

FAMILY MATTERS

Cultivating human capital, financial capital and innovation
across generations in family businesses



Research conducted by

TABLE OF CONTENTS

A MESSAGE FROM U.S. TRUST PRESIDENT KATY KNOX	1
--	---

INTRODUCTION

By Gregory Fairchild	2
----------------------------	---

SECTION 1

CASE STUDIES

Lawrence Gray

GrayCo	6
--------------	---

Kim Morrish and Simon Morrish

Ground Control	14
----------------------	----

Jim Bright and Joe Bright

Dunk & Bright Furniture	20
-------------------------------	----

Doug Perry and Macon Brock

Dollar Tree	26
-------------------	----

Case Study Themes

By Gregory Fairchild	32
----------------------------	----

SECTION 2

HUMAN CAPITAL

“Why Family Businesses Put the Human in Human Capital”

by Morela Hernandez	35
---------------------------	----

“Diversity: How Diversity Can Achieve a Company’s Strategic Goals”

by Martin Davidson	44
--------------------------	----

FINANCIAL CAPITAL

“Investment Structures for Effective Family Business Operations”

by Mary Margaret Frank and Elena Loutskina	45
--	----

INNOVATION

“Leading a Business in the Smart Machine Age Calls for Innovation”

by Edward Hess	53
----------------------	----

CONCLUSIONS AND LESSONS LEARNED

By Gregory Fairchild	60
----------------------------	----

ABOUT THE CONTRIBUTORS

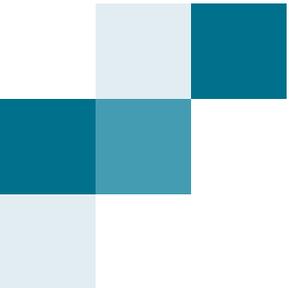
University of Virginia Darden School of Business

Martin Davidson	64
Gregory Fairchild	64
Mary Margaret Frank	65
Morela Hernandez	65
Edward Hess	66
Elena Loutskina	66

U.S. Trust, Bank of America Private Wealth Management

Karen Reynolds Sharkey	67
Rebecca Eyre	67
William Cohen	68

ADDITIONAL THANKS	68
--------------------------------	----



A message from U.S. Trust President Katy Knox

Many of our clients manage and own family businesses. These owners consistently impress me with their commitment to building businesses that contribute to the economy and society for decades. Business owners are often focused on retaining management within the family and yet history shows that transitions through successive generations can create unique challenges. Any business evolution requires early and frequent planning. This is proven even more important if the goal is to keep it in the family.

Family Matters is a resource designed to help family business leaders focus on the transition of their business to the next generation. The white paper starts with four real-life journeys that span different industries, geographies and generations.

These perspectives offer important lessons beginning with the experience of a founder and continuing to an owner in the family's fourth generation. We also address human and financial capital as well as innovation, the three areas that most concern our family business clients. This research concludes with how to develop the next generation, the importance of implementing a family agreement and key strategies to stay innovative.

We stand ready to help you with business transition planning as you identify and navigate the unique challenges for your family's business. We are grateful to the University of Virginia's Darden School of Business for their partnership on this paper.

Katy Knox

President

U.S. Trust, Bank of America Private Wealth Management

INTRODUCTION

by Gregory Fairchild



All growing businesses face challenges as they build from their entrepreneurial beginnings—whether they are global conglomerates or successful local companies. Family business owners who wish to retain control through the generations face a distinct set of challenges and opportunities. This paper drills into the issues of intergenerational transfer and offers insights into what family business owners should consider as they work to create sustainable businesses and plan for the future. A series of original case studies also demonstrates hard-won lessons learned from family-owned businesses.

WHAT DEFINES A SUCCESSFUL FAMILY BUSINESS?

Responsibility. Leadership.
Flexibility. Growth.
Modernization. Innovation.

Businesses must constantly balance these defining elements of a successful operation. When a company is owned by a family—whether in its first generation or fifth—that balance can present unique challenges.

In the United States, family enterprise remains the dominant form of business, with approximately 90 percent of U.S. companies owned or controlled by a family.¹ While many of these businesses are small, there are many large, well-known companies, as well. Regardless of their size, family-owned businesses perform well, often outperforming their nonfamily-owned counterparts, particularly in the financial markets.²

Effective management of these companies—which play both economic and social roles—is critical and complex, and can become especially complicated during transitions and the curation of

intergenerational leadership. According to the consultancy Family Business Institute, only about 30 percent of family businesses survive into the second generation.³ When the third generation comes into leadership, only 12 percent of businesses are still viable and only 3 percent of all family businesses operate into the fourth generation or beyond. Taken together, these statistics mean that successful transitions over time are the exception, not the rule.

Yet some businesses defy the odds, and family business owners remain driven and hopeful; two-thirds of business owners say other members of their family are involved in the business and 71 percent believe that family involvement provides a competitive advantage. Of business owners contemplating an exit, 52 percent intend on selling or transferring the business to family members and/or employees.⁴ Research indicates that effective succession planning, coupled with innovation, can make all the difference in connecting the families' optimism and the businesses' ability to thrive through multiple generations.

¹ *Forbes*, "The Facts of Family Business," July 31, 2013.

² *The Washington Post*, "Report: Family-owned businesses are doing better than the rest," September 29, 2017.

³ Family Business Institute, <https://www.familybusinessinstitute.com/consulting/succession-planning/>.

⁴ 2018 *U.S. Trust Insights on Wealth and Worth*, 2018.

THE JOURNEY OF FAMILY BUSINESS LEADERS

This white paper aims to help family businesses thrive and transition smoothly from one generation to the next as they strive to build a sustainable business that will last across generations. Its object is to answer questions modern family business leaders are asking as they ponder,

“What’s next for our family and our business?”

Family businesses have unique strengths and challenges, and the intent of this white paper is to provide insights into the dynamics that combine family, management and value creation. Family companies have long been at the heart of business; providing reflections on how to keep family businesses in their families brings to light important leadership themes:

- Establishing and fostering company values, culture and relationships
- Identifying conversations for business leaders to have (and when, and with whom)
- Seeking new perspectives by leveraging difference to achieve strategic goals
- Investing strategically in business operations
- Supporting growth and change across all areas of the business
- Achieving innovation for long-term success

The paper is divided into two sections. We start with four case studies that highlight the journeys of family business leaders as they transition their family businesses. The real-life cases offer important lessons and span industries, locales and generations.

Lawrence Gray ***GrayCo***

GrayCo began as a lumber company and operated for more than a century before pivoting to become a commercial real estate venture when the moment was right. While for years the leadership was comprised only of non-family members, Lawrence Gray brought just the investment strategy experience the business needed, boosting not only family engagement but also philanthropy.

Kim and Simon Morrish ***Ground Control***

The Morrishes’ award-winning U.K. landscaping company embraces stewardship governance. They have designed policies, practices and procedures that encourage employees’ personal involvement in the business, inspiring them to work toward common goals of outstanding customer service and growth.

Jim and Joe Bright ***Dunk & Bright Furniture***

As the Syracuse, New York-based furniture retailer Dunk & Bright prepares to transfer leadership from the third to the fourth generation, the family-owned company reflects on its defining elements of success, including treating the business as a research lab in constant flux, which leads to agility, and insights into developing the next generation.

Doug Perry and Macon Brock
Dollar Tree

The family behind the pioneering discount retailer shares its roots in the toy business, which spawned an innovative idea that led to a 14,000-store retailer across 48 U.S. states. Keys to their success were investing in a people-centric workplace and making the right decisions at the right times.

Following the case studies is a summary of common themes related to talent, next generation development, communication, innovation and building and sharing wealth that presents practical content for family business leaders. We hope these themes are useful to other family business leaders. The second section focuses on the three areas that most family business owners contend with: human capital, financial capital and innovation.

- **Human capital:** The successful preservation of family values in the business culture hinges on how leadership deals with the valuable asset of human capital. This section addresses how to develop the next generation, the importance of family values, taking a stewardship approach and the critical need for effective communication.

- **Financial capital:** Though financial conversations are sometimes difficult, facilitating these conversations is incredibly important. This section approaches the ways a family constitution can clarify the future by creating a roadmap for the eventual transfer of wealth and a family's approach to investment and philanthropy.
- **Innovation:** Unprecedented technological advances are accelerating the need for all businesses — not just family-owned businesses — to become technology-enabled, hyper-learning communities. This section recommends four critical business transformations that companies should consider to get — and stay — ahead.

We conclude the paper with a series of lessons learned for family business leaders as they seek to navigate generational transitions, create an inclusive environment to achieve strategic goals, build investment structures for success and innovate to stay competitive. Through a combination of real-world case studies and best-in-class academic research, this paper highlights how families might avoid pitfalls, achieve longevity and create both personal and professional success.

CASE STUDIES

GrayCo	6
Ground Control	14
Dunk & Bright Furniture	20
Dollar Tree	26
Case Study Themes	32

“At the end of the day, my decisions
are about preserving 125 years of
family legacy, wealth and reputation...”

LAWRENCE GRAY

LAWRENCE GRAY

GrayCo: Innovating Across Industries and Generations

GrayCo began as a lumber company and pivoted to become a commercial real estate venture when the moment was right. While for years the leadership was comprised only of non-family members, Lawrence Gray brought just the experience the business needed in investment strategy and general management and was able to boost not only family engagement but also maintain its tradition of philanthropy.

FAMILY FIRST: A LONG-TERM PLAN AT GRAYCO

Never lose sight of your mission, but don't be afraid to change course.

This approach has served the Gray family well for the past 125 years.

While the company's current holdings are in real estate, "we are essentially a family office," says Lawrence Gray, chairman and CEO of Richmond, Virginia-based real estate investment company GrayCo and a fifth-generation family member. The mission is clear: "We are in business to steward the wealth of the family."

PIVOTING INDUSTRIES

The Gray family wealth originated in lumber. In 1884, Alfred Lee Gray and his wife, Hester, moved from Delaware to Tidewater, Virginia. Alfred bought a sawmill and began acquiring timberlands throughout the Southeast, eventually settling the company in Waverly, Virginia. His three sons, Elmon, John and Horace, joined him in the business. For a century, various descendants kept a steady hand, buying land and guiding the lumber business through cycles of prosperity and

retrenchment. But by the late 1980s, a governing group of family members admitted the business's long-term prospects looked dim. They were stuck in the middle: less nimble than small operators and without the scale of the giants. Changing environmental policies also increased the difficulty of using the land profitability. Additionally, the low financial yield — and the single concentrated bet (a single asset: timber and a single location: the tidewater area of Virginia) — put the family, which then numbered more than 30 people, financially at risk. It made sense to diversify, but could they switch gears?

As a young man, fifth-generation Lawrence Gray remembers ongoing discussions among his father, Horace A. Gray, III; his cousin Elmon Gray; Elmon's sons Bruce and Garland; and Elmon's brother in law, Wally Stettinius, all of whom were board members. Eventually, they made a bold decision. Given the land had been owned in the family for generations, these real estate assets had a very low-cost basis, so they could use an IRC Section 1031 tax-deferred exchange structure to sell the land and exchange for commercial real estate thereby transferring the basis into new assets without tax implications for the family.

They hired an entire new management team who guided and staged the sale of the timberland portfolio, identified exchange property, and managed the deals. Within 18 months, they sold 75 percent of their land—over 100 years after the family started their lumber business.

It was innovative and forward-looking and a perfect example of keeping one's eye on the mission—of maintaining the family's wealth—Lawrence Gray notes.

“We had been a lumber company for 100 years, but that wasn't going to work for much longer. We had to totally re-characterize who and what we were.”

The timing could not have been better. It was the late 1980s, early 1990s; the recession had knocked the wind out of commercial real estate while land values had fallen by far less. Banks were essentially legislated to sell foreclosed property at bargain prices. The Grays were able to reinvest and even expand their portfolio using all equity from the land exchange to invest capital quickly. Following the initial transactions, they borrowed a modest amount of mortgage debt and bought more commercial real estate.

The senior Grays took an important step that Lawrence believes was crucial. Recognizing they did not have the requisite real estate expertise in the family, they broke with the tradition of family management and hired a commercial real estate team to run the company. Instead of serving as managers themselves, family members would

govern at arm's length, via a board of directors made up of two members from each branch of the family. Another important step given the growth of the family was assuming an unwritten policy of no family members in the day to day management team in order for the board to remain completely objective regarding management performance.

“That was an incredibly important decision,” Lawrence says. “With a lot of families, wealth creates hubris and they try to do things they're not capable of doing. I owe a tremendous amount to the generation ahead of me for recognizing their true capability set and for going out and hiring expertise.”

LEARNING AS THEY WENT

Yet any major shift comes with bumps. Because the §1031 exchanges were set up quickly, the Grays ended up with a portfolio containing a little of everything: office parks and industrial locations, shopping centers and multi-family communities. Each type of property had maintained vastly different cash flows, management demands and risk profiles.

“We learned as a business through the school of hard knocks,” Lawrence Gray says. But once again, the mission—protect the family's wealth—guided them.

It was more important to make low-risk choices and protect their principal versus chasing unpredictable returns. From there, “we realized that the apartment asset class had a return characteristic

that best fit our family investment objectives” to preserve principle, generate steady current returns and appreciation in value over time. They sold off retail, office and industrial properties to focus on luxury apartment communities across the Southeast, from Virginia to Florida.

Today, 85 percent of their portfolio is multifamily housing and the remaining balance of 15 percent is land. GrayCo apartment communities, which are stylish and amenity-filled (pools, gyms, landscaped common areas, etc.) are well suited for millennials. This demographic is expected to become the largest U.S. adult population by 2019. They are reluctant to accrue debt and are known for putting off major purchases, such as home buying, until later in life. Meanwhile the 15 percent of investment in land is split between two categories: land zoned for master planned development and timberland, retained from the major land sales in the early 1990s when GrayCo exited the lumber business. Much of the timberland land is earmarked for future development.

“We’ve kept a toe in the master-planned community business as a hedge against a market shift away from rentals towards home buying,” Lawrence notes.

ANOTHER PIVOT: A KEY PLAYER COMES HOME

In 1998, Lawrence Gray — great-great-grandson of Alfred — joined the board of directors. An active and outspoken board member, Lawrence built a 17-year career in real estate investment banking, working for J.P. Morgan, Morgan Stanley, and finally as a senior manager in Wachovia’s real estate division. After the

2008 financial crisis and the acquisition by Wells Fargo, Lawrence Gray took an exit package from Wachovia. His plan was to take a year off and spend time with his children, but an immediate need called. As a GrayCo board member, he was aware the chief executive officer was planning to retire at the end of 2009 and Lawrence was concerned about what he saw as a “strategy drift” at GrayCo. He believed the company was overinvested in and overly focused on master-planned communities and had structured management team incentives in ways that were not aligned with the family’s long-term mission. At the same time, he felt the Company had assembled an extremely strong management team and apartment investment track record providing its owners with a “scalable” opportunity. Despite the unwritten anti-nepotism policy, he approached the Company Chairman, Elmon Gray, about becoming CEO.

