simply a question of being clear about who does what, although that is the essential first step. It is equally important to divide responsibilities on a logical basis from the point of view of the business.

The absence of a clear organisational structure and of a board that can stand back from the day-to-day management of the firm and think about strategy is likely to cause problems within the family. Family owners, who are not involved in the running of the firm, are in a position to view the business from the outside, in a fairly detached way. They may question whether the firm is being run as efficiently as it would be if it were organised more formally. Or whether the fundamental issues concerning its future are being properly addressed by the directors – such issues as whether the firm should diversify, merge, seek alliances or even put itself up for sale.

An effective board, in the sense of a board which concentrates on policy rather than on management, and a logical management structure are necessary conditions for retaining broad family loyalty in a growing family firm and for the continued success of the firm itself.

Management vs. Strategy
The Cadbury Case continued

When I joined the Cadbury company, the duties of the individual directors owed a good deal to history. The apparently haphazard allocation of duties among directors was accepted and understood by those who had grown up with it, but the spread of responsibilities made little sense to the coming generation of employees and was a source of delay and confusion to the managers. Where responsibility for a function was divided between directors, for example, issues related to that function could only be decided by the board.

In the same way, the board, which in those days met weekly, acted in practice as a management committee, rather than as a true board. I suspect that this is the pattern in many family firms. One consequence of having, what is in effect, a management committee rather than a policy-making board at the firm's head is that strategic issues tend to become submerged by management issues, which require immediate attention and decision.

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Corporate Governance Structures

Once a family firm has grown beyond the point where there is a close identity between the members of the family managing it and those who share in its ownership, there is every merit in providing a clear and accepted structural division between the governance of the firm and the deliberations of the family.

Family Councils – Promoting Dialogue

It makes sense to encourage all the family members with an interest in the firm to arrange to meet at regular intervals to discuss family and business issues. Such gatherings may start by being informal, but there are advantages both to the family and to the firm in moving to some kind of properly constituted family council or assembly. This involves deciding who is entitled to membership – for example, should members by marriage who may not own shares be included? – and it is also useful to elect someone who can speak for the family, probably the assembly's chairman.

Arguably, family shareholders can be treated like any other shareholders with the opportunity to ask questions and express their views at an annual meeting. This, however, weakens the link between the family and the firm, which is what distinguishes the family enterprise from other forms of business and should be a source of its strength. It also fails to make the most of the advantages which a family forum has to offer. A family forum provides a recognised means of communication between the family and the firm. Family members can debate issues between themselves and express agreed views through their chairman. In return, family executives can explain the firm's plans, policies and progress at forum meetings. This enables members of the family not in the business to understand the thinking of the executives and it is an opportunity to gain their support for the firm's strategy. At the same time, the existence of a family forum makes it clear that the forum is the accepted link between the family and the firm, rather than approaches by individual family members. If whoever speaks for the forum is not involved in the management of the firm, the separation between responsibility for the affairs of the family and those of the firm is complete.

Guardians of Founding Values

An example of the advantage to a firm of having a dialogue with family owners not in the business concerns the character and values of the enterprise. Family firms have their own individual character, usually reflecting the beliefs of its founder. A useful role for family shareholders not involved in the running of the business is to act as guardians of those values. The executives of a family business have inevitably to make changes in the operations of the enterprise to maintain its competitive position. The family members outside the business can help them to do so in ways which are in line with the firm's original philosophy. The obligation on family members, who wish their views to carry weight, is for them to take the trouble to understand the reasoning behind executive decisions and to make good use of the information which the executives pass on to them. Again the views of the family are relevant when making key appointments, in order to retain the support of the wider family for those actually engaged in managing the firm.

Decision-Making Power

The essential point is that there should be no doubt where the power to make decisions lies. It is solely with the executives in charge of running the business. The wider family can, however, through its own forum, provide sound counsel which will assist the executives in their task. This relationship depends on the executives keeping the family informed (within the limits of confidentiality) and being prepared to listen to their views, as well as on the family taking its advisory role conscientiously.

The Value of a Board

My recommendation to family firms once they have grown beyond the point where the founder or a family partnership can effectively manage the firm is to establish a board of directors. This is a means of progressing from an organisation based on family relationships to one

that is based primarily on business relationships. The structure of a family firm in its formative years is likely to be informal and to owe more to past history than to present needs. Once the firm has moved beyond the stage where authority is vested in the founders, it becomes necessary to clarify responsibilities and the process for taking decisions. It is no longer enough to allocate duties to whoever is thought to have the time to take them on.

