



# Professionalizing the Family Business

Establish a culture for data-driven, repeatable processes.

by Michael Dannenberg

In the lower middle market, especially with closely held family businesses, there is frequent discussion on the need to “professionalize” the business as a logical progression in its lifecycle. While the term “professionalization” is vague, and in some ways pejorative, it refers to the implementation of a set of repeatable processes, systems, and people that allow businesses to accurately measure performance and enable a culture of continuous improvement.

For many entrepreneurs and leaders of closely held businesses, taking steps to professionalize seems like a tremendous bureaucratic burden, with minimal added value. They love their company and often credit the informal, entrepreneurial nature of management with its success. This is understandable, and in the short term, they may be correct. However, as a business and its competition evolve, a system reliant on a single person, individual knowhow, and personal relationships creates considerable risk to the owner and provides an obstacle to a future sale process. For this reason, we encourage owners to begin thinking about professionalizing the business in advance of a sales process or an event that interrupts this inherently fragile structure, thereby capturing the value for themselves, rather than for future owners.

## ESTABLISHING PROCESSES

Professionalizing begins with establishing repeatable processes to govern and manage the business. Ideally, this starts with a vision and detailed strategic plan that reflects the values, beliefs, and standards that have defined the entity as a business. It should honestly address where the business is today, where it is going, and what is needed to get there. It should include plans for ownership succession and the future of management. To the entrepreneur that is firmly behind the wheel, setting the organization’s future priorities and verbalizing the strategic vision may sound like wasted resources, but when the objective is to encourage all employees to pull the oars together, this simple exercise and its continual communication allows all key stakeholders to clearly understand and be in a position to act on shared priorities. If done properly, this plan becomes the framework from which all decisions, especially those

with respect to the allocation of resources, can be based.

## THE ANNUAL BUDGET

A direct extension to this plan is the annual budget, which should be developed by man-



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agement and approved by ownership or the board of directors. Whereas the strategic plan may set more general directives, the annual budget needs to be concrete. It should outline specific objectives and financial goals against which each executive, manager, and employee is measured. Budgets are not a novel concept, and exist in almost any business. In the context of professionalization, the difference is the detail with which the plans are developed, the



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employment of specific operating data, and the effectiveness with which it can be used as a tactical tool to measure performance and drive improvement.

## TRANSITIONING TO A MANAGEMENT TEAM

As businesses evolve, they invariably become more complex. Growth involving new customers, new channels, and new geographies, requires manpower and specific skillsets that may not exist within the family or original

team. Solving this problem requires transitioning from a single leader with an informal structure to a professional management team having a broader range of skills and distinct responsibilities. This does not necessarily happen overnight, but in almost all cases, as new executives from outside the family take on a greater significance, the set of informal agreements that previously existed becomes less effective, and it becomes necessary to clearly define roles, incentives, controls, and required business practices with written documentation. Additionally, as management and ownership become bifurcated, it is critical to have oversight and independent validation. This can be achieved through an independent audit or review and the establishment of a board of directors, which may or may not include independent advisors.

## DATA-DRIVEN DECISION MAKING

A big differentiator between an early stage and a professionalized business is the use of data to drive decision making. Although all businesses utilize data to some extent, closely held businesses tend to be more entrepreneurial in nature, relying on experienced judgment rather than analysis. As a result, limited resources are allocated to development of systems and processes. We see this difference highlighted during the due diligence process of many of our sell-side engagements, when acquirers ask for detailed data on almost every aspect of the business. This presents a natural conflict, as heretofore this level of data, whether it exists or not, has not been used to achieve successful results. On the other hand, for the professional buyer, it is critical, as they intend to systematize the business to replace the fragile network of capabilities and individual knowhow with repeatable processes driven by actual data. This means the buyer will need reporting capabilities that enable careful development and measurement of financial and operating performance to evaluate the business as a whole, and managers individually. In addition, they will be beholden to a much wider audience, with multiple stakeholders (board of directors, limited partners, lenders, auditors, etc.) who require detailed reporting that will need to be provided

timely and accurately. This often requires significant upgrades in technical systems, modification of business processes, and the addition or replacement of personnel.

#### **AVOIDING RISK**

We work with many businesses which the investment community would not deem to be “professionalized,” but which have become solid, profitable businesses, with defined com-

petitive advantages and deep barriers to entry. Often these businesses are built on limited resources with a founder who drives every aspect of the business and is involved in every decision. These businesses tend to be characterized by an entrepreneurial, “roll-up your sleeves” attitude with roles and responsibilities that are not clearly defined and a general management structure that is informal in nature. Although

this structure has been successful, perhaps required for this stage of development, the entrepreneur with hands firmly on the wheel bears risk. To the extent an owner can begin the professionalization transition that will ultimately be required for the business to thrive over the long term, the business can be prepared for the next generation and better positioned for a future buyer. **zs**



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