The Right Leader at the Right Time:

How Family Businesses Can Compete for Executive Talent

Russell Reynolds Associates

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INTRODUCTION

While the world is moving to new forms of entrepreneurship, family controlled and governed businesses (FCGB) remain a large and powerful force in the global economy. Indeed, using a broad definition of family firms, almost one-third of all companies in the S&P 500, as well as 40% of the 250 largest French and German companies, are family owned.

In spite of their reach and prominence, family firms now confront acute challenges in attracting and retaining senior executives. Indeed, many family firms seeking to enrich their leadership ranks with outsiders openly question whether they can effectively compete for top-tier talent.

In this paper, we outline the factors driving the challenges confronting family firms in the market for executive talent; in turn, we offer guidance and a framework for:

- Determining when "going external" for executive talent is the right answer for family businesses.
- Attracting (increasingly sought-after) executives to family firms.

CONFRONTING AN INCREASINGLY COMPETITIVE MARKET FOR TOP EXECUTIVE TALENT

As a growing share of FCGBs undertake thoughtful succession-planning processes, many have begun to wonder if they might be "priced out" of the market for leading CEOs. Indeed, many firms feel that the long-term incentive packages offered by both public and private equity (PE)-backed firms are putting the best performers out of reach. While these compensation schemes once were reserved for an elite cadre of executives at publicly traded companies (primarily in the U.S.), the increasing worldwide presence of private equity funds and the growing emphasis on equity-based compensation at public firms are making this phenomenon more pervasive.

This trend will not abate. Private equity funds in Europe and in North America have more than $2 trillion already invested and have $1 trillion in available funds. While these numbers appear to be small when compared with the size of family controlled and governed businesses and of the global stock market, PE-backed firms have positioned themselves as strong, aggressive competitors in the market for top executive talent.

These dynamics have created an increasingly challenging environment for family firms seeking to compete for external talent. The financial rewards offered by non-family firms will rarely be matched by family firms; and this "financial rewards gap" might appear too daunting to overcome.

That said, there are highly advantageous elements of the employment value propositions offered by family firms. To capitalize on these advantages, family firms must align their unique strengths to the specific employment preferences of (and tradeoffs considered by) top executives.

INSIDE THE MIND OF CEO-CALIBER TALENT

CEOs today are confronted with significant tradeoffs depending on the nature of the company they intend to join. While CEO-level talent must assess a wide range of factors associated with any potential employer, the major tradeoffs focus on: (a) the shareholders' timeline vis-à-vis the execution of a strategy (shorter vs. longer) and (b) the magnitude of their individual equity association with the firm (lower vs. higher).

Timeline

While publicly traded companies are increasingly judged for their quarterly performance and private equity-owned companies often target three- to four-year exit timelines, family owned businesses traditionally have taken a longer term view of performance.