“I said I believed we needed someone with a background like mine and I also knew what it would take to hire someone like me,” he recalls. At that point, he felt he had the qualifications and knew the company extremely well having sat on the GrayCo board for a decade. His approach with the board was to emphasize these characteristics and downplay the family connection. “I wanted it to be maybe the tenth reason down the list of why they should put me in the position,” Lawrence says.

With Elmon’s blessing, Lawrence met with each director individually to take his temperature about placing a family member in the top management position and to outline his general business plan including immediate and longer-term

priorities. Following these meetings, the board (excluding Lawrence) met as a group and agreed to name Lawrence as the chief executive officer.

As CEO, Lawrence immediately began laying the groundwork for his business plan, unifying GrayCo's operations so it could be run as a company and not as a series of individual real estate investments. As retention of his key senior team was a critical priority, actual change was somewhat slow. Lawrence spent considerable time in the first six months meeting with his team to better understand strengths, traveling to each of the company's properties, and speaking and listening to his key managers and long-tenured staff to ensure any changes did not disrupt the parts of the culture he wanted to maintain. He re-engineered the incentive plan for senior management, refined career paths, and delegated authority to his key team members and raised the first co-mingled investment fund, with outside investors investing alongside the family. The GrayCo Capital Advisors fund was invested during 2011 to 2013 generating strong financial returns thereby paving the way for a second fund. This additional capital has allowed GrayCo to diversify, expand its assets, and collect asset management fees by managing other people's money. This plan has been an important part of the company's capital and growth strategy and, for Lawrence, will continue to be an important part of GrayCo's business strategy going forward.

TRANSPARENCY, INNOVATION AND ENGAGEMENT

Lawrence Gray wasn't hired because he was family; however, now that he runs GrayCo, he never forgets he is protecting the financial interests of over 70 living family members. He feels the weight. "At the end of the day, my decisions are about preserving 125 years of family legacy, wealth and reputation — not about my annual paycheck or bonus," he says.

As the sixth generation matures, he is already thinking about future transitions and company leaders. To him,

transparency and family engagement are the keys to longevity.

"As I grew up a fifth-generation family member watching the third and fourth generations, there was a deliberate element of opaqueness, of protecting the family from their wealth," he says. "There was limited disclosure." Management reporting was weak, and it was difficult for family members to understand what they owned. Lawrence believed it made GrayCo vulnerable. "One of the reasons family businesses break down is because members know they have wealth invested, but they don't know how much it is, how to get it out, or how distributions work. They can't actually see if they are making money or not." He worried that a lack of transparency would breed complacency and resentment or force inopportune decisions by both management and family members.

Modeling GrayCo after public companies, Lawrence and his management team host an annual meeting and quarterly conference calls for family members. He presents the results of the preceding quarter and then opens the call up for questions, reminding family members that this is their company. Last year, he launched a junior board whereby four members of the sixth generation (ranging in age from 15 to 40) serve a one-year term observing the board's meetings. Not only does this provide an opportunity for increased involvement from junior family members to get more involved, it also serves as training for future board members.

Lawrence wanted to operate GrayCo with full transparency, “as if we are competing for owners’ capital . . . we don’t want anyone to feel we’re holding their money hostage. We are constantly benchmarking financial performance and we’re very clear about tracking our performance relative to public REITS, the stock and bond markets.”

Finally, though strong results have meant that most family members keep the majority of their money invested in GrayCo, Lawrence encourages family stakeholders to use the profit distributions from one-time transactions to diversify. The objective is to say “this is an effort by the management team and the board to give you opportunities to invest on your own.”

GIVING BACK TO THE COMMUNITY

Today, as the management team identifies partners and employees, personal reputation matters more than GPAs or their salaries at former employers. The Gray family also has a long history of philanthropic giving. “We receive lots of calls from groups that do incredible work for our community, but we don’t have staff to vet these causes and organizations.” As a way to channel its corporate philanthropy, GrayCo has established a matching gift program for directors and employees. This allows directors and employees to donate to causes personal to them. This philanthropic giving primarily benefits organizations in Virginia, where the Gray family businesses have been headquartered for over a century.

PASSING THE BATON

How has the Gray family beaten the odds and survived through five generations (with everyone still speaking to each other!)? Here are a few key actions they took:

The family pursued lumber technology patents, including in particleboards, to generate cash to buy tracts of timberland. Eventually, they amassed more than 100,000 acres.

The family members created a partnership to roll up individual timberland properties into a consolidated ownership structure, a difficult and complex transaction. In a 2013 Commonwealth Land Forum speech, Lawrence Gray noted, “There must have been a very low jerk factor in the family because we were able to get through this formation transaction and create the consolidated ownership entity that really is a critical part of who we are today.”

The senior family leadership realized that their core business—timberland—was not going to provide for the family in future decades. Setting aside emotion, they left the familiar path and moved into commercial real estate, hiring outsiders to manage the business on a day-to-day basis. To avoid conflict, all involved family members left direct operational roles and instead assumed governance roles on a board of directors where each family branch was equally represented.

Eight to ten years after the formation transactions creating GrayCo, the board and management shifts their commercial real estate strategy to focus primarily on apartment property ownership and management and commences the sale of the office, industrial and retail properties, exchanging them for apartment properties.

Based on very successful returns from a modest amount of investment in land development, the company expands its investments in this area at the height of the housing boom.

Recognizing one of their own has the qualifications and experience, the GrayCo board names Lawrence Gray, great-great-grandson of the founder, CEO of GrayCo.

Under Lawrence Gray’s leadership, GrayCo refines its holdings to significantly downsize the land development business and focus on luxury apartments, creates the GrayCo Capital Advisors investment fund model using outside investment, and engages in new transparency to increase family knowledge and engagement.

1950s
through 1960s

1970s

Late 1980s,
Early 1990s

Late 1990s,
Early 2000s

Late
2000s

2009

Lawrence Gray is proud of his heritage. This Gray mindset is not just in how the business is run, but how the children are raised, how the family is represented, how they model integrity and how they give back.

Present
day

“There is no need to share bloodlines to be part of Ground Control’s culture and family.”

KIM MORRISH

KIM MORRISH SIMON MORRISH

Ground Control: A Landscaping Business Flourishes in the U.K.

An award-winning landscaping company embraces stewardship governance by creating a unique culture of employee ownership and responsibility, inspiring staff to work toward common goals of outstanding customer service, teamwork and growth.

As a young girl, Kim Brown Morrish watched her grandfather and father demonstrate a commitment to both customers and their community through her grandparents' company, L.L. Brown Insurance, founded in 1927. With values rooted in customer service, choice, independence and community, the family business made a lasting impression on Kim as she pursued her personal passion to become an entrepreneur.

Today, Kim and her husband Simon are proud majority owners of Ground Control, the U.K.'s largest landscaping business with over \$182 million in annual revenue, 1,100 employees and 5,000 tied subcontractors/field teams, supporting over 45,000 commercial sites and offering 15 unique services. Fourteen years ago, the Morrishes forged a path that would radically transform their new family-owned business to make Ground Control what it is today.

Founded in 1973, Ground Control was initially a single-owner company with the goal of personal independence and wealth. While known for outstanding customer service and delivery, the company was lacking investment in new business systems and offered limited training and employee development. Ground Control was ripe for transformation. Acquired by the Morrishes (majority) and the existing

directors in 2004, the company had only three clients and 40 subcontractors, and a primary focus on grounds maintenance—cutting grass. Kim recalls that their acquisition was an opportunity “to transform Ground Control into a strong family-owned business built on exemplary customer service, internal employee investment and strategic innovation.”

Collective accountability
and a shared vision fostered
a new climate.

SHARED VISION AND SUCCESS

In 2004, after the buy-in management buy-out, the Morrishes continued to work with the founder and original four directors. While retaining their sector-specific expertise, the company embraced new leadership, vision, strategy, execution, and most importantly, a new company culture. The most immediate change was to instill the notion of individual ownership and collective responsibility. This structure and philosophy are based on meritocracy, empowerment, heavy investment in people and employee equity participation.

Kim revealed that the founder and directors received shares based on their investment, the Morrishes buy-in management buy-out resulted in 25 percent of the equity remaining with

the founder, 20 percent purchased by the leadership team and 55 percent purchased by the Morrishes. The current executive team owns 30 percent of the business, while the Morrishes control 70 percent of the shares. Similarly, every employee receives share options and can invest in buying additional shares. In their own words, the Morrishes consider themselves a “modern family business.”

“In addition to financial participation, we made large investments in our people,” said Kim. “We want to attract and develop phenomenal leaders.” With a newfound focus on the internal stewardship of their employees,

Ground Control solidified its commitment to not only its customer base, but its greatest asset — its employees.

Ground Control invested heavily in leadership training for all high potential leaders by supporting Executive MBA programs at Harvard, Warwick, Henley and Cranfield Universities, encouraging a wide array of accredited courses for all employees through “University of Ground Control,” customized one-on-one professional coaching and, most recently, a new in-house “Leadership Academy” for next generation executives.

They also built—and continue to build—strong personal relationships. “Our employees are on a journey together with us. We trust that they will make sound decisions along the way and they trust that we will do the same,” she says.

New people come in and quickly acquire that sense of trust and the shared culture that defines the company.

Kim is always looking for talent, with the attitude that they can’t run the business without it; whatever the size or structure of the business, when you talk about culture, it’s about the people. Even with tremendous systems, you need the right people.

EXPANDING THE BRAND AND SERVICE PLATFORM THROUGH INNOVATION

The new management team decided to diversify into different sectors and services such as landscape design and build, winter maintenance and snow clearance, fencing, vegetation management for rail and electric power utilities, arboriculture, ecology and roofing. By expanding beyond cutting grass, Ground Control has widened its client base and focuses on predictable and steady income streams. Diversified services to a wide array of blue-chip clients has created exciting employment opportunities and strong partnerships and investments in their entrepreneurial subcontractor workforce.

Upon acquisition, Simon spearheaded the development of state-of-the-art technology to separate the business from the competition. They unveiled a new software suite to help customers manage their services, operations, and outdoor assets and access a dashboard to retrieve key service information and view mobile workforce schedules. The TotalView mapping system is based on GIS technologies and includes a

comprehensive, readily accessible and site-specific graphical database, helping both customers and Ground Control reduce operational costs and increase efficiency. It optimizes route planning and execution, reducing “dead” travel time and inefficient routes between sites.

Next, Ground Control began to pursue long-term strategic partnerships with blue-chip national clients with diverse property portfolios throughout the U.K. The company currently maintains tens of thousands of sites in England, Wales, Scotland and Northern Ireland.

Since 2005, one year after the buy-out, Ground Control acquired Manor Fencing and Moray Landscapes in Scotland to provide in-house expertise for fencing and winter maintenance. Five years later in 2010, Kim and Simon saw an opportunity to enter the public sector domain and acquired Vale Contract Services, already serving public housing, education and emergency services. In all acquisitions, the Morrishes retained the former owners and management teams, and continue to work side by side.

Ground Control continued to expand services into landscape design and build, winter maintenance and snow clearance, arboriculture, ecology, vegetation management, roofing and pot hole repair with strategic acquisitions in 2012, 2016 and 2018. It has become the full, one-stop solution to its customers’ external property needs. The continued dedication to superior customer service and transparent service delivery has produced a consistent client retention rate of 99.2 percent, with a compound annual growth rate of over 25 percent.

CULTURE IS KEY

The Morrishes attribute the company’s success to its culture.

Ground Control defines its culture by equity participation, teamwork, relentless customer focus, integrity, and doing things smarter, cheaper, faster and better.

They put their people at the center of everything they do.

Ground Control has committed to a culture of developing people and strongly encourages continued enrichment and education. From sending employees to global executive MBA courses, to participating in year-long management training programs, professional development allows their leaders to acquire the skills, communication techniques and acumen for thriving in their jobs at Ground Control.

“You have to invest in people,” Kim observes.

An empowered and appreciated employee will honor the customer and will reduce not only staff turnover, but customer turnover.

It’s as simple as this: If you always do the right thing by your people, and focus on outstanding customer service, you’re going to be successful.

Culture is such an integral part of Ground Control that the employees' bonus structure was built around individual contribution to culture much more than financial contribution or individual performance. Aside from an employee's salary, a semi-annual bonus is distributed based on a holistic assessment of teamwork, driving innovation, and outstanding customer service as it relates to and promotes the company culture. The Morrishes want their employees to ask, "How can I best serve our customer and support my colleagues? How can I drive innovation and savings, while always acting ethically and in the best interest of our internal and external stakeholders?" It is important to develop thoughtful leaders and employees committed to the business, but also deeply invested in their peers, clients and each other. Mentorship within the company is also celebrated as the older generations give back to younger generations.

This was also true for their internal awards system. The business receives complimentary feedback from customers and shares it as an emotional and financial uplift for employees and field team members, who are often the face of the company. Any time a customer submits a feedback form, a director picks up the phone and immediately calls the mentioned field team or employee. The director then reads the feedback and thanks the employee for demonstrating the values of the business. They then

put it in writing and send it to the employee — along with a check — as added appreciation.

Extending beyond the workplace, Kim shares that over the years her family has hosted annual company barbecues for employees and families, sports events and garden parties, provided valuable work experience for children whose parents work for the company, and has hired an unusually high number of husband/wife and parent/child teams. Ground Control is an extended family and that mindset serves as the foundation for, what will hopefully be, future generations.

GIVING BACK TO THE COMMUNITY

Ground Control is committed to supporting the communities it serves. From providing education and engagement with the National Maritime Museum to community planting days with various clients, the company is present and active in local communities. Customers often approach Ground Control with projects for schools, hospitals and other service organizations, and Ground Control donates both the materials and the manpower.

Ground Control matches fundraising up to approximately \$650, for all of the charities their employees support. They also invest in local interests and help run events through the company, such as charity football matches and walks.

THINKING AHEAD

In the short and medium terms, Ground Control has a relentless focus on talent recruitment. With Simon continuing his role as CEO, Kim's focus has shifted from operational leadership to transformational leadership. Her priority is to again develop the executive team and next generation of high-potential leaders. The original team, promoted in 2004, retired and was replaced gradually between 2008 and 2016. The Morrishes are currently identifying the next tier of emerging leaders from the ground up. The company views these leadership transitions as a "new" generation and, by that definition, they are currently in their second generation, preparing for the third leadership transition. Kim and Simon are also increasingly involved in social impact ventures and wish to provide career opportunities for Ground Control staff in these innovative enterprises.

As for the next familial generation,

"We would love for any or all of our four kids to be involved in the business if it's the right thing for them,

but with children between 10 and 18 years old, it is too soon to tell," Kim said. The Morrish children have literally grown up with the business, working during the summer and supporting their parents hosting employee and client events. "They may not be interested

in cutting grass, per se, but passionate about the business and innovative culture. It is not about what you do on the ground—literally, we cut grass, which is not necessarily innovative. But it is about best-in-class culture, innovation and IT." She is not wrong: In 2016, Ground Control was honored by Her Majesty the Queen with the Queen's Award for innovation based on its leading-edge technological systems used to maintain external spaces that are safe and enjoyable for all.

