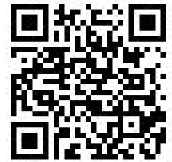

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Family businesses: their virtues, vices, and strategic path

Michael K. Allio

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Family businesses, ranging from tightly held, private operations to publicly traded, global corporations, are a major component of the world economy. Anyone under the impression that they tend to be lethargic, lackluster competitors should note that as a group they significantly outperform non-family businesses[1]. But, as long-time observers of family businesses have noticed, many of the traits that make them strong performers also exacerbate their weaknesses, threatening the ongoing viability of the firm. This article takes a close look at the characteristics of family businesses, and explores why key strengths, when carried to extremes, can eventually impair performance. It offers prescriptions for leveraging their key virtues, and avoiding their common vices. Finally, the article proposes a strategic approach to managing family businesses that can help to ensure their prosperity – and survival.

Many people don't realize that family businesses are a powerhouse of the US economy; in fact, approximately 60 percent of all public companies in the US are family-controlled[2]. According to *Business Week*, more than a third of the S&P 500 are family-controlled[1] and 37 percent of 2003's *Fortune* 500 companies are family-owned[2] (Exhibit 1).

On average, the 177 family companies in the 2003 S&P 500 far outperformed non-family companies over the past ten years, by a variety of measures, including return on assets, shareholder return, and revenue growth[1] (Exhibit 2).

Many of the top performers over the past decade are family-run firms, spanning a broad range of industries. Many of the legendary firms in this country are family-run, and continue to dominate their markets, generation after generation: examples include retailing titan Wal-Mart,

Exhibit 1

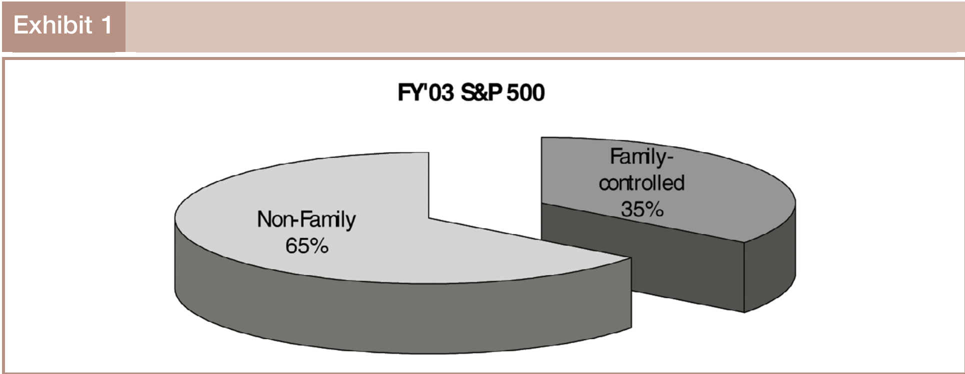
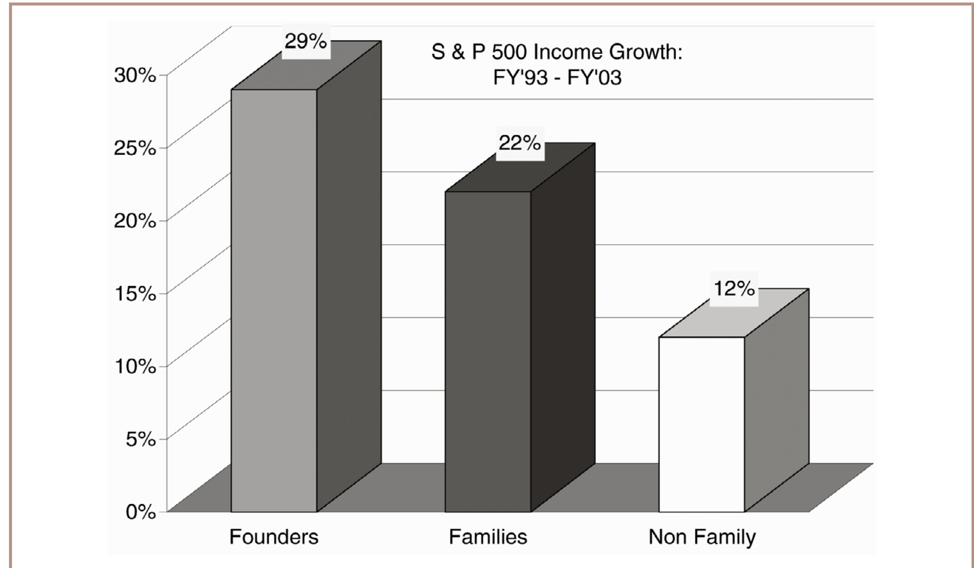


Exhibit 2 S&P 500 income growth



automotive leader Ford, Cargill (international commodities trader and the world's largest private company), and a host of brand name luminaries[3] (Exhibit 3).

