

Family Business Corporate Governance Series

CEO succession planning

June 2015



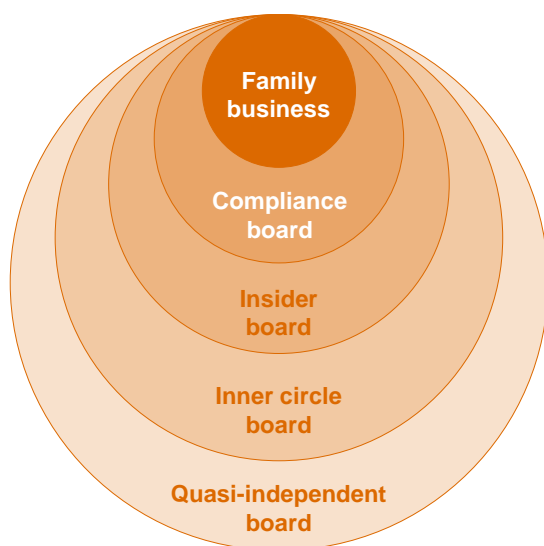
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PwC's perspective on family business corporate governance

Individual- and family-owned businesses are a vital part of our economy. If you or your family owns such a company, you understand how important the company's success is to your personal wealth and to that of future generations. If you're a nonfamily executive at a family company, you also recognize that its profitability and resilience are vital to your job security and financial well-being.

We see more family companies interested in corporate governance today than we did a decade ago, as shown in changes they've made to their boards. While some family companies have a board only to satisfy legal compliance requirements, more are moving toward the outer rings on the family business corporate governance model, below. Ultimately, owners will choose which level best suits the company's needs and when changing circumstances mean the company's governance should transition to another ring.

Family business corporate governance model*



* Some companies also have an advisory board to advise management (and directors). Advisory board members don't vote or have fiduciary responsibilities.

Compliance board. While most states require companies incorporated in the state to have a board, the requirement may be as simple as a board of at least one person that meets at least once per year. A company may have only the founder on its board. In the early stages of a founder-led company, this type of board may well be the best fit for the company, since the founder is usually more focused on building the business than on governance.

Insider board. Such a board often includes family members and members of senior management. This membership can better involve the family in the business, help with succession planning, and introduce additional perspectives to board discussions. The insider board may be created by the founder—who may no longer be the CEO—or by the next generation owner(s) of the company. That said, the founder/owner(s) retains decision-making authority.

Inner circle board. In this type of board, the founder/owner adds directors he or she knows well. These may include an accountant, lawyer, or other business professional who guided or influenced the company, or the founder's close friends. These directors may bring skills or experience to the board that are otherwise missing, and they may be in a position to challenge the founder/owner(s) in a positive way. Such boards might create an audit committee or other committees. That said, the founder/owner(s)—who may or may not be the CEO—retains decision-making authority.

Quasi-independent board. This level introduces outside/independent directors who have no employment or other tie to the company apart from their role as directors. (See the Family Business Corporate Governance Series module [*Building or renewing your board*](#) for a more complete discussion of independent/outside directors.) These directors introduce objectivity and accountability to the board, and they expect their input to be respected. Board processes and policies will likely become more formalized with outside/independent directors on the board. The number of committees may increase. This outermost ring on the family business corporate governance model is most similar to governance at a public company.

59% of CEOs and CFOs of **147** family-owned/owner-operated companies report having a “formal board of directors that acts on behalf of company owners to oversee the business and management,” per a PwC 2013 survey.

We recognize that governance at any family company will be determined almost exclusively by what the founder (or family members who control the company) wants. You may have a compliance board or an inner circle board—and those may be entirely appropriate for where your company is at present. We’ve seen numerous family companies that benefited greatly from moving toward the outer rings in the governance model—especially when anticipating a generational transition.

In this Family Business Corporate Governance Series, we’ll help you understand how to build an effective board for your family company, and how boards can assist with some of the particularly challenging issues family companies face. This module addresses how a board can help you prepare for CEO succession, including whether to keep company leadership in the family.

Each family company’s situation is unique and we can’t address every scenario. Our goal is to provide a framework of how corporate governance practices apply to family companies so you can decide what’s best for you.

Interview insight

You need to plan early for generational transitions—voting rights, estate plans, and tax issues are all intertwined with the company. And I mean early. Even 5 years before the event is way too late.

