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Family Business Succession, Innovation, and Compensation: What You Need to Know

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Family business succession planning, innovation, salaries, legacy, and values are topics that all business families grapple with at times, especially when they include multiple generations with different world views. Two family business thought leaders on these topics -- FamilyBusiness.org Senior Editor Professor Mat Hughes of University of Leicester, and consultant and investor R. Adam Smith -- share some family business advice in this discussion, which is based on Smith's earlier live **LinkedIn audiocast (https://familybusiness.org/content/How-families-can-run-their-businesses-with-both-head-and-heart)** .

Smith is an expert in investment banking, alternative investing, and governance for family firms and a member of a business family himself. He has served as a strategic advisor, dealmaker, and financier to global private companies. In 2002 he founded Circle Peak Capital LLC, and is the sole founder of Wisdom Board Inc, founded in 2020. Hughes is a Schulze Distinguished Professor and Professor of Innovation and Entrepreneurship at the School of Business at University of Leicester, in the UK.

Their discussion focused on family ownership and values; picking the right successor; compensation for family and non-family members; and being bold without sacrificing the business's resources – all factors that influence the business's ability to innovate and attract the talent who can make it happen.

Here are some key takeaways.

Explore Beyond the Familiar Products and Services

Family businesses tend to follow a particular trajectory, pulling away from innovation. In our work we've seen that family businesses put most of their emphasis on operational excellence, or what can broadly be described as an exploitative innovation strategy. This means they capitalize on the existing capabilities, competencies, products and services of the business rather than looking at something entirely new, a process we call explorative innovation. Being exploitative is relatively low risk, and its safety and returns are fairly well established. But these innovations can constrain the family business's capabilities and tie its future to a recurring product and service line.

Family firms may have the resources and the capabilities to innovate but not necessarily the willingness. This is where the right leadership and management can make a difference. It can start to change the thought processes among family owners and managers and help unlock more explorative innovation strategies. In our research, we've seen that involving the next generation family members in the business's decision-making and strategizing generates new ideas to fold into the strategy process and helps that kick-start that change.

Decide Who Will Lead Next

Familes must consider who is in the best place to take on and lead the business. What are the hopes, desires, and ambitions of younger relatives as the next generation? What resources do they bring in terms of knowledge, networks, capacity, and ideas that will benefit the family business? Should professional managers be brought in to make up for any shortfall?

Give Next-gens Your Values, Not Just Wealth

Family owners deeply value the opportunities the family business creates for developing, maintaining, and passing on a legacy to the next generation. The business and its wealth is part of that, but so are the values and principles of founders. Identify the values held across the different generations involved in the family business, and work to align those values to shape the family of the future and the business of the future.

Family members' emotional connection to their business directly affects investment and exit behavior. For example, younger generations may want to cash out of the business rather than continue the family's enterprise and legacy, undermining what previous generations have built. Clashes between present decision-makers and next-generation family members can disrupt this and other key financial decisions. On the other hand, a lack of faith and trust in younger relatives to take the business forward risks throwing away legacy-in-the-making. Think about your legacy and legacy-in-the-making, and build deliberate actions to enrich and protect that legacy. This will help strengthen the next-gen's emotional connection to what previous generations built.

Expect Different Attitudes About Wealth and Money

Different generations, be they Baby Boomers, Generation X, or Millennials, have different values. They've been brought up in a different type of society with a different type of education system and a different type of world that emphasizes different messages to them. As a direct consequence of that, what we see is that these different generations have a very different mindset as to what they consider to be important. Sometimes, the difference is driven by value and principles; very often it's about wealth and money.

Philanthropic efforts, for example, are important for modern generations who will perhaps be the next in line to inherit the family business. For example, today's generation has grown up in a world where climate change is an existential danger, discussed at school. So because of that, they are already highly sensitized to that, affecting their behavior and values. And so there, when this occurs in the family business, we see these clashes of generations. This can cause tension between whether or not there is an alignment between the current and future generations and what that may mean for the business, its legacy, and its longevity.

Be Mindful of Salary Differences

The family business's ownership and legal structure—whether it's a publicly listed family business or an entirely privately owned family business – can affect how much employees are paid. If the family business is publicly listed, the market for talent will impose certain professional standards for compensating employees. In private businesses, the owners and managers have much more direct control, and the **degree of professionalization may vary (https://familybusiness.org/content/does-the-family-matter-improving-executive-compensation-practice)** . They may pay family members and non-family members differently for the same work. This is because of what academic research calls bifurcation bias: the tendency for family businesses to deliberately and consciously treat their family members differently from their nonfamily employees. This affects many aspects of the firm: from organizational justice to decision rights to rewards and compensation.

Professionalize Your Compensation System

Compensation frameworks are typically intended to achieve two things. One is to reward past performance; another is to incentivize forward-looking behavior. But compensation frameworks send a third signal to employees and the labor market about what the company measures and rewards. Employees will subsequently make this their priority, and the labor market and potential employees will notice and will either be attracted to the firm or steer clear of it. Audit your compensation frameworks for the signals they send to family and nonfamily employees about your values, your goals, and what really matters.

Balance Boldness With Disciplined Management

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Entrepreneurship, innovation, and keeping the entrepreneurial spirit alive are the lifeblood of any business. We've already seen how involving the next generation can help unlock new innovation opportunities, while the older generation of leaders might fear a radical departure from the status quo. The resulting tension and fear are not unfounded. In his most recent research, Professor Hughes envisioned how the highly entrepreneurially oriented business actually looks. It's unencumbered and focused on breakthrough innovation, not operational excellence. It's focused on making new discoveries, not refining what is already there. It wants new revenue sources, not just established revenue streams.

This brings a risk of repetitive failures, where the repeated search for the one breakthrough that can fund other breakthroughs quickly and aggressively drains the business's resources. We call this entrepreneurial entropy. The highly entrepreneurial firm will exhaust resources quite aggressively, increasing the risk of failure. To counterbalance this, have good strategic and management processes in place to handle how the firm approaches innovation. This will help ensure that the pursuit of innovation doesn't tear a hole in the firm's cash reserves and free resources.

Listen to the Audiocast

Link to an audiocast of the discussion **here** **(https://app.fusebox.fm/embed/player/track/1Vx6a14WB9/8)** .

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