Family firm predominance is by no means restricted to the USA: some of the world's largest are also closely held and family controlled, including:

- Samsung (electronics, $98 billion in revenues, 22 percent family owned);
- LG Group (diversified products and services, $81 billion, 59 percent);
- Carrefour (retailing, $72 billion, 30 percent);
- Fiat Group (automobiles, $61 billion, 30 percent); and
- Peugeot Group (automobiles, $57 billion, 42 percent)[4].

Bred for success

Why do family businesses prosper? While competitive advantage, business strategy, and *kismet* have roles to play, we'd propose the following five meta virtues.

Loyalty

Family firms boast a highly developed sense of loyalty to the core unit. Blood is often thicker than water, and family members tend to test their actions against a higher standard than ''9-to-

Exhibit 3 Top 10 US family firms (2002)

Rank	*Firm*	*Focus*	*Revenue ($ billion)*	*% family*
1	Walmart	Retail	245	38
2	Ford	Automobiles	163	40
3	Cargill	Commodities	50	85
4	Koch	Oil, gas, agriculture	40	100
5	Motorola	Telecommunications	27	Not available
6	Viacom	Media	25	68
7	Tyson	Food	23	80
8	Weyerhaeuser	Timber	19	Not available
9	Loew's	Hotels/tobacco	17	30
10	Mars	Candy	17	100

> “ You work harder when your mother is watching you. ”

5 managers''. As one senior VP in a $1 billion-plus privately-held family firm summed it up: ''You work harder when your mother is watching you''. Loyalty to the family impels many to drive harder, longer, and to eschew self-serving actions for the common (family) good. Loyalty is espoused as a core value, and tends to reinforce itself over time, as the family legacy grows. The fruits of loyalty are firms that span generations[5] (Exhibit 4).

Focus

Successful family firms usually maintain exceptional focus on their core business, or markets. Examples abound, from Dell's continued tight aim on consumer-direct computer and peripherals demand, to Estee Lauder's uncanny hit ratio in cutting edge, upscale cosmetics. This virtue is often instituted as a family tradition (''We built the business on this''), although the cost of focus is high – many family business leaders cannot leave work at the office; it follows them to the dinner table, the golf course, the piano recital, and Sunday brunch.

By sticking to their knitting, successor generations capitalize on knowledge, relationships, and infrastructure that have withstood the test of time. And single mindedness can often prevent feckless adventures. When a second generation family member at a home-furnishings licensing firm embarked on rapid diversification, extending the family brand beyond furniture and lighting to unfamiliar product categories and channels, the repercussions were dramatic: he was replaced. ''Opportunities pop up every day'', comments the successor president, son of the founder, ''but we have a responsibility to stay true to our roots, and never forget where we came from – money's no compensation for diluting our heritage''. With a renewed commitment to the core portfolio, the brand's licensing revenues soared.

Speed

Intense internal politics aside, family firms tend to move more quickly than bureaucratic traditional firms. They often offer either a crystal-clear hierarchy (father as chairman and absolute sovereign, sons and daughters as VPs), or a relatively small set of decision-makers (the family council), so decisions can be made swiftly, with little debate. In fact, according to a recent survey of more than 1,000 family firms, 25 percent cite no board involvement at all, and only half have boards that meet more than twice a year[6]. Key managers know who to go to secure funding, and they usually know how to package their proposals in the short-hand that family members respond to: ''the old man's not interested in internal rate of return (IRR) or

Exhibit 4 Family firms with staying power

	Origin	*Focus*	*Founding date*
Family firms			
Kongo Gumi	Japan	Construction	578
Hoshi Hotel	Japan	Innkeeping	718
Barone Ricasoli	Italy	Wine/olive oil	1141
Barovier & Taso	Italy	Glass making	1295
Richard de Bas	France	Paper	1326
Antinori	Italy	Wine	1385
US firms			
Zildjian	US	Cymbals	1623
Tuttle Farm	US	Agriculture	1638
Bachman Funeral	US	Funeral services	1769
Laird	US	Brandy	1780
Crane & Co.	US	Paper	1801
Yuengling	US	Beer	1829

diversification, but if you can show him the impact in market share and cash flow, it's a lock'', explained a senior VP at a $60 million engineering construction company.