— A family member who is an executive and director of the company

This module on CEO succession planning addresses:

The basics of CEO succession planning.....	1
What's special about succession planning in a family business?	3
How can the board help in succession planning?	10
Questions to consider	13

The basics of CEO succession planning

Of the many elements you need to consider when running a business, succession planning is too often given low priority. And that's understandable. It's important, but there are usually other more immediate matters demanding management's attention. In this publication, we discuss CEO succession in family businesses, including the decision to keep leadership in the family versus hiring nonfamily managers. We also describe how boards can add value to the succession planning process.

When looking for the next CEO, you first need to define what skills and attributes will be essential to lead the business in the future. You'll then select the candidate who best meets the criteria and fits with the company's culture.

Succession planning's goal is to provide the least amount of disruption to your business and to give you the widest possible choice of qualified candidates before you make that decision. While the process may consider candidates from outside the family and the company, in many cases it focuses on managers who are already with the company. It considers these internal candidates' business skills, leadership skills, and experience—and what development, mentoring, and new roles they need. Such grooming allows them to step into various key positions and to be well-positioned for an opportunity to be selected as the new CEO when the time comes.

Effectively developing bench strength in the management talent pipeline will give your company more choice of internal candidates. That said, when a CEO change is imminent, you'll also likely want to consider whether anyone from outside the company might be a better choice.

The subject of succession can be a delicate one in a founder- or family-run business. (Indeed, it's a delicate topic in most other types of organizations, as well.) And when someone has incubated and grown a company, it can be even more difficult to consider.

Founders often struggle with when to turn company leadership over to the next CEO and what their role will be after they do so. As a result, many fall victim to the “sticky baton syndrome”—where they hand off to new leaders in theory, but actually retain control of what really matters. (You may also wish to see the leadership succession discussion in PwC's 2014 *Family Business Survey*¹.)

Interview insight

The founder and all his children are on the board. One of his children is the CEO, but the founder still runs the business.

— A PwC Private Company Services partner

¹ More information about PwC's 2014 *Family Business Survey* is available at: <http://www.pwc.com/gx/en/pwc-family-business-survey/index.jhtml#>

If the founder (or current CEO) has identified a retirement date, there is generally a greater chance that the succession planning process can unfold in a thoughtful manner. But many companies face less ideal circumstances, especially if sudden illness or incapacity (or worse) means there's an immediate need for a new leader—even if temporarily.

Emergency succession is especially difficult if the founder/CEO hasn't shared (or even considered) his or her choice for successor. If the founder is incapacitated, it can lead to a leadership vacuum, with other family members or managers disagreeing on who should take the lead or in which direction the company should head. Such a situation can disrupt the business to a significant degree if it persists.

Interview insight

One of the most important board responsibilities in a family company is to ensure there's a robust process around succession planning. Unless boards ask questions, it doesn't happen.

— A PwC Private Company Services partner

Boards can encourage founders and CEOs to address succession planning, which protects their companies' future. Many directors believe that choosing a new CEO is one of the most important decisions they make, since the CEO drives company strategy and culture. More than half (56%) of the 147 family business CEOs and CFOs who responded to a 2013 PwC survey consider succession planning to be one of their board's main responsibilities.

In this publication, we focus on the CEO transition. We don't address ownership transfer issues, individual and family wealth issues, or business structure issues. While such items can impact CEO succession decisions, they require specific planning and consultation with appropriate professionals.²

² See further discussion about ownership transfer in the Business Succession chapter of PwC's 2015 edition of *Managing Your Wealth*, available at: <http://www.pwc.com/us/en/private-company-services/publications/tax-wealth-management-guide.jhtml>

What's special about succession planning in a family business?

In some family businesses there's an expectation that the next company leader will be a family member. This may work for many companies and families—especially if a well-qualified family member has been groomed for the role and can bring a broad range of relevant experience. Family succession may be a stabilizing force for the family, the company, and its employees. And it may motivate other family members to pursue careers within the company.