Clear Lines of Authority

The formation of a board provides the basis not only for a logical organisational structure, but also for establishing clear lines of authority and responsibility. This starts with the board, because the board has to determine which decisions are reserved to it. The board then determines how the powers which it delegates to executives shall be exercised. Introducing order into a firm's structure should not be seen as an attempt to impose bureaucratic rules, thereby weakening informal family arrangements which had worked well in the past and stifling creativity. A decision-making structure which is accepted and understood by everyone in the firm will avoid confusion, lobbying and the wasting of time.

Stability and Continuity

A board also offers a means of safeguarding the stability and continuity of the firm. An organisation based on informal family relationships is at risk from unexpected rows or losses in the family. A board is better placed to deal with such shocks to the system and to adapt to inevitable changes in the business environment than a more hierarchical structure. It can provide for continuity by bringing members of the next generation into the board's council at an appropriate stage and by setting down the firm's beliefs and policies for their guidance.

An important advantage of having a working board in a family firm is that issues of difficulty because of their family implications are more likely to be dealt with, rather than put off, as they may well be in a looser form of organisation. Examples of such issues are the retirement of senior

family executives, especially the head of the firm, succession within the family, the appointment of non-family members to the board and whether to become a publicly-quoted company. These are incidentally all issues where the counsel of experienced non-family outside directors could prove invaluable – a matter which deserves a section to itself.

Two final points to make regarding the value of boards to family firms relate to strategy and to chairmanship.

A Formal Board
The Cadbury Case continued

A formal Board was introduced in the Cadbury family business on the death of one of the two brothers who ran the firm from 1861 to 1899. My grandfather recognised that the next generation of family had to be brought into the management of the firm and that a stable structure for the future direction and control of the firm had to be put in place. A board structure of this kind was less dependent on individuals than the previous partnership and it had the authority to decide on such questions as succession and the entry of family members into the firm. The board's authority stemmed from its being formally organised with a clear statement of its responsibilities and from its collegiate nature. The decisions of the board were not those of an individual but those of a team.

Although the first board of five was made up of my grandfather in the chair and four members of the next generation, two of whom were his sons, it had its constitution, it met regularly and kept minutes of its meetings, (we have a complete set of Cadbury board minutes from 1899 to the time of the merger in 1969) and the directors had their individual responsibilities. Thus it was clear where the authority for decisions lay and decisions were properly recorded. Although it was more of a management committee than a board of directors in the modern sense, that did not detract from the importance of this move. It brought order into the running of the business, it ensured that issues were dealt with and not shelved and it provided for the future continuity of the business.

Strategy

Family executives in charge of growing businesses are likely to be fully occupied dealing with the day-to-day management of the firm. It is difficult for them to find the time and the opportunity to consider the longer-term future of the enterprise and to plan for it. One of a board's key tasks, however, is to determine the firm's aims and objectives and how they are to be achieved. Boards can only address these strategic issues adequately provided they appreciate that this is their primary role rather than that of managing the business day-to-day. Boards need to concentrate on those tasks which they alone can perform, such as setting the firm's strategy and charting its future course. This requires a clear line to be drawn between direction, which is the job of the board, and management which is the job of the executives. Unless that distinction is clear and understood throughout the firm, there will be confusion over where the power of decision lies and over who is accountable for decisions. Equally, unless a board focuses on its strategic function, it will tend to go by default.

Moving to Monthly Meetings
The Cadbury Case continued

When I joined the Cadbury board, we gave insufficient time to strategy and one reason for this was that we met every week. Weekly meetings are likely to be dominated by immediate issues affecting the running of the business. The board only fully applied itself to its real job of direction with the merger between Cadbury and Schweppes, when we moved to monthly meetings and had outside non-executive members on our board.

The Chairman's Role

The way a board works depends not only on determining its role, but also on its chairman. The chairman is responsible for the agenda and for the conduct of board meetings. Chairmen are also responsible for ensuring that directors have the information which they need in order to arrive at considered decisions. It is up to chairmen to ensure that all directors are able to express their views since they all carry equal legal responsibilities for the conduct of the business. It is also for chairmen to initiate some form of assessment by board members of the effectiveness of their boards. The decision by boards who to appoint as their chairmen is therefore significant in any company, but particularly so in a family firm where chairmanly qualities must take precedence over seniority.

"Eaton's demise also underlines the importance of outspoken independent board members in family companies."[3]

The Canadian Globe and Mail, 24th August 1999.

