Successful Family Business Management

BY EMILY GRIFFITHS-HAMILTON

In July of 1962, Sam Walton founded the first Walmart store in Rogers, Arkansas. Walmart is still largely owned and operated by the Walton family. Photo Source: Walmart

Family businesses have been the economic powerhouses that drive local, national and global economies. However the failure rate of family business and wealth transitions is an astounding 70% in each generation. In this article the author discusses the unique nature of a family business and how to effectively engage its diverse group of shareholders relating to the family factor.

There is no institution more enduring than the family business. According to the Family Firm Institute, family businesses – businesses in which decision-making is influenced by a family – constitute between 70%-90% of GDP annually and create 50%-80% of jobs in the majority of countries worldwide today. That makes family businesses economic powerhouses that drive local, national and global economies. For every high-profile family business like Alphabet (Google), Berkshire Hathaway, Walmart, LVMH, Tata, BMW, Bosch, Alibaba, Lavazza, Kikkoman, Tattinger and Samsung, there are thousands of lower-profile, private family-owned businesses making decisions about how to manage and grow their operations.

Further, results from the September 2018 Credit Suisse Research Institute report entitled "The CS Family 1000 in 2018" concluded that "family-owned companies tend to outperform the broader equity markets", noting that "the drivers are a combination of factors that stem largely from a focus on long-term revenue growth as well as a focus on innovation financed by organic cash flows." And that, "greater family ownership also tends to increase the use of longer-term financial targets for management remuneration and family-owned companies prefer conservative funding structures for investments."

However, for those families looking to maintain family ownership across multiple generations, research from the early 21st century indicates that the failure rate of family business and wealth transitions is an astounding 70% in each generation. This means that if 10 first-generation families develop transition plans, only one of those families will remain in control of the business and or their financial wealth by the third generation. This failure rate has remained consistent throughout recorded history around the world, giving rise to the telling proverb of 'shirtsleeves to shirtsleeves', 'rags to rags', 'clogs to clogs', 'barn stall to barn stall', 'rice paddy to rice paddy' in three generations. In other words, transition plans are equally likely to fail whether they are crafted in countries with the lowest possible tax rates or in those with the highest rates, in old world cultures or newer ones.

This same research found that the origin of the 70% failure rate lies within the family itself, with a failure being defined as a family involuntarily losing control of the family business and or financial assets of the family through factors like family feuding, mismanagement, miscommunication, inattention and foolish expenditures. Additionally, four specific causes and the rate at which they were cited were identified as:

Without an active and engaged ownership group to guide it, a family business is like a ship lost at sea, with no clear destination.

With the failure rate and the causes of failure in mind, the next critical step being taken by family business researchers is to better understand the fundamentals of successful family businesses that have transitioned successfully across multiple generations.

a. 60% Breakdown in communication and trust within the family unit
b. 25% Unprepared heirs
c. 12% Lack of mission
d. 3% Failure of professionals

With the failure rate and the causes of failure in mind, the next critical step being taken by family business researchers is to better understand the fundamentals of successful family businesses that have transitioned successfully across multiple generations. One of their keys to success has been their ability to continue the family legacy of successful decision making, beginning by understanding the primary difference between the operations of a family business and a business controlled by a diverse group of shareholders relating to the family factor.

Successful families recognise that their family business is comprised of three separate systems, each with specific decision-making needs and responsibilities, represented by:

a. **The Family:** Responsible for the articulation of shared values and the development of a shared vision for the family members' human and intellectual assets, physical and emotional well-being and all that they know, and financial assets.
b. **Family Business Ownership:** Responsible for the articulation of shared values and the development of a shared vision and/or goals for the family business, in conjunction with the family's shared values and vision. Family business ownership is also responsible for ensuring that family business management is effectively working to meet these objectives.
c. **Family Business Management:** Responsible for the development of a strategic plan that shows how the family business ownership's shared values, vision and goals for the business will be achieved.

Regarding the family factor, a family business has a unique group of shareholders: multiple generations of family members whose connection to the business often arises involuntarily through birth or marriage. A successful family business must find a way to work with this group of shareholders. The most effective way to do it is to proactively engage the group as participants in the family enterprise, and that means educating them on family enterprise basics such as Earning a Voice, Family Meetings, Ownership and Leadership.

Earning a Voice

Knowing that successful decision making is fundamental to the success of any business, it is simply wrong for family members to believe they are entitled to a voice in family business decisions simply by virtue of birth or marriage. Birth or marriage can give family members a seat at the family table and a voice in *discussions* about the family's shared values and vision. Beyond those conversations, however, consider the advantages to be gained when family members are expected to earn a voice before having input into *decisions* that require a level of expertise, like decisions on the future direction of the family business, mergers and acquisitions, investments, employment, compensation, etc. After all, quality voices make quality decisions. When everyone knows that decisions are being made by respected family members who are qualified to make them, trust in the decision-making process is increased, along with acceptance and support for the decisions themselves.

Each family develops its own list of criteria for earning a voice within each of the three systems in the family enterprise, reflecting the unique nature of the family and the family business. In the end, when family members are clear about what it takes to earn a voice in any of the three enterprise systems – the family, family business ownership and family business management – the expectations of family members are easily managed, with each family member knowing what is needed to earn a voice in the decision-making process.