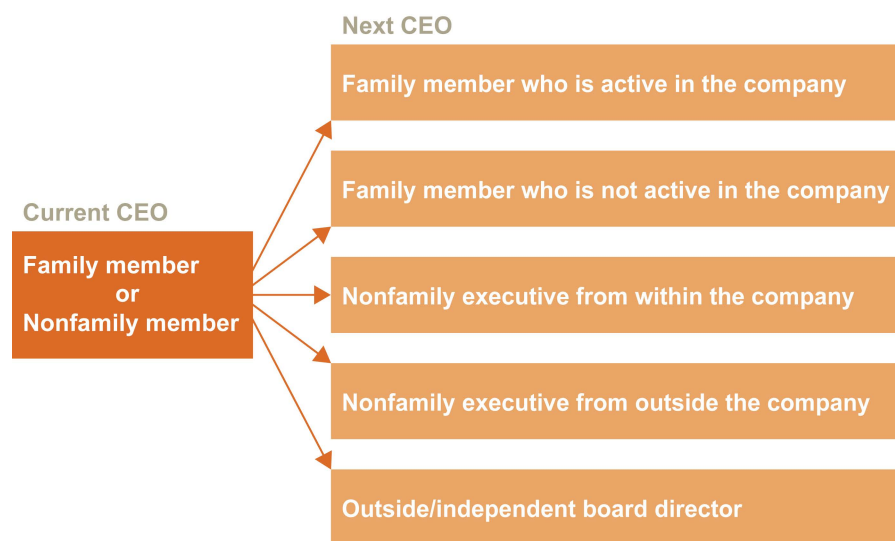
But not all families have someone who is ready to step into a CEO role. Plus, restricting succession to family excludes candidates who may bring vital skills to the role. Other highly qualified executives may choose to leave the company if their advancement is capped. The bottom line: family-only succession may not lead to the best successor CEO. There are a number of other choices you can consider.

Interview insight

Start succession planning early while time is still your friend.

— A PwC Private Company Services partner

Range of choices for family business succession



When might you consider appointing a family member as the next CEO?

- The family member (whether in the current leadership generation or a successor generation) has the aptitude, is appropriately qualified, and wants the position, and
- The controlling owner(s) supports this family member as the new CEO, and
- The family and the board also support the selection of this family member.

Choosing a CEO from outside the family (a “nonfamily CEO”) to run the company can be difficult—especially if past successions were always kept in the family. When might you consider such a person?

- The business needs an outside CEO to bring new ideas and processes.
- No family successor is qualified and willing to take the position.
- The family no longer wants day-to-day responsibility for the business.
- A family member wants the position but is not yet ready to take over. To help prepare that individual, you might select a nonfamily CEO to run the company for a period, and charge that person with coaching/mentoring the family candidate for future leadership.

What are family businesses doing in practice? As shown in PwC’s *2014 US Family Business Survey*, almost half plan to keep management in the family, while a quarter expect to hire a nonfamily CEO. Most of the remainder expect to sell the business.

Contemplated form of ownership change

Pass to next generation to own and run	48%
Pass to next generation to own but not run	26
Sell the business	19
Don’t know	7

[Responses from 154 key decision-makers at US family businesses.]

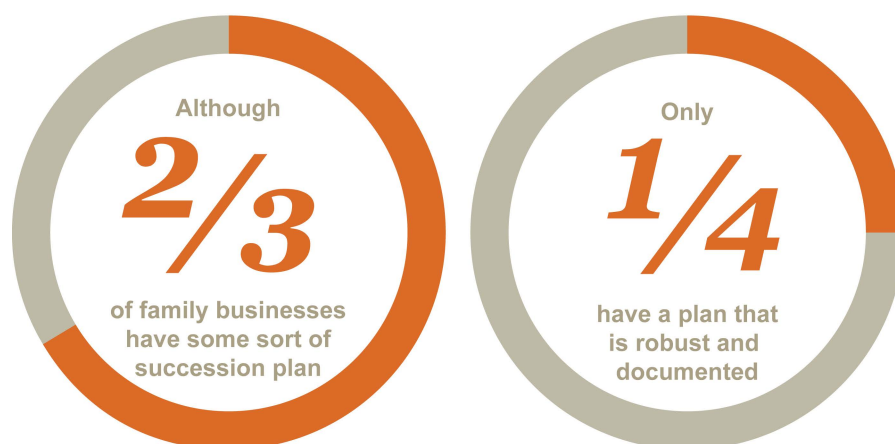
Succession planning in family companies becomes particularly complex as the family grows and ownership is handed down over generations. Many who work in and with family businesses point to the transition from Generation 2 to Generation 3 (G2 to G3) as being among the most challenging. Why? Because there are typically more members of G3, raised in different families with different influences and experiences—and perhaps different values. The G2 to G3 transition is also often the point where family businesses put a more formal CEO succession process in place.