The Value of Outside Directors

Non-executive directors have a special value for family firms. One of the merits of having a board of directors at the head of a firm is that it provides the ideal way to bring independent outside advice into a family firm's councils. Sharing information, which is power, is a step which families may be reluctant to take. Firms will have their own professional advisers but that is a special and strictly confidential relationship. Consultants may be brought in to tackle specific problems or issues. The appointment of a consultant marks a willingness to involve outsiders in decisions and that can be an important stage in the evolution of a family firm. The differences between a consultant and an outside board member are primarily those of continuity and commitment. Consultants work to a brief, present their findings and may or may not be involved in their implementation. Their commitment to the firm is limited to the assignment which they have undertaken.

Appointing an outside board member means sharing responsibility for the direction of the business with someone who is neither a member of the family nor an executive. It means letting them see the firm's books and being totally open about the firm's financial position. This may be a major issue for family executives, if family members not involved in the business are not privy to this information. Yet there are considerable advantages to a family firm in having experienced outside directors on its board:

Contentious Issues

They can give objective advice on issues which relate directly to the family and may well be contentious such as appointments, succession and retirements. They are equally well-placed to advise on how best to balance the interests of the firm with those of family owners who are not in the business, over issues like dividend and investment policy, mergers, alliances, takeover offers and whether to become publicly-quoted. They help to counter possible allegations of nepotism or self-interest on the part of family executives and the outside directors may also be specifically asked to settle the remuneration of the family board members. The advice of competent outside directors is not only valuable in itself, because they can draw on their experience of other business situations, it also provides an assurance to all members of the family that decisions, with which they may or may not agree, are those of a board not exclusively composed of their relatives.

Equal Treatment

They can ensure that all directors, whether family or non-family, regardless of seniority, are treated as equal in board meetings. This is mainly important in respect of those executive directors who are not members of the family. It is not simply that their views may be overridden by the family directors and that they may be inclined to defer to the family when divisive issues are being argued out. They may also feel that it is up to the family to have the final say on such financial matters as profit margins, dividends and investment, since it is primarily their money which is at stake.

Strategic Thinking

In my experience, the greatest value of outside directors has been in the field of strategy. Having spent my working life in one firm, I was well aware of how much my thinking about the business was limited by history and experience. Clearly knowledge of the firm and its industry is a vital element in forming a strategy for the future, but so is the ability to look more widely at where future opportunities may lie.

Qualities that a board looks for in its outside directors are independence of mind and judgement, relevant experience and commitment to the firm and its future. It is independence of mind that helps to resolve conflicts of interest and to inspire trust in the board's decisions and actions. Commitment means that they must be able to devote sufficient time to their directorial duties.

Asking the Right Questions
The Cadbury Case continued

The contribution of the outside directors of Cadbury Schweppes was to ask the right questions. These questions were sometimes uncomfortable, like whether parts of the business should be sold to put more resources behind those that were to be retained and they were not questions we would necessarily have raised from within the business. It was up to the executives to provide the answers, but from this board dialogue between insiders and outsiders a bolder and ultimately more successful strategy was hammered out than had we not had the benefit of that external view of the firm and its prospects.

Advisory Boards

It may be asked how far family firms can look to advisory boards to provide necessary external advice without bringing outside members into the boardroom itself. Clearly, advisory boards can play a useful role and may well prove a sound first step. Advisory boards are there to advise and not to direct and control. They therefore stand some way back from the decision-making process. This makes it difficult to recruit the kind of candidates to them who perhaps might be most useful to the firm and it certainly makes it difficult to retain their enthusiasm and interest in a purely advisory role. The provision of advice which can be acted upon or not, as the case may be, does not meet the needs of a family firm in the same way as having external board members with the same responsibility for the future of the firm as the family directors.

The Keys to Success

Family firms have to strive to be as well-managed as the best of their competitors. The need for a professional business approach is arguably even greater in a family than in a non-family firm so all members of the family should take the trouble to understand the part they should play in the continued success of the firm. Because it is difficult to separate family relationships from business relationships, clarity of role is particularly crucial in family firms.

What actions can family firms take to increase their chances of survival and success, once they have moved past the stage of being owned and managed by their founders? There are three essential requirements.

Clarity of Role

First, they have to think through the present and future relationship between their families and their enterprises. This in turn should lead to a clear and understood structure which separates the governance of the firm from the affairs of the family. Both family executives and family owners have responsibilities to each other. The executives, once appointed, alone have the authority to take decisions, while being accountable to those with an ownership stake in the business. The links between the family and the firm should run in both directions, but should be channels of communication, not command.

Members of the family should take the trouble to understand the part which they can play in the continued success of the firm. Family owners who are not managers have the responsibility of appointing competent directors to run the firm on their behalf – and then let them get on with their job. Owner/managers need to appreciate that they wear two hats and to be sure that they are wearing the appropriate one when making decisions.

