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How Family-Owned Companies Can Remain Successful across Generations

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Family-owned companies are one of the most important pillars of every economy. The drawback, however, is that only very few manage to remain successful across several generations. But that need not be the case.

"The first generation creates wealth, the second manages it and the third studies art history." This adage, which is commonly heard in business circles, suggests that remaining successful across several generations is the big challenge for family-owned companies. A new white paper published by Credit Suisse provides some possible solutions.

Let's take Daniel Torres (60), for example: An entrepreneur from Madrid. He founded his own pharmaceutical company in 1989 and is married to Elena (57) with two adult children. Entrepreneurship is in their blood. All four run their own companies, in different industries. Daniel would like his company to remain in the family.

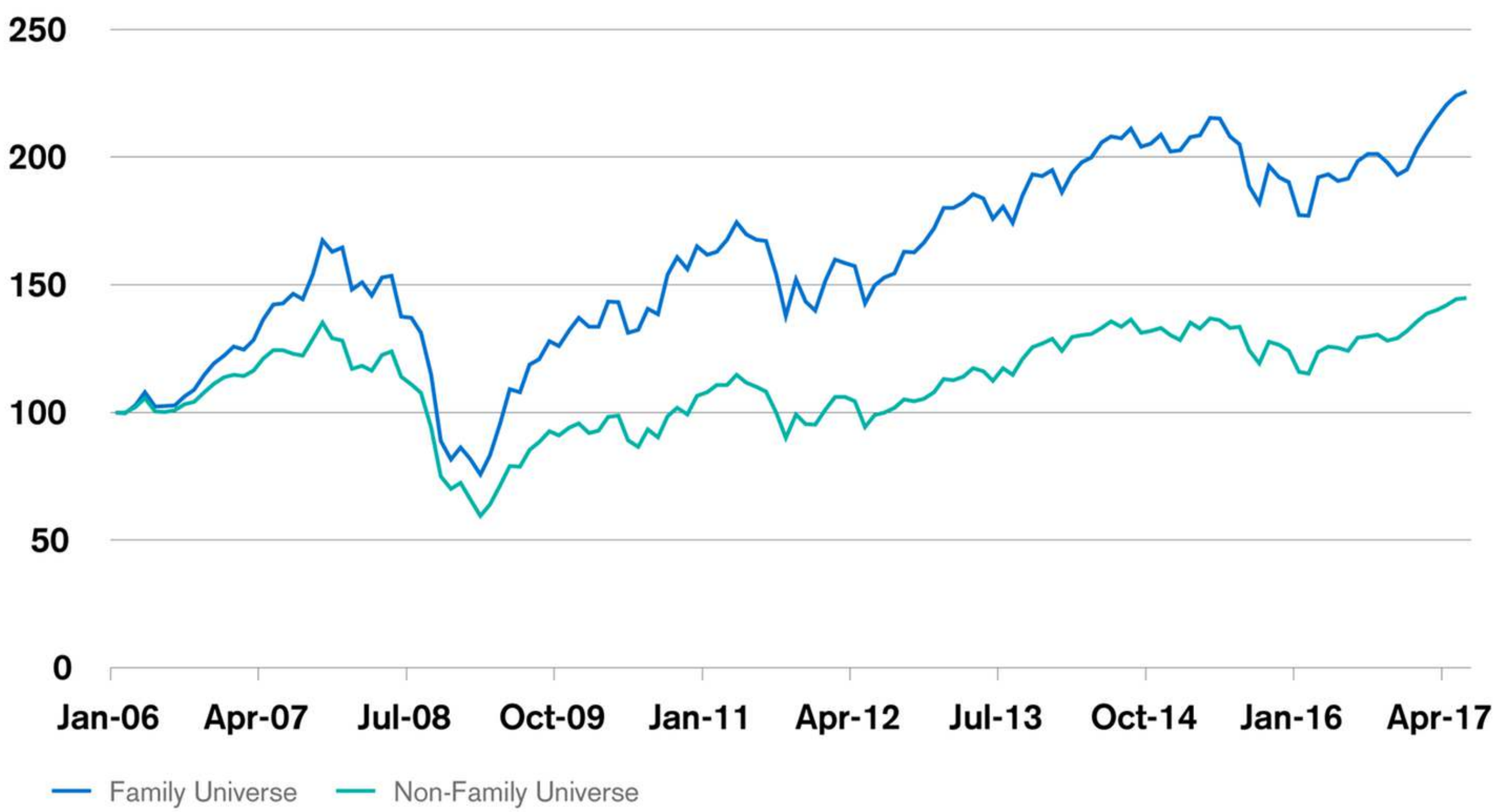
Or: Osamu Murakami (70) and his sister Akira (65) from Tokyo. Their company has been manufacturing high quality luggage since 1980 and has successfully established itself in the market. Their children all work for the company. Competition has intensified in recent years. The next generation wants to focus on innovation, but Osamu and Akira have their misgivings about this.