CONTINUED GROWTH AND SUCCESS

Ground Control has twice been tapped by the London Stock Exchange as one of the top inspiring businesses in the U.K. and Europe. In April 2018, Ground Control was named in *Inc. Magazine's Inc. 5000 Europe 2018* as one of the fastest-growing private companies in Europe. Ernst & Young shortlisted the Morrishes in 2016 and 2018 for Entrepreneur of the Year for their transformational leadership. Their modern family business continues to thrive. What was once a single-service, high-risk company, is now a stable, diversified \$182 million business with a remarkable culture and endless career opportunities. As the next generation of high potential employees, along with the family members of their existing staff grow up and explore their interests and passions, opportunities at Ground Control will abound. There is no need to share bloodlines to be part of Ground Control's culture and family.

“The key to successfully passing down a business through a family is to not presume that it will happen.”

JIM BRIGHT

JIM BRIGHT JOE BRIGHT

Dunk & Bright Furniture: A Bright Future

Preparing for the next leadership transfer, from third to fourth generation, Jim and Joe Bright are solidifying a healthy future for their 91-year old family business. Through hard work, discipline and a lot of heart, the Bright family continues to shine and credits success to their desire to stay nimble. The world continues to change and how a company reacts, or fails to react, may have a lasting impact for future generations.

LIKE FATHER LIKE SON

To talk to Jim and Joe Bright is to understand how history repeats itself. Both father and son — the third and fourth generation owners, respectively, of Syracuse, New York-based furniture retailer Dunk & Bright — have the same early memories of helping out at the family store. Both unloaded furniture (lots of work) and both manned the store's annual Irish Bargain Party sale (much more fun). But most critically, both had

the freedom as young men to choose whether or not to take the reins of the company,

which today operates in the same location on Syracuse's South Side as it did when it opened nearly 91 years ago. "My dad [Pat Bright, Sr.] always discouraged me from thinking too much about the business," Jim Bright, current owner of Dunk & Bright, recalls. Jim wanted Joe to grow up with the same freedom he did. "I felt that if Joe was expected to join the family business it might compromise his ambition or the self-satisfaction he'd feel getting a job, moving up in a company, and being independent."

HISTORY

Dunk & Bright opened in 1927 on Salina Street and Brighton Avenue as a small local store. Today, the big white store with the bright blue lettering is a 100,000 square-foot showroom containing everything from window blinds to carpet, from mattresses to room vignettes. Throughout it all, each Bright generation has put their own stamp on the business.

Company founder Bill Bright, Jim's grandfather, was a furniture salesman who moved from Bridgeport, Connecticut to Syracuse with dreams of having his own store one day. He found his backer in an impressed customer, William Dunk Sr., who agreed to provide capital to open Dunk & Bright. The store opened on November 14, 1927, with an illustrated advertising notice promoting the store as the answer to every homeowner's dream — free unlimited parking, design services and great deals. Although the deals have changed through time, originally offering a walnut bedroom set for \$95, now starting at \$959, the company's underlying message remains the same — wide selection, convenience, and local roots.

In the early 1930s, the Bright family decided to buy out William Dunk Sr., making the Brights sole owners of the company. After the passing of Bill Bright, his widow, Catherine Bright, and their son-in-law kept the store afloat until the second-generation owner, Pat Bright [Bill's son], inherited the business in 1952. Jim calls his father a “merchandising genius” who oversaw a period of rapid growth for the company and pioneered many of the innovations that distinguish Dunk & Bright today. Pat dramatically expanded the store's footprint to make Dunk & Bright a destination where customers could see a huge variety of furniture displayed at once. He also recruited certified interior designers as salespeople and incentivized them to visit customers' homes to create floorplans with complete decorating suggestions, a practice unusual for the furniture industry at the time. This one-on-one, customized service for customers remains a major revenue stream for the company and is currently the source of their largest-dollar transactions. Pat also inaugurated the infamous Dunk & Bright Irish Bargain Party sale, an annual event that invites customers to celebrate Irish heritage while taking advantage of promotional deals throughout the store.

Jim Bright purchased the family business in the early 1990s and modernized the rambling structure he had inherited through the diversification of product offerings, reflecting the proliferation of Asian imported furniture. He also launched the company's e-commerce operation. “I'm proud that we have over a thousand items in stock in our store and that they are also online, with accurate inventory counts, that show up highly ranked in search,” Jim notes. His son, Joe Bright, is currently focused

on expanding their e-commerce operations and expanding their digital marketing efforts. Although Dunk & Bright's web traffic is strong, online sales currently account for only five percent of the company's total sales.

In the last year, digital marketing efforts include product retargeting through Facebook and selling their products through Google, resulting in strong initial results. Dunk & Bright's next goal is to expand their presence on Amazon where they currently offer 3,500 products to consumers.

BUILDING ON OUTSIDE EXPERIENCES

For Jim Bright, the key to successfully passing down a business through a family is to not presume that it will happen. He recalls that his father, Pat Bright, did not present the idea to Jim until he was nearly 30 years old, married and living in New York City where he had worked for GE Capital and Canadian Imperial Bank of Commerce.

“My experience was in analyzing other businesses, other models. I knew nothing about the nuts and bolts of retail or furniture,” he says. One day, his father called him to review the store's performance, and asked Jim to provide a value estimate of the business. Jim recalls that when he stated his estimate, his father asked if he would like to buy him out of the company! “Then it's worth less than I said,” Jim joked in response to his father's question. Banter aside, the idea appealed to Jim and remained present in his mind. Jim recalls, “I was envious of people running their own businesses, no matter what size. I wanted to make the decisions.”

As Jim contemplated his own retirement from Dunk & Bright, he decided not to divide the business among his children. He remembered that his father and uncle suffered a falling out over the store and as a result, he believed that

trying to “share” a business among several family owners would ultimately tear a family apart.

After a three year transitional period, Pat decided to sell the business to his son, Jim Bright. “He made the decision to offer only me the chance to buy the business and to sell it to me all at once,” Jim says. “It left me somewhat leveraged, but I had 100 percent control.”

Jim’s early years as sole owner of the business proved difficult. He was faced with the challenges of needing to implement a costly new computer system while using his cash flow to pay down debt. The years he spent in the Manhattan banking industry gave Jim the discipline he needed to focus on Dunk & Bright’s big picture and to empower his team members to own their responsibilities. “There are so many components to a retail business that it would be overwhelming if you tried to do too much,” Jim observes. “Get too focused on certain details and you’ll miss another important aspect of the business.” He focused on improving the vital components of the business first, providing a strong foundation for the business to grow towards the future.

FIRST STEPS TO LEADERSHIP

Beginning in his early years, Jim’s oldest son, Joe, was actively exposed to the business. Although it was never assumed that Joe would inherit the business, Jim made it a priority to give Joe substantial projects within the business throughout his childhood to help develop his leadership skills and see how he could fit into the business.

Throughout his childhood Joe worked on delivery trucks, bought media and even worked in the store during sales promotions.

When the company moved to a new, modern warehouse space, Joe coordinated the transportation of the inventory out of the old 12-story building in downtown Syracuse and into the more modern facility 15 minutes away. Despite being a teenager in high school, Joe successfully recruited a team of his classmates to work overnight shifts moving the inventory into the new warehouse. “We had to move \$2 million worth of inventory without damaging things or disrupting deliveries,” he says. The team completed the project in just three weeks, beating his father’s standard two-month estimated timeline.

Joe went on to work as a district manager for Aldi, a low-price grocery store chain, managing four stores in Northern New York. “Aldi taught me the importance of face-to-face interactions in retail, constantly being in the stores and not trying to drive the business through email,” says Joe.

After attending business school, Joe moved to California to work for Danaher, a Fortune 500 science and technology conglomerate, as a pricing manager in finance. “Probably my most important takeaway was to be aggressive about sales. Grow the top line and things will be okay.” The lessons Joe learned from these experiences directly impacted how he leads Dunk & Bright today.

Having recently moved back to Syracuse from California, Joe is committed to actively learning all he can about the family business. Today, Joe is overseeing all aspects of the business and puts in the long hours it requires. As a leader, he is willing to do any task that is needed, including manning the store’s web site’s LiveChat and working on Saturday’s. He truly loves the all hands on deck energy of the business. “I think almost everyone at our company prefers a crazy busy Saturday to a slow Wednesday morning,” he says.

Although timing on transitioning ownership has not been determined, Jim says that Joe will have the opportunity for 100 percent ownership of the company in the future. He is conscientious of how the transition will take place to avoid Joe having to take on as much leverage as he did in his initial years of owning the company. “I would also be open to a different transaction that, for example, might allow the company’s capital to be used to reinvest in the business for growth opportunities,” says Jim.

Through past and future ownership transitions at Dunk & Bright,

the goal of taking care of the family and its members first remains constant.

Jim considers his role in the company to be a consultant and an advisor. “If I think I can add something to his [Joe’s] decision-making, I will. I’ll share some history — why we did it this way, the pros and cons, the history of someone’s compensation,” Jim says. He exercises this advisory role with an occasional note to self that it is Joe’s turn to call the shots at Dunk & Bright.

CONSTANT CHANGE IN CHANGING TIMES

A benefit of keeping a business within the family is the privilege to learn from family members that have come before you.

Joe recalls that his father taught him to “Change your business often and quickly if it is not performing to expectations.” He says, “If the weekend’s sales are poor, don’t passively accept it. Come Monday, change advertising, store policies, delivery policies, whatever it takes to get business humming again.” As a result, the Bright family experiments constantly. “We’re always trying lots of things, using the store as a lab, seeing what works and moving on quickly if it doesn’t” Jim says.

The company currently does not have a specific procedure for funding innovation. Instead, every three or four years, they allocate between \$300,000 and \$500,000 for major capital expenditures. Jim says that most of the funding for innovation comes from their large advertising budget. “The business is highly promotional, so we spend a lot of money on advertising, shifting those dollars around, trying new ideas and new things,” says Jim. Dunk & Bright currently advertises heavily with television ads and Google ad words, and also has a smaller radio presence. Recently, Joe pushed for the company to try “edgier” campaigns aimed at reaching younger audiences. In addition to innovative advertising, he is focused on figuring out ways to successfully offer free two-day shipping on sofas to their customers.

Joe is also a vocal member of the Syracuse business community, and presented at a city council meeting to oppose a highway project that would eliminate a stretch of the highway closest to Dunk & Bright, a decision debated by father and son. Jim worried about the potential consequences of getting involved in a controversial community issue while Joe felt it was imperative to represent the best interests of the business.

Although sometimes on opposite sides of a decision, Jim says it is a pleasure to have these business discussions with his son,

whether it is in the office or at home. “We can discuss what worked or didn’t, implement or discard changes,” Jim says. “This is what I love about this business—decisions aren’t deadly. You can react and do a lot of things.” At the end of the day, Jim emphasizes that everything is changeable—and needs to be in order to be successful. “I’m not worried about Joe preserving a legacy, and, to be honest, I shudder when our business is referred to as ‘long time running’, or ‘old’, or ‘historic,’” Jim says. “I worry that we might get stuck in place and don’t change with the times. I’d rather be known as a brand new, fresh business if that were possible.”

As Dunk & Bright transitions through generations of Bright family leadership, it remains focused on innovation and constant change,

allowing it to be successful through changing times.

Today, Dunk & Bright Furniture’s Syracuse showroom is considered to be New York state’s largest furniture showroom, at 100,000 square feet, while also maintaining a separate distribution center in Liverpool, New York. The store currently employs 77 full- and part-time employees, while having employed nearly 6,000 people since the store first opened their doors in 1927. With Jim Bright serving as President, and his son, Joe Bright, leading by his side as Vice President, Dunk & Bright is poised to innovate and excel.

“...the board advised me that the biggest job now is to find your successor and provide for the future.”

MACON BROCK

1953:

Ken Perry opens Ben Franklin franchise

Mid-1960s:

K&K 5&10 launches with Ken Perry at the helm

Late 1960s:

Ken's son, Doug, and his son-in-law, Macon Perry, join the K&K 5&10 team

DOUG PERRY MACON BROCK

Dollar Tree: In the Best Interest of the Family

When all is said and done, it was important to do what was best for the family. With over half a century of experience and wisdom, the family behind K&K 5&10, K&K Toys and Dollar Tree reflects on lessons learned while navigating the toy industry and pioneering discount retailing. From the early days under the family patriarch to a new company and second generation leadership, and ultimately the decision to go public, the Perry family recounts how a dwindling industry, changing landscape and sudden growth led to necessary decisions — always made in the best interest of the family.

FROM A FRANCHISE TO INDEPENDENT OPERATION

Doug Perry grew up in Norfolk, Virginia, spending time with his father, Ken Perry, in his Ben Franklin franchise store. His father opened the store in 1953 and quickly developed a local clientele, particularly with the families of military servicemen who populated the Tidewater area. As veterans returned home and the baby boomer generation rose, the store's toy department sales quickly surpassed sales in their other departments.

Seeking independence from the franchise business, his father set out on his own in the mid-1960s and renamed his store "K&K 5&10," after himself, Ken, and his wife, Kathryn. As the surrounding areas grew, the store became the center of the growing population. In the late 1960s, Ken's son, Doug, and his son-in-law, Macon Brock, joined K&K 5&10 as a part-time employee and a manager-trainee, respectively. Doug and Macon watched

as the toy department's sales continued to rise, the business gained even more popularity, and ultimately the family decided to segment the market and specialize exclusively in toys. In 1970, Ken, Doug and Macon opened K&K Toys, Inc. and the business became one of first retailers to discount toys and earned a reputation as one of the area's best places to shop for children's toys. K&K 5&10 remained open and managed by the family.

On his decision to join the family business, Macon recalled, "The reason the business was good for me was the family atmosphere. My wife worked in the business with me, we were raising children, it was always in a support role but we all got along really well and you didn't have the pressures of corporate politics so I think that's the advantage of a family business particularly when starting out."

1970:

Ken, Macon and Ken's son Doug open K&K Toys, Inc.

1986:

Started the Dollar Tree Store

1991:

Sold K&K Toys, Inc. to KB Toys

1995:

Dollar Tree, Inc. went public on the NASDAQ exchange

As K&K Toys, Inc. grew, Doug recruited Ray Compton in the mid-1970s to help the company. “We needed someone to help with our finances and technology upgrades. We were retailers. We were not that good in the back room. Ray fit like a glove. He brought us out of the Dark Ages,” Doug recalled. Ray agreed to join the company because he felt “good chemistry with Doug and Macon” and saw “a family with desire, energy and smarts.” Ray remembered, “They allowed me to run the finance department. There was no micromanaging by Doug and Macon; instead, they unleashed their talent. I felt 100 percent support.” Alongside Doug and son-in-law Macon, and with the addition of Ray, the businesses were in good hands and Ken slowly started to take a back seat.