The shareholders of a publicly quoted company do not expect to intervene in the day-to-day management of the firm in which they have invested. Nor do they expect to make personal use of the firm's facilities. Family owners are in precisely the same position, but may not

find it easy to confine themselves to the shareholder role. One reason for this is that the contact between family shareholders and directors may be daily, as opposed to the once-a-year rhythm of the general meeting. It is precisely because it is difficult to separate family relationships from business relationships that clarity of role is so crucial for family firms.

An Effective Board

Second, the continuing success of a family firm is best assured if it is headed by an effective Board. One with competent, independent-minded, outside directors on it, who will bring with them outside knowledge and experience. Family firms need to be able to draw on the best independent advice that they can find, in order to complement the strengths which come from the family's expertise and commitment.

The first task of such a board is to clarify precisely what the aims of the firm are. This is a vital aspect of the management of any enterprise, but it is especially important in a family firm because, if members of a family firm have differing views on the purpose of the business, the stage is set for misunderstanding and dissent. If the board draws up an unequivocal statement of business objectives, owners and managers know where they stand.

A Logical Organisational Structure

Next, the structure of the firm should be aligned to its purpose, so that the pattern of organisation is logical. The chain of command and the decision-making process should be clear. Jobs need to be properly defined and responsibilities allocated; the assignment of tasks should be known inside and outside the firm. All of this helps to avoid arguments within the family about the way in which the firm is being run and responsibilities shared.

Equality of Opportunity

Finally, the firm's policies on recruitment and promotion need to be written down and respected. The importance of these policies to members of the family is self-evident, but it is equally important to non-members of the family considering whether to enter the firm. It is not easy for members of what has solely been a family firm to accept the need to bring in non-family executives at a senior level and to treat them as equals.

> "The job of the board is all about creating momentum, movement, improvement and direction. If the board is not taking the company purposefully into the future, who is? It is because of the failure of boards to create tomorrow's company out of today's that so many famous names in industry continue to disappear."[4]
>
> *John Harvey-Jones*

What kind of goals should the boards of family firms set themselves? The ultimate task of a board has been admirably summarised by the former head of Imperial Chemical Industries, John Harvey-Jones.

Achieving that transformation is the challenge for boards of family firms, determined to build a successful future for their enterprises. Their comparative advantage derives from the commitment of the family. Time tests that commitment with the widening of the family circle and the increasing separation of ownership from management. The best guarantee of maintaining continuity in a family firm is to establish a sound governance structure. The aim of this report is to encourage family boards to share their experience and to define which forms of governance best suit their particular circumstances, in recognition of the immense economic and social potential of family firms throughout the world.

Case Study 1
Textil Molinos, Argentina

A Tale of Two Mills

Textil Molinos was founded in 1949 by Marco Antonio Karplan and his brother. Newly arrived from Turkey, they quickly recognised the opportunities available in Argentina's textile industry, and settled down to work their way up the ranks. Starting as warehouse supervisors, they learnt everything they could about the business. Within a few years, they had established a small factory and were buying fabric and manufacturing clothes. Soon, they had opened their first fabric dyeing facility.

Thanks in part to strong import controls, the company enjoyed rapid growth in its early years. The early dyeing and dry-cleaning operation soon developed into four distinct business operations:

- The core business of buying fabric, manufacturing and selling clothing
- A process of vertical integration, incorporating spinning mills to buy cotton and produce yarn
- Fabric production
- Carpet production

During this initial phase, the company's management model was very simple. The brothers decided issues between themselves. In order to facilitate the decision-making process, independent directors were hired to assist in reaching a consensus. These directors could voice opinions, but did not vote. The outside directors were instrumental in allowing the two brothers to run the company smoothly for 45 years, although they never voted on an issue. They provided specific know-how and helped establish an effective decision-making process, which the brothers considered seamless and non-contentious.

When it came time to introduce their sons into the family organisation, they incorporated new family members according to

age. Between them, the two brothers had six children. First, the oldest of the six sons joined. Over the years, and in function of their age, he was followed one by one by the others. By the end of the process, five of the six sons had joined the firm: two sons of the elder brother and three of the younger (Marco Antonio's father).

Family Divisions

During this period, the company grew vertically through two separate divisions: the spinning mill and the weaving mill. The spinning mill bought cotton, turned it into yarn and sold it to the weaving mill, which manufactured fabrics for sale. The oldest brother's sons worked at the weaving mill while the younger brother's sons worked at the spinning mill.

Over time, reaching consensus became increasingly difficult. The second generation's style led to heated arguments. Decisions were no longer unanimous. The lack of agreement on shared issues led to an independent board structure for each business. While there was agreement among the children within each of the two families, they disagreed strongly with their cousins from the other brother's family.

