

Changing Lanes

Transition planning for entrepreneurs and family businesses

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with compliments from



Edward Rosenfeld



Guiding Families and Business. Now to Next.

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Consider Both Sides of the Coin

Statistics show that although more than 80% of business owners would prefer to pass the torch to family members, only 30% of these privately-owned companies do so successfully. A lack of adequate preparation, planning, and communication are the causes cited.

A number of years ago, we identified three key factors that handcuff business owners and prevent them from putting the same time and effort into planning for the continuity of their business as they did growing the business over so many years:

- The unknown – they don't truly understand how to transition a business.
- Uncertainty – they aren't sure that the business could thrive under new leadership.
- Lack of urgency – there is too much to do today and no time to focus on tomorrow.

The end result is a total lack of confidence – in themselves and their children. Yet transitioning a business isn't something that happens every day so why should anyone, young or old, be expected to know the ropes?

Few business owners realize the impact their inaction has on the succeeding generation. Whether verbalized or not, the next generation is attune to the underlying concerns. If these doubts are not addressed, the prospective successors can become intimidated, lose confidence in themselves, rely on others to shoulder many of the responsibilities that are rightfully theirs, and generally become hesitant in their roles.



This issue of Changing Lanes considers both sides of the coin. It explores one less-utilized but extremely valuable tool for managing the fears of both generations while at the same time grooming and mentoring next generation leadership. 

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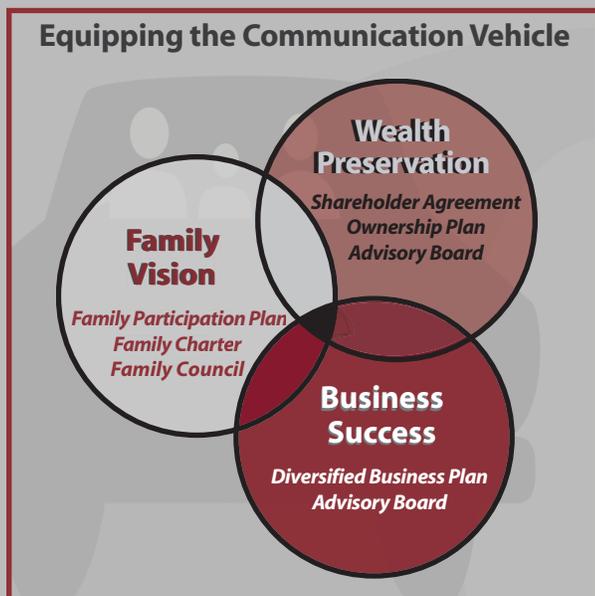
Remember – Alignment is Key

The last four issues of Changing Lanes have explored the components of a roadworthy communication vehicle that is well-equipped with plans and policies that document and align the objectives of each area of the business.

You learned that the Family Charter and Family Participation Plan incorporate the family vision and are vital for creating alignment with both the ownership philosophy of wealth preservation, and the management philosophy of ensuring a competitive and profitable business.

Now we examine the structures that will enable families to maintain that alignment in each of the three areas of the business. These structures also serve as appropriate forums for the creation and implementation of the governing plans and policies discussed above, and as such are necessary for achieving balance in the first place.

In this issue, we explore the use of an **Advisory Board** in maintaining alignment. In the *Business Circle*, an Advisory Board serves as a forum for overseeing the implementation of the strategic direction of the business. It is also a valuable structure for pursuing the goal of wealth preservation and financial independence within the *Ownership Circle*. 



The Power of An Advisory Board

It is unwise to be too sure of one's own wisdom.

It is healthy to be reminded that the strongest might weaken and the wisest might err.

Mahatma Gandhi

Many successful entrepreneurs will attribute their great achievements to their personal determination, great decision-making skills and even reliance on gut instinct. Unfortunately, the very qualities that brought about their success can later become key weaknesses.

To quote John Ward, Clinical Professor of Family Enterprises at the Kellogg School of Management:

“Successful entrepreneurs can't change personal patterns. We see business after business become rigid, frozen by unchanging industry definition, company mission statement, competitive assumptions, and day-to-day policies. The formula that provides early success must change with the times.”

Simply put, these businesses ended up suffering from a severe case of tunnel vision, the only cure for which is a hefty dose of objectivity from an outside party. For larger organizations and public companies, this objectivity comes in the form of independent directors.

This same lack of objectivity can certainly limit the potential of family businesses. Within a business family, new ideas and individual opinions tend not to be viewed objectively by siblings, parents, in-laws or cousins. In addition, there is often distrust of outsiders, a resistance to change, or no formal process for making decisions, resulting in limited opportunity for the next generation to develop critical-thinking and leadership skills.

A Family Business Advisory Board can limit such tunnel vision. It ensures a fresh viewpoint from the outside. It provides protection for both the goose and the golden eggs! It helps create greater choice for the eventual sale of the business, either internally or externally.

For business families, it is the closest thing to a silver bullet. 

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The Role of An Advisory Board

An Advisory Board is primarily a think-tank that stimulates communication and promotes a “we-focus” among current and future owners and the management of the business. Its ultimate objective is to enhance the creation and preservation of wealth while managing the risk that is inherent in all business entities. It not only acts as a sounding board for the senior generation but also serves as a training ground and provides guidance to next generation leaders.

Similar to a Board of Directors, the focus of an Advisory Board is to garner the insight of people from outside the business – people who have specific knowledge or expertise in privately-owned businesses and can bring a different perspective to the discussions.

However, unlike a Board of Directors, this board does not have the power to make decisions – it operates solely in an advisory capacity. While a Board of Directors can decree what actions must be taken to fulfil the needs of the shareholders, the role of the Advisory Board is to explore new opportunities, challenge the status quo and make recommendations to the owners, the Board of Directors, the CEO and/or the Management team.