AN INDUSTRY EVOLVING

As the 1980s approached, toy store chains began encroaching on the children’s toy market. Competitors such as Toys “R” Us and KB Toys had strong negotiating positions for their big box stores with attractive locations, while Walmart and other discount retailers established toy departments within their stores. Toy manufacturers were also giving preference to national toy store chains. In short, specialty stores like K&K Toys, Inc. struggled to compete.

Doug, Macon and Ray saw the shift, but Ken Perry’s conservative inclination discouraged the company from taking a national strategy, an approach that may have allowed them to capitalize on the manufacturer consolidation. The family

disagreed but stayed the course as the industry continued to change. Learning from this experience, Doug vowed to never again allow the company to be squeezed out by market changes.

A (MILLION?) DOLLAR IDEA

When faced with shrinking margins, Doug, Macon and Ray began to seek ways to diversify their business. A story about a dollar discount store in the local newspaper caught their attention and the team was intrigued by the possibilities of the trendy idea.

Ray remembers “Doug was visiting one of our stores in Portsmouth, Virginia, when he noticed a neighboring Everything’s A Dollar store. Doug went into the store to check it out. He got all excited, buying whatever he could get his hands on. He came back to our office and dumped out everything in his shopping bag onto my desk. Then he exclaimed, ‘We’re going into the dollar business.’”

With established relationships with toy manufacturers in Asia and experience gained from K&K 5&10, the team decided to compete in the dollar discount space. In 1986, using K&K 5&10 collateral to borrow \$50,000, Doug, Macon and Ray formed a new company with their spouses and Dollar Tree (formerly Only \$1.00) was born. Macon controlled the merchandise, Ray controlled the finances and Doug sought out real estate opportunities, in addition to serving as CEO from 1986 to 1999.

From the beginning, the team was surprised by their success. Ray remembers “We opened the Dalton, Georgia, store in November. By New Year’s, we knew we had something.” Within a year, they successfully opened four more stores and within the following year, they added another 16 locations. Many skeptics, including developers and manufacturers, started to notice the high traffic.

Their dollar discount business was booming, unscathed by the recession in 1991, but the niche toy business was on the decline. Mindful of the new opportunity and in the best interest of the family and their beloved retail legacy, Doug, Macon and Ray made the decision to sell K&K Toys, Inc. in 1991 to competitor KB Toys. Macon stated the sale of K&K Toys, Inc. was “a family reorganizing event”. It allowed Ken Perry to retire comfortably and

the new partnership between members of the younger generation, eager to earn their fortunes, was now a single focused business: discount retailing.

THE NEXT LEVEL

Focusing solely on the dollar business, the young partners nearly doubled sales in 1992 and realized a 345 percent increase in net income from \$2.2 million to \$9.8 million. To maximize the growth potential of Dollar Tree while also lowering their personal risk, Doug, Macon and Ray considered selling a stake in the company. Convinced that

a strong balance sheet was most important for a growing company, the partners were careful not to become excessively leveraged. So while business was indeed booming, the young entrepreneurs incurred loans and realized their financial and personal lives were tied up in the company. As their children grew older, Doug, Macon and Ray became less comfortable mortgaging their futures. “We decided to take some shekles off the table,” Doug says.

As CEO, Doug was initially uninterested in taking the company public. “I’m not into role playing, nor do I want to be a public figure. I preferred to stay low key and out of the public eye,” he said. As they mapped out the company’s future, the idea of taking on partners appealed to the group. By then, Dollar Tree had grown to include 179 stores. “We had to be strategic,” Doug said. “We had to do this to take the company to the next level.” By late 1992, Doug, Macon, and Ray were committed to seeking a deal in order to do what was best both for the family and their business.

THE DEAL

Macon stated he was adamant that the deal be “a true partnership” with a 50/50 split in equity, an approach considered idealistic and unrealistic by most private equity firms. The team was also determined to find a partner that would not force them to give up control of the company. Ray remembers “We had 20 years of retail experience in the toy and dollar business and never had a year of losses. In seven years of operating Dollar Tree, we had 100 percent cash return on stores.”

Through John Megrue, a connection made in the sale of K&K Toys, the Dollar Tree team was introduced to Saunders Karp. As the former managing director of Morgan Stanley and chairman of the Morgan Stanley Leveraged Equity Fund, Megrue founded and directed the private equity investing activities at Morgan Stanley. In 1990, he had decided it was time to resign from the firm and launch his own investment fund.

The companies proved to be a good fit and formed a 50/50 partnership. Not long after, John Megrue became a partner. His initial was soon added to the firm's acronym brand—SK became SKM and the firm catapulted Dollar Tree into a different league. Macon assumed the role of CEO in 1993 and they continued to grow to 260 stores. All three founders felt motivated, engaged, were working hard, and had a sense that their opportunities were elevating, knowing SKM's exit strategy was to eventually go public with the company or sell it. Dollar Tree was on a new path, the right path, and one fully supported by the family.

INVESTMENT IN A PEOPLE-CENTRIC WORKPLACE

From the beginning, Dollar Tree executives took pride in knowing the people who worked for them. Doug, Macon and Ray offered people within the organization opportunities to show what they were capable of doing. Before long, promoting from within became a corporate principal. They worked hard to build a culture of respect throughout the whole organization. In an industry in which turnover was high, Dollar Tree had no retention issues. Ray remembers:

“No one ever forgot how important the person is who opens and closes the doors at our stores.

“From the time we had 40, 70, then 120 stores across the nation, we needed an organization of good people to have success. People were our primary focus. We took pride in watching our people do well. We were never the top-paying organization in town, but people stayed. We never lost anyone we didn't want to lose. We were able to foster a culture that people liked to be a part of.”

NEW TALENT

During an annual top management retreat in the mid-1990s each executive was asked to lay out their career path plan. Ray recalled:

“We trusted each other and shared our personal goals. My goal was that at age 55, I would work my way out of the business. That within seven years, I would find someone better—smarter, than me—to mentor. My plan was to let that person work on everything I did. I wanted to make sure my ego never got in the way. Macon told us that he loved being a retailer and was going to stay until he was 65. And Doug, if I recall correctly, was already mentoring Bob Gurnee to lead the real estate effort.”

With the plan for his own replacement in mind, Ray hired a new controller. Just as with Doug and Macon, it was always Ray's intent to find his successor and have him or her shadow ahead of transition. For seven years, Ray provided

his protégé with the opportunity to monitor meetings and go on road shows as his understudy. He then stepped back further as both a new chief financial officer and a new chief operations officer took over.

“The new people to the party changed our pressure points,” Macon said. “As technology was adopted, job requirements changed.” Although Macon wasn’t working on a timeline, when the time was right, he knew he wanted to follow the steps recently taken by Ray and phase out from his leadership role.

“My role as the CEO in this rocky but fun era is to plan for management development all the while, but the one thing that has changed so dramatically is the growth of the company from a few hundred stores to many thousands of stores. With that growth, you can’t run it the way you used to. We recognized that early on and the board advised me that the biggest job now is to find your successor and provide for the future.”

“The burden of realizing my partners were leaving the company and all their direct reports were coming to me,” Macon says, “was a watershed moment and defined the need for succession planning.”

As far as family continuing in the business, the team did not want to force their children to go into the family business. “We wanted them to get educated,” Doug said, “and if they thought they wanted to get into retail—go out and spend three or four years with another firm.”

It was important to both Doug and Macon that children have the opportunity to determine if the current business was the right fit at the right time.

Macon’s son joined the business for three years as a buyer, and ultimately discovered his passion as a young entrepreneur. He decided to start his own venture and Macon provided his son with both his blessing to pursue his dream and emotional support.

LASTING LEGACY

Dollar Tree would not be the organization it is today without the original three founders. Even through retirement, their dedication, commitment and support of new leadership continued. Doug served as Chairman of the Board from 1986 – 2001, and Chairman Emeritus; Macon served as Chairman of the Board from 2001 – 2017 and Chairman Emeritus until his death in 2018, and Ray continues to serve as a member of the board since his retirement in 2002.

What started as a single family variety store evolved to an impressive +14,000 stores in all 48-contiguous states. Every decision was made in the best interest of the family, and their desire to preserve yet grow their business. Today, Dollar Tree honors the family legacy and proudly celebrates its roots.



CASE STUDY THEMES

By Gregory Fairchild

Passing a family business down to the next generation is a delicate act. Family leaders have to balance a commitment to traditions, with a willingness to question themselves: Which values stand the test of time—and which need to evolve? How do we prepare the next leaders? How can we innovate and avoid becoming insular, without destroying the valuable legacy we have inherited? In the case studies, we saw the following themes emerge, which can help family businesses address these critical questions.

PEOPLE FIRST: SPOTTING AND HARNESSING TALENT

Talent is the lifeblood of every business. For family businesses, it is critical to map out skills family members bring to the table, and fill gaps by hiring outsiders. When it comes to staffing, there needs to be a clear-headed assessment that puts aside egos. GrayCo survived a major transition period because it avoided wealth-created “hubris,” according to Lawrence Gray, and hired outside experts. The family reached an agreement to step back from all day-to-day management and supervise at arm’s length, via a board of directors.

At furniture retailer Dunk & Bright, third-generation owner Jim Bright also draws a line between where his skill set ends and his team’s starts. Because he allows talented employees the space to develop and lead key business functions (like buying and merchandising), Dunk & Bright has a stellar track record for retaining people in an industry known for high turnover.

The continuity in sales staff has meant long and profitable local customer relationships, a key to competing against the national chains.

In other family firms, the goal is to make outside hires feel like family. In building up landscaping firm Ground Control through acquisitions, Kim Brown Morrish has kept existing management teams and former owners in place after their firms have been acquired. In some cases, these executives get a seat on Ground Control’s board and a financial stake. It allows the Morrishes to focus on maintaining their guiding values and vision for the whole company, while harnessing others’ expertise to manage the different business units.

DEVELOPING THE NEXT GENERATION

When you are an insider at a family firm, it is invaluable to play “outsider” for a while. In our case studies, we saw family leaders encourage younger generation family members to work elsewhere in order to

gain skills and establish personal autonomy. This meant younger leaders were joining *by choice*, not falling back on the family firm out of necessity. By working outside the company, these future leaders learned about different kinds of leadership, received candid feedback, and proved themselves. Jim Bright worked in Manhattan banking after earning his MBA. His son, Joe, now vice president and the heir apparent, worked for Aldi and Danaher. Both say those outside experiences provided technical skills and valuable perspectives when they returned to Syracuse. Lawrence Gray built a 17-year career in real estate investment banking, working for J.P. Morgan, Morgan Stanley, and finally as a senior manager in Wachovia's real estate division. When GrayCo needed to recruit a CEO to unify, grow and professionalize the company's operations, Lawrence had impeccable credentials. The fact that he was a blood relative was a bonus, but almost incidental, as his resume was ideal. The Morrishes say they will encourage their children, who are young now, to grow and learn in different fields, and to make independent choices about joining the business.

COMMUNICATION: ENGAGED OWNERSHIP

Trust matters in business — and especially in family businesses. Lack of trust is one of the key reasons family businesses disintegrate. Know who you serve, and treat family stakeholders both warmly and professionally, said the family business leaders. To create engaged and knowledgeable family ownership, Lawrence Gray uses annual meetings, and quarterly conference calls with family members. He encourages questions and proactive scrutiny of the business. Communication and a belief in organizational transparency are key to maintaining trust — an essential element of any relationship, whether professional or personal. In family

businesses, leaders must place a premium on maintaining trust. Families can use regular newsletters, monthly conference calls or meetings of family councils that include representation from all the family's branches, who may be involved to varying degrees and benefit from the business in different ways.

INNOVATING AND STAYING AGILE

Innovation can be a messy process: many ideas tried, lots of dead ends, with a few promising concepts that emerge. Family businesses that survive across generations embrace the unknown and take smart chances. Jim and Joe Bright, for instance, see their store as a lab, where experimentation is constant and reacting quickly to customer demand is critical. The Dollar Tree second-generation leadership team — Doug, Macon and Ray — took a strategic chance on a new discount retail concept, merchandise for \$1. The Morrishes set aside capital to bring innovation into their industry, investing in such things as mobile software that allows customers greater on-demand viewing of services, workforce and schedules. They have expanded across services and countries, always trying to partner with the strongest players in that business sector.

The family businesses that survive will need to show strong commitment to both transformation and patience. They will need to encourage their people to adopt an innovation mindset and to take the smart, creative risks that can lead to breakthroughs.

BUILDING (AND SHARING) THE WEALTH

For successful family firms, candor and a common mission regarding money is crucial. More than any other reason, financial disputes are behind firm breakups and painful family divisions. Every family founder emphasized that money should not be held hostage if

and when family members desire freedom from the business. At Dollar Tree, the second-generation leaders sold the company's original retail business, K&K Toys Inc., in order to buy out founder Ken Perry and allow the company to pursue a promising avenue: discount retail. So that the 70-odd living family members can understand what they own and how their investment is performing, Lawrence Gray benchmarks GrayCo's performance against the stock and bond markets. The Morrishes

at Ground Control believe that their board members should hold a financial stake in the business *and* work for it directly. At the employee level, their bonus structure is tied to metrics on collaboration, innovation and service so that financial capital reinforces a positive company culture. The goal is "employees committed to the business, but also deeply invested in their peers, clients and each other."

Thanks to the generosity of the owners profiled, these case studies demonstrate and share the best practices of successful family owners — with the hope that more of today's family firms will survive through future generations.

HUMAN CAPITAL



Morela Hernandez
Associate Professor of Business Administration

HUMAN CAPITAL

Why Family Businesses Put the Human in Human Capital

The successful preservation of family values in the business culture hinges on how leadership deals with the valuable asset of human capital.

- *The next generation will have its own development needs.*
- *Employees are more committed to businesses that give them a sense of personal responsibility.*
- *Communication is key to maintaining trust.*

FAMILY BUSINESS: THE NEXT GENERATION

When it comes to transitioning a family business, it is imperative to preserve what is distinctive about the family and the business identity it has formed. This does not mean the company can not innovate and change, but the core of the business must have direction and purpose, though its products and services may evolve. Business is not just about creating profits — it frequently comes from a sense of purpose or an entrepreneur's passion — and in the midst of transition, the values a family has infused into the organization can serve as a North Star, even as the business evolves.

When a family member first takes the helm from another, he or she is likely benefiting from being raised with the values on which the company was founded; the family culture is not new territory.

But those values may look different between generations: Younger generations may have had radically different upbringings than previous

ones, perhaps even thanks to the success of the family business. They also may look different contextually; through the lens of the business, those values may take different shape. For instance, hard work in college may feel vastly different than the hard work required to start or run a business.

So how does an older-generation family business owner onboard another generation who may have had limited contact with or responsibilities for the business? How can this business owner formulate a process through which the next leaders authentically learn and understand the family values and apply them to the business?

Company leaders can encourage their younger family members to work outside of the company. Working with people who do not depend on your family for their livelihoods can be a vastly different experience that may offer important lessons, from empathy to exposure to a range of leadership styles. This also provides experience without the stress and burden, often felt by rising generations, of sustaining the family business for the next generation. Other businesses can offer perspective, relevant skills and the experience that can also provide the potential leader earned credibility.