Deep pockets for growth

One of the chief advantages of a successful family empire is quick access to considerable resources. The family war chest is, in many ways, earmarked for reinvestment in the family business, so managers can move rapidly to pounce on opportunities in the marketplace. Nimble responses, and accelerated investment, have allowed firms like the third-generation-run V. Suarez & Company, a leading diversified distributor (one of Puerto Rico's largest private firms, and one of the largest Hispanic firms in the USA), to dramatically enhance its competitive position. In 1992, Budweiser held more than 52 percent market share in Puerto Rico; five other brands held the rest, and V. Suarez, while well-positioned in other beverage categories (wines & spirits), clung to a shrinking share (<15 percent) with Schaefer. Nonetheless, in what appeared to be a mature (classically unattractive) market, V. Suarez leadership decided to launch a new, untested ''foreign'' brand – Coors Light. They devised a bold marketing strategy that redefined the product's ''rocky mountain'' positioning to their seashore environment, targeting an emerging segment of the market (active, upscale 18 to 30 year-olds). They also mobilized a robust special events and promotional program that cut across traditional lines of distribution, reaching their target segment island-wide, at multiple points of sale. Results from their initial market test were so strong that management took the unprecedented step of shifting resources from conventional brands to out-and-out war against the entrenched Goliath, Bud.

Seven years later, as a result of extraordinary investment in advertising, promotion, and island-wide delivery performance, they had reclaimed market leadership. Today, under close Suarez family stewardship, Coors continues to dominate the market, with a 53 percent share, generating over $300 million-plus in revenue and making V. Suarez the single largest distributor of Coors in the world (380 million cans/annum!)[7].

© Coors Brewing Company

A final advantage for family-firms in this context: patient investment. While emotions may run high, family firms can often afford to ride out market or implementation vicissitudes without triggering bank covenant defaults, or having to navigate venture capital ROI imperatives.

Follow-through

To the discomfort of many a non-family manager, in family businesses you can run but you often can't hide. Senior managers, or owners, are so closely identified with the business that they take implementation personally. Failure to follow-through is more than a business shortcoming; it can become a question of family honor. Accordingly, in a family or founder-run business context, implementation is often exalted, and carefully scrutinized. Put another way, protecting shareholder value is far less abstract a motivation when the shareholders are down the hall.

The flipside: ''I know it was you, 'Fredo' ''

Launching and building a family business is part of the American dream. But as many disenchanted family members and non-family managers have learned, it can also become a nightmare. Family politics can be a blessing or an utter burden (as the Corleones of the ''*Godfather*'' movies illustrated). For every Tyson and Anheuser-Busch success story, there's a Parmalat, Imclone, or Adelphia scandal. In fact, just a third of family businesses survive into the second generation, only 12 percent survive into the third generation; a mere 3 percent operate at the fourth generation level or beyond[8] (see Exhibit 5).

Why do family businesses stumble? Here's a hit list of five common vices of family businesses. Ironically, they stem from the same virtues cited above, but taken to extremes (see Exhibit 6).

Blind loyalty

Loyalty to a family or a tradition is of course an admirable quality. But emphasizing loyalty over rationality is a major risk for family businesses, for a number of reasons:

- **Staffing**: the lore of family businesses is rife with tales of nepotism – from the innumerate older brother CFO to the daughter with a freshly-minted Master of Fine Arts degree crowned VP of public relations. When family members are given jobs they can't handle, firms often