These two examples show two key problems: Issues with business strategy and succession planning. "Family-owned companies face a two-pronged challenge," says Cristina Cruz, Academic Director of the Entrepreneurship Department and Professor of Entrepreneurial Management and Family Business at IE Business School, Madrid. "On the one hand, they have to secure the success of their businesses long-term. And on the other hand, they have to bring this in line with their family structures and values. That's a very delicate balancing act." It is on this premise that a new white paper recently published by the IE Business School in collaboration with Credit Suisse is based. The focus: How can entrepreneur families be successful across generations?

Involving the Next Generation Early on

The fact of the matter is that family-owned companies are generally more successful than other competing companies. They outperform the broader equity markets in all regions and sectors since 2006 by on average 400 basis points per year. According to the last study conducted by the Credit Suisse Research Institute (CSRI), they grow faster and are more profitable.

Market-cap-weighted sector-adjusted returns: Family-owned companies have outperformed since 2006

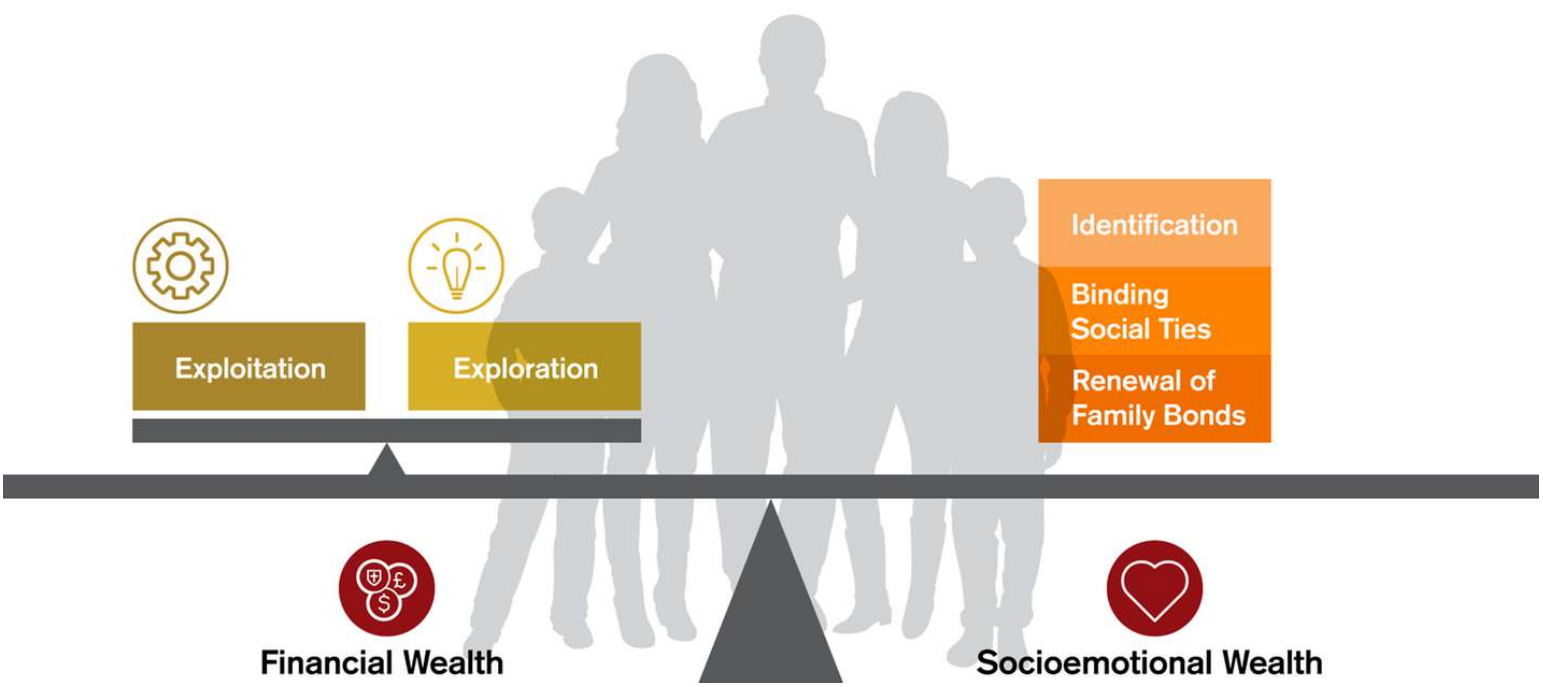


Source: Company data, Credit Suisse estimates

But the crux is that only a fraction these companies survive beyond the fourth generation. The White Paper gets to the bottom of this fact. "Every family is unique," says Cruz. "It's important to understand how they make decisions. And how they involve the next generation in these processes." For company founders this means accepting a potential loss of control and being open to the ideas of the younger generation. For their heirs, it means appreciating the family's values. According to the study, the next generation is aware that it is the family values – including aspects such as control mechanisms, the family's identification with the company, and social and emotional ties – that make up the unique character of a company. "The older generation must actively pass on the family values to the younger generation. They can't acquire this knowledge anywhere else," says Cruz.