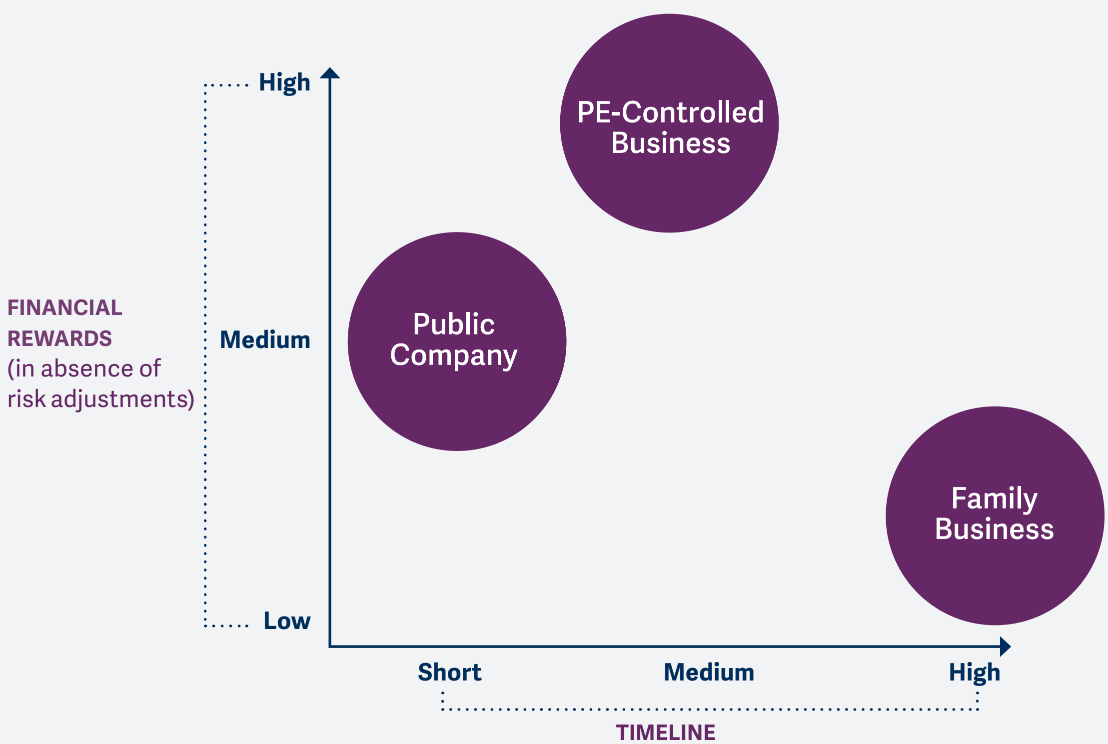
Equity association

Some of the best leaders in the world are increasingly interested in participating in the enterprise risks of the business they manage and in gaining the commensurate returns. The most significant forms of capital association tend to occur in private equity-owned companies, where returns can easily be an order of magnitude above the returns achievable in family firms.

When these tradeoffs are compared (and in the absence of risk adjustments), they commonly drive CEO-level talent toward private equity firms: a medium time frame for higher returns (Exhibit 1 illustrates these tradeoffs).

Given this dynamic, what can family businesses offer in order to attract and retain the best non-family leaders?

EXHIBIT 1: ILLUSTRATION OF RETURNS VS. TIMELINE



CAPITALIZING ON THE ADVANTAGES OF A LONG-TERM ORIENTATION

Whether private or public, family owned businesses tend to take a longer term perspective to avoid risking family wealth and control over the business. Family owners are naturally inclined to preserve and transmit their wealth. This longer term perspective usually goes along with more conservative strategies and a moderate propensity for business transformation plans.

On the other hand, a long-term orientation is a real asset for a CEO who needs to implement transformational change. While firms undergoing notable change must move quickly (and maintain momentum), overly aggressive timelines can endanger any well-considered strategy. When tasked with driving large-scale transformation, many CEOs will favor an environment that acknowledges the reality that transformation rarely happens overnight. And family owned companies often are unique in their ability to authentically offer these environments.

That said, the tendency of family businesses to prioritize wealth preservation may conflict with a CEO's need to take the risks required to execute a bold transformation agenda. Exhibit 2 demonstrates how these two factors—(a) a family firm's desire to "preserve vs. develop" and (b) the level of business transformation required within the firm—intersect to create four distinct environments. Each of these environments will attract (or repel) different types of leadership talent. And each environment will create conditions that make some executives far more likely to succeed than others.

The suboptimal environment is found in the upper left of the chart. The goals of "preserve and transform" directly clash, effectively requiring the implementation of large-scale change in a highly risk-averse environment. Few executives (internal or external) will be willing to operate in such an environment.

For external CEOs, the most attractive environment often is found in the upper right (an emphasis on "growth and development" combined with a need for a major change). This also is the environment in which an external CEO candidate will perceive a lower risk of failure.

The environment in the lower right is commonly favorable for external CEOs. In today's world, this probably is an evolutionary environment in which a more intense level of business transformation will be required over time. This also is true of the environment in the lower left, which frequently will be attractive to (and the right fit for) family leaders.

EXHIBIT 2

REQUIRED LEVEL OF BUSINESS TRANSFORMATION	Preserve ········ ULTIMATE FAMILY GOAL	········ Develop
High	Suboptimal environment for an external CEO. Perceived risk may lead the CEO to ask for high financial returns.	Best environment to attract talented CEOs from outside. The alignment of goals will lead the CEO to ask for more reasonable financial returns.
Low	Best environment to attract and retain family leaders at the helm. Probably a situation *in the making* and shifting to a higher level of business transformation over time.	Good environment to attract talented CEOs from outside. Probably a situation *in the making* and shifting to a higher level of business transformation over time.

FINDING POWER IN A CLEAR SENSE OF PURPOSE

In addition to offering a longer term perspective, family businesses offer a second valuable asset to executive talent: a stronger set of values in what often is defined as a sense of purpose.

In November 2012, Nicolas Kachaner, George Stalk and Alain Block published a *Harvard Business Review* article entitled "What You Can Learn from Family Business." The conclusion of a comparative study of 149 publicly traded, family controlled businesses with revenues of more than $ 1 billion in the U.S., Canada, France, Portugal, Italy and Mexico was that family businesses focus on resilience more than on performance. One of the seven factors characterizing management for resilience was identified as the existence of a stronger set of values (culture), which develops effective team dynamics and a collective mindset. Creating a culture of commitment and purpose rarely relies on offering financial incentives but, instead, on setting a superior mission for the business and aligning people around values such as respect, discipline and diversity. Family businesses frequently are unique in their ability to create a culture defined by these traits.

