PASSING ON THE CROWN

More family firms are facing up to their biggest problem: avoiding a crisis as the business passes from one generation to the next

MOST of the world's best-known companies at some point listed their shares on stockmarkets, thus opening their ownership beyond the ranks of the families that founded them. Yet even among so-called "public"
companies, many remain controlled, or at least to some extent influenced, by the very same families. Indeed, the majority of businesses are family-controlled, from unsung millions of modest firms to commercial giants such as Wal-Mart, Ford, Samsung or Hyundai. One study in the mid-1990s reckoned that more than 90% of all enterprises in America were family-owned. At Coca-Cola, the views of the Woodruff family still count; at Nordstrom, a giant retailer, the family still controls 30% of the shares. Despite a painful sequence of deaths among its patriarchs, few people think the Agnelli family intends to give up its influence over Fiat.

In fact, depending on how you define "influence", families have some sway in between 35% and 45% of America's 500 largest companies. In other parts of the world, the proportion is higher still. Even in Britain, which lacks an overtly strong family-business culture, about two-thirds of all companies, public and private, describe themselves as family-owned.

Today, more family firms may well be changing hands than ever before.
Work by Joe Astrachan of the Cox Family Enterprise Centre at Kennesaw State University in Georgia suggests that a wave of new family firms were created in the 15 years or so after the second world war. As a result, the shift to second-generation ownership of these firms has been growing steadily in recent years and will soon hit a peak. In Australia, for example, one in five proprietors is aged 65 or more, and more than one in ten is over 70. According to the Family Firm Institute, a specialist consultancy, almost 40% of America's family-owned businesses will have changed their leadership (ie, a generational change or the arrival of professional managers) between
2003 and 2008.

Family firms combine all the tensions of family life with all the strains of business life, and at no moment do both sorts of stress combine so forcefully as at that of generational change. Even with a desire to keep the business family-owned, it may be hard to do so. For instance, a survey of 47 family firms, all of them second-generation or beyond, commissioned by J.P. Morgan Private Bank for a conference of the Institute for Family Business in London earlier this year, found that an impressive 52% expected to be family-owned and -managed in a generation's time; and a further 26% expected that the next generation would be owners but not managers. Only 7% expected that the company would have no family involvement; and the remaining 15% were uncertain.

But in reality, very large numbers fail to make the leap. Only a third of businesses successfully make the transition from each generation to the next, says Mr Astrachan--"and that figure has been very stable, and is true around the globe." The majority are either sold or wound up after the founder's death. Some studies suggest that only 5% of family firms are still creating shareholder value beyond the third generation.

One striking illustration of this is the tiny membership of Les Henokiens, a club named after the long-lived Enoch in the Bible for businesses that have been in the same family for 200 years or more.
Only 32 companies, more than one-third of them Italian, have signed up.

One common feature is that over time the number of family members with an interest in the company has swollen, often reaching hundreds--so there is plenty of scope for squabbling. Yet the survivors have managed to avoid arguments, often because a protocol has been agreed that governs how the family and the business interact, including when and to whom shares can be sold.

Why do family firms so often fail to make the generational leap? And are there recipes for greater durability? Undoubtedly, family businesses are more complex and difficult to manage than the tiny minority of non-family firms whose governance is the main subject of most management research. Family firms are frequently more riven with intrigue and visceral hatreds than a medieval court--and for similar reasons. Substitute the founder for a medieval monarch and the professional managers for courtiers, add in a pair of rivalrous heirs with jealous wives and scheming cousins, and you have the perfect recipe for a Shakespearean drama.

It should be no surprise, then, that some 70% of those attending the annual meeting of the Family Firm Institute in Boston in early October were family therapists. The army of consultants that has sprung up to help family firms resolve differences has its roots deeply sunk in psychoanalysis. Succession is the moment that most often calls for their services.

SUCCESSION AND SUCCESS

The vast majority of family businesses consist of a single founder-owner or founder-couple, sometimes employing relatives who come into the business to help or to find a job. A study by four family-business gurus, published seven years ago ("Generation to Generation"), reckoned that about three-quarters of family firms in America took this form. A further 20% are sibling partnerships; and 5% are "cousin consortia". "Succession is the ultimate test of a family business," say the authors. "Once the business has been transformed from an individual venture into a family enterprise, its continuity becomes a unifying concern." The very task of keeping the family firm in existence may thus sometimes provide the glue that holds quarrelsome relatives together.

