Family Businesses: Successes and Failures

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Family businesses are widely seen as the backbone of the economy – they create wealth, they provide jobs, they are locally rooted and connected to their communities and they seem to be around for long periods of time. Yet, despite the many positive aspects of family businesses, there is also a darker side. Family conflicts, incompetent members of the next generation and flamboyant lifestyles are just some of the more frequent criticisms about family businesses.

At IMD, the Lausanne-based business school, we have studied the complexities of family businesses for over 25 years. In our research and educational work with family businesses from all over the world, we have gained some extraordinary and deep insights into the dynamics that can either drive family businesses to achieve outstanding performance – often over many generations – or drive them to fail – often with long-lasting pains for the involved families. Two important lessons can be gained from our global research:

1] Each multi-generational family business develops its own particular history, which is made up of both gains and pains, but it is essentially based on a culture of resilience and the unshakeable commitment to succeed over the long term.

2] Each family business is basically a story about people – entrepreneurs and their families whose personal values and visions leave an indelible imprint on the businesses that they have created and that subsequent generations continue to manage.

It is here that we start to understand and appreciate the differences between family-owned businesses and the anonymous public corporation. The latter can never really aspire to the longitudinal, personal influence of a family’s leadership over generations. When it works well, there is a balanced exchange between the family and the business that adds value and often results in the business being enormously successful. Problems arise when the entrepreneur’s vision – which is essentially focused on creating new and better products and services – is increasingly seen by other family members as a simple mechanism to make money. The delicate balance of rights and responsibilities of owning families vis-à-vis their business tends to shift over time towards a growing sense of entitlement by the owners to a never-ending – and increasing – flow of dividends. Sometimes, this shift is abrupt when a strong and successful leader disappears and an ill-prepared next generation needs to assume control.

In other cases, as the family grows and the number of family shareholders increases exponentially, with sometimes-costly divorces, the business is gradually forced to hand over more money to the family. In essence, entrepreneurs and their families create the wealth, but it is ironically also the families who are essentially the single biggest cause of failure of family businesses. And most families we have encountered in conducting our research and educational activities understand this and fear the changes in their influence over the business. But sadly, in our experience, only a minority of families in business translate their fear into a pro-active approach with the clear objective of ensuring that future generations wisely exercise their rights and responsibilities by having well-balanced exchanges between the family and the business that add value.
A structured approach to understanding family businesses

It is important firstly to understand the fundamental structural difference between the characteristics of FAMILY and the characteristics of BUSINESS.

Individuals form a family, not by choice, but by automatic inclusion for life. In contrast, individuals are invited to join a business based on the principles of meritocracy, and they are given a contract with a timeline and a clearly defined job description outlining what the business expects from them. A business compensates an employee as long as services are being rendered. Families, on the other hand, attempt to provide support – moral and financial – as long as a family member needs it. Businesses are usually governed by rationality, whereas families are usually governed by emotions. In our research, we somewhat freely apply the “socialism” label to the family, in an attempt to describe a more egalitarian and needs-based structure. Business is, of course, the “capitalistic” counterpart. Therefore, in family businesses two systems co-exist that are not naturally suitable for co-existence! The more the family grows, the greater the risk of potential conflicts that result from ignoring the different needs of each of these systems. The most typical conflict arises when family members from the next generation of an owning family assume that they are automatically entitled to a position in the business. Parents are often caught in the trap of wanting to help their children, who may be finding it difficult to get their first job, or who have failed elsewhere, so they give them a job in the business even though they do not have the proper credentials. The resulting negative impact on employee morale can be astounding and is almost always underestimated or simply ignored by the family!

To address the diverse and opposing needs of the interaction of “socialism” and “capitalism” within the family business, many families have chosen a simplified approach by distancing the family from the business. They have, “Let the business be run by the truly professional non-family managers,” and given the family ownership rights in the form of dividends. The risk of this “black and white” strategy is that over time the family will understand less and less about the business and the only truly meaningful connection between the family and the business is money – the dividends! It is predictable that sooner or later family members will rightfully question the logic of locked up wealth in an illiquid ownership structure, thus pushing for the sale of their shares and eventually the sale of the entire business. Some families see this as the price they must pay for “protecting the business from the family.” Other families have taken a more complex approach to managing the family and business relationship. They have encouraged next generation members to consider the family business as a source of employment, but based on principles of meritocracy. They believe that a well-structured presence of family members in the business will add value and contribute to the longevity of the business, which will benefit many future generations.

In our research, we have come across non-family CEOs who have praised family members working in the business by saying, “They are more committed, they work harder and they keep the family values alive and meaningful.” And the other family members who are passive owners are educated as responsible owners who have both rights and responsibilities. This seems to work best when they feel proud to be ambassadors for their family business. But this requires a code of conduct, carefully communicated information, education, meetings and social events. The most successful family businesses have understood these needs and have invested in support structures, such as family offices in larger cases. The objective is to build and manage a culture that benefits both the family and the business.
The diversity of roles
When families grow, it is usually seen as a happy event! For families in business, however, more family members mean more complexity, since they bring a diversity of interests, skills and needs. This diversity needs to be understood, accepted and carefully planned. **Figure 1** shows a structured approach to understanding role diversity inside family businesses.