Both entities play an important role in the growth, professionalization and ongoing sustainability of the business yet many family businesses have yet to recognize the value of having an outside perspective. Only a minority of privately-owned businesses have a structured Advisory Board in place and fewer still have professionalized to the point where a legal Board is responsible for major decisions.

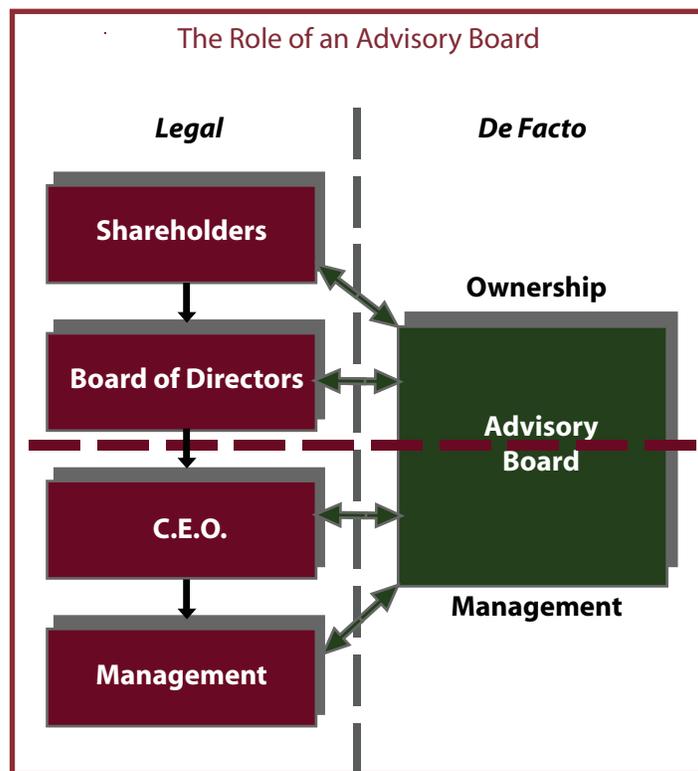
Yet every business owner has a mentor or outside advisors whom they trust and consult on an ad hoc basis. Taking this one step further and having regular meetings with these mentors and advisors will provide the opportunity for great ideas to develop from good ones.

And when it comes to preparing for the eventual sale or transition of the business, an established board, either legal or advisory, will greatly enhance the saleable value. 📌

Strategic or Operational?

Theoretically, an Advisory Board will focus on either the ownership area, or the management of the business. In practice, many small businesses set up one board that switches focus between these two key components.

The role of an Ownership Advisory Board is to protect the wealth and set the stage for continued growth. In other words, it looks after the goose that lays the golden eggs!



We call this a **Strategic Board**. Its mission is to meet shareholder objectives and ensure a return on investment through the development of a viable long-term strategic direction for the company and a fair and equitable entrance and exit process for individual shareholders. The Ownership Advisory Board acts as a catalyst to initiate:

- 📌 A 5-year Strategic plan that outlines a clear and unified direction.
- 📌 Development of appropriate ownership principles, such as the criteria for buying and selling shares, as a foundation for an effective Shareholder Agreement.

📌 A Wealth and/or Estate Plan that protects each shareholder's investment.

- 📌 Suitable shareholder compensation that links to the current profitability.
- 📌 A contingency plan that adequately protects shareholder assets from unforeseen events.
- 📌 Discussion around the criteria for ongoing reinvestment in the business.
- 📌 Enhanced communication and learning among current and future shareholders.
- 📌 Preparation of next generation owners for their role as Directors.

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Finding the Right People

We recommend your Ownership Advisory Board include at least one independent with first-hand knowledge of a family operation and the issues your industry will face during the next five years. Highly-respected, recently retired CEOs are a good choice. Representation from the current shareholder group should comprise of family members who are involved in the day-to-day operation and some who are not. Some businesses also choose to recruit a member of their team of professional advisors while others feel that such an appointment would conflict with their current business agreement.

The make-up of a Management Advisory Board is slightly different. Typically the mainstay of such a board is the CEO and other key members of the Management team. Family members who are not involved in the business may be included if they have a specific competency or interest that will be of value. The required outside perspective can be gained from the inclusion of a respected individual from the same or similar industry.

When inviting an outsider to sit on your Board, first consider what attributes you require then send an invitation to serve that provides the recipient with clarity around:

- Your Board's mandate and objectives.
- Their authority, responsibility and accountability.
- The benefits of serving and the compensation for their commitment.

For information on the specific responsibilities of a board member or for assistance in setting up an Advisory Board that can mentor your future leadership, please give us a call. 



Strategic or Operational? *continued*

On the other hand, a Management Advisory Board focuses on ensuring a profitable and competitive business. It is an **Operational Board** charged with producing more golden eggs! Its mission is to ensure the business meets its strategic objectives and is never dependent upon one specific person for its success. Key functions of a Management Advisory Board include providing input into:

- A roadmap to deliver the vision (a diversified business plan).
- How to implement this roadmap to take the business to a higher level.
- Best practices for managing the business assets and business performance.
- Defining the ARAs for the Management Team.
- Developing a comprehensive mentoring process for the Management Team.
- Linking compensation to ARAs.
- Developing and implementing a management succession plan.

Generally, *Strategic* or *Ownership* Advisory Boards meet once a quarter, although they can opt to meet more frequently in the start-up stage. *Management* or *Operational* Boards typically meet monthly or bi-monthly at minimum.

Additional meetings can certainly be scheduled as required. We recommend meeting off-site where possible so as to avoid disruptions stemming from the day-to-day issues that will undoubtedly arise. 



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