Five Key Attributes of Long-lasting Family Businesses

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Family businesses face several governance and performance challenges when they expand from their small beginnings. Future generations of the founder may insist on retaining business leadership, at times regardless of their suitability. As the number of family shareholders increase with each successive generation, their commitment to carry on the business may get weaker. Thus, with business growth comes the challenge of maintaining strong business performance, while family growth demands keeping the members committed and capable to manage the business.

In this article, the authors identify five areas that family businesses must regularly synchronize to achieve enduring success. This summary presents the suggestions authors make in the article.

Family

Family businesses can fail due to family conflicts over money, nepotism and fight for succession. Long lasting family businesses ensure that the family's strong sense of purpose transmits from generation to generation. Setting up family institutions (forums, council etc.) and adoption of transparent, policy-based decision-making mechanisms bring clarity, objectivity and wider acceptance of decisions. These mechanisms reinforce mutual trust and bring family members together. Nurturing the next generation with core family values and a sense of pride in the larger purpose served also greatly contribute to making a long-lasting family business.

Ownership

Business ownership eventually gets dispersed in multiple generations with passage of time. Expansion needs are sometimes met with infusion of fresh capital from external investors. Therefore, maintaining family control over the business is a crucial aspect, as it may also become a potential source of conflict during inter-generational transitions of power.

Shareholder agreements or holding company structure with clear rights and norms for family and external shareholders bring stability in business ownership. Documented policies for right of first refusal, dividend and payouts, voting rights etc. help responsible ownership to evolve in the family, thereby making family business survive across generations.

Governance and the business portfolio

Absence of shared strategic direction and professional governance are often found to be the key reasons for family business failure. Lack of policies, systems and processes make decision-making an ad-hoc and arbitrary process, thus giving rise to conflicts and business failure. Long lasting family businesses tend to have strong corporate governance mechanisms. Empowered boards with external experts, governance mechanisms like audit and performance evaluation committees and regular meetings for strategy formulation and assessment contribute to long-term survival of business. Long lasting family firms tend to take a long-term view of business and refrain from temptations of short-term benefits. However, it is also very important to keep reviewing the business portfolio with the changing business environment, so that a ‘right’ mix of businesses – i.e. businesses with stable cash flows along with high-risk–high-gain businesses, is always maintained.

Wealth management

Family members have cash requirements for maintaining life styles and for significant family events (i.e. professional education/marriage/new house). In family businesses where wealth is not professionally managed, such needs are financed through large cash withdrawals from the business. This adversely affects the business and creates differences in the family. However, long lasting family businesses establish mechanisms for professional wealth management that anticipates and provisions for such cash requirements of all family members.

Diversification of wealth portfolio in various asset classes and spreading the corpus in fixed, semiliquid and liquid assets ensures that the risks are diversified while investments generate steady stream of returns. Long lasting family businesses often institutionalize wealth management activities by setting up a family wealth office that follows rigorous investment and divestment criteria.

Foundations

Philanthropy is an important aspect of family businesses. Sharing wealth fulfills social responsibility of the family and also earns a good name for the business. However, giving away money alone does not ensure social impact, which often requires greater engagement of the family with a cause. Long lasting family businesses develop mechanisms like family foundations to systematize the process of giving. Family foundations have a distinct setup with their own objectives and evaluation process. They also serve as a vehicle for instilling family values in the next generation members. Through their well-planned social interventions, the family foundations help in developing a lasting legacy of the family.

Practical Implications

Family firms mostly start as small businesses, but as they grow, they become more complex and challenging to manage. Family forums and policies that address family needs, responsible ownership structure, good corporate governance and effective management of the family’s wealth and its foundations are critical to ensure family business survival across generations.

Those family businesses that effectively master on all the five dimensions successfully transform themselves into long lasting institutions. This requires a lot of effort and perseverance but is a worthy pursuit for all the benefit it brings to the business, the family and the society.

Source: *Insights and Publications, McKinsey & Company, January 2010.*
(http://www.mckinsey.com/insights/organization/the_five_attributes_of_enduring_family_businesses)