Figure 1: Three circles with tie

The separation of family, management, passive ownership and active ownership (Board of Directors) introduces boundaries and highlights the presence of different perspectives. Not all family members are alike; some may just be members of the family while others may assume multiple roles, e.g. number 15 who carries the burden of weighing and managing potential conflicts of interest between the family and the business. Any family member present in both the ownership and/or management circles is potentially exposed to conflicts of interest. How can they choose when it is best to decide in the family’s interests rather than the ownership or management’s interests? Or vice-versa. And what are the criteria to help make these often-difficult decisions? The best answer for dealing with this dilemma comes from successful multi-generational family businesses. Rather than suppressing the difficult questions and dilemmas, they have adopted an open mindset and a transparent process based on open and honest communication. At the heart of this process is the acceptance of the natural diversity of interests and needs of family members, based on their respective positions in the graph. These different interests are expressed in regular meetings that interest groups structure with formal agendas. But this will only work if all family members share the same values and vision for the business. This requires an explicit process by each new generation to find an answer to the question, “What are we going to do together in our generation?” Successful family businesses invite members of the next generation to find an answer to this question and to commit to it. But they also accept that some family members may not share the same values and vision and therefore they may opt out of ownership. The explicit and formal commitment to a shared vision for the family business is a powerful foundation for constructive business growth backed by a unified family. But wise families also create a process for dealing with difficult conflicts. They often appoint a trusted, senior outsider as a referee. Knowing that there is a conflict resolution mechanism in place, is often the best way to avoid conflicts or to deal with them before they escalate.

Generational transition: The biggest conflict
Conflicts that are difficult to avoid involve succession. It is statistically proven that generational transition is the highest risk for continuity and that the vast majority of families in business fail to effectively deal with it. Our family business research at IMD has in large part focused on the causes of these failures and has identified the best practices used to avoid them. The good news is that many of these failures can indeed be prevented by appropriately and comprehensively preparing for generational succession. The lesson from the most successful family businesses around the world is that they have seen generational transition as a long-term process rather than a short-term event. At the
heart of the process is the understanding that the family business is truly a “people business” where careful thought and preparation must be applied to preparing the next generation for a role in the business. Through our research into failed family businesses, several patterns have surfaced. The most frequent one is that the parent generation applied pressure – explicit and implicit – on the next generation to assume a leadership role in the family business. It is astounding to see that this pressure frequently starts with the selection of the first name of the first-born child. Several generations may have the same first name, and in the US, they may even add “Junior” to the first name. The pressure then continues with the selection of business studies for the next generation. And once the studies are terminated, the message from the parent generation is that it is better to join the business immediately to gain practical experience in your own business.

In contrast, the most successful multi-generational family businesses follow a different path. While the outcome is often the same – namely having next generation members work in or lead the business – the parents realize that a successful and happy life cannot be enforced, so they want members of the next generation to be free to make their own decisions and assume full responsibility for them. These families develop a strong and meaningful motivational approach early on, whereby the children are carefully familiarized with the business and shown the difference it makes to the lives of the people involved. Older generations of the family and retired business employees are brought back to tell stories – business stories – to the children. The objective is to bring the business alive and give it a heart and soul rather than just present it as a collection of financial figures and balance sheets. Through our research, we have discovered families who spend much time and money to keep documents, photos and videos with the explicit purpose of presenting them to the next generation. They realize that a university education can prepare the next generation for business roles, but not for ownership roles in family businesses. In essence, they have developed their own internal curriculum for helping members of the next generation understand the specific complexities of the family business and make better choices for their individual futures. These families have a strong sense of pride, responsibility and humility.

Succession means predictable paradigm changes
One of the most relevant conceptual models, which highlights the need for change management in family businesses, is shown in Figure 2.

As depicted, there are three phases in the lifecycle of family businesses with fundamentally different characteristics, cultures and needs. The founder’s phase typically involves an entrepreneur who builds the business alone, with full power
and control. It is characterized by an "I" culture because the capital, or assets, of the business reflect the personality of the entrepreneur who has built the business in creative and "revolutionary" ways. Similar characteristics can be applied to following generations where sole or dominant owners fully control the business. Typically, the oldest family businesses in the world have applied this model of passing on full ownership to one descendant. This model can also be found in monarchies and in farming.