Family Meetings

Family meetings are essential in any family enterprise. Successful multigenerational families know

Four specific causes of the 70% failure rate of family business

that working together in harmony to make good decisions greatly increases the likelihood of achieving long-term goals. Individuals are not always born with the natural ability to collaborate with others, even those to whom they are closely related. However, this is a skill set that can be learned, and like any skill, the more it is practised the stronger it will become. Family meetings give family members a place to learn how to work together. Each time a family has a successful meeting, in which family members not only share their own perspectives but also listen to and consider the ideas of others, the group's collaboration skills are strengthened. And by strengthening their ability to work well together, families can prepare themselves to collectively handle the unforeseen challenges that arise on any multigenerational journey.

Additionally, family meetings are the most effective forum for averting the primary causes of failed family business transitions. As members participate in creating the family's shared future through family meetings, these meetings become a place to strengthen trust and communication, to prepare the upcoming generation for their future roles and responsibilities, and to reinforce shared values and develop a shared vision. Family meetings are also an effective way to provide clarity and transparency about the decisions made by the family enterprise, thereby strengthening trust in and unity and commitment to the decisions made in pursuit of the family's long-term goals.

While all family members can be **active** owners at the same time, assuming they have earned a voice, not all can be **passive** owners at the same time.

Ownership

Understanding the role of ownership is vital in any family business. The roles and responsibilities of ownership are much different from management. Ownership, in alignment with its articulated shared values, vision and goals, provides direction to family business management while balancing risk and reward. Ownership sets the business vision. Management's task is to implement it. Ownership in a family business includes an awareness of what it takes to be or create a responsible, engaged and active ownership group. Without an active and engaged ownership group to guide it, a family business is like a ship lost at sea, with no clear destination. Family business management too is left adrift. A family business in such a state is only one competitive economic storm away from failure.

Ownership is key to the survival of any business, and a family business is no different. This makes ownership an excellent educational topic at family meetings. This is because a common belief among family members in upcoming generations is that of the *managing* owner, who is also the one running, operating or managing the business, which *is* typical in the first generation. However, in later generations of the family, there is a spectrum of different kinds of ownership in a family business ranging from passive, merely collects dividends, making no conscious decision to stay as an owner, is often stuck and therefore along for the ride to an active owner, not employed in the business but takes a genuine interest and is attentive to all the business's issues. While all family members can be active owners at the same time, assuming they have earned a voice, not all can be passive owners at the same time.

Having open age-appropriate conversations about the ownership structure will help prepare the upcoming generation to take the helm. This kind of transparency builds emotional ownership by the family – one of the things that sets a family business apart – and demonstrates trust in the upcoming generation. Though these conversations may seem difficult in the beginning, these conversations are one of the most important investments you can make for the successful multigenerational transition of your family business.

Leadership

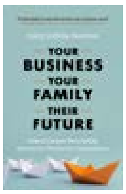
Often overlooked, there are leadership roles which are specific to family businesses and because family

is involved, even the most practical issues these leaders have to deal with can become emotional. In early generations, the family business builder and leader often fills the roles of management, owner and family leader. In later generations, some family members will ascend to family business leadership through their work and ambitions; others may evolve into family leadership roles they hadn't contemplated as they were growing up.

A *family business leader* is someone who has aspired to and earned the leadership role. They're the individual ultimately accountable for the success or failure of the business, and they play an integral role in successful family business transition plans. The *family leader,* on the other hand, is the glue in a united family. Unity is something a multigenerational family can't have too much of. And yet the importance of a family leader is often overlooked, not recognized until the family begins to rupture at its weakest points when the current family leader is gone. Family members follow a family leader not because of coercion but out of respect and loyalty for everything the family leader has done to support individual family members and the family as a whole.

The role of the family leader is a thoughtful and sometimes emotional one, something not entered into lightly. Being an effective family leader means putting the needs of the entire family, as well as of individual family members, before their own. It means nurturing the development of each family member while maintaining a focus on the collective good. It means showing you have everyone's back by ensuring accountability to whatever the family's collective goal might be. It means having tough conversations with individuals who threaten the good of the collective family, not to punish them but to help them get back on course.

Family businesses are special entities. To run them successfully requires paying attention to the three fundamental systems at work: the family, family business ownership and family business management. Management is the system that is most easily addressed, since it is taught in business schools across the globe and can be professionalised through the hiring of qualified non-family members. Less attention has been devoted to ownership, but that system too can be easily handled once the critical role of ownership is understood. The family factor, which is the primary cause of failed family businesses, is more challenging because emotions can get in the way of continuing the family legacy of making good decisions. However, by having family leaders who ensure that family members at the respective decision-making tables have earned a qualified voice and schedule regular family meetings to educate and manage the expectations of the upcoming generation, and provide a forum to deal with family issues outside of the family business, the family factor can also be effectively managed and success achieved.



Emily Griffiths - Hamilton, CPA, CA is a Chartered Accountant, a Family Enterprise Advisor and a Conflict Resolution Coach who brings three generations of experience to the subject of wealth and family-business transition planning. Her latest book, *Your Business - Your Family – Their Future : How to ensure your family enterprise thrives for generations,* is available on Amazon, and in Waterstones and WH Smith. Her works may be found on www.buildyourfamilybank.com.

Family members follow a family leader **not because of coercion but out of respect and loyalty** for everything the family leader has done to support individual family members and the family as a whole.