✓ **Company leaders can encourage their younger family members to work outside of the company.**

To further that sense of credibility, some businesses mandate that next-generation leaders work their way up through the business and across different areas—rather than enter at a senior level. Entry-level or junior tasks might cover a range of roles, such as stocking shelves, bookkeeping or customer service positions. Not only does this give the successor an enterprise perspective, it may also instill strong morale for other stakeholders in the business who witness leadership earned—not given.

Likewise, it is essential to the morale of non-family employees—and perhaps the professional development of the younger generation—that no preferential treatment is shown in performance management and evaluation. Many family businesses have family members’ performance reviewed by non-family members and also make it a practice to have non-family members manage family members. Certainly, the family may be transparent about members intended for leadership roles, which may mean additional time and attention for leadership coaching. However, the standards to which they are held must be equivalent to those who are currently their peers. From the beginning, it behooves all involved to formally define expectations, roles and responsibilities.

VALUES: WHAT STAYS THE SAME, WHAT SHIFTS

The family’s values may remain the backbone of the business, but the way they are expressed may evolve through the years. Family members are wise to remember that changing times may call for innovation in how values are acted upon, and the same values may be personalized across generations.

Just as a business may evolve in its daily operations—it may have started out storing information via carbon copies in a filing cabinet in one generation and progress to cloud storage in another—so might its expression of core values. Perhaps in one generation a priority on employee collaboration and affective ties might have meant a company potluck; perhaps in another, it means a company hack-a-thon.

The simple nature of progress does not necessarily call for a change in the unique culture of the company, but may call for a development in how it is demonstrated. Not only does that mean adapting to contemporary life and technology, it means future leaders have the opportunity to bring their own strengths and perspectives to the company. But first they may need to discover them.

AUTHENTIC ENGAGEMENT AND LEADERSHIP DEVELOPMENT

While the business already has its own identity—values can keep an organization steady and focused, even as the business may pivot and evolve—its future leaders may need to find their own identities, strengths and passions before they can contribute to the culture in meaningful ways.

So how can one engage the next generation of leaders authentically, while they evaluate what interests them and hone their leadership skills?

The earliest engagement could be an organized internship program at the family business for the next generation.

✓ From the beginning, it behooves all involved to formally define expectations, roles and responsibilities.

Such a program could be for summer internships and/or school-year programs. The idea is to gauge the next generation's interest in the business while the older generation gains an understanding of who might fit.

Also, young people early in their development may consider taking a gap year between high school and college. This can create space for future leaders to experiment and find unconventional ways to express themselves, learn independence and broaden their perspectives.

Slightly older prospects might, as mentioned, work at other companies to broaden their skill sets. Or they may engage in philanthropy and volunteering, participate in an apprenticeship or attend graduate school. The experiences a change of scenery offers can create greater self-awareness and identify areas of strength and weakness, independent of parents and close relatives.

Meanwhile, outside the context of family and the business, the next generation of leaders can develop the skills demanded of modern markets in order to keep the business nimble and responsive to contemporary customer demands that might be new to founders or previous generation leaders. For example, maintaining an understanding of the fresh and evolving space of social media may help, as family businesses are built on relationships, both with individuals and other businesses. After all, this transfer of leadership is what leads to change and innovation for the survival and success of the family business.

✓ Give the younger generation space to make mistakes, which are inherently part of learning.

THE ELEPHANT IN THE ROOM... AND TRAINING

Inherently, the way one interacts with a younger family member differs from the way one interacts with a younger colleague.

A common obstacle for the trainer—whether parents or grandparents or uncles and aunts—is the perspective of the relationship, which must shift. It takes an adjustment process to view children/grandchildren/nephews/nieces as professional adults.

A psychological transformation may need to occur on the side of older-generation trainers, in which they begin to view the trainee not as a child, but as a valuable member of the business. This may come with professional growing pains. The incumbent leaders have to give the younger generation space to make mistakes, which are inherently part of learning and adapting to new leadership roles.

With a thoughtful perspective, the way the senior and junior generations interact in the business context can benefit from the trust they may already have as family members, though the business setting will naturally change the relationship dynamics.

MANAGERS, OVERSEERS AND SHAREHOLDERS

Family business governance entails three integrated components: managers, directors/overseers and shareholders. So far, we have focused on those who will lead or manage the business and

Leadership From the Inside or Outside?

by Mary Margaret Frank and Elena Loutskina

Before handing over the reins of a family business to the next generation, the founder must ask two pertinent questions:

- Does the next generation **want** to be a part of the leadership team, including the current leadership?
- Do they have the necessary **skills**?

Given that the qualified candidate pool within the family's next generation may be small, and the age difference between parents and children may be significant, founders may need to look for a suitable replacement outside the family to run a company. In that case, they need to:

- Implement a systematic approach that starts with identifying and hiring candidates with the required depth of experience, accomplishment, leadership and personality the company needs.
- Develop candidates to understand family culture and values. Notably, in this process the founder needs to be open-minded to new ideas and operational strengths outside CEO candidates can bring to the table.
- Conduct in-depth conversations with advisers about structuring estate plans and investment policies. The views of the prospective CEO need to be considered in the process to ensure smooth transition and the ultimate well-being of both the family and the family business.

have stressed the importance of properly identifying and training future managers. However, it can be equally important for a family to prepare some of its members to be effective directors or overseers. They may not actually work in the business, but can frequently contribute as board members, bringing unique perspectives gained in their own careers. In some cases, the business would have a formal legal board of directors, but in other cases, it may establish a business advisory board consisting of both family and independent members. Still other family members may not be managers or directors, but could contribute by just being good, informed shareholders.

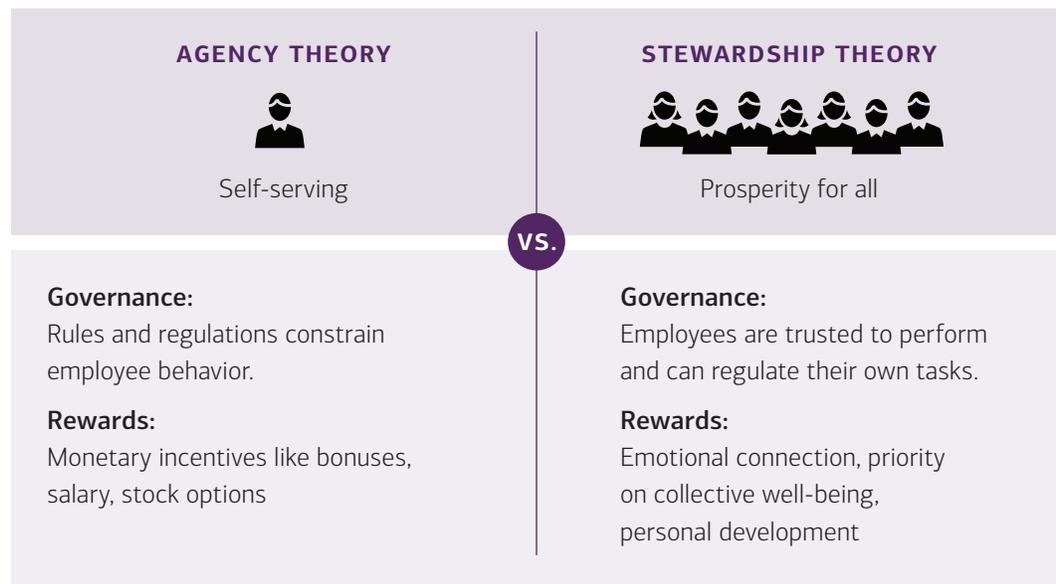
MODELS OF LEADERSHIP

Businesses are structured around perspectives based on two distinct theories: agency and stewardship.

Businesses organized around agency theory base their processes on the expectation that people will act in their own self-interests, even at the expense of others. Frequently, those self-interests are economically motivated, which leads to a business structure with control mechanisms, like pay-for-performance compensation standards—a means of aligning the employee's interests with those of the company. It also may mean strict rules are put in place to monitor individual behavior.

On the other side, businesses governed by a stewardship theory embrace the idea that leaders inspire stakeholders with a sense of personal responsibility for the long-term well-being of the organization and prosperity for all — their motivation is not fully self-serving. Organizations rooted in stewardship are structured so that individuals behave in self-governing, self-directed and internally motivated ways. The culture and systems of these businesses encourage personal and social responsibility, foster collaboration and emphasize intrinsic rewards, such as trust and reputation. This environment can fuel employee motivation to care about the resources allocated not only to themselves but also to others.

A stewardship approach in family businesses is often correlated with employees' commitment to the continuity and longevity of the business.⁵ Further, it can provide a beacon for family businesses to navigate transitions, ensuring the organization and people remain invested in their original culture and values.⁶ Transition periods in which stewardship behaviors are enhanced may foster a greater sense of organizational identity, while promoting and sustaining the integrity of the business — regardless of which cultures and values are a defining part of the family business.⁷



⁵ Hernandez, M. (2012). Toward an understanding of the psychology of stewardship. *Academy of Management Review*, 37(2), 172-193.

⁶ Ibid.

⁷ Ibid.

How an Organization Can Embrace a Stewardship Model:

- Encourage collaboration outside hierarchical relationships or siloed departments.
- Promote employees' sense of responsibility for outcomes and sense of autonomy in completing tasks.
- Create a shared sense of values and purpose—explicitly state a valued cause or principle with which employees can connect.
- Emphasize long-term goals for the organization and its people.
- Install leaders with the right personalities and leadership styles.
- Build relationships across departments or divisions to foster a more comprehensive understanding of organizational cross-functional demands and opportunities.
- Offer developmental training and other programs to facilitate employee growth and advancement.

COMMUNITY BEYOND COMPANY

When an organization preserves and exemplifies its family values, its long-lasting relationships tend to flourish—not just with customers and employees, but with the community in which it operates. The reservoir of goodwill contributes enormously to organizational resilience.

Family businesses typically have a special appreciation for their community roots and the relationships with those who make their businesses successful. These roots and relationships allow businesses to withstand moments of hardship and adversity.

COMMON GROUND IS . . . COMMON GROUND

Using qualitative data from almost 200 organizations across a variety of industries and in a multitude of communities that experienced different

types of adversity, individuals who form relationships across the community develop resilience in their ability to respond effectively to hardship.⁸ The individuals observed in the study—including family business owners—successfully overcame hardship through their local relationships. Specifically, a shared connection to the area amplified the bond between these businesses and members of the community: Common ground was literally their common ground.

A connection through a shared sense of community links directly to social responsibility. If we define being socially responsible as putting the interests of others first and self-interest second, then

a family business will need to put its relationships and roots first and its personal goals and agendas second

⁸ Hernandez, M., Baker, S., Hess, M., & Harris, J. (expected 2019). Organizational resilience: A social exchange perspective. In B. Caza, N. Powley, and A. Caza, *Handbook of Organizational Resilience*. Edward Elgar Publishing.

✓ Families may communicate with members with regular newsletters, monthly conference calls or family council meetings.

while maintaining its values, of course. To care more about the collective well-being versus the immediate well-being of the business, family business leaders must decide that the business is in it for the long haul and be willing to make sacrifices for the benefit of that longevity. This may present short-term burdens, though the burdens are exchanged for long-term benefits, such as the community's loyalty.

COMMUNICATION WITH NON-FAMILY STAKEHOLDERS

Because stakeholders outside the family — including customers, vendors, employees and members of the local community — are integral to the survival and prosperity of a business, a savvy business leader will identify stakeholders and their motivations and interests, which should directly feed into an engagement and communication strategy.

Reciprocal communications, which listen and respond to invested parties, can create a sense of shared responsibility, to invest others in the welfare of the business and, if necessary, a positive solution to a problem.

COMMUNICATION WITHIN THE FAMILY

Communication and a belief in organizational transparency are key to maintaining trust —

an essential element of any relationship, whether personal or professional. Because family businesses are inherently

both, trust is doubly important, and family members must place a premium on maintaining it.

Like families themselves, family businesses come in all shapes and sizes, and intra-family communications can and should be tailored to their needs. Family members should have a clear understanding of how they will be kept informed, and a formalized communication plan can help ensure this happens. Communication routines can build confidence that the business is well-managed and that it still aligns with the founder's values, as well as increased trust that leadership has the family and the business' best interests at heart.

Families may communicate with members with regular newsletters, monthly conference calls or family council meetings that include representation from all the family's branches, who may be involved to varying degrees and benefit from the business in different ways. For decades, dozens of Henry Ford's descendants — who together own a special class of stock that gives them 40 percent voting control of Ford Motor Company — have met quarterly to discuss the business, though only a handful work directly for the company.

As a bonus: Communication in the family business may lead to innovation. Research suggests that the highest levels of innovation are associated with a family climate in which all members are encouraged to interact freely and frequently, as well as enjoy moderately similar values and perspectives.⁹

⁹ Sciascia, S., Clinton, E., Nason, R.S., James, A.E., & Rivera-Algarin, J.O. "Family Communication and Innovativeness in Family Firms," *Family Relations* 62 (July 2013): 429 – 442, doi: 10.1111/fare.12014.

Even When the News is Bad

When family businesses confront events that could negatively impact their stakeholders, the way in which leaders respond can affect the business' reputation, financial well-being, and ultimate survival. In today's always-on society, the need to respond can happen quickly, whether the news comes through social media or other channels. If a family member at the helm falls ill or an environmental issue affects the community, communicating the situation that impacts the business is necessary to preserve those all-important relationships.

Research suggests best practices of how and when to share news in crisis communication:

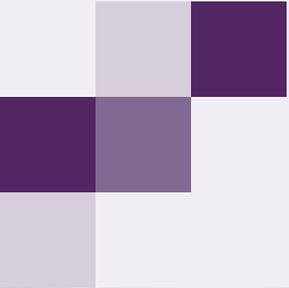
- Leaders can minimize potential damage by providing candid, transparent communication to their stakeholders.
- Such communications and news conveyed at a carefully determined time in a public forum can reduce uncertainty.
- It is essential that stakeholders see that the business is in control of the situation and is taking action.¹⁰

The same tenets hold true of businesses in transition, whether they are operating under new leadership or with new structures in place.

In a family business, few matters are as vital—and potentially fraught—as succession planning. For new family members to successfully enter a business, they must find ways to fit their own vision and talents into the values and strategy of the firm. Critically, family members need to be seen both by the family and the existing workforce as credible additions to the organization. Such credibility is built by a thoughtful onboarding process that may include holding progressive roles in the organization over many years and being managed and reviewed by non-family members.

Also, outside experience can prove to be a vital part of an effective transition. When entering family members have built track records of success elsewhere, they arrive as qualified hires, prepared to bring new insights and innovations into the core business. Communication throughout the process is vital. Shareholder family members who do not serve in direct management roles need to be kept in the loop about succession planning and the key mix of both inside and outside talent the firm uses to stay competitive.

¹⁰ Baker, S. & Hernandez, M. (2017). Communicating with stakeholders when bad news is uncertain. *International Journal of Public Leadership*, 13(2), 85-97.