Exhibit 5 Family business survival rates

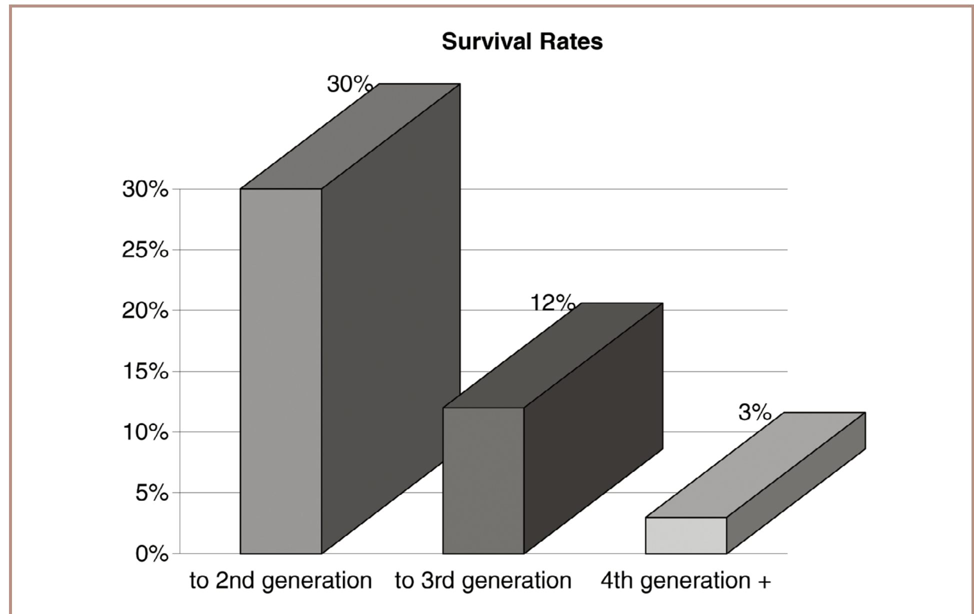
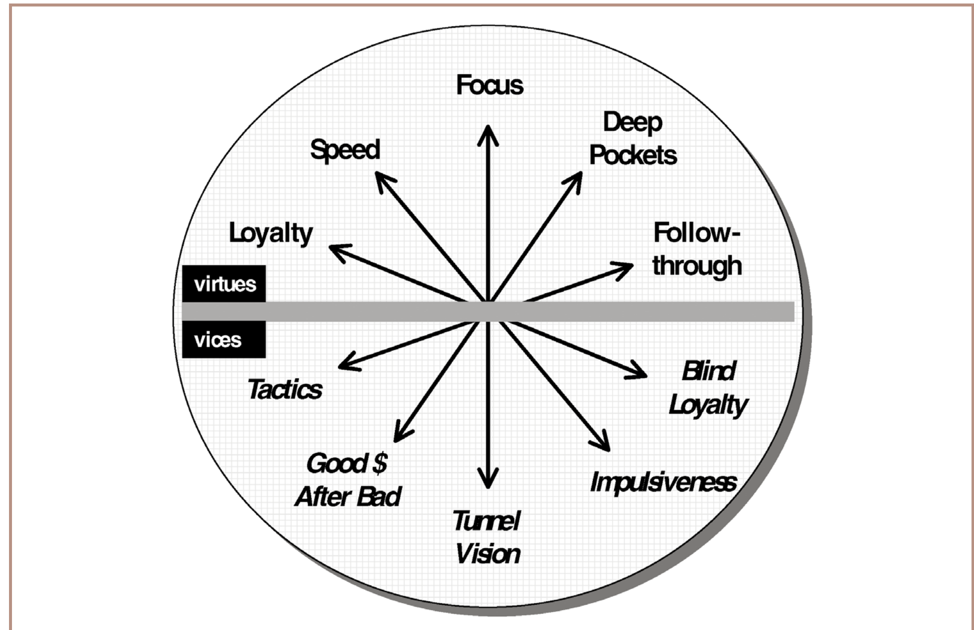


Exhibit 6 Virtues or vices



perform an elaborate dance of accommodation to protect them, usually in vain. Performance aside, in today's tough market for gifted talent, even the hint of favoritism or the lowering of the hiring and promotion hurdle for family can demotivate professional managers.

- **Decision-making**: another common pitfall is blind adherence in strategy or decision-making to the family ''party line'', or worse, to the traditional business model. Now more than ever, to be successful, firms have to listen and respond rapidly to market dictates – not internally mandated ones. While traditional relationships with suppliers, for example, need be respected, in the marketplace performance and competitive advantage rule. Market-based decision-making regarding management selection and succession planning is also critical:

cutthroat competition and rapidly evolving channels of distribution demand professional managers – not necessarily those with the right last names. Yet the trends are discouraging: while an estimated 40 percent of family businesses will change leadership over the next five years, more than half of their CEOs aged 61 or older have not prepared succession plans[8].

- **Rewards**: a third common shortcoming of family-run firms is inequitable compensation and rewards systems. In many cases, the mechanics of bonuses and salary levels are hidden behind the veil of family privacy, a habit that is increasingly under fire in our pay-for-performance culture. Overtly favoring under performing family members has a debilitating effect, as does the converse: underpaying top performing outsiders: ''you hope they end up treating you right, but at a certain point, you ask yourself why you should bust your hump to line their pockets'', points out the former non-family VP of a $200 million pharmaceutical firm.