The group's management structure grew from a single board of directors to three, one for each of the businesses and a third, central board, which dealt with shared issues, with participation of both families. Each of the three boards also had non-family members as advisors.

In hindsight, disagreements were the cause for this management structure, despite the efforts of unrelated advisors to help the board reach unanimity. The management process was not completely halted, but decision-making required the assistance of outside advisors, and there was never any true consensus. Over time, there was a gradual loss of unity (*afecto societatis*) between the families. Each branch wanted total control over the other's business.

This transition stage, from the company run by brothers to the company run by the brothers and their children, ended in the complete division of the initial holding into two companies. Capital ownership, leadership and management were divided equally among the two brothers. The older brother's family took overall responsibility for the

weaving business and the younger brother's family for the spinning business. Throughout the process of dividing the group in two, the role of the non-family advisors was crucial in reaching agreement.

Unifying Decisions

Dr. Marco Karplan, now CEO of the weaving group, reflecting on the company's history and situation, eventually became convinced that the two companies needed to be run by a single board of directors, including non-family directors. He realised that the company needed independent opinions that would really be taken into account by family members. The respect that family members always felt for independent directors tended to deliver decisions that were more objective and rational.

Our decision today is to move towards a board composed of:

- 3 family members working in the company group
- 2 non-family managers who work in the group
- 3 independent directors, chosen unanimously by the brothers

We believe this to be the right decision to ensure continuity, although it may prove a challenge not to have a family majority on the Board.

The criteria the company selected in identifying independent directors included:

- They must be CEOs at the companies they work for
- They should provide the know-how and skills the group presently needs, namely:
  Greater openness towards global markets
  A better understanding of capital markets

– They should contribute professionalism and a sound economic perspective to the board

Our strategic drive is growth. Today, we have revenues of around $80 million, with five factories. Our competitors are large companies, who work with highly professional standards. Our governing structure must be equally professional in its decision-making process. We do not want to repeat the past. We believe that our continuity depends on our being able to share the strategic direction of the company with independent, non-family professionals.

Case Study 2
GMS Group, Chile

A Supermarket for the Printing Industry

The GMS Group was created in Chile in 1974 by three professionals with long and distinguished careers in the printing industry: Fernando Guzman, Jaime Sanchez and Hans Meisel. Previously employed by Chile's largest printing company, Cochrane (now part of the RR Donnelley & Sons Group), the three men left to establish a business of their own distributing and selling printing supplies. One of the three partners, Hans Meisel, resigned in 1989. Since then, the ownership of the group has been shared equally by the two remaining partners, both of whom are active in its management.

GMS started with US$30,000 in capital and originally focused on consulting by providing advice to printers. It soon evolved into distributing supplies to the printing sector and later entered the paper and pre-press equipment market. Today GMS is a conglomerate with over US$70 million in sales and more than 400 employees. It expanded its domestic operation to cover neighbouring countries, including Bolivia (1988), Argentina (1992), Peru (1995) and Venezuela (1997). It is the undisputed market leader in its segment, offering more than 4,000 products to over 2,000 clients. The Group also developed and acquired several new businesses whose activities were complementary to GMS's core business.

The founders ascribe their success to having been the first to identify and develop the concept of a supermarket for the printing industry, offering both paper and printing supplies. The root of their impressive achievements? A combination of relevant experience and a very human approach to management. Special efforts are made to respect and respond to employees and to create a caring corporate culture.

Transition Time

About ten years ago, the founders began to reflect on the need for a successful transition to the second generation. They had a very clear sense of responsibility about the need for GMS to thrive after they retired from the firm, and started to think about how to ensure this. Two of Fernando Guzman's sons, both with distinguished academic and professional careers outside GMS, joined the company. The founders also worked with a prestigious local university that assisted them in restructuring the family business and separating family issues from business ones.

As a result, a new Board was formed, with three outside directors particularly focused on strategic issues. These directors don't have a formal right to vote but are nonetheless very influential. The directors were selected by both the families that own the GMS Group. A list of candidates was put forward by the two families and, after an in-depth review, they reached a consensus on three names. They also decided to create a Family Council to deal with issues of succession, family and ownership.

Like having an In-House Consultant

The main reasons cited for reorganising and bringing in outside Directors were ensuring the continuity of the GMS Group in the long term and providing management with a formal, professional sounding board. Prior to these changes, there were no formal Board meetings. Today, the board has five members (the two founders and three outside directors). It meets 4 to 5 times a year for about five hours and the directors receive a modest annual fee for their time.