The second phase involves the children of the founder or the dominant owner. It is characterized by an "us" culture because the siblings share the power over the business. Often better educated than the previous generation, they bring new competencies to the business and often apply them to improving the operational efficiencies after the turbulent, revolutionary growth from the previous generation. This phase is about creating an environment of teamwork based on trust and professionalism. Most family businesses fail at this very difficult juncture, where power sharing replaces total control. The "I" generation has never experienced a succession towards an "us" culture. This leaves the sibling generation typically ill prepared and lacking an effective role model. In addition to the emerging difficult intragenerational relationships, the inter-generational relationship with the senior generation becomes increasingly conflicted. Founders find it very difficult to let go of control and imagine the business without their leadership. Few founders manage the shift from egocentric power control to humility and the realization that the business needs new leadership.

The third phase brings in the cousins and the family now has a larger number of members and branches. This phase is about diversity and power separation – "us and them" – with some involved in the business and others not involved. The business is now large enough to run by itself – at least for a certain period. Those family members who are passive owners and receiving dividends will want that to continue without risky strategies, whereas those working in the business will be concerned about growing it to satisfy the increasing demand for dividends by the growing family. While the sibling phase was about unity in a small family, the cousins' phase is all about managing diverse characteristics, skills, interests and needs. Few families effectively manage this difficult transition. The key to success is accepting the diversity rather than suppressing it and putting in place a practical, transparent and effective governance structure.

Governance – for family, ownership and the business

A fascinating way for growing families to think about how they can structure their way of managing themselves and their businesses, is to compare themselves to democracies. Like a nation, growing family needs to define WHY they want to stay together, HOW they are going to create decision-making structures and finally WHO is going to exercise leadership. The family needs to agree on sharing the same values and vision for wanting to stay together. The values are expressed by the inherited, underlying culture that each new generation must make their own. In growing families, inevitably there will be some family members who will not share the same values. They may not like the commitment to hard work and austerity or simply the family connection to the business. Successful families understand and accept this and facilitate their departure without unnecessarily "punishing" them for their different views. Those staying will feel stronger and more united as they define their shared vision or "dream" for their own generation. This is a powerful motivational moment in the lifecycle of a new generation, namely finding an answer to the question, "WHAT are we going to do together as a family in business?" The explicit outlining of the vision is the "guiding star" for the future from which a family constitution is derived. This is an explicit and more detailed document elaborated directly by the family with rules and
guidelines that govern the behavior of the family in particular and other individuals. The key elements are employment policies for family members in the business, conflict resolution mechanisms and, most importantly, emergency planning guidelines in case of a family or business crisis. It also structures family communications for the entire family (family assembly) and for the delegation (family council) that assumes some family leadership responsibilities.

The next level of effective governance focuses on ownership objectives. An owners’ council defines and decides on the family’s wealth strategy and asset allocation by asking, “What is the right level of risk diversification for the family wealth?” Larger families in business create their own family office, which is the administrative link between family members and the wealth structure. Importantly, one of its key functions is to create and manage an educational curriculum to prepare the next generation for responsible ownership roles in the future.

Finally, the business has its own governance structure with a board of directors and strategically selected independent directors. Compared to the board of directors in a public corporation, the vast majority of family businesses underutilize the potential value that boards can bring. In addition, it is rare to find truly independent directors on the boards of family businesses. An overview of the various governance structures is shown in Figure 3.

While all elements shown in this graph should be used once a family business reaches the cousin generation and has a larger number of family members who have diverse needs and interests, it is equally important for smaller families to use the conceptual breakdown’s three key levels of governance – family, ownership and business. It may not necessarily make sense for a small family to distinguish between a family assembly and a family council, but the logic of deciding on and having a basic family constitution is still compelling.

Is there a success formula for family businesses?

As stated in the beginning, family businesses are essentially people businesses. This is too often forgotten as proven by the large failure rates. Families who have built sustainable businesses over generations give us the following key insights for successful family businesses:

Figure 3: Governance for families in business
1) They often benefit from the independence provided by their private ownership, as they can pursue unconventional business strategies. Over four generations, the Zegna Group in Italy has successfully built a business model around forward vertical integration, whereby they control almost every step of the value chain. The family ownership brings the family values alive in a vision, which deeply cares for the next generation, not just the next five years.

2) They have thought deeply about the role of the family both inside and outside the business. They have created a strong culture where family members understand that they are stronger together, but only if they play by a common set of defined rules. They understand the fine balance between the rights and responsibilities of each individual. The governance structures in place provide transparency and foster leadership and, most importantly, trust within the family. This is the case in the sixth generation Bonnier family business, the leading Swedish media company. One family member leads the business; another family member leads the family.

Finally, successful families understand that they need to add value to the business, instead of just seeing the business as a provider of dividends. This added value on the part of family members comes in different shapes and forms, including actively leading the business, supporting the business strategies, understanding the business and industry deeply, playing ambassadorial roles (by inactive family members) and, last but not least, caring for the communities in which the families’ businesses operate.

Family businesses have the potential to outperform any other form of business organization through their inherent synergies between capital and management. They are guided by the uniquely powerful value of wanting to build a healthy business that they want to pass on to their children. Today, we have a much better understanding of what it takes to sustainably keep families in business. All families with a business owe it to their previous and future generations to learn, reflect and plan wisely.

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