Impulsiveness

The speed in decision-making described as a virtue above has a dangerous flipside: strategic impulsiveness. The quickest response is not always the best: in many contexts, the formal process of articulating a strategy, performing market tests, constructing alternative future scenarios, engineering a financial model, and determining ROI informs decision making by generating essential data. Equally important, the interactive process of developing a strategy helps balance perspectives, engage key managers, and cultivate buy-in in advance of implementation – all keys to success. Most family firms, however, do not embrace strategy development formally: a recent survey determined that just 37 percent have a written strategic plan (which implies that even fewer use the plan as a practical tool to drive decision-making)[8].

Myopia/tunnel vision

Focus is clearly a virtue, particularly in strategic terms, because few firms serve multiple markets equally well. Focusing on fewer opportunities is often linked to delivering greater returns on investment. Family firms can stumble, however, when they focus on the past, instead of the present, or the future. In the case of Microsoft (run to a large degree on the instincts of founder Bill Gates), one could argue that too rigid a focus on operating software systems led the firm to neglect the powerful opportunities that Internet navigation holds. Alternatively, as an example of how to broaden focus, consider the Bulgari family's recent successful diversification from jewelry alone into related luxury goods (fashion accessories, fragrances) and services (branded hotels) as an upscale global brand.

Too much focus on the internal politics of a family firm, at the expense of market perspective, can lead to skewed judgment, as the recent travails at Adelphia illustrate. And it's no secret that the tunnel vision inherent to family struggles is particularly painful and destructive. For example, siblings in business together run the risk of measuring their position in the family hierarchy (i.e. their ''worth'' as a person) based on their title or salary.

Good money after bad

While family businesses may have more latitude to invest quickly in growth, they may have to surmount a related risk: emotional, rather than strategic investment criteria. When conventional sources of financing (banks, VCs, existing shareholders) are not required, the justification for investment can be far less rigorous. For instance, many outsiders have questioned Edgar Bronfman, Jr's tenacity (and appetite) in selling off the family ''jewels'' of Seagram Company to fund his pursuit of a starring role in Hollywood.

In another case of emotional commitment to an investment, the founder of a development-stage biotech firm had committed to funding an emerging anti-viral platform technology for

“Just 37 percent of family businesses have a written strategic plan . . . even fewer use the plan as a practical tool to drive decision-making.”

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close to a decade. When development milestones were not met, and competitors leapt ahead with preemptive patent filings, he persisted in allocating additional resources – most of the firm's working capital – to chasing an elusive victory, thus depleting the coffers and de-motivating his executive team. They argued, unsuccessfully, for a narrower, more practical, product focus, to little avail. Because decision-making was founder-dominated, there was no precedent for the board to apply restrictions or even propose alternatives. The result: the management team quit, dilutive outside financing was required, and the firm lost its competitive traction. The lesson: while an active, independent board may slow down decision-making, it can also provide much needed outside perspective and balance, a point the enforcers of the Sarbanes-Oxley legislation are determined to underscore.

Tactics over strategy

The virtue ''follow-through'' also has a dark side in the context of family businesses: taken to excess it can mean compulsive attention to day-to-day details and to tactics instead of strategy. In a medical services company, the CEO founder spent several days each month scrutinizing the individual expense reports and timesheets of three levels of his staff to track ''violations'' – cutting into the time he could work with clients (his billable time), and eroding staff morale.

Because the family's capital is indeed at stake, family managers can forget to respect the boundaries in doggedly following the money. When decision-making, and the rationale for setting priorities, are reduced to a 'family" issue, the impact on outsider-managers is devastating. The company grows risk averse, short-term tactics become the order of the day, and strategic, longer-term thinking is abandoned.

Prescriptions

The texture and tenor of family dynamics vary significantly, and it's dangerous to generalize. However, here are four tested guidelines or prescriptions for minimizing risk, and maximizing a family businesses ability to sustain and create value.

Formulate strategy, formally

The healthiest family firms formally, and systematically, commit to strategy development. An annual, balanced process comprises both internal and external analysis, and convenes not just the family, but also key non-family managers. In practice, off-site workshops that integrate education, analysis, and strategy development work best. Part of the agenda should be to lay out the rationale for resource allocation, and demystify the priority-setting process. A short list of key topics that should be covered:

- industry, market and competitive structure and trends;
- customer dynamics and trends;
- key success factors;
- financial trend analysis;
- internal issue identification and resolution;
- competitive advantage;
- scenario development;
- strategy selection;
- resource requirements, and allocation;
- managerial systems issues;
- performance metrics; and
- implementation roadmap.