In the family's opinion, the value of the outside Directors has been to:

- ask valuable questions
- propose creative ideas
- require strict control over management decisions
- question traditional ways of operating (such as pushing for more synergies between subsidiaries' back offices)
- bring an objective and impartial view of strategic issues (it's like having a McKinsey consultant in-house)

The outside directors have varied backgrounds. They were chosen for their:

- youth (GMS wanted people closer in age to the second generation)
- relevant experience
- involvement in the daily operations of their respective businesses (they all hold relevant executive positions in other companies)
- global knowledge and previous exposure to family firms. One of the three external directors is seen as having an excellent business sense, 'smelling' a good business opportunity. Another is methodical and always asks the right questions, while the third excels in bringing about agreement on difficult decisions

Case Study 3
Germany

A Sleepy Success Story Awakens

In 1940's Germany, two very different pioneering personalities founded what was to become one of the world's leading technical medical products companies. One was an outstanding researcher and innovator, the other a skilled networker. They combined their strengths to construct a resounding entrepreneurial success – turning an idea into a world class company with a turnover of DM 300 million.

A Slumbering Giant

The company enjoyed constant growth for decades by producing, selling and expanding rapidly and on an ambitious scale. However, by the mid-1980's the company started suffering from complacency. Although pioneering companies can coast on initial innovations for some time, the challenge of maintaining a similar level of success into the future remains ever present. Increasing competition and more innovative products on the market meant that, for this company, their competitive edge was wearing thin. Inadequate management and a lack of marketing experience started to take its toll in a complex and fast-changing industry. New managerial and organisational structures were becoming imperative.

The company re-evaluated the Board's objectives and functioning. Family members, after creating an initial Board of Members, redefined the Board's role as follows:

- to improve management and technical know-how
- to mediate between the family and management
- to control and supervise planned or completed developments

Until the early 1990s, the Board of Directors included only family members or former company executives. Their quarterly meetings never managed to get beyond the superficial. The company's more serious problems were never dealt with. To turn this slumbering company around required a major shift – led by a Board President who could be both unbiased and action-oriented. He would have to be savvy enough to recognise the problems and strong enough to implement a solution. The Board had to move beyond simply establishing new goals. It had to be able to control and measure their achievement.

New Ideas, New Impetus

The family concluded that only an external Board recruit could achieve all of these goals, on the condition that they had the personal authority to overcome the negative perceptions they would encounter as inevitable outsiders. The company recruited a dynamic, 37-year-old senior partner from a well-known strategy-consulting firm specialised in the pharmaceutical industry. One of the families knew him, and his competence quickly earned him the respect and trust of the other group as well.

His role was to bring about significant changes in exchange management, strategic re-orientation, and organisational restructuring. By 1994 the company took its first significant steps towards change and the impact of the new recruit was clearly perceptible in the results, confirmed by all involved. These included:

- competent Managing Directors
- a major strategic course correction
- excellent turnaround
- achievement of all defined goals

– efficient follow-up

– new business directions

The Head of the Board of Directors' unbiased 'outsider' position gave him the power and the stamina to clearly define, carry out and follow-up on all strategic priorities. He turned the Board of Directors into a competent and highly valued group. New ideas and innovations were introduced into the company, concepts that could never have come from internal management due to lack of competence or breadth of experience. The Board became more impartial with respect to its family-owned status and stayed focused on what needed to be done to put the company back on track.

Saved from its Fate

These changes could only have been achieved by allowing the Head of the Board of Directors to define and implement new company structures – without being blocked by family issues or traditionalists. The Board of Directors became a trusted source of impartial review and analysis. And it was in a position to apply the pressure required to realise its goals, including hard decisions like dismissing a top manager. Through its revitalised Board of Directors, the company changed into a modern organisation, with marketing and production concepts that increased profitability and prepared the firm for the next century.

Over its 50-year history, the company grew through various stages, from innovation and growth to stagnant complacency. Its likely fate would have been to be ruined or sold. But the family's shrewd decision, which goes against the grain in many family businesses, to recruit new blood and external professional competence, saved the company from this fate.

Case Study 4
Sogrape Vinhos, Portugal

Great Wines from Great Passion, Portugal's Best-selling Rosé

Sogrape Vinhos de Portugal was founded in 1942 in Northern Portugal. Fernando Van Zeller Guedes developed a highly original and easily recognisable bottle for a completely new kind of wine – the *Mateus Rosé*. The immense popularity of this wine quickly made it a market leader. It became the forerunner of a huge number and variety of wines produced and exported by Sogrape over the subsequent 50 years.