Interview insight

Our next [G3] transition will be easy, but we'll have a more complicated situation with G4. There are more of them, and not everyone's involved with the company.

— A family member who is an executive and director with the company

Insights from PwC's 2014 US Family Business Survey



Having an appropriate governance structure in place, including an established board (preferably with outside/independent directors) helps increase the odds that CEO succession will be successful. (See the [*What is a board's role in a family business?*](#) module in this Series for more discussion about what you can expect your board to do.) Practically speaking, even with a process in place, the founder or family members who control the company will have the final say in selecting the next CEO.

Succession in the family

A family business may ignore succession planning or take an informal approach in its early years, then pay more attention to it as the business matures—and as the founder ages. It's not unusual for founders to employ their children (G2) to perform basic tasks when they're teenagers, and then have them take on more meaningful roles as adults, depending on their interests and aptitudes.

While “growing up in the business” can be a great learning experience for the next generation, a challenge they may face is being taken seriously when they are given some increased responsibility. Employees may discount the next generation's knowledge and maturity, making their transition into new roles more difficult.

Another challenge is that existing employees may assume nepotism is at play when family members are hired or promoted. You can mitigate this challenge to some degree with proper planning, transparency, coaching, and communication. For example, you can define baseline job standards for each role (college degrees, specific credentials, and internal and external experiences) and require that all job-seekers, including family members, meet those standards.

Interview insight

It's common practice for family companies to have their next generation work outside the business for several years. This lets them see how value is created in another company, gains them experience, and earns them the right to a job in the family company.

— A PwC Private Company Services partner

Some families want the next generation to “earn” the right to work for the company, rather than see employment as an entitlement. Accordingly, they encourage (or even require) their succeeding generations to build important skills outside the family company. Outside accomplishments also help family members establish credibility once they do join the business.

Some family businesses actively discourage family members from working at the company, apart from having summer jobs or internships when they are young. Whether your company encourages or discourages family members from working there, it's important to establish policies about family employees early on. Such policies can help guide sensitive decisions about family member employment issues and help enforce consistency.

If it's important to keep company leadership in the family, you can improve the likelihood of there being a family member who can become a successful CEO if you pay deliberate attention to developing high-performing family members. How can the company support their development?

1. Identify an executive to coach them about the company, its industry, and other aspects of the business.
2. Expose them to strategy development, product development, finance, and marketing—as well as operations—to give them a well-rounded foundation.
3. Assess their skills, aptitudes, and interests periodically and identify where they need additional development.
4. Invite them to observe—and possibly present at—board or board committee meetings, so they can see how the board operates and understand its role. This also gives them exposure to board-level issues that can help in their personal development.
5. Encourage them to be entrepreneurial. Some companies give younger family members a budget to pursue some of their own ideas within the company—allowing them to develop important business skills by implementing an idea they conceived.
6. Expose them to community activities the company may be involved in, and encourage them to participate in organizations that support high-potential executives, like the Young Presidents Organization. Bring them to industry-related conferences, events for family businesses, or even governance conferences to expose them to broader issues.
7. Involve them with the family council (if one exists) so they understand that group's role interacting between the company and the family.

Interview insight

The founder's children didn't have the skills to run the business. They know operations, but not strategy, finance, innovation, or marketing.

— *An executive at a family company*

Interview insight

They are constantly scouring the family to see if anyone may be able to run the business. Then they ensure those individuals get the education and experience they will need.

— *A PwC Private Company Services partner*

This may sound straightforward, but we don't want to suggest it's simple. Succession planning often becomes more complex in family businesses as the family grows and ownership is handed down over generations. It can become especially complicated if multiple family members are competing to be CEO, which can create acrimony and even lead to rifts in the family. Sometimes we see one family branch leave for another company. Other times, the family may choose to break the company apart, with different spin off companies run by the various top family candidates. The CEO/founder can help avoid rancor by being candid with possible successors about their prospects. But even with that, if a family member is overestimating his or her potential, problems may be unavoidable.

Succession from outside the family

It's not unusual for a nonfamily CEO to run a family business. One-quarter of respondents to PwC's *2014 US Family Business Survey* say the company would be passed to the next generation to own but not run.