The strategic planning process should encourage key functional managers to fully participate – family and non-family. Adding board members or advisors into the mix with operating executives promotes the sharing of perspectives and perceived priorities.

The output from this process should be a succinct, practical document that key managers and family members can use to guide decision-making as they begin the process of implementation. For non-family members, this document provides the reassurance that they are privy to the real rules of the game.

Communicate strategy, and performance metrics

One of the central, ongoing challenges in a family business is bridging the line of demarcation between ''insiders'' and ''outsiders''. Formal strategy development helps break down the barriers; clear communication of that strategy is the logical next step. A crucial component of the message is a clear set of performance metrics. Too often in family businesses middle managers don't know what they're being judged on, and many suffer from trying to satisfy competing performance metrics (e.g. growth versus profitability). The solution: distilling the strategy and the metrics that count into a small set of easily understandable measures, and sharing them throughout the organization. Simplicity and communication by the company leadership enhance the chances for manager buy-in, and commitment to implementation.

Commit to management development, and succession planning

With so many baby-boomer CEOs beginning to retire, the turnover in leadership at family firms will continue to intensify. The best approach is to start cultivating high potential talent now. According to a *Fortune* magazine survey, a full 71 percent of the *Fortune* 500 run formal mentoring programs, while only half (or fewer) non-*Fortune* 500 firms do[9]. Formal succession plans, and diverse skills training, are the recipe for cultivating committed, enlightened, professional managers – and for trumpeting your firm's commitment to building a future for your team, regardless of their genes. The politics of family expectations are fraught with danger, and balancing continuity with competence is never easy. But properly positioned, an infusion of new management blood can have a remarkably positive impact. Rivals that challenge family managers force them to prepare and evolve. Cosmetic powerhouse Estee Lauder provides a sound example of this approach: three third generation Lauders occupy managerial positions, and each has been compelled to toil in the functional trenches – for years – before advancing to greater responsibility. There's little you can do to eliminate the weight of a family name, but you can take steps to minimize conflict, or the perception of nepotism, by clearly delineating both job descriptions, and career paths, for all key managers, irrespective of pedigrees.

Balance inside and outside perspectives

The final prescription is the most difficult to implement – but perhaps the most important.

Engage a diverse board. A formal strategy development program provides a forum for some exchange of ideas, and ideally, balances internal perspectives with outside benchmarks. But empowering and expanding a diverse board is an equally important step for the leadership of family firms. In delicate matters such as compensation, or diversification beyond the traditional model, seasoned outsiders serve as a sounding board, and can often tell truths that insiders can't, or challenge time-honored practices. Surprisingly enough, in healthy boards, the presence of outsiders can help relieve tension by acting as proxies, and challenging taboos. ''Abandoning an entire product category would never have occurred to me'', reports the CEO of a $10 million commercial equipment manufacturer. ''We built our business on that product, and were poised to reinvest in upgrading our machinery to eke out better margins. But the market has moved on, and my independent director contended that withdrawing now was probably more prudent than slugging it out all the way down the curve . . .''. In this example, the firm decided to reallocate precious resources to accelerating their primary product lines – improving earnings before interest, tax, depreciation, and amortization (EBITDA) without additional capital expenditures.

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> “ Virtue itself turns vice, being misapplied . . . ” (William Shakespeare (1596), *Romeo and Juliet*, Act ii, Sc. 3. ”

Benchmark at the business level. Strategic planning is the right mechanism for incorporating a range of inputs, and breaking the hold of tradition or a family-centric perspective. When a comprehensive planning program isn't an option, a good start is to benchmark your firm's performance in key criteria against other relevant firms. Example dimensions to evaluate are:

- growth;
- profitability;
- market share;
- productivity;
- efficiency; and
- turnover/retention.

Process benchmarking of core functions (e.g. customer service, fulfillment, product development) at best-in-class firms outside your industry can also provide invaluable independent perspective – facts that a family lens can't easily distort.

Convert outsiders into insiders. Explore compensation plans that align the interests of all key managers. When non-family managers enjoy incentive compensation that rewards them for achieving the strategic goals of the overall business, the barrier between outside and inside fades: the ''family'' gets bigger, and stronger. Straightforward and consistent communