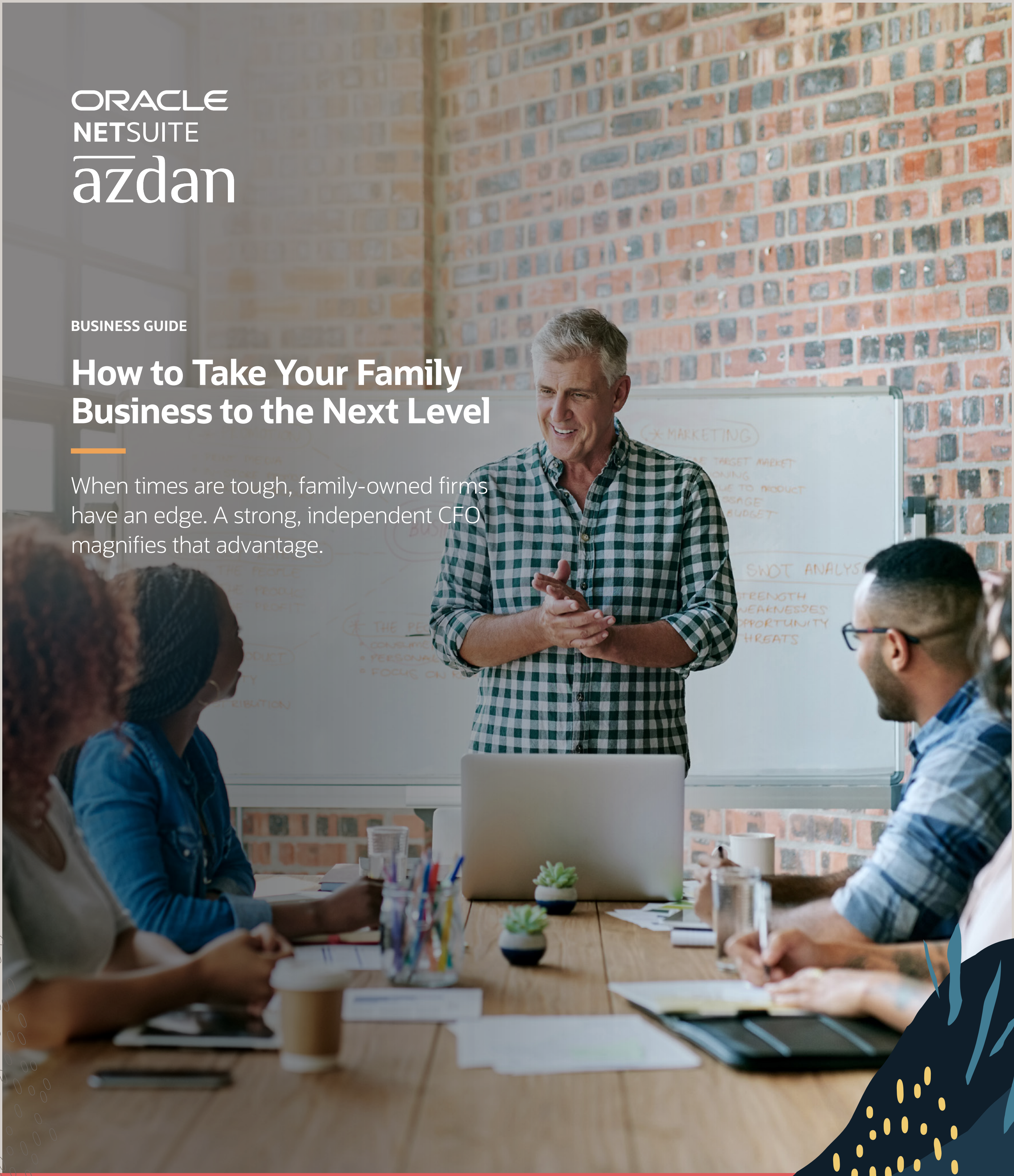
BUSINESS GUIDE

How to Take Your Family Business to the Next Level

When times are tough, family-owned firms have an edge. A strong, independent CFO magnifies that advantage.



Grab a seat and enjoy.
Read Time: 11 minutes

How to Take Your Family Business to the Next Level

When times are tough, family-owned firms have an edge. A strong, independent CFO magnifies that advantage.

The U.S. Small Business Administration says 29% of firms with employees were family-owned in 2018. And they typically have strong cultures that inspire confidence: The 2022 Edelman Trust Barometer says that family-owned businesses (FOBs) are the most trusted companies, with 67% of respondents saying they trust them over privately held (58%), publicly traded (56%), and state-owned (52%) businesses.

There are lots of reasons for this, as we'll discuss, but one key is that FOBs are more likely to have positive impacts on their communities and employees.

They're also optimistic about weathering hard times. In December 2020, BanyanGlobal Family Business Advisors surveyed FOBs around the globe, and their outlook, even in the midst of COVID-19, was positive. They were focused on improving operational efficiency, refining their decision-making processes, and putting development opportunities in place for subsequent generations. Even then, at a low point for the economy, a full quarter of those surveyed said they believed their market share would increase in the future.

That's because FOBs have an advantage in times when resiliency, not rapid growth, is the goal. Because of their strong cultures, they're better able to pull together toward common objectives. They prioritize preserving cash while focusing on the well-being of their employees and communities, which circles back to trust.

One respondent to the BanyanGlobal survey summed it up: "There's nothing like a crisis to bring the family closer together."

Problem is, as FOBs get to a certain size, they find they lack the ability to standardize processes, design and execute growth strategies, and make sure systems are compliant and optimized — particularly when it comes to finance.

In many cases, the tipping point comes as the second generation becomes involved in the business, bringing new ideas and energy. In his 2018 book *Resilience of 100-Year Family Enterprises*, Dennis Jaffe says that by the third generation, successful FOBs have evolved from small businesses whose purpose is to support a family financially to sophisticated enterprises that run on "clear, firm and effective business principles."

Translation: Sometimes families need external talent to come in and help modernize the business.

But no matter how strong an FOB's culture, there are challenges when an outsider joins in a position of oversight and authority, especially in the finance function. Keys to success include identifying when bringing in external talent becomes a necessity, attracting the right people and, ensuring your hire is a good cultural fit.

Table of Contents

CHAPTER 1

5 Ways Outside Finance Pros Help

Usually, organizations realize they need to bring in external help when the business reaches a point where gaps start to show and mistakes start to happen. Or, they realize they need a CFO who's not a family member to reassure the board, banks, and investors — they're often seen as an independent broker between the family and others with a financial interest.

Here are four areas an external financial professional, like a controller or CFO, will look to get a handle on immediately.

1. Process

Within FOBs, founders or leaders may disregard processes when following them is seen as inconvenient. Or, there may not be processes in place at all. Not only is that no way to grow, it causes tension within the organization. A newly hired CFO can improve or put in place processes and ensure they're aligned with company operations and followed consistently.

Meena Gupta is COO at NearbyMovers, a service that helps people find and book local movers and shipping services. The company knew it was losing money because of a lack of process, so it decided to look outside of the family for someone who could bring real-world experience to process improvement.

"The job requirements were for someone with experience in fast-growing companies, who could handle multiple priorities and who had a track record of success," Gupta said. "However, what we really needed was someone who could come in and help us streamline our operations and make recommendations for long-term growth."

When the company brought in an external CFO, Gupta was surprised at how many gaps there were in NearbyMovers' collection activities. The CFO immediately increased revenues just by improving that one process.

2. Financial governance
When it comes to finance, a lack of sophisticated processes leads to wasted money and missed revenue opportunities.

Mike Collins is the founder of MCA, a family-owned managed IT services provider with offices in 13 states. As his business model shifted from project revenue, hardware sales, and printer maintenance into true managed services, Collins realized he needed help.

"We were recognizing managed services revenue as maintenance revenue, but we knew we had to segment those lines of business," Collins said. "We couldn't figure out if we were actually making a profit or not. There were lots of mistakes."

3. Metrics measurements
At a certain point, some of the KPIs a company tracks no longer align with its financial reality. Like Collins, your business model may have changed. Maybe you're working in new geographies or moved ordering and delivery processes online. Or perhaps as you added employees, you failed to properly track performance and associated incentives.

Here are just a few areas an external finance professional can help you focus on:

- Macroeconomic indicators: FOBs tend to ignore macro indicators like energy and commodities costs, unemployment numbers, and so forth — until they take a bite out of cash flow or revenue potential. Despite the goodwill customers feel, they may be forced to spend less on your company's products or services. An external finance pro will have the acumen to watch and interpret those metrics and their impact on your business.
- Supply chain: How many days of inventory do you have on hand? If you stockpiled, are you accounting for those costs, like additional space and insurance? Do you know how to forecast how supply chain issues will impact your business? These are all questions finance pros know to ask.
- Labor costs: In a job market this tight, metrics associated with labor costs are critical. Wages must be competitive, benefits need to be robust, vacation time may need to be increased, and so forth. The cost of turnover changes as employees switch jobs more frequently. As an FOB, you may not have considered, for example, offering unlimited vacation as a differentiator even though it removes a financial liability — unused PTO — from your books.
- Forward looking indicators: All organizations track their revenue, but that's a rearview-mirror metric. Fewer watch real-time indicators like revenue per new client or even metrics associated with non-revenue-generating job functions. How many leads has that new marketing campaign brought in, for example? Leading indicators are more difficult to identify and track, and FOBs need a real professional to do so properly.

  "I've always had a love-hate relationship with KPIs, because it feels like those metrics become a hammer looking for a nail," said Collins. "But there are some that I was missing before we brought in external help, like employee satisfaction or how much profit to reinvest into the business to achieve goals outside of financial growth."

  But Collins was careful to point out that he didn't adopt all of his new CFO's suggestions. For instance, he opted against strictly tracking engineers' time to resolution or call length because his culture is that technicians take the time they need to develop real relationships with customers, and he didn't want to disrupt that.

4. Tech and systems
PwC finds that only 42% of family businesses say they have strong digital capabilities, and just one-third report having a clear and documented roadmap for expanding their use of technology. No plan to optimize technology, solutions, and systems can be a real competitive disadvantage.

That's not to say a finance professional is going to double as a CIO. But an external hire has likely seen how IT is done at other firms and can make recommendations on moving to cloud services or engaging an integrator or managed IT services provider, for example.

A lack of operational technology can also hurt your business. James Richards is the CEO of family-owned IT outsourcer Stronghold Data. In the summer of 2022, his wife realized that the business had grown such that QuickBooks could no longer handle its needs. Richards was an accounting major in college, but even he didn't have the skills necessary to manage implementing a professional services automation (PSA) solution, an enterprise-level accounting system, an ERP, and other technology upgrades he knew could help the company grow.

"We needed real expertise," said Richards. "We couldn't just do the 'quick and easy' way of keeping the books with the solution that worked when we were a small business. The complexity was immense."

Stronghold hired a finance pro with expertise implementing these systems who was able to guide the company's choices.

5. Governance, risk, and compliance
We've all heard horror stories of FOBs where a family member or longtime trusted employee is found to have embezzled from the business. Even if no malfeasance is involved, a company may still run afoul of the IRS. Financial statement fraud may be committed by people who are simply trying to make the business appear more successful than it actually is.

Often Job No. 1 for an incoming CFO or controller is to put in place controls, such as requiring multiple signatures for significant transactions and segregation of duties within finance, which involves dividing responsibility for bookkeeping, deposits, reporting, and auditing between different people. Circling back to technology, an ERP system can automate accounting operations, including accounts receivable, accounts payable, and cash management, and enforce segregation of duties and strict approval mechanisms, all of which help prevent unauthorized transactions.

CHAPTER 2

Know Your Needs and Goals

After six years of consistent growth, Gupta knew his company needed help to continue expanding, so he and other execs started searching for a CFO.

"The family members who were handling financial positions at the time were stretched thin, and we knew we needed someone with fresh perspectives," Gupta said. "We also wanted to make sure that the candidate we took in had experience in a family-run business, which is quite rare."

When hiring external talent, it's important to know exactly what you're looking for and why. Often, that requires taking a hard look at the business and various family members' ideas about where the business should go and what their roles in it should be.

Answering these questions can help you home in on the characteristics and skills you're looking for.

Q: What are your long-term goals?
Are you planning to sell the business when you retire, or will the next generation take the reins? Do you have a succession plan in place? Do you want to keep the status quo for your FOB and maintain current revenue or grow it into a larger enterprise? Do you want to expand into a new vertical? What about a new geography?

Knowing where you want the business to be in five to 10 years is key to finding someone who can get you there.

Q: What are your short-term goals?
In a recent survey, PwC reports that 57% of family businesses say expanding into new markets or client segments is a top priority for the next two years. If this is you, which new types of clients do you want to go after? Forty-five percent want to pursue new strategic acquisitions or mergers. These firms will want to hire people who have M&A experience. Want to introduce new products or services like 50% of respondents to the survey? You want someone with a background supporting product development and marketing.

Q: Are you prepared to delegate?
It's tough to give up some control of a business you built and back someone making decisions you might not have made. Can you do it? Are you willing to tell a family member that they're no longer in charge of certain financial decisions? Have you sat down with stakeholders and very clearly defined the responsibilities and authority level a new hire will have?

The last thing you want is for an attractive candidate to walk away because they suspect every day will be a battle just to get the job done.

Q: Where are your biggest skills gaps?
Are family members honest with themselves about the point at which their expertise stops? Not everyone is as lucky as Richards, whose wife readily admitted she needed help. Sometimes it has to be the founder or owner who makes that evaluation, and that can be a tough conversation to have. You may consider using an outside business analyst to assess the needs of the company and deliver an objective assessment.

But eventually, you must decide: Is it more important to grow the business or to spare someone's feelings?

Q: What's the hire's career path?
One of the biggest hesitations superstar CFOs have about joining an FOB is that, often, there's no room for advancement because top-level roles are held by family members who aren't going anywhere. Maybe you're willing to create a new executive role or even oust or demote the family member who's currently in the finance lead position. But don't assume those you interview will know this.

Be honest with yourself and with candidates about growth potential. If you don't see much opportunity, consider an outsourced or virtual CFO, at least to start.

Q: Do you have industry-specific needs?
Richards didn't just need a controller. He needed one with experience in IT, or at least in an industry with similar systems and billing models.

"There's a learning curve to IT, and we needed someone who could navigate it fast," said Richards. "They needed to know how to audit vendor invoices and translate them into client invoices. They needed to understand who we charged per user or per device and why. They needed to know how to use integrated systems so the right expenses were allocated to the right clients, then maybe translate that into a flat rate for certain clients."

If your company requires a specific skill set or location, say so upfront so you don't waste your and the applicant's time.

Darren Peddle, CFO of Sunrite Greenhouses and Greenway Greenhouse, says that when that family company was looking to bring in external financial help, they knew they needed someone who would be in it for the long haul. Its industry is pretty niche, and it's located in a rural area that wasn't exactly a hotbed of job seekers.

"They were firm that the candidate had to have knowledge and competence in agricultural accounting, ability to lead, attention to detail, and experience with financial analysis and reporting," said Peddle.

At the same time, they were so focused on agricultural experience that there were some things they missed in the initial job description, like project management, negotiation skills, public company accounting as one subsidiary is now trading on the stock market, valuation techniques, and the ability to guide an expansion strategy.

It took months for Sunrite to find Peddle, but that patience was rewarded with exactly the right candidate for the job.

Q: How would you describe your company culture?
Are you a suit-and-tie business? Do there tend to be lots of collaboration and whiteboarding sessions? Is it imperative that employees are at their desks not a minute past 8 a.m.? Are people able to work remotely? Is spending social time outside work hours expected? How about volunteering in the community?

> "It can be difficult to find someone who is a good fit for your company culture, and it can take time for them to understand your business. However, if you do your homework and find the right person, the benefits can be enormous."
>
> Meena Gupta, COO, NearbyMovers

Culture is built of a ton of little characteristics and quirks, so keep that in mind. In fact ...