Promoting an executive from within the company has distinct advantages. The founder/CEO and the board know the candidate's strengths, weaknesses, and accomplishments. The executive understands the company, the industry, and the culture, and already knows customers and employees. And importantly, he or she likely has relationships with and the trust of the family.

If there are no capable executives or family members ready to step into the CEO role, the next option is to recruit from outside. Even when there is a good internal candidate, it can be helpful to understand what talent is available outside the company.

Recruiting from outside generally costs more (and may take longer)—particularly if you use an executive search firm. Someone has to define the requirements, identify and screen candidates, and then interview viable ones. After that screening, the founder/owner(s) and a few board members can interview the most promising candidates and discuss which one to select.

An outside candidate should understand your company, meet executives and owners, and assess its financial and competitive position. Since such information is often highly confidential, you can have the candidate sign a nondisclosure agreement.

Before extending an offer to an outside candidate, you'll want to conduct thorough due diligence. This involves checking references and credentials, determining if the candidate has a criminal record or other legal issues (including past bankruptcies), and taking other similar steps. Indeed, you may wish to perform the same vetting for internal candidates, if they were hired before the company had such HR protocols in place.

For some family companies, nonfamily CEOs are the norm. Succession planning, or a CEO search, is much the same in this situation as it would be in a nonfamily company. That said, the family may want to periodically challenge itself on its decision to continue having nonfamily CEOs, particularly if there is a family member with the skills, experience, and interest to run the company.

Sometimes an interim CEO is hired to run the company while preparing a family member to take the CEO position at a future point. An interim CEO in this kind of role might be someone whose career is winding down but who is not yet ready to fully retire. In these cases, expect to negotiate a different employment package with the interim CEO than you would for a “permanent” replacement—involving compensation that recognizes the shorter-term nature of the role.

Another option—which we see in emergency succession situations—is to have a board director step in to run the company until the board can find a permanent CEO.

How can the board help in succession planning?

Interview insight

The worst mistake outside directors can make is to assume the issue of succession has been taken care of. We need to insist on discussing the plan.

— An outside director at a family company

Interview insight

We said to our young CEO: “We know [discussing emergency succession] isn’t pleasant, but we’re trying to protect your family.” We asked which internal managers might be ready, or which family members could step in.

— An outside director at a family company

Interview insight

The lead director has a sealed envelope with the name of a successor in the event anything happens to the CEO.

— An outside director at a family company

Boards (particularly the outside/independent directors) can play an important role in succession planning. First, since experienced outside directors likely have been through CEO successions with other companies, they can bring discipline to the process. Second, outside directors can provide valuable counsel to the owners on whether any family members are ready to take over running the business, or share their perspectives on which family member should be selected.

How might directors guide succession planning?

1. Ensure succession planning is on the board agenda

Unless directors put succession planning on the board’s agenda, it likely won’t be addressed. It can help to have the board discuss succession planning annually. Broaching the subject could require delicate conversations with management, the founder, or other owners. It forces them to think about future control of the company as well as their own mortality—not easy topics.

In addition to that discussion, management should create opportunities for the board to meet with high-potential family members and managers throughout the year. This allows directors to see these people in action, develop relationships with them, understand their skills and potential, and mentor or coach them. Knowing these individuals allows directors to have a richer discussion about succession.

2. Prepare for emergency succession

Even if you have a robust succession plan, unforeseen events can upend your projected timeline for the CEO transition. The sudden loss of the leader in a family business will be an emotional time for the family and often for company employees. So it’s important to have an idea of what to do in an emergency succession.

It may mean accelerating the promotion of a planned successor or calling upon a current executive or a family member to take over on an interim basis. Another alternative is for a director to step in as interim CEO. The latter two options allow the board and owners time to conduct a thoughtful process before naming a permanent successor.

3. Advise when selecting the next CEO

If you want to keep leadership in the family and if there is only one qualified family candidate for the CEO role, the board's job is easy. But when there are many candidates who want the role, the decision gets more complicated.

While the founder/owners will have the final say, outside directors can provide perspectives on which candidate is best suited and ready. Indeed, directors who have run other businesses may be particularly skilled at assessing who might be the best choice.

Directors can also provide valuable counsel if they don't believe *any* internal candidates are ready to take the helm, even with additional coaching or ongoing mentoring. If the decision is to use an executive search firm to look for the next CEO, directors can help it define the criteria and understand family dynamics before starting the search.