DIVERSITY

By Martin Davidson



How Diversity Can Achieve a Company's Strategic Goals

Leveraging the differences among people in all businesses — and especially family businesses — drives business success.

- *Different kinds of people provide different perspectives.*
- *Different perspectives — when skillfully mixed and managed — foster greater collaboration.*
- *Greater collaboration drives business results.*

At first glance, family business leaders might not consider diversity a particularly important issue. After all, the business is built around the commonality of the family. However, tremendous differences exist within families. And engaging those differences is relevant to all businesses striving for success in the modern day economies.

Diversity is often taken to mean differences of race, gender or age, with organizations declaring success in diversity by recruiting a cadre of employees who look different. However, leveraging difference in business is not simply about hiring individuals who look differently from each other and hoping for positive bottom-line results. Rather, business leaders must first ask the critical question: How does difference help achieve the strategic goals of the business? This inquiry helps companies decide what kinds of differences are significant for the business and how best to acquire the diversity of thought, background and experience that will drive business success. It is important for business leaders to ask this question, as its answer will help the company truly innovate.

In a family business, any variety of differences — introversion vs. extroversion, detail orientation vs. big picture thinking, or boomer vs.

millennial — may be important to address in order to run the business well. For example, senior family members may think differently from younger members about how best to attack new markets, how best to develop a product, or how best to take advantage of social media. Skillful leaders encourage their employees to express differences, negotiate conflicts and come to productive solutions that move the business forward.

Decision-makers and leaders must be vigilant in seeking out different perspectives and identifying leaders who feed the mission and the strategy of the company. For family businesses, these leaders and perspectives may or may not be in the family. If they are in the family, they may not be the next in line for a leadership position. Yet perhaps the right person to propel the family business forward is a family member with a well-aligned career or a family member who is able to navigate the digital age.

A wide body of research reinforces the intuitive truth that bringing together different ideas and managing how those ideas are integrated, yields better results: more innovation, better team (and company) collaboration and morale, and better financial returns. These results apply to virtually all companies, including family businesses.

FINANCIAL CAPITAL



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FINANCIAL CAPITAL

Though conversations about wealth planning are difficult and raise sensitive issues, families should prioritize these discussions as early as possible, especially when the legacy of a family business is at stake. Creating a family constitution can provide a roadmap for the eventual transfer of wealth by addressing the future management of the business and can formalize the family's approach to investing as well. The constitution is also an opportunity to define the impact the family wants to have on both. When it comes to family businesses, the lines between personal and business investments blur, as do the lines between investment and philanthropy, when family companies consider new investment opportunities for social impact.

Holistic consideration of the past and future is as fundamental to managing financial capital as human capital.

For individuals leading family businesses, they must first ask:

1. How do you define family?
2. How much do you want to integrate the family's personal resources with its business resources?

Defining family establishes a clear understanding of the key stakeholders in personal investment and business decisions. The degree of integration could be limited so that the family manages its investment portfolio independently of the business's strategy — much like any employee of a company. However, what makes owning a family business unique is the ability to optimize the integration of personal and business resources to meet the family's goals. That being said, the family must take care to ensure that any integration leaves the business with sufficient resources to thrive and is not seen as an extra source of funds for personal advantage.

In managing financial capital, the family should consider:

1. What are the family's assets and liabilities?
2. How does the family intend to deploy those assets and manage those liabilities to achieve its goals?
3. What additional resources does the family need to achieve its goals?
4. What role will philanthropy play in the family's overall plan?

It is not necessary to know accounting and finance to answer these questions. In fact, accounting does not capture many assets such as integrity, professional networks and brand reputation or liabilities such as poor culture and ill-equipped management on a balance sheet. The objectives of these questions are: to ensure explicit consideration of the family's values as revealed in the goals; to reflect holistically on the resources available and required to meet the goals; and to be intentional about the use of resources and the sources of capital needed for success.

THE IMPORTANCE OF A FAMILY CONSTITUTION

Engaging the family to create a family constitution is an avenue to generate an explicit dialogue that defines scope, answers questions and creates an appropriate action plan. Like a strategic plan used in business, a family constitution can coordinate plans for the family's wealth generation, communicate the plans to the family, educate and motivate the family around the plans, and provide a benchmark for evaluating those responsible for implementing the plans. The family constitution will call for a long-term plan for the holding and management of the family enterprise and may include an overall family mission, a philanthropic vision and strategies for wealth transfer. Frequently, an Investment Policy Statement is part of the required documents listed in the family constitution.

A typical Investment Policy Statement will define:

1. Structure(s) of the investments such as trusts, retirement plans, investment management accounts, etc.;
2. Governance of the structure(s) including decision-making, executing, monitoring and reporting; and
3. Investment strategy to achieve the return and risk objectives given risk tolerance and constraints.

In the case of a family business, the business is typically a highly concentrated and significant component of the family's investment portfolio, and thus a key aspect of the investment policy statement.

The desires, talents and constraints of family members' contribution to the success of the family business can be considered in the family constitution.

It is often helpful to incorporate the families feelings regarding (i) the desire to see the company retained in the family or a willingness to see it positioned to sell at an opportune time, (ii) guidelines for selling interests in the family business, particularly to non-family members, (iii) the allocation of shares among family members, particularly when some family members are not involved with the company, and (iv) the makeup of the board of directors among family and non-family members. Oftentimes, families rely on the unwritten familial bond and may view written policies as a sign of a lack of trust. The unformalized method works for families until it doesn't, and when it doesn't, it can cause misunderstanding and heartache. Policies outline how the family will work together on any number of issues, ranging from risk management and distribution of assets to code of ethics and recreational (vacation homes, boats, planes, etc.) usage. They are a voluntary, versus legal, commitment among family members.

Because technology has increased the rate of innovation and how family members lives' evolve, the family constitution also needs to allow for flexibility, adaptability and routine evaluation. Skills needed today are most likely not the talents needed by future generations to grow the company. Younger generations may also have other passions they wish to pursue. The family must consider how it wishes

✓ Engaging the family to create a family constitution is an avenue to generate an explicit dialogue to define scope, answer questions and define an appropriate action plan.

to support those directly involved in the business and whether it wants to provide for the pursuit of personal or professional passions, which could lead to future growth in the family business as younger generations innovate in unforeseen ways.

If the family allows the younger generation to spread its wings away from home, it can provide financial support in a variety of ways, with the help of the business. The obvious way is through cash distributions paid from the business to family shareholders who can then choose to support other family members through a personal investment or gift. As of 2018, this investment or gift can be up to \$15,000 without tax consequences. Cash distributions to family shareholders can come by way of dividends or repurchasing shares. For companies without sufficient cash flow to fund growth and the cash distributions, the company can incur new debt to provide the funds.

Families can also employ more sophisticated methods to control the receipt and timing of the distributions through a variety of trusts. These activities sometimes fall under the banner of a “Family Bank.”

One practice is for the family trustees to segment a portion of a longer-term dynasty trust as a family bank. The trust’s activities can include investing in family members’ businesses, lending funds to the business and providing mortgage funding to individual members, etc.

In the end, the family constitution provides a forum for the family to outline its values, and determine the extent to which and structure by which, it exerts control over those values through the management of its financial resources and investment in its future generations.

VOTING AND CASH FLOW RIGHTS

When a founder decides to incorporate others into the business, there are two issues of significant importance — voting and cash flow rights —

and those two do not always go hand in hand. Understanding when, how and if they should deviate from each other and the implications such deviations might have on business operations is an important consideration for the effective running and transitioning of a business.

When turning the business into a family business, the founder must consider how much of each right he or she is willing to relinquish. Sharing financial successes early allows family members to participate in a company’s successes sooner. Sharing voting rights is subject to more debate. From one perspective, sharing voting rights provides various family members a bigger seat at the table, vested interest in the company and preparation for intergenerational transition. From another perspective, sharing voting rights may, at times, deprive the founder of the ability to make quick business decisions as a broader set of stakeholders needs to agree on the path forward.

The founder has complicated decisions to weigh regarding the optimal structure for the business when transitioning the business to a new leader in the family. The founder must consider how much of the voting rights he or she wants to transfer to the new leader. Should he or she transfer control or retain a majority share and keep the ability to steer the company in a preferred direction? Conversely, the new leader must consider whether sharing voting rights with the experienced founder is a benefit or an impediment to leading the company to a new era.

When considering cash flow rights, the set of considerations becomes more complex for the founder and may include tax, trust and proper incentive structures. Even a new leader of the company should have significant cash flow rights or bonus structures in place so that his or her interests are aligned with those of the company. Consequently, intergenerational transfers can result in a more complex set of ownership structures.

While considerations for the founder of a business undergoing a transition are extensive when the succession stays within the family, going outside leads to even larger questions regarding control. Is the family willing to monetize the company through a sale and move on? If not, then more in-depth questions about the extent of desired control arise. The next outside leader and his or her leadership team will need suitable compensation, which will take cash and appropriate incentivizing might require offering equity. Generally the more equity you give, the more you dilute control.

In these cases, the founder must consider a structure in which the family maintains voting majority as shareholders so that they can control the composition of the board of directors, which selects, advises and retains—or not—the CEO. The founder may create stock with different voting rights for family and outsiders. However, the cash flow rights must be the same if the business is structured as an S-corporation; not so for a C-corporation. Examples of private companies that used dual classes of stock to share cash flow rights with new shareholders through an initial public offering include The Estée Lauder Companies Inc., or more recently Facebook. In these cases, the dual share classes allow some to hold a disproportionately higher share of voting rights relative to cash flow rights.

The founder must simultaneously consider the rights to cash distributions upon transition. (See below).

Distributions

Questions to ask include:

- Will equity holders expect dividends?
- Would they expect these dividends to grow in concert with the company's growth or are steady dividends expected regardless of the company's performance?
- Should any assets be distributed from the family business during the transition of voting rights to non-family members?
- Has any member of the family provided a personal guarantee on the company's debt that needs to be addressed?

✓ **Intergenerational transfers can result in a more complex set of ownership structures.**

Given the complexity of these issues, the implications for the business, and the myriad of options available to structure the control and voting and cash flow rights, incorporating finance professionals is key. Turning to a specialist provides an opportunity to get creative and current solutions to meet founder and leadership needs and help ensure the success of the business while maintaining control within the family.

Timing is also of great importance. The state of affairs for a family business can change quickly.

Not having a specific plans in place becomes especially problematic if the leader becomes incapacitated or dies before a family's estate and business succession plans are in place. Early conversations and decisions can benefit the family's business as well as any outside investments so that risk and volatility in the personal and financial realms will not interfere with the success of the family business for generations to come.

PHILANTHROPY: THERE IS NO RIGHT OR WRONG WAY TO GIVE BACK

Incorporating values and culture into a philanthropic strategy presents countless opportunities to invest in a cause or a community. With an abundance of options for giving back, philanthropy is less and less defined by giving cycles and amounts and is, instead, defined by who and what is supported via investments or gifts, and how that support affects the legacy of the company. Family businesses can embrace philanthropic endeavors that are highly valued by the family or community through methods and structures that work best for them.

Consider a few examples that help to illustrate the multifaceted world of philanthropy. Levi Strauss & Co. supports causes that affect its community members. Headquartered in San Francisco, California, the Levi family cared about the effect HIV had on the local community. So, the company's giving supported advocacy and care of the affected population. While perhaps not a cause personally linked to Levi Strauss or his nephews, who inherited the business, the philanthropic support of HIV-related causes aligned with the business thanks to its location. Since 1983, Levi Strauss & Co. and the Levi Strauss Foundation have contributed more than \$60 million in grants to HIV/AIDS organizations in more than 40 countries, creating a lasting legacy for the family business through philanthropy.

Ben & Jerry's played an important role in the Vermont community through nontraditional philanthropy. Similar to Levi Strauss & Co, Ben & Jerry's established a foundation through which they donated 7.5 percent of the company's profits annually. Additionally, the founders incorporated socially progressive causes and a strong commitment to the community in their daily business operations spanning all stakeholders from suppliers to customers. They have also reached out to broader communities in need, for example, by creating an ice-cream flavor to provide demand for harvestable tropical rainforest products. Ben & Jerry's moved beyond engaging in philanthropy through the work of its foundation and imbedded it in the company's operations, paving the way for enterprises that explicitly desired social impact within their business model.

✓ Family businesses can embrace philanthropic endeavors that are highly valued by the family or community through methods and structures that work best for them.

SOCIAL IMPACT: AN INNOVATIVE INVESTMENT PHILOSOPHY

The core premise of the impact investing movement is that one cannot solve societal ills through pure philanthropy. Investors in this space may differ in the way they pursue impact, but all focus on achieving a double bottom line: financial and social returns. The double bottom line investment philosophy now spans a variety of asset classes and investment vehicles. Investment options range from private equity funds, which invest directly in companies and projects to offer sustainable *for-profit* solutions to various systemic societal challenges, to mutual funds and exchange-traded funds (ETFs) that invest in public companies considered best in class on environmental, social and governance (ESG) objectives.

This movement capitalizes on trends in the global marketplace. First, many companies recognize that being a socially responsible company helps with talent recruitment and retention. As an example, surveys report that millennials are more inclined to support issues and companies that personally affect them by both working for and buying from socially responsible companies. Second, investors have become more interested in making not only a financial return on their portfolios, but also making a difference with it. These trends are paving the way for a new model of giving back. Impact investing is different from traditional philanthropic giving and focuses on investing with cause.

Family businesses interested in pursuing this philosophy can consider adapting their operations to capitalize on the growing interest from employees, customers and investors in social impact.

For example, an increasing interest exists across industries in understanding social implications to supply chain practices, from responsible sourcing of raw materials (e.g., child labor) to sustainability of natural resources (e.g., renewable energy). Investing in better practices, especially environmental practices, can save companies money, while not thinking about these dimensions exposes companies and families to reputational risks that can prove difficult to mitigate in the modern world of social media.

Impact investing also offers family members an avenue to give back to society that differs from philanthropy or their company's commitment to socially responsible operations. Specifically, individual family members can make an impact through their choice of investments across a spectrum of approaches and deploy their deep business knowledge to drive social change.

If the family is interested in making an impact through their investment choices, investment management professionals and family offices are becoming increasingly aware of the options in this space. These investment

- ✓ Being a socially responsible company helps with talent recruitment and retention.

options vary in their ability to generate impact on specific social issues versus encourage overall socially responsible operations. Many of the options are new and interesting, but their track records are often unproven. Promises of market returns should be viewed with caution, like any other investment. These investments have two sources of returns and two sources of risk — financial and social.

Private funds have raised substantial capital to invest directly in projects for social impact and financial return, but the supply of investments that meet the double criteria is uncertain. Whether these investments earn market returns over extended investment periods is an open question; however, what makes these opportunities interesting is their innovative approach to social impact. In addition, the worldwide assets under the management of passive ESG funds, such as ETFs and mutual funds, has tripled in five years.¹¹ Most of these funds target market returns, as well as social impact, through either broad-based ESG or a theme, such as diversity or climate.

