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Why Family Businesses Lose Valuable Non-family Executives

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A key executive quit after years of uncertainty about pay, ownership and succession. The case shows why family firms must communicate career paths before problems erupt.

NOTE TO TEACHERS: The downloadable supporting document (above) includes material to guide classroom discussion.

This case is based on a real family business, although the specifics have been changed to hide the identity of the firm and the people involved. It is a powerful case to discuss in a family business class because it brings to light the difficulties of being a nonfamily member in a family business and the importance of communication.

Over the past few weeks, Smith & Taylor Law Firm has been dealing with the shock and logistical changes brought on by a key executive of their practice deciding to resign. Paul Duffey started at Smith & Taylor 15 years ago and has been a huge asset to the firm for over a decade. Paul had been taking on increasing levels of responsibilities and given greater autonomy with each passing year. Because of his long tenure with Smith & Taylor and prowess as a lawyer, there were some clients who would deal only with Paul. During his time at Smith & Taylor, Paul had built strong relationships with many of the firm's key clients. His great success in the courtroom and in negotiating business deals had also earned Smith & Taylor a strong reputation within the community and greatly contributed to the firm's financial success. As a result, he was being groomed to be the "bridge" between the founding partners' planned retirement in the next five to seven years, and the founding partners' daughter joining the firm, with the intention of her taking over the ownership of the business once the succession was complete.

In 1993, Jack Smith and Heather Taylor founded Smith & Taylor Law Firm and it quickly became a very reputable and successful firm. For the past 20 years, Jack and Heather have also been happily married with three daughters. The oldest daughter, Stephanie, is interested in pursuing a career in law and will likely be the only daughter to join the family's law firm. Last year she graduated from a prestigious law school in New England, and she is currently preparing to take the bar exam so that she can join Smith & Taylor.

Smith & Taylor is a boutique-style law firm with 32 law associates and five partners, including Jack and Heather. Because of the firm's small size, Jack and Heather treat their team as family. In particular, due to Paul's time with Smith & Taylor and close relationship with the founders, Jack and Heather viewed him as another child. He had been a part of everything from family dinners to the children's graduations. Jack and Heather saw Paul as the son they never had. And they thought Paul also saw himself as part of their family. Thus, when Paul handed in his resignation, it was a huge shock to Jack and Heather. They felt betrayed.

Why Paul Resigned

During a corporate function, Paul approached Jack and asked for a meeting. The next day, when they met in the office, Paul told Jack that he would be leaving Smith & Taylor in three weeks. Paul also explained that he intended to join another law firm in the same office building. The new position would allow him to explore other intriguing areas of law. He felt that after fifteen years in the same practice he was ready for a new challenge.

However, upon further probing, Paul admitted that his main reason for leaving was because he felt underpaid by Smith & Taylor, and he was concerned about potential family dynamics and uncertainty caused by their daughter, Stephanie, joining the firm. Paul

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emphasized that this decision was not easy, and that he had been thinking about leaving for a long time. He was concerned that passing business ownership to their daughter would negatively affect his career.

Jack and Heather were extremely frustrated that Paul had kept these negative thoughts to himself over the past year, and that he was just addressing them now, when it was apparently too late to find an alternate solution. At first, they were shocked and then sad. The timing of Paul's departure could not be worse; they had planned for Stephanie to join the firm later that year, working as Paul's protégé. As they transitioned to retirement, they envisioned Paul leading the firm and mentoring Stephanie.

Later, Jack approached Paul to find out what had happened. Paul revealed that he had been actively looking for work at law firms for the past few months. Recently, he found a firm that would be a great fit, and they offered him a position. Jack was shocked that Paul did not have the trust nor the confidence to share his concerns about compensation and the upcoming succession. Although Jack viewed Paul as part of the family, obviously Paul did not reciprocate those feelings. Jack wondered how he could have been so wrong about their relationship and Paul's commitment to his family and business.

How the Company Responded

At home that evening, Jack and Heather developed a plan. With Paul's departure to a competitor, they had to ensure that Smith & Taylor remained healthy for the sake of their family and their employees. They listed their concerns:

- Paul had strong relationships with many key clients. Thus, they didn't want any clients to follow Paul to a competing law firm, which could negatively affect their firm.
- Paul was an influential member of the team, which created the risk that other team members could follow Paul to his new firm or look for other job opportunities outside the firm.
- Time, effort and expense associated with finding and training Paul's replacement.
- The abrupt departure of Paul could damage Smith & Taylor's reputation.

After identifying these concerns, Jack and Heather realized that their immediate solution was retaining Paul, and they developed a generous counter job offer (see Exhibit 1). The next day, Jack and Heather offered Paul the new compensation package: partial ownership in Smith & Taylor and a 15% salary increase**.** They told Paul that upon retirement, he could sell back his shares at market +5%. Paul thanked Jack and Heather and told them that he would consider the offer overnight.

Exhibit 1

Smith & Taylor LLP
Commonwealth Ave, Boston, MA 02115

April 1st, 2018

Paul Duffey
1 Boardern Road
Boston, MA, 02117

Dear Paul,

For more than fifteen years, you have been a highly valued lawyer at Smith & Taylor. We would therefore like to extend to you the following compensation offer to demonstrate our appreciation for your loyalty and unique skillset. Your current responsibilities and role as "Partner" and "Boston Team Leader" at Smith & Taylor will not be affected by this compensation package.

Your new compensation package includes the following:

- 20% ownership of Smith & Taylor L.L.P.,
- Base compensation of $250,000 per annum, which constitutes a 15% salary increase,
- As a shareholder, participation in the Growth Bonus (which is likely to offer an additional $10,000 to $25,000 per year to your base compensation),
- Five weeks of vacation per year,
- All of the benefits found in our corporate benefits handbook,
- At retirement, shares can be sold back to Smith & Taylor at market value + 5%.

We are delighted to offer you this opportunity to participate in the ownership of Smith & Taylor and hope that you will accept. This offer reflects your importance and value to our team.

Sincerely,

Jack Smith | Heather Taylor

Teaching Notes

The next day Paul met with Jack and Heather and told them:

"I appreciate your new offer and it saddens me more than I can ever truly express, but I must refuse it. I have been thinking about this career change for a long time and I really do believe that leaving Smith & Taylor is best for me and my personal development."

Soul Searching

Jack and Heather were at a loss for words; they truly thought their counteroffer would give Paul everything that he desired and would keep him with Smith & Taylor. Over the next few weeks, while searching for Paul's replacement, they considered how they could prevent this from happening again.

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They concluded that they did not have a specific succession plan and so they never discussed retirement and succession plans with employees. More importantly, they never shared their vision of Paul mentoring Stephanie, leading Paul to feel uncertain and anxious about his future role at Smith & Taylor. Yet, they kept asking themselves the following questions:

- What kept Paul from being open about his concerns?
- Why did Jack and Heather misread Paul's family-like relationship?
- Was making the counter offer a good decision or a mistake?
- How can this be prevented from happening again in the future?
- How can we prevent clients from leaving to follow Paul?
- How should we now prepare Stephanie for eventual ownership and leadership of Smith & Taylor?

Additional Search Terms: entrepreneurship courses, teaching ideas, teaching resources, classroom ideas, entrepreneurship classes, business schools, business school classes, entrepreneurship students, professors

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