> 43 percent of family firms do not have a succession plan in place, with only 12 percent making it to a 3rd generation
>
> PwC Family Business Survey 2016

And yet, taking into account the specific values of a family-owned business – or what Cruz calls socioemotional wealth – is only one half of the equation. Ultimately, it is about achieving a "dual balance", or in other words, the magic formula for long-term success. On one side of the scale is financial wealth, which comes about from the happy medium between optimizing existing resources and strategies (exploitation) as well as the ability to be innovative and adapt (exploration). On the other side of the scale is socioemotional wealth. "If all of these factors are balanced, then the ideal conditions are in place for success across generations," says Cruz.



A Question of the Right Balance

So what would Cruz focus on in the examples of the Torres and the Murakami families? "It is important to get a clear understanding of the situation," says Cruz. "Very entrepreneurial families such as the Torres have to decide: Do they want to take their individual dreams and develop them into a shared, cross-generational vision? Do synergies exist between the individual companies? If yes: What kind of advantages would they have vis-à-vis the competition?" The Murakami family, in contrast, is a prime example of operative efficiency - at the expense of innovation and family values. "In this case, the ideas coming from the next generation could provide new momentum. Once again, it ultimately comes down to the fact that it will only be possible to successfully take the step from family business to a long-term entrepreneurial family if there is a good balance between the company's direction and family values."

Further Information

Cristina Cruz and Laura Jiménez: "Latin American Entrepreneur Families: How to increase cross-generational potential?" (Publication available only in selected countries)

"The CS Family 1000". Study by the Credit Suisse Research Institute on the attractiveness of listed family-owned companies from an investor perspective.

"The Swiss Family Business Model". Study by the Credit Suisse Research Institute on the financial performance of listed family-owned companies in Switzerland.

Tags:

Succession Planning, Next Generation