While 64 percent of social impact investment options target market returns, the remaining offer concessionary returns.¹² A market return is simply not possible for many needed and desired social outcomes. However, one can consider investing in funds with concessionary returns as a philanthropic alternative. Suppose an investment is expected to earn a risk-adjusted return of five percent while the market earns eight percent. However, suppose the investment is in a company that manufactures a product that empowers women to protect themselves from HIV and other sexually transmitted diseases. This product is most needed in developing countries where women's rights are

most compromised, and they can't afford protection. Is the investment a bad investment because it earns only five percent when the market earns eight percent? Not if the five percent compensatory return produces a better social outcome than earning eight percent and then donating three percent to a philanthropic alternative. Options exist to accept a lower risk-adjusted return and support market-based efforts to solve societal issues or to donate to the family's favorite philanthropic cause, or some of both. Both philanthropic approaches are needed in society. The question is what types of causes and opportunities are the right fit for the family.

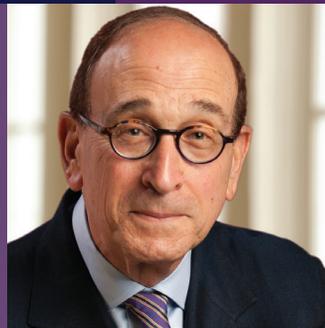
Overall, there is an increasing number of ways to make a difference, many of which target risk-adjusted returns. When considering whether to incorporate social impact into personal wealth management or family business operations and strategy, one needs to step back and assess what impact he or she would like to make on the world. Once individual and family preferences are clear, an investment and philanthropic policy that addresses the long-term view must be developed. The process for engaging, therefore, is to begin the conversation now and to consider the personal and professional trajectories of the investors. In addition to the changing mindsets of family members over time, other factors for consideration include risk tolerance, areas of impact and how those areas relate to the business. Engaging a group of trusted advisers (i.e., wealth adviser, attorney, tax specialist, etc.) can provide the necessary guidance for creating an estate and business succession plan that can effectively evolve as the business and family grow.

✓ **Engaging a group of trusted advisers (i.e., wealth adviser, attorney, tax specialist, etc.) can provide the necessary guidance for creating a family constitution, an estate plan and a business succession plan that can effectively evolve as the business and family grow.**

¹¹ Passive Sustainable Funds: The Global Landscape published by Morning Star (May 2018). https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Passive_Sustainable_Investing_Landscape.pdf.

¹² 2018 GII Annual Impact Investor Survey https://thejiin.org/assets/2018_GII_Annual_Impact_Investor_Survey_webfile.pdf.

INNOVATION



Edward Hess
Professor of Business Administration
and Batten Executive-in-Residence

INNOVATION

Leading a Family Business in the Smart Machine Age Calls for Innovation

The Smart Machine Age is upon us and is driven by unprecedented technological advances. It will become increasingly important for companies to become more technology-enabled and able to change their mindset and behaviors more quickly and better than their competitors.

- *We are in the age of disruptive innovation.*
- *Businesses need to develop uniquely human skills, as well as technology capability.*
- *Investment in innovation processes is crucial.*

Multigenerational family businesses often serve as the financial foundation and legacy of the family, and further, as stable job providers and meaningful philanthropic leaders in the community. To keep these important businesses competitive in today's transformative age, it is imperative that they embrace innovation not only in their products and services, but also in operations and management.

The Smart Machine Age (SMA) will prove as transformative — if not more — than the Industrial Revolution was for our ancestors. Technology advances in the areas of artificial intelligence (AI), the Internet of Things, big data, and increased digital connectivity and computing power will transform the way business is done. To compete and succeed in this age, businesses — including family enterprises — will be need to become technology-enabled, hyper-learning communities. A hyper-learning

community is one that embraces continuous unlearning and relearning, both at a rapid pace and on a large scale.

According to research by the chief economist of the Bank of England, projected job losses in the U.S. over the next decade or so will be 80 million.¹³ That number is more than ten times the number of manufacturing jobs lost over the past decades in the U.S.

Industries will not necessarily transform in unison and the degree of disruption may not be uniform;

a report by McKinsey Global Institute suggests that by 2030, jobs in predictable environments (food preparation workers, production workers, general mechanics) may decline by 25 to 35 percent due to automation, while jobs providing care (child care workers, nurses, pharmacists)

¹³ Andrew Haldane, "Labour's Share" (November 2015), www.bankofengland.co.uk/publications/Pages/speeches/default.aspx.

¹⁴ Jacques Bughin, James Manyika and Jonathan Woetzel, Jobs Lost, Jobs Gained: Workforce Transitions in a Time of Automation (December 2017), McKinsey Global Institute: https://www.mckinsey.com/-/media/mckinsey/featured%20insights/future%20of%20organizations/what%20the%20future%20of%20work%20will%20mean%20for%20jobs%20skills%20and%20wages/mgi%20jobs%20lost-jobs%20gained_report_december%202017.ashx.

may rise 50 to 100 percent.¹⁴ But ultimately, all industries will be impacted, and there will be industry leaders and followers.

The good news: Business leaders can prepare. In the face of massive technological disruption, large AI platforms, big-data sets and the best algorithms will contribute to success, but so will uniquely human skills—skills that are essential in creating the kind of innovative company culture that will keep a business relevant.

These human skills include:

- Higher-order thinking that is critical, innovative and creative
- High emotional engagement with other human beings in the delivery of customized personal services
- Real-time, non-routine problem diagnosis and problem solving that requires complex manual dexterity

From Darden research in successful innovative organizations, we understand the formula for building a high-performance innovation capability.

It involves putting the right people in the right environment using the right processes that drive innovation behaviors, and it calls for a different internal business system than the Industrial Revolution model that dominates U.S. businesses today. To build an innovation capability requires transforming both the business and its people. (To read lists of the required elements in terms of environment, processes and human behaviors, please see page 59 at the end of this section.)

Family businesses will face existential questions. For instance:

- Does it go ahead and invest now in transforming itself into a hyper-learning community that can continually innovate and become part of that industry's AI ecosystem?
- Does the business have the human capital to continue and thrive?
- How does a family business continue to create value for the next generation(s)?
- Or does it take the accumulated business assets and invest them differently to provide security for existing family members and future generations?

FOUR CRITICAL BUSINESS TRANSFORMATIONS

To excel in the SMA, organizations should consider the following four types of business transformations:

1. Technology: The first and perhaps most obvious type of business transformation will be the integration of new technologies and data analytics. The architecture of that integration and the choice of where to start are important strategic and technical decisions. For the family business leader, a starting point is to ask: Do we begin with the customer, our business processes or our business model? Do we build, buy or partner? In many cases, current chief technology officers or chief information officers may not be well-versed in the new technologies. Additionally, building the abilities to analyze data and effectively deploy the insights throughout the organization will prove challenging. This transformation can result in an empowered, cross-functional team that effectively collaborates and improves the company together.

2. A New Human Capital System:

The second transformation is a systemic redesign of the organization to create a technology-enabled, “human excellence system” that produces both operational excellence and innovation. This may call for a new leadership model, company culture and processes designed to optimize human learning, which will be essential to innovation.

This human excellence system promotes and helps to develop human mindsets and behaviors that enable human cognitive and emotional excellence in concert with technology and data analytics. Enabling these mindsets and behaviors is increasingly beneficial, as the kinds of work activities that humans will be called on to complete—the types of thinking, emotional engagement, and complex problem-solving that technology will not be able to perform well—do not come naturally to most people. Most of us, through nature and nurture, are inclined to be confirmation-seeking, emotionally defensive and ego-affirming thinkers. Luckily, we can train ourselves to learn, as well as manage our egos and emotions, with a human excellence system.

Cultivating human cognitive and emotional excellence drives businesses to develop cultures based on candor, idea meritocracy, data-driven decision-making and fast experimental iterative learning. Additionally, these cultures will exhibit three psychological principles: positivity, self-determination and psychological safety. Although technology will reduce human headcount, it also will push businesses to become more humanistic, people-centric workplaces that reduce the two big human inhibitors of innovation: ego and fear. The psychology of human

learning and emotions will become as, if not more, important for business success than strategy and finance.

3. Leaders Become Enablers:

The third major transformation is a new model of how to lead and manage others. The Industrial Revolution model of hierarchical, all-knowing, command and control type leaders and managers does not optimize innovation in the new SMA. The reality is that a leader cannot command, control, direct or coerce innovation or the kind of higher cognitive and emotional human performance that underlies it. And innovation cannot be optimized in an environment high on fear and low on trust. Instead, leaders can enable innovation by earning the trust and respect of others through thinking, collaboration and enabling others to take their cognitive and emotional abilities to higher levels. The best leaders will be enablers of organizational and individual excellence. Enablers must be role models with the necessary mindsets and behaviors and, in many cases, that will require leaders to transform themselves, too.

4. Human Resources Becomes Human Development:

All of the foregoing transformations mandate a transformation of human resource functions into human development functions. These are focused on development and not limited to human resource policies and regulatory compliance. To do so requires the transformation of human resource professionals and processes, including measurements, rewards, hiring, training and retention practices. Innovation effectiveness depends on human development and the attraction and

✓ **Cultivating human cognitive and emotional excellence drives businesses to develop cultures based on candor, idea meritocracy, data-driven decision-making and fast experimental iterative learning.**

retention of the best human workforce. It is highly likely that the quality of an organization's human capital may well be the key differentiator when smart technology becomes ubiquitous. Moreover, as technology continues to advance, the speed and quality of an organization's learning will come into play. Humans who excel at lifelong learning continue to add value alongside a smart machine that in many cases will have the ability to teach itself. This means that organizations ultimately will benefit if they become a hyper-learning community.

STAYING COMPETITIVE: HOW MUCH SHOULD A FAMILY BUSINESS INVEST IN INNOVATION?

Considerations regarding a family enterprise investment in innovation include the variables of the business' current condition, competitive landscape and industry, and how the business chooses to pursue innovation.

Innovation can be built or it can be bought, and an innovation capability can be installed company-wide, in a business unit or in a business process dedicated solely to innovation.

In all cases, being innovative and staying competitive in today's world calls for an "outward" facing data collection and analysis system that monitors, searches for, and collects data about market trends, competitors and customers. Such a system will generate insights regarding current opportunities

and scenarios about how the game may change. Most often, innovation derives from combining existing things differently or by finding new ideas from different industries, other geographical locations or competitors that the family business can replicate.

Innovation is a funnel process and a probability game. It takes a multitude of ideas to generate some viable innovation experiments that may generate a few new growth initiatives that warrant investment. For family businesses, this means the creation of an environment that enables and promotes innovation behaviors and develops a higher tolerance for failed experiments — much higher than what is normal or acceptable in today's operational excellence activities.

Common corporate inhibitors of innovation abound, including department silos, corporate politics, short-termism, group think, the tendency to use standard business planning and financial analysis processes too early in the innovation processes, and basing executive compensation on short-term results. As family businesses are frequently private, they have the ability to focus on the long-term and may be able to create a culture free of such inhibitors with minimal resistance, rather than being restrained by quarterly reports, the pursuit of short-term gains and answering to shareholders.

Building an innovation capability also requires implementing innovation processes and training employees on effective use of these processes.

- ✓ **Being innovative and staying competitive in today's world calls for an "outward" facing data collection and analysis system that monitors, searches for and collects data about market trends, competitors and customers.**

The size of an experimentation budget depends on the size and type of family business and its business model, its competitive position and industry dynamics, the lifecycle of its current products and services, and whether or not it will make innovation a company-wide capability.

For most companies, however, the upfront costs of transforming the culture to better enable innovation, establishing innovation processes and training employees are not prohibitive. By using a rapid experimentation process, businesses can design and invest in fast and low-cost innovation. Bigger investments can be introduced at the stage of funding a portfolio of innovation ideas.

Not every innovation project will pay off, but those that do may create new revenue streams. Importantly, having an innovation mindset and established processes will position the business for the future.

AN EVOLVING WORLD, BUSINESS AND FAMILY

As the world and technology evolve, so must the family business and, thus, the family.

That likely will require behaviors that enable the family unit itself to operate as a hyper-learning community with respect to the business. Key will be learning mindsets and behaviors, including open-mindedness, humility, empathy and compassion for each other, reflective listening, the ability to think critically and innovatively, and the ability to create collective family intelligence through reflective collaboration. In many cases, this will involve

training family members to think critically and innovatively and further develop their emotional and social intelligence.

Family business leaders will need a strong commitment to both transformation and patience. The principles and processes of the required transformation are clear and conceptually easy to comprehend. The hard part is the human part—changing human mindsets and behaviors faster and better than the competition.

✓ Models for Building a Successful Innovation Capability¹⁵

High-performance organizations that excel at innovation, creativity, business operations and analytics share common cultural characteristics. Examples include Google, Intuit, United Parcel Services, Pixar Animation Studios and Bridgewater Associates LP—and family- and employee-owned company W.L. Gore & Associates.

Common Cultural Components

- A humanistic, people-centric culture and leadership model
- Continual learning and personal development
- Team culture not a “star” culture
- Devaluation of elitism and hierarchy
- Candor and confrontation of facts
- Idea meritocracy with data-driven decision making
- Emotionally positive work environment
- Permission to speak freely
- Duty to constructively debate, challenge the status quo, and dissent
- Psychological safety
- Mitigation of ego
- Mitigation of fear
- Values “not knowing” and knowing how to learn
- Collaboration over internal competition
- Humility
- Mutual accountability
- Meet individuals’ self-determination needs

Behaviors to Encourage Within the Organization

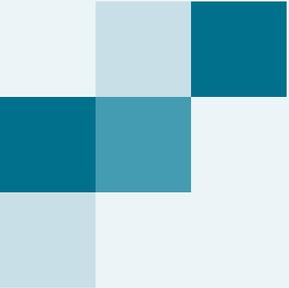
- Humility (quiet egos)
- Mindfulness
- Open-mindedness
- Empathy and compassion
- Reflective listening
- Managing one’s thinking
- Managing one’s emotions
- Connecting, relating and emotionally engaging with others

- Courage to explore and to embrace change, ambiguity and new challenges
- Learning resilience
- Being truthful and treating others with respect and dignity
- Seeking feedback and striving daily to improve
- Rigorously using processes
- Mutual accountability
- Excellent collaborator
- High emotional and social intelligence
- Data-driven thinker who stress-tests his or her thinking

Key Processes

- Rigorous hiring for cultural fit
- Real-time, frequent feedback processes
- Transparent, fair, and consistently applied reward and promotion policies
- Measure behaviors not just financial results
- Measure learning and personal improvement (speed and quality)
- Meeting Management Tool
- Critical Thinking Tools
- Creative and Innovative Thinking Tools
- Rapid Experimentation Tool
- Collaboration Tools
- After-action Reviews
- PreMortems
- Mental Rehearsal or Visualization
- Mindfulness
- 360-degree reviews

¹⁵ Hess, Edward D. *Humility Is the New Smart: Rethinking Human Excellence in the Smart Machine Age*. Berrett-Koehler Publishers, 2017.