4. Set the new CEO's compensation package

If a company is still led by its founder, the board may not be involved in setting CEO pay. But with successor CEOs, the board can advise on creating a package that will motivate and compensate the new CEO at an appropriate level. And when the new CEO is a family member, directors can help ensure that person is fairly compensated in a way that rewards performance while not harming the economic interests of other family owners.

Interview insight

We benchmark executive compensation against our public company competitors because we compete with them for talent.

— A family member who is an executive and director of the company

5. Assist with leadership transition

A first-time CEO can find it daunting to have a broader scope of control. A CEO recruited from outside the company needs to understand family dynamics and company culture. Directors, especially those who have experience as CEOs and who understand the business, can be a good source of support through the transition.

Interview insight

I said I would accept the CEO position only if every one of the founder's children agreed.

— An executive at a family company

The board can also help deal with family members who didn't get the CEO role but believe they should have. Some of these individuals may never be suitable CEO material. Others might be CEO material, but need additional "seasoning." Either way, having directors participate in such discussions—possibly together with the founder/owner(s)—helps remove an unneeded distraction from the new CEO.

Both the board and family leaders can support the transition by indicating they expect everyone to respect the chain of command. If any instances emerge where family members appear to be trying to undermine the new CEO's authority, the board can support the CEO in applying the appropriate consequences. It can also encourage the CEO to develop a strong and respectful relationship with the family.

Questions to consider

1. Are our high-performing executives—family and nonfamily—getting the opportunities they need to develop?
2. Are we paying enough attention to our succession plan? Is it a regular item on our board agenda?
3. Does the board (and family) have sufficient opportunities to get to know potential CEO candidates?
4. Do we have the right policies in place regarding family members working at the company?
5. Is nonfamily management an option to move the business forward?
6. Do we know what we would do if the CEO was suddenly unable to serve?

Other modules in this series...

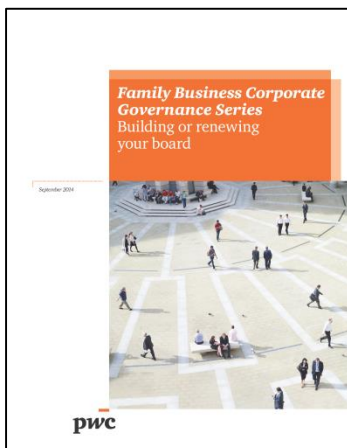


Family businesses don't have to have a board, but there are compelling reasons for them to consider whether they should. And a family business board doesn't have to look like a public company board—there's a lot more flexibility in how the family might structure it. This publication explores the issues a family business should think about if it is considering creating a board of directors:

- What does a board typically do?
- What are the advantages to having a board of directors?
- Would the family have to give up control of the company, or share confidential information with outsiders?

You can download this module at:

<http://www.pwc.com/us/en/corporate-governance/publications/corporate-governance-role-in-family-business.jhtml>



When a family business decides it's time to create or renew its board of directors, there are a number of issues to consider. This publication explores these issues specifically for a family business.

- What knowledge, skills, and attributes would be helpful to have on the board?
- Do we need outside/independent directors?
- Would a board of advisors work better?
- Which family members should get a seat on the board?

You can download this module at:

http://www.pwc.com/en_US/us/private-company-services/publications/building-renewing-your-board.jhtml

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Catherine Bromilow is a partner in PwC's Center for Board Governance. She works with boards of directors and audit committees of major public and private companies and institutions, providing insight on leading practices. She has worked extensively with boards and directors from a number of countries.

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Catherine speaks frequently about corporate governance leading practices with boards and at conferences and seminars. She is a Certified Public Accountant (licensed in New Jersey) and a Chartered Professional Accountant, CPA CA (from Canada) and holds a Master of Accounting degree from the University of Waterloo in Canada.

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John works closely with the firm's Private Company Services practice, focusing on family businesses and other private companies, and leads efforts to publish governance thought leadership for these companies. He has also developed other thought leadership publications, including *Governance for Companies Going Public—What Works Best* and *Director Dialogue with Shareholders—What You Need to Consider*. He contributed to *Audit Committee Effectiveness—What Works Best* and *Board Effectiveness—What Works Best*. He consults frequently with client engagement teams and speaks at client events.

Prior to rejoining PwC in 2008, John wrote the *AICPA Audit Committee Toolkit* and edited the spin-off versions for not-for-profit organizations and government entities.

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* Forbes 2014 List of America's Largest Private Companies

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