Today, *Mateus Rosé* is sold in 130 countries, and is Portugal's most-exported wine. This is the result of the dedication and charisma of the company's founder and his deep-rooted conviction that great wines can only be made with great passion. Fernando Van Zeller Guedes passed this sense of passion on to his son, Fernando, who takes enormous pride and pleasure in the quality of the family's wines.

Sogrape made a clear strategic choice to produce local wine locally, so their wines are exclusively obtained from Portuguese grape varieties and produced in Portugal. This approach differentiates the firm from other Portuguese wine producers.

Growing the Firm and its Brand

At his father's side from an early age, Fernando Guedes, currently the Chairman of the Board, joined the management team in 1952. Since then, he has turned his father's dream into reality. Over the years, he has led *Sogrape* to develop a vast portfolio of internationally acclaimed, high quality wines.

Over the years, *Sogrape* passed through four different strategic phases:

1942-1986: Satisfying Demand, The Rosé Boom

The first phase was dominated by the success of *Mateus Rosé*, which rapidly obtained worldwide distribution. During these years, the basic preoccupation was to satisfy the demand created by marketing investments.

1987-1992: Building a Brand

The next important phase was characterised by concentration on the Mateus brand, defining priority markets, repositioning the brand and creating a global communications approach. Following the studies and recommendations of external strategy consultants, *Sogrape* began diversifying within its core business by acquiring Portugal's leading port wine company, A.A. Ferreira, and by making investments outside the wine business. During this phase, the third generation joined the company. Fernando Guedes' three sons Salvador, Manuel and Fernando took on a variety of functions.

1993-1996: Extending the Brand

Then began a strong emphasis on extending the Mateus brand with the introduction of a white and red Mateus Signature wine. The President, Fernando Guedes, gave *Sogrape* a strong personal touch by appearing regularly in communication campaigns, expressing his passion for wine.

1996-present: Restructuring and Expansion

After restructuring the group into three sub-holdings (wine, real estate and services), *Sogrape* acquired another port-wine company, Forrester & Cia. (mostly known for its Offley brand) from Bacardi-Martini. The Guedes family remains the Sogrape Group's main shareholder, with Bacardi-Martini.

As part of its strategy to concentrate on wines, in 1998 *Sogrape* acquired one of Argentina's largest vineyards, Finca Flichman. Salvador and Manuel Guedes are involved in the management of the Portuguese wine business while Fernando moved to Argentina.

The group now has a turnover of about US$150 million and employs 750 people.

Opening the Board to Outsiders

During the late eighties, sustained growth and expansion, a diversifying business, and the entry of the family's third

generation into management led the Chairman of the Board to realise that to take the company into a new era, he would need to recruit experienced professionals externally. He added an Executive Board member, as well as a group of four young marketing professionals. So the Board consisted of five members (the new executive director and four family members and minority shareholders). A few years later, in 1995, when the Sales and Marketing Director retired, a new non-executive director was appointed from outside the company. The president looked for someone with the profile of an experienced senior manager with international experience and a proven track record.

A Breath of Fresh Air

The new director brought a breath of fresh air into our board. Extremely dynamic, he was able to help the board focus on its most important priorities and decisions – diplomatically, but with firm convictions. One of the other board members summed up his contributions as follows. He:

- forced the Board to concentrate on their tasks
- imposed a different decision-making rhythm
- challenged other board members with new ideas and concepts
- supported and inspired confidence in the actions proposed by other members
- contributed with the view of someone who is outside, looking in
- was always available for informal discussions

From 1987 to 1992, with an initial rhythm of monthly meetings, the board transformed *Sogrape* from a small, successful family-owned company to one of Portugal's proudest showcase companies.

Case Study 5
DOGI, Spain

High Value Added Stretch Fabrics

The DOGI Group was founded in 1954 in Spain by Josep Domenech. He remained the company's majority shareholder, with a 50.1 % equity stake, after its 1998 stock market listing. From its headquarters in the province of Barcelona, DOGI leads the European market in its core business, the production and sale of high value-added stretch-fabric for lingerie, swimwear, and sportswear. The Group's customers include some of the world's leading names in lingerie and swimwear, such as Vanity Fair, Sara Lee and Warnaco.

Responding to Recession

Until the early 90's the company's success was based on strong manufacturing expertise and domestic market growth. Management was highly personalised. But in 1992, the company suffered from the dual pressures of Spain's economic recession and integration into the European Community that resulted in strong new competition, particularly from Italian manufacturers.

In response, and to ensure the company's financial footing, Josep Domenech sold some of the company's equity to MERCAPITAL (a Spanish investment bank). A board was created to represent shareholders, but it had no independent directors. A new strategy was established to professionalise management and expand into the European market.

