Family Business Survival and the Role of Boards

– *Nick Wilson, Mike Wright and Louise Scholes*

Survival across generations has been an important goal for family firms. It is well accepted in literature that firms that are governed well survive longer. The board of directors plays an important role in determining the firm's quality of corporate governance. However, family firms are frequently blamed for poor norms of governance. They often lack an independent board and other governance structures such committees and councils that not only help the firm in making objective decisions but also in monitoring their execution. This leads to ad-hoc decision-making and threatens the survival of the family firm. In this article, the authors probe the role of the boards in family business survival and arrive at critical findings that have practical implications for family firms.

Governance and Family Firm Survival

Family firms are expected to survive for long due to the owner family's desire for continuity of family legacy. Higher levels of social capital and lower agency costs that are typical characteristics of family firms also aid them to achieve longevity. Family goals like preservation of socioemotional wealth and family reputation also contribute to the likelihood of family firms surviving longer than non-family firms do. However, the role of corporate governance on family firm survival largely remains unexplored. Board of directors of a firm is the apex body that establishes the norms of governance in the organisation. It is therefore natural that the quality of the board in terms of its composition - mix and the knowledge and experience of its members would have a profound effect on the governance mechanisms in the firm, which in turn will affect its survival.

Exploring the Board's Role

From a large database of over 700,000 medium and large family and non-family UK based firms with annual sales of $10 million or more, the authors identified over 12,500 cases of bankruptcy within the period of 2007-2010 and examined the board governance factors that led to bankruptcy. Board composition was the most important aspect of the study. Several characteristics of the board were considered. These included -

1. ***Gender Diversity*** – It helps the firm in accessing wider pool of human and social capital and is known to reduce conflicts and risk-taking. It was measured in terms of the ratio of female directors.

2. ***Age of Directors*** – Older members are known to have more experience and can help bring stability and preserve values. The average age of directors, their age variation and experience was factored in the study.

3. ***Proximity*** – Directors staying close to the firm can better monitor it. Ratio of directors who stayed in close proximity to the firm measured this factor.

4. ***Number of Directorships*** – Directors must be able to devote time to the firm and multiple directorships limit that. Hence this was included in the analysis.

5. ***Past Failures*** – Failures can signal incompetence but are also learning opportunities. Therefore, a ratio of past failures to current directorships held by the board member was included in the analysis.

6. ***Independent Directors*** **–** They contribute to the firm through an objective perspective, special expertise and holding management to accountability. This was measured by the ratio of independent directors on the board.

Other than the above, the study also took into account the firm's financial indicators, audit and compliance indicators and non-financial aspects like board size, industry risk and concentration, diversification and number of subsidiaries.

Key Findings

The study found that family firms had significantly lower failure rate than the non-family firms. More specific finding of the study were –

(i) Compared to non-family firms, family firms put together stronger and stable boards that help them avoid failures.

(ii) Director proximity to the firm was found to be crucial in managing bankruptcy risk. The close involvement of family directors and strong channels of informal communications among them that help quick diffusion of issues explain this.

(iii) Family firms were found to have more female board members than non-family firms. Gender diversity reduced failure rates and conflicts and improved board stability.

(iv) Family firms were likely to have more experienced boards and also had higher age diversity.

(v) The directors of family firms were found to have lower past failure rates.

(vi) Board size and members' network (multiple directorships) were found to be related to lower failure risk.

Practical Implications

Family firms need to carefully develop a board of directors that is rich in knowledge and experience. They will benefit from improving their local director networks and mentoring initiatives. Improving the gender balance will help family firms tap into wider human talent pool and reduce conflicts. Striking a good age mix of the directors will help family firms bring together the strengths of experience of the seniors and energy and fresh perspectives of the youth. Increased diversity on board will bring the benefit of having multiple perspectives that will improve the quality of decision-making and improve governance, thereby contributing to the longevity of the firm.

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