Succession in a family business is not an event but a process. Rarely does the patriarch sit with his lawyer for a morning and hand over the family company at the stroke of a pen. Instead, there is typically a two-stage process. It involves the transfer of both management and ownership. "Succession is not complete until both management authority and ownership rights pass on," says John Davis of Harvard Business School. "But they tend not to pass at the same time." The older generation may hang on to ownership until death--or even beyond, in a sense, if ownership is vested in family trusts.

Parents may willingly hand over the burden of management to the next generation, long before they give up the privilege of control. Passing on the key right to vote shares involves "transfers of power, of status and even of identity," says John Ward, who teaches family-business management at two business schools, one on each side of the Atlantic:
Kellogg in the United States and IMD in Lausanne. No wonder psychoanalysts so often get involved.

Of course, the second and subsequent generations have a choice. Keeping the family in the business may mean continuing both to manage and to own it--or the family may own the business but play no part in its management. Families in northern Europe seem especially willing to contemplate the second option, says Mr Ward. More than in other parts of the world, Europeans are willing to put professionals in to manage the family firm. Moreover, Mr Ward reckons, more families are now willing to accept the split, as a way to keep the family involved but distance it from the day-to-day operations.

But where succession replaces a single founder-owner with a band of brothers or consortium of cousins, new problems arise. Ivan Lansberg of Lansberg, Gersick, a consultancy that specialises in family businesses, recalls that much of his company's business five or ten years ago was about

persuading the patriarch to let go. Now, it often entails talking to the second generation, baby-boomers who spend a lot of time managing relations with siblings or cousins who are in management or are shareholders. "It's very different from being a lone entrepreneur," he points out.

The second-generation relatives who run the business may not be as united or as driven as the founder. The cousins who are shareholders may want to get their money out, or may have less faith in the new management than they did in the original owner. And the second generation may enjoy less authority with the rest of the family than the individual who originally created the business.

Corporate succession is always a tricky moment. Many bosses dawdle on the way to the exit. In "The Hero's Farewell", Jeffrey Sonnenfeld of Yale University found that chief executives were significantly less willing to contemplate stepping down than were other senior executives.
And, even after retirement, they hung around: 57% of them retained an office at the firm for at least two years (compared with 23% of senior managers).

With corporate founders, reluctance to hand over the reins may be even greater. Founders generally long for their descendants to continue the family firm: a survey by Arthur Andersen in the late 1990s found that 81% of older owners wanted the business to stay in the family, although 20% were not confident of the next generation's commitment to their business. But many make it hard for the children to do so: the Andersen survey found that 25% of older shareholders in family businesses have done no estate planning apart from writing a will. Often that leaves heirs at the mercy of inheritance taxes that can force the sale of the business.

Sometimes, the founder faces a real dilemma: his daughter or nephew may be more astute than the oldest son whom he sees as a natural successor; he may want the shares to pass to one child, in order to retain control in a single set of hands, rather than dividing his inheritance equally among his children; he may trust his children but mistrust their spouses. At such points, the emotions of a parent can interact disastrously with requirements of a secure transition.

Yet delay in establishing who inherits the business may discourage the most talented of the next generation from investing time in it. Tony Bogod, chief executive of the BDO Centre for Family Business in Britain, recalls a father of 68 who would not hand over ownership of the business to his son, who had spent 15 years in the business and had run it for some time. "But you said, some day all this would be yours!"
protested the son. "Yes," said his father, "but I didn't say you wouldn't have to pay for it." The son had to raise GBP21m ($38m) to buy the family firm.

MOVE OVER, OLD CHAP
Being beastly to the heir has a long history. The first Henry Ford bullied his son Edsel for years. Thomas Watson senior, the founder of IBM, refused to pass on the reins until he was 82. Serge Dassault, of Dassault Enterprises, was 61 years old before his father gave him the chairmanship of the family aircraft business. In Britain, a television series fronted by Gerry Robinson, a former chief executive, has won viewers by repeatedly exposing the painful tensions that a lingering founder can cause within a family business.

Delays can be disastrous, says Mr Ward. "If a succession isn't done by the time the boss is 65, it becomes very difficult," he says. "Once they get to 70-75, it can be hard to let go."

If the old do not go, the young may not stay. Instead, they may leave and set up a rival business of their own. It may take the shadow of the Grim Reaper to get things moving: "Nothing helps unblock a stalemate about succession as effectively as a mild coronary," says Manfred Kets de Vries, author of a book on succession.