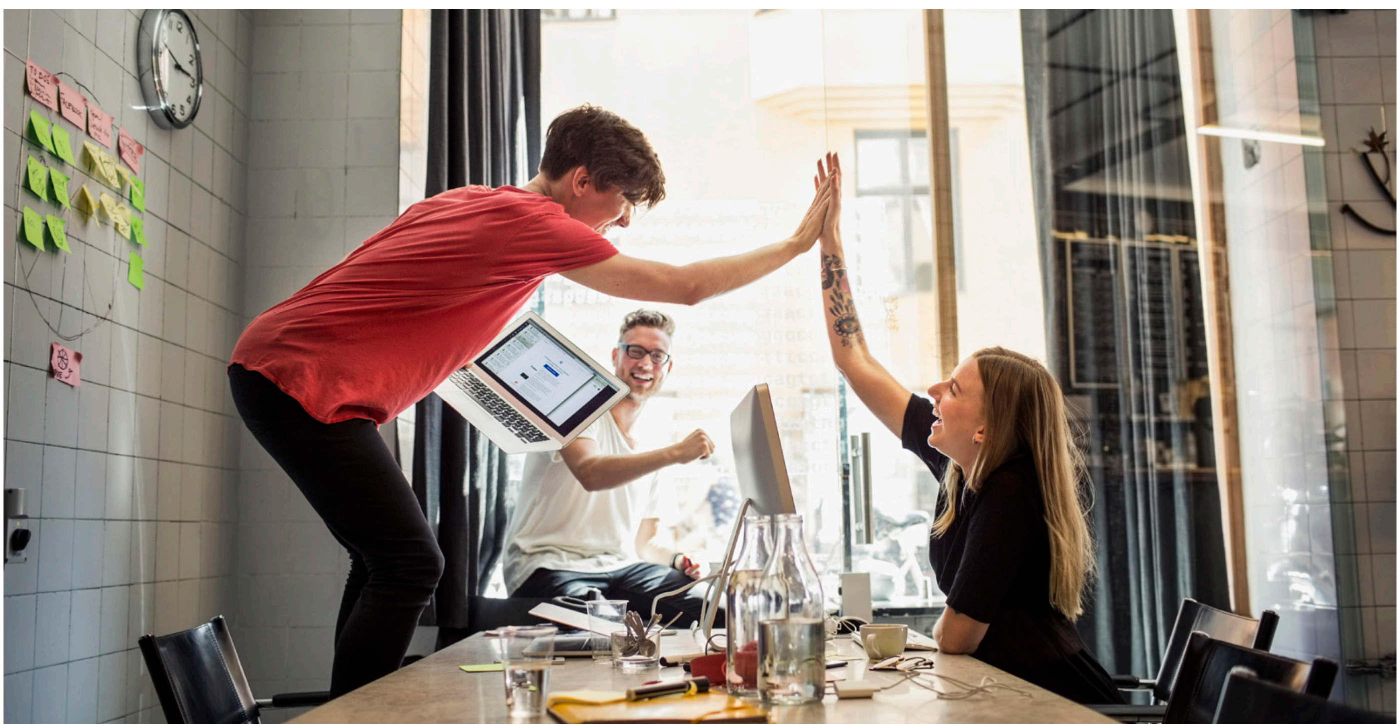
CHAPTER 3

Culture Eats (Financial) Strategy for Breakfast

A strong culture is one of the best things about FOBs. When the core employees are from the same family, they share similar values, communication styles, and histories. There's a trust level that you don't often see in other organizations.

Family-owned businesses also tend to pay more attention to the well-being of their employees. Communication lines are more open. They're clear about what they stand for, and by and large, everyone is on the same page.

These days, we hear lots about how Americans are looking for more meaningful jobs with a healthy work-life balance and a culture they can believe in. A family-owned business can check all those boxes. The key is being able to pin down the characteristics of that culture so that you can make sure your hire is a good fit.



CHAPTER 4

Compensation Isn't Everything

The talent crunch is real and ongoing. While unemployment numbers are beginning to stabilize after a summer of tremendously good news for job seekers, it's still a candidate's market.