CONCLUSIONS & LESSONS LEARNED

By Gregory Fairchild

Family businesses are a major force in the American economy, representing eight-in-ten of all U.S. companies. Some of the best-known American brands — like Walmart, Nike, Nordstrom and Ford — have founding families as their biggest shareholders.

When working well, family businesses are powerful. They embody stability, commitment for the long haul, and a goal of prosperity both for the firm and the community it serves. Studies show many consumers instinctively trust family-owned companies.¹⁶ It is no coincidence that organizations large and small — from the local plumber “family operated since . . .” to consumer products giant SC Johnson, “a family company” — tout their familial heritage to consumers.

But for all their strength, keeping family firms in business past one generation is notoriously difficult. In fact, a mere three percent of family businesses survive into the fourth generation. These businesses cope with the same competitive pressures that any firms do, but also face increased emotional complexity. When personal and professional interests overlap, there is a higher risk for conflict.

No matter the industry or size, successful family businesses share a common skill set. They know how to manage succession, create clear financial objectives and prioritize innovation. These factors, among others, allow family firms to make breakthroughs, weather economic downturns and drive greater profitability over the long-term than non-family firms.¹⁷

LEADING BY EXAMPLE

Family enterprises manage two types of human capital: family members and outside (non-family) employees who can take on roles varying from leaders and advisers, to board-level overseers and even public figureheads. To be successful, family businesses need to

be fair and attractive places to work, both for younger family members and for talented outsiders who will bring the expertise to help keep the business competitive. How family members are brought into the company matters tremendously. It provides an important signal about whether the business operates as a meritocracy and is a vital source of trust for all. Employees will watch closely to see that family members earn their way in, and aren't just hired without regard to ability. Ideally, family development programs start early, with interested young adults learning about the business, observing its processes, holding entry-level roles or trying their hand at small-scale projects. At junior levels, family members should be managed and reviewed by non-

¹⁶ <https://hbr.org/2015/04/study-customers-really-do-trust-family-businesses-more>.

¹⁷ <https://www.ffi.org/page/globaldatapoints>.

family members as often as possible. At some point, it is critical the family member spends some time working outside the family business. By serving in independent roles, family members gain credibility and confidence. Time away also helps family members identify their interests and talents, as well as what areas will be ones in which they will need to rely on others. This self-awareness increases the likelihood they will ultimately find the right “fit” within the business.

FINANCES FOR THE FUTURE

Do love and money mix? Not always, but successful family businesses figure out the articulation of the family’s financial goals. Three habits are vital: written statements that outline goals and vision, regular and transparent communication about results, and guidance from non-family advisers to provide financial expertise and neutral perspective. In successful family businesses, family shareholders are clear about what the business does, how their wealth is being managed, and how matters such as cash flow and voting rights are handled. Financial conversations should cover matters both big and small. These can range from profound questions about the legacy the family wants to leave in the community to who can use certain business assets for personal matters, and whether there should be an associated cost. It is vital to put agreed-upon policies in writing to avoid unnecessary misunderstandings and tensions. Finally, finances should be structured so that family members do not feel their personal lives are held hostage to their financial stake in the firm. As much as feasible, options for selling shares or ownership stakes, as

well as opportunities to use dividends to diversify and/or finance independent ventures, should be formalized and documented.

THE INNOVATION IMPERATIVE

Like all companies, family businesses need to be agile, flexible and innovative. An innovation mindset is particularly critical as it serves as a natural balance to the “rootedness” that can come with a family legacy. When traditions or one operational mindset becomes too dominant (“We’ve always done it this way”), it can hamstring a company. Instead, family businesses should strive to be nimble, rather than nostalgic. They should continuously benchmark new approaches against current processes and strategies. Family members in active oversight and management roles should model a growth mindset that keeps them open to learning and willing to hear new ideas, whether they originate in the C-suite or at the frontline. They should fund innovation not just through an R&D budget, but by continuously investing in learning opportunities, skill development, IT systems and new partnerships. While innovation should be threaded through everything the family business does, family businesses can use generational transitions as meaningful occasions to reassess and reinvent elements of the business.

A LONG-TERM STRENGTH

Family businesses are well-positioned in today’s frantic global market. By being answerable to a smaller unit of people and by making strategic decisions that align with a real mission, and by being able to take the long view of their mission and legacy, family businesses

can prioritize longevity over short-term, unsustainable gains. To thrive, family enterprises must deal with the complicated balance of keeping the family unified but not insular, of being agile and innovative, without losing their roots. It is a challenge that, one hopes, will bring out the best in these businesses.

Lessons Learned

To help a company thrive across multiple generations, research shows that family businesses benefit from:

Taking a stewardship approach. Speak publicly and often about the company's mission and values — and make decisions that show a willingness to protect the long-term interests of the employees and community over short-term profits. A stewardship approach is not only a moral choice, but a smart business approach too. Stewardship management is correlated to employees' stronger engagement in the company's mission and, ultimately, greater profitability.

Leaning on values. Demand that family members model the company's values, not just paying lip service but publicly "walking the walk." At Dunk & Bright, Joe Bright is vice president and heir apparent, and he demonstrates the retailer's commitment to service by taking shifts handling the website's customer inquiries. When an organization exemplifies its family values, it builds goodwill with customers, employees and the community in which it operates. This helps organizations stay resilient during tough times.

Continuously engaging and developing the next generation. Encourage family members from young ages to learn what the business does and to shadow employees so they feel a sense of excitement and "psychological ownership." At GrayCo, young family members can serve a one-year term on a junior board that shadows the current board of directors. Start family members interested in building a career with the firm in entry-level roles that are managed and reviewed by non-family employees so that the culture is seen as fair and merit-based. At the same time, respect a desire for autonomy — not all family members are interested and suited for the business. Craft other ways to serve, such as running philanthropic efforts, gathering family history, serving as a liaison between the family and the company, managing internal family communication efforts and so forth.

Balancing cohesion with respect for difference. While families should practice unification by common purpose, they must also welcome diversity of thought and experience. For many families, generational differences are a key form of diversity. The founding generation will have a markedly different experience from those who inherit an established business and who face an entirely new set of challenges. Acknowledging that differing opinions — and healthy debate — are part of making the firm better can help prevent blind spots and allow the company to seize opportunities.

Rewarding innovation. Recognize and reward employees who ask questions, propose new ideas and take smart risks. In particular, support employees who take on the analysis of complex situations, propose unexpected solutions and persevere in testing new ideas, whether or not they produce hoped-for results. Companies that will survive the next decades will be able to provide real-time problem-solving and superior, customizable services.

Treating outsiders as well as “insiders.” Acknowledge when the family does not have the capacity, interest or temperament to perform roles within the firm, up to and including the CEO role. Empower talented non-family employees to grow their skills, maintain real authority and meaningful career paths up to a share in ownership or partnership. At U.K.-based landscape firm Ground Control, for instance, every employee receives ownership shares and the options to purchase more. Employees currently own 30 percent of the company.

Talking numbers. Make sure all family stakeholders understand how the company competes in its industry, what risks and liabilities exist and the quarterly details on performance. If possible, create opportunities for family members to use special dividends to diversify their investments or fund their own ventures.

Communicating, communicating, communicating. Keep the family generations in regular contact, both personally and professionally, so that institutional knowledge is shared and there is a common sense of identity and mission. Communicate business news large and small via newsletters, monthly conference calls or family council meetings. Even with large, far-flung families, organize occasions to gather as many relatives as possible. A great deal of organic goodwill can be generated by such reunions. Ultimately, such connectedness may be the glue that allows the family to come together when difficult but necessary decisions need to be made.

FINAL WORDS

Family businesses are the lifeblood of the U.S. economy, responsible for more than half of the country’s gross domestic product and total employment. Because a family business is a source of great pride, identity and wealth, older generations yearn to pass the business successfully to the next generation. The goal of this paper is to encourage the success of family businesses with examples and research on how to cultivate human capital, financial capital and innovation to prevail in today’s modern world.

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Martin Davidson is an expert on global leadership with an emphasis on how to manage diversity to generate superior performance — an approach he pioneered called Leveraging Difference. He wrote the book on diversity in business, *The End of Diversity as We Know It: Why Diversity Efforts Fail and How Leveraging Difference Can Succeed*. He's experienced in helping senior leaders develop the skills they need to thrive in global environments.

Davidson consults with a host of Fortune 500 firms, government agencies and social profit organizations. He has served as chief diversity officer for the Darden School, and as the national chair of the Gender and Diversity in Organizations Division of the Academy of Management. Davidson writes a blog called "In My Opinion," found at www.leveragingdifference.com.

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Fairchild was named one of the 10 Best Business School Professors in the World by *CNNMoney/Fortune* in 2012 and one of the 50 Best Business School Professors by *Poets & Quants*. He was the lead investigator in a study of business models and public policy issues in the field of community development finance, an initiative supported by a \$850,000 grant from the John D. and Catherine T. MacArthur Foundation.

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Her expertise in regulated disclosure focuses on tax, financial accounting and patent reporting. Additional academic interests include the integration of business and public policy, including public-private partnerships.

Frank practiced as a CPA and worked for Arthur Andersen in Washington, D.C., as a senior tax consultant. She currently serves on the board of directors and chair of the Audit Committee of the Female Health Company. She wrote “The Potential for Inflating Earnings Through the Expected Rate of Return on Defined Benefit Pension Plan Assets” with Brian Adams and Tod Perry in *Accounting Horizons*.

Frank was awarded the 2014 Aspen Institute Faculty Pioneer Award for her innovative work teaching business school graduates how government and business can work together to solve problems and create opportunities.

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Prior to academia, she worked in finance at Enron in Houston, Texas — experiencing the roller-coaster ride of this now infamous business case. Given her professional background, it might come as no surprise that her research interests and expertise focus on the ethics of leadership. She also studies the role of diversity in organizational systems and decision-making practices. She is widely published in a number of top-tier academic journals, including *Academy of Management Review*, *Journal of Applied Psychology*, *Personnel Psychology*, and *Psychological Science*. Her work has also appeared in media outlets such as *Time* magazine, *Financial Times*, *Huffington Post*, and *The Washington Post*, as well as featured on National Public Radio (NPR). Hernandez is a quarterly columnist for *MIT Sloan Management Review*. She teaches courses on leadership at Darden, has worked as a leadership development coach for senior-level executives in the executive education programs at Duke and the London Business School, and consults with a number of government agencies, social profit organizations and global companies.

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Edward Hess is a top authority on organizational and human high performance. His studies focus on growth, innovation and learning cultures, systems and processes, and servant leadership.

Hess has authored 12 books, including *The Physics of Business Growth: Mindsets, System and Processes*, co-authored by Darden Professor Jeanne Liedtka, *Grow to Greatness: Smart Growth for Entrepreneurial Businesses*, and *Learn or Die: Using Science to Build a Leading-Edge Learning Organization*. His latest book is *Humility Is the New Smart: Rethinking Human Excellence in the Smart Machine Age* (January 2017), co-authored by Katherine Ludwig. He has written more than 100 articles and 60 Darden cases, and his work has appeared in more than 400 global media publications and programs.

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Elena Loutskina is an authority on banking and securitization. She researches corporate financing, venture capital and innovation, and earnings management.

Her main research focus is on the impact of the securitization markets on the financial management of financial and nonfinancial corporations. Loutskina also explores the role of corporate venture capitalists in increasing the value of entrepreneurial firms. She has been invited to present her research at the Federal Reserve System, Federal Reserve Board, International Monetary Fund, European Central Bank and Banque de France.

Loutskina's most recent papers in top finance journals include "Corporate Venture Capital, Value Creation and Innovation" (with Thomas J. Chemmanur and Xuan Tian) in the *Review of Financial Studies* and "Financial Integration, Housing and Economic Volatility" (with Philip E. Strahan) in the *Journal of Financial Economics*.

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Karen Reynolds Sharkey is the National Business Owner Strategy Executive with U.S. Trust, Bank of America Private Wealth Management. Headquartered in New York City, Karen directs the bank's strategy, outreach and offerings to entrepreneurs and their family members. Karen partners with advisory teams and specialists nationally to provide thoughtful guidance on critical issues including business succession, liquidity strategies, family governance, wealth transfer, investments and philanthropy.

Karen joined U.S. Trust in 2010, serving as a Market Executive for Metro New York and was a member of the Metro New York leadership team, prior to her current role. Previously, Karen spent 17 years with the Investment Bank at J.P. Morgan. She holds an M.B.A. from NYU Stern School of Business and her B.A. in Economics and History from Rutgers College.

Karen serves on the advisory board of the Eugene Lang Entrepreneurship Center at Columbia Business School, the board of directors of the New York Women's Foundation, and the advisory council of the Riverside Symphony. She was a contributor to *The Owner's Journey*, a white paper published by the Eugene Lang Entrepreneurship Center at Columbia Business School in collaboration with U.S. Trust, in addition to the recently released *Women's Entrepreneurial Journeys* white paper published by U.S. Trust.

Rebecca Eyre

Senior Vice President, U.S. Trust Marketing

Rebecca Eyre leads business owner marketing strategy at U.S. Trust. She develops targeted marketing programs, creates thought leadership content and builds advisor tools. Prior to her current role, Rebecca led marketing for Merrill Lynch's Private Banking and Investments Group. Previously, Rebecca held several marketing and strategy positions within Bank of America's Global Commercial Bank and its predecessor organization, Fleet Bank. Before joining Bank of America, Rebecca worked for a large scale international engineering and construction company in Southeast Asia, was a management consultant and ran the international remittance business at a major financial services company.

Having worked around the world, Rebecca brings her global perspective to the Cherie Blaire Foundation, where she has mentored three women launching their businesses in Pakistan, South Africa and Namibia. She earned a Master's degree in International Business and a B.A. majoring in Philosophy and Italian Studies with minors in Chinese Studies and Political Science from the University of California, San Diego.

Rebecca was a contributor to the recently released *Women's Entrepreneurial Journeys* white paper published by U.S. Trust. Additionally, she serves as the President of the Board of Directors of the Choral Arts Society.

William Cohen

Group Head, Executive Client Coverage

Will Cohen is a Senior Vice President and the Group Head of Executive Coverage at U.S. Trust, Bank of America Private Wealth Management. Will is responsible for leading the Executive Coverage Team to deliver an exceptional client experience, partnering with advisors to bring the unified delivery of multiple wealth management disciplines: investment management, trust and estate planning services, customized credit and lending, and philanthropy. He has spent his career advising clients, helping them capitalize on opportunities and identify efficiencies to grow and transfer wealth effectively. He has particular depth advising C-Suite executives, multigenerational families and nonprofit organizations.

Prior to joining U.S. Trust in 2014, Will was an Executive Director in J.P. Morgan's Private Bank and a Private Wealth Advisor at Goldman Sachs. Will earned his B.S. in Industrial Engineering from Northwestern University and his M.B.A. from the University of Virginia Darden, School of Business.

Will is active in civic and nonprofit activities, including the Virginia Museum of Fine Arts Foundation (Board Member), the University of Virginia Darden School of Business (Corporate Advisory Board Member) and the Virginia Institute of Autism (Community Advisory Board Member).

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