Savvy CEOs recognize that a strong culture (animated by a clear sense of purpose) is an essential ingredient for the implementation of ambitious transformation agendas. In turn, family businesses can harness the strength of their values (and sense of purpose) to attract talented CEOs who are willing to trade (some) financial rewards in return for operating in a high-commitment culture.

THREE SUCCESSFUL EXAMPLES OF NON-FAMILY LEADERS RUNNING A FAMILY BUSINESS

Numerous family businesses have relied on non-financial incentives to attract and retain an excellent CEO. The three examples below demonstrate the power of a "CEO employment value proposition" that offers a long-term orientation, an inspiring family purpose and sound governance.

1

LEGO

Building a future in which learning empowers children to become creative, engaged and lifelong learners.

Fifteen years ago, Lego, a Danish privately held company, wasn't as prosperous as it is today and was facing serious challenges. In 2004, third-generation CEO Kjeld Kirk Kristiansen left his position to Jorgen Vig Knudstorp, a young externally appointed CEO, and decided to step back into the role of Deputy Chairman.

Reporting to a seven-member Board of Directors with three independent members, the new CEO has grown the company to almost €3 billion in sales and has succeeded in increasing enterprise value by 13 times in 10 years.

2

THE CAMPARI GROUP

A leading player in the spirits category with 150 years of history.

In 2005, Bob Kunze-Concewitz became the CEO of Campari only two years after joining the family owned and controlled company as Marketing Director. Rosa Anna Magno Garavoglia, who owns 51% of the capital voting rights, decided to promote him. Her son, Luca, became Chairman of the Board. He keeps a busy non-Campari agenda. Over the last seven years, Campari has grown by 50%. Kunze-Concewitz is highly committed to continue this growth path and to build shareholder value.

3

DYSON

"Our interest is in technology, engineering and design. As a family business, we are able to keep the focus and philosophy long term and to develop technology that might be 20 to 25 years away."

Sir James Dyson founded Dyson 22 years ago. Dyson emerged from the Silicon Fen cluster of startup companies around Cambridge. Sales rose to above £2 billion last year. Convinced that the company should remain a family business, Sir James made courageous choices early on to ensure proper leadership and governance while his sons were becoming ready for succession. He hired Martin McCourt as the company's first external CEO in 1996 in order to concentrate on innovation and engineering. In Sir James' words, "Creating things requires believing in the impossibility while putting a sanity check around you." Max Conze, who joined the company from Procter & Gamble in 2010 as President, North America, succeeded McCourt as CEO 2011.

Sir James also developed a strong Board of external Directors, counting among them Warren East, CEO of Rolls-Royce. In 2013, Sir James asked his two sons, Jake and Sam, to join the Board as Non-executive Directors. With the support of the Board, Sir James folded Jake's lighting company into the business. Jake now is in charge of the lighting division and reports to the CEO.

Sir James' thoughtful leadership decisions have positioned the company for growth and innovation while simultaneously maintaining the values and ethos of a family business.

While unique in many ways, these three cases share three attributes that have proved to be consistently compelling to CEO-level talent:

- A long-term orientation.
- A superior sense of purpose.
- A bold decision by the family to step aside from the daily operations or to concentrate on a very specific area while maintaining a sharp emphasis on the governance of the company.

PUTTING IT ALL TOGETHER

Family businesses have been able to attract and retain external CEOs with highly attractive non-financial value propositions. That said, over the last few years, the gap between financial rewards in PE portfolio companies and family firms has widened. In addition, a significant number of CEOs have obtained the expected returns out of a PE challenge; as such, they have lowered the perceived risks associated with tackling these challenges.

As family businesses seek to attract CEO-level talent, they must openly and constructively address the realities of this gap in financial rewards. As mentioned earlier, the alignment between the "degree of preservation" and the "level of transformation" at family businesses can overcome some of the gap, as can the compelling non-financial factors that often are unique to family firms. Still, the remaining financial gap must be addressed directly.

With this in mind, we recommend that family representatives proactively lead discussions on the following topics with external CEO candidates:

- Assessment of the magnitude of the "financial rewards gap" and determination of whether it can be overcome.
- Clarification of the degree to which the family wants to preserve wealth.
- Agreement on the intensity of the business transformation agenda to be implemented by the CEO, as well as the timeline for its execution.
- Evaluation of fit with the values and culture that define the company.

While none of these discussions will be easy, it is only in addressing them that a family business can present itself as a valuable and exciting alternative to other forms of ownership.

AUTHOR

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