And there's competition aplenty: 92% of private companies in PwC's February 2022 Pulse Survey said that hiring and retaining talent are very important to their growth strategies. FOBs are no exception, particularly for second- and third-generation leaders. According to PwC's 2022 U.S. NextGen Survey, three-quarters of these next-generation executives cite talent retention and acquisition as a high priority over the next two years.

All this means that family-owned businesses must challenge themselves to be competitive. FOBs, as discussed, tend to dole out smaller salaries and compensation packages versus their counterparts. According to the IZA Institute of Labor Economics, family firms pay employees 3% to 5% less than their counterparts.

What initiative or effort will receive fewer resources because the company is devoting those funds to a new hire? Gupta says it wasn't an easy choice to make.

"The decision came with cash flow, with the corporate cash position the greatest consideration in mind," she said. "We needed to make sure that the business could finance the compensation of a finance expert on an annualized approach. This way, we would be able to guarantee a long-term business relationship with the person we were taking in."

It's more than just salaries, though of course that's a big piece of it. As a candidate, you'll want to know you have a solid future with an organization, and FOBs face some challenges here.

Three areas candidates will certainly ask about:

1. Expected pay raises. The Wall Street Journal reported that the average tenure of an FOB CEO is 25 to 28 years. Compare that to the four to six years at a publicly traded company, and that means that the outlook to move into the top spot at a family firm is bleak. Because leadership roles tend to be held by family members for quite a while, and opportunities for advancement can be limited, that means opportunities for the pay increases that come with promotions are limited, too.

   Note that a controller or VP of finance who wants that CFO title may be willing to take less in base pay in exchange for the top title.

2. High variable pay. To dodge high salaries, many FOBs base compensation on high variable bonuses and incentives that can be tied to aggressive and difficult-to-reach performance achievements. While functions such as sales may be accustomed to such a structure, it's a hard sell for finance pros who are traditionally compensated mainly with base pay.

3. No stakeholder opportunities. Odds are, unless there are plans to go public and that's why you need a CFO, the FOB is going to remain privately held within the family. Maybe it's a long-term goal to bring in investors, but opportunities for external talent to gain a stake in the company may be limited. Sharing equity with an outsider can cause concern and discord among family members. Still, particularly with executive positions, it's reasonable for finance hires to ask for a share of the growth they're going to help the company achieve. It can be a delicate balance.

4 Creative Incentives

The Society of Human Resource Management (SHRM) lays out a few examples of long-term incentives that may help offset lower salaries.

LTI Option	Example	Pro	Con
Cash	Candidates are awarded a cash payout equal to 50% of base salary paid out over a three-year period, dependent on achievement of a specific performance goal.	Simple to understand and execute.	Inflation can negatively impact cash value over time. FOBs will need to get creative to find ways to compensate for this, such as setting up deferred compensation accounts where employees can invest the cash.
Phantom Stock Units (PSUs)	This feels like real stock, but it's a cash vehicle that grants no voting rights to the holder. Each PSU holds a value equal to a percentage of the company's value that vests over time and is paid out based on the company's value at payout.	Keeps ownership within the family while keeping the employee invested in the company's financial health.	Requires some external valuations of the company, and if the share price drops, the incentive the employee receives drops in value over time.
Phantom Appreciation Rights (PARs)	Another incentive that feels like stock options in a publicly traded company. Provides incentive in terms of the appreciated value of a share, but recipients cannot choose their payout date and have no voting rights.	Employees have a stake in the financial health of the company, and if the share price drops, the company spends less money on the incentive.	On the flip side, the employee loses out if the share price drops. Also requires periodic external valuations of the company.
Equity	Offers a true ownership stake in the organization. Not tied to performance, but instead to a vestment period.	Often makes sense when a company's succession plan doesn't include the next generation.	Requires all current equity holders to be on the same page, so you're asking family members to give up control and part of the company to external talent.

The Bottom Line

For a small startup, it made sense for all members of the family to pitch in and serve in different roles. But as a company grows, skills gaps start to be apparent — particularly in the realm of finance.

When speaking with a controller or CFO about joining your growing FOB, realize what you're bringing to the table, and take a close look at intangibles that can offset possibly lower compensation.

The right fit is out there for you. Just do your homework, and you'll find someone who'll become almost part of the family.

āzdan