In mid-1993, Richard Rechter joined the company as General Manager to spearhead the new strategy's implementation. Organic growth was enhanced through product development into higher value fabrics and several acquisitions were made. A substantial cultural change process was also introduced, shifting the company from its existing product orientation towards more of a market focus. Major change and reorganisation programmes were undertaken in all areas.

With the best individuals in the company, a new management team with a more professional approach was established. The logistics, industrial and commercial processes were changed, instilling customer-oriented processes into the company. Service and product quality greatly improved. Several highly qualified, global professionals joined the company to reinforce areas weakened by tremendous sales growth (30% per year).

Going IPO

With the business growing, the company's position in the European market improving and positive results restored, Josep Domenech chose to buy back MERCAPITAL's share in the company in 1996. The following year the company prepared for an IPO. The board was reorganised to include two independent directors. Although this was in response to the stock market's formal compliance requirements, both Mr. Domenech and Mr. Rechter believed that independent directors would reinforce the board's supervisory role and serve as a sounding board for management issues.

Today, DOGI's sales represent Pesetas 20 billion (US$100 million) and profits Pesetas 1.3 billion (US$6.5 million). The IPO was a success, the share price has increased and the company is planning its entry into the Asian and American markets.

In Mr. Domenech's and Mr. Rechter's opinion, the particular value of the outside directors has been to:

- Bring diversity that expanded the horizons of the company
- If on the Board everybody thinks the same, this means there is little thinking
- Contribute different ways of approaching certain problems

- **Outside judgement has proven to be very valuable in validating our acquisition decisions**
- **Give access and influence other decision-makers in issues affecting the business**
- **And, more importantly, send a message to the financial markets about the seriousness and commitment of the company's strategic and management decisions**

In Richard Rechter's words *Talent attracting more independent talent can make a decisive difference for companies that want to grow and succeed.*

[1] John L. Ward, Professor of Private Enterprise, in his foreword to **The Family Business – *Its Governance for Sustainability*** by Fred Neubauer and Alden G. Lank, Macmillan Business 1998.

[2] Philip Clarke, **Small Businesses: *how they survive and succeed*,** David & Charles 1972.

[3] Article on the collapse of Eaton's family-run retail empire in Canada, August 1999.

[4] Sir John Harvey-Jones, **Making It Happen: *Reflections on leadership*,** Collins 1988.

Egon Zehnder International specializes in recruiting and assessing business leaders with outstanding track records who will create competitive advantage and sustainable value for our clients.

The world-wide success of our firm has been built on the special quality and accuracy of our insights into the strategies, competitive landscapes, and people dynamics of corporations – and their leadership requirements at the highest levels.

We are unique in always using competency-based interviewing, which has been proven in research to be twice as likely as unstructured interviewing to predict the future performance and suitability of candidates.

Our culture of seamless collaboration and global knowledge-sharing also allows us to go well beyond recruitment in facilitating and influencing business relationships. Our clients acknowledge the added benefits of knowing what we know, everywhere.

State-of-the-Art Advice

The Board Consulting and Director Search Practice Group focuses its efforts on the highest level of an organization – the board – and works in a collaborative manner with the chairman and its members to recruit directors whose independence, intellect, integrity, and courage will strengthen the board and create sustained competitive advantage.

Through a highly developed approach to board analysis, and in close collaboration with our clients' directors, Egon Zehnder International identifies the critical competencies required of the board as a whole, and its individual members, that best enable the board to matriculate from its traditional role of "oversight" to a more valued role of "contribution". Indeed, an effective board – one comprised of the right people, focusing on the right issues, and working in an environment where dialogue, and not monologue, is occurring – is perhaps a company's most strategic asset.

Our goal is to ensure that the board has a balanced perspective and that the collective wisdom of the directors is unleashed and contributed for the benefit of the company's shareholders.

Our clients range in scale from start-ups, to privately held family firms, to the world's largest corporation. Whether we are:

– building a board from scratch at the stage of an initial public offering

– appraising and restructuring an existing board

– internationalizing an existing board

– assisting a family firm with the appointment of independent directors

– creating a strategic Advisory Board, or

– advising on appropriate corporate governance practices

Egon Zehnder International delivers uncommon insight and outstanding business leaders.

Our equal, global partnership structure, and single-profit center approach, ensure that our clients receive the full benefit of the decades of knowledge and contacts that our consultants have built up over their careers with our firm. Whether an engagement is scoped in nature as local, country, continental, or global, Egon Zehnder International's consultants provide salient and pertinent advice and counsel.

Our knowledge, contacts, and efforts result in an outstanding board of directors.

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