# HUMATICA CORNER

## Mastering the transition from family-owned to PE governance

Sponsors have pulled their hair out trying to reform the governance of previously family-run businesses. Clearly, there are many successful ones, including Swarovski, Mars and ALDI. They often opt for a public listing to instil rigor in their governance. Others have chosen to remain private for good reasons including the unique flexibility these markets provide - to be more agile, more entrepreneurial, or more patient than the quarterly-results treadmill of public firms.

Family business success often relies on not-so-obvious cultural factors and behaviours. These subtle strengths can become weaknesses when the firm is acquired by private equity, and asked to execute a new, more aggressive value creation plan. It's the moment when the management practices which drove success in the past need to transform in order to gain momentum under PE ownership for the future. Humatica has studied governance differences carefully over the years in order to help incumbent leaders successfully transition to the demands of private equity.

The greatest risks come from management teams not understanding the implications of private equity ownership up-front. In particular, the owner's risk profile shifts dramatically - from a family that has most of their assets in one company, to an institutional investor that distributes risk across a portfolio. Family businesses are run to avoid risk and minimize $\beta$. PE seeks. This subtle shift goes mostly unnoticed at signing, but has huge implications on every aspect of the new portfolio company - especially on the way it is led and run.

It's no surprise that we observe major differences in decision-making and execution between successful serial buy-out teams compared to family-run businesses. Whereas a more collaborative, incremental approach is common in family firms, in which non-financial considerations often play a large role; private equity demands non-stop, assertive decision-making on value enhancing measures. It's 3D speed chess vs. checkers. Family business managers are often too timid and risk-averse to make clear decisions, and too slow to implement. Many of them are not able to shift their risk tolerance in line with the PE owner's fast enough, and are replaced.

Another challenge is overcoming differences in transparency and communication between the ownership models. One of the greatest legitimate risks for family owners, especially first-generation entrepreneurs, is having their innovation stolen by an insider who becomes a competitor. It's logical for them to therefore be secretive and rely on a few trusted relationships within the firm. However, by the time a company is acquired by an institutional fund, it's beyond these embryonic risks. At signing, *accelerated growth* becomes the new priority. And, activating the organisation to achieve this requires greater transparency and open communication. Incumbent management routinely misses this shift and its implications on their leadership style, behaviour and communications.

The key to success with family-owned buy-outs is to maintain the traditional strengths of the family's culture, but at the same time anticipate and develop new leadership competencies and processes. Humatica provides tools and services to help portfolio leaders understand the challenges up-front, and master this exciting transition.

Humatica™

*Hard Facts for the Soft Factors*