But, even if the owners are willing to pass control to their children, the children may have other plans. A survey of the children of owner-managers of British family businesses, by Sue Birley, formerly of London's Tanaka Business School, found that the most commonly cited reasons for not joining the family firm were a lack of interest in a business career; a feeling that "the business would not allow me to use my talents"; and a lack of interest in the particular business. An even clearer explanation seems to be gender. Of the children surveyed, 75% of sons worked in the business, compared with only 35% of daughters; and daughters accounted for 77% of those whose main reason for not joining was a lack of interest in a business career.

Those missing daughters may make a difference. Some family-firm advisers think that transition of a family business from father to daughter is easier than from father to son--especially to the first-born son, viewed by most specialists as the most difficult succession of all. Perhaps if more women went into the family business, more might make the transition.

Scions also need training and support. Alex Scott, who runs Sand Aire, a fourth-generation family business, found being in the family firm in Britain was lonely: "People here are less comfortable with being associated with the family business than they are elsewhere." He was much comforted by a visit to the Family Business Network, based in Lausanne, where he met for the first time hundreds of other people in the same boat. He set up the Institute for Family Business in Britain, specifically aiming to help heirs entering a family business to learn the job.

LOVE, POWER AND MONEY

How can family companies improve their chances of survival? Several studies of firms that have passed successfully down many generations suggest that there are ways to raise the chances of longevity. Mr Davis is writing a book on seven families whose businesses have been notably long-lived; and Heinz-Peter Elstrodt of McKinsey looked at 11 such family businesses in an article in the MCKINSEY QUARTERLY, the consultancy's house journal, last year. Mr Elstrodt found a clear need for professional management and for a continuing family commitment to owning the business. Some research suggests that firms that switch early to professional management find it easier to survive than firms that wait. Michael Lubatkin of University of Connecticut's business school found that firms surviving to the third generation and beyond were those that had put in place at an early stage formal rules to ensure effective family governance.*[1]

Families whose businesses survive seem to operate on a set of agreed principles that pass from one generation to the next, written or unwritten. These, says Mr Astrachan, should ideally include the creation of a board of directors that must meet at least three times a year; a process of strategic planning that allows everyone to debate and agree upon the broad direction the company is taking; and family meetings, ideally two to four a year, that include as many of the owners as possible.

Increasingly, consultants try to persuade the families that own younger businesses to think through and draw up rules of their own. This is hardly a new idea: it was pioneered by Bonnier, a Swedish media and publishing group, in the 1950s. But it provides a chance for families to talk through issues and head them off before they become problems.

One of the key decisions when the family retreats mainly to an ownership role is how to constitute the board. Many family businesses have none. Survivors, the McKinsey study found, tend to have strong boards, and usually one that includes a significant proportion of outside directors.

A second vital decision is the circumstances in which family members can join the company. Survivor family businesses often exclude family members entirely, or insist that they work successfully elsewhere before they apply and face an evaluation as rigorous as any outsider before being taken on.

A third key decision is to build an appropriate strategy. Because family-owned businesses have a more restricted access to capital than publicly quoted firms, they tend to concentrate in

businesses that require relatively few assets, such as trading, consumer goods and retailing. There are exceptions: Vittorio Merloni has built his company into one of Europe's biggest manufacturers of white goods. And family firms are often more diversified than quoted companies--they are, after all, by far the family's main asset, and so the firm's own diversification makes family owners feel more secure. Shareholders in quoted companies have more scope to diversify their own portfolios by buying shares in other firms.

If those three decisions--the make-up of the board, the terms on which family members can join the firm and the creation of a strategy--are well made, then family businesses stand a good chance of surviving. But there is one further essential--the family must want to continue. With each generation, the gap between management and ownership widens, as does the gap between the company and shareholders. Mr Bogod thinks that selling the family firm is becoming more acceptable and more common.

So the final essential for successful long-term survival is to keep the family involved, and willing to carry on as owners from one generation to the next. Keeping owners on board can entail wielding sticks as well as dangling carrots. If it is difficult to sell the shares in a family business at their true market value, then family owners have a stronger incentive to sit tight.

Many founders who are now bequeathing their businesses to the next generation may find that their children are unwilling to carry the responsibility. Inherited jobs are out of fashion. But, at its best, a family business can take a long-term view, behave with occasional altruism, and care about product quality in a way that quoted companies often find difficult. Society, as well as the economy, would be poorer without them.

* "A Behavioral Economic Framing of Agency Problems at Family Firms" by Michael Lubatkin, William Schulze, Yan Ling and Richard Dino, forthcoming in the JOURNAL OF ORGANIZATIONAL BEHAVIOR[2].

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[1] http://www.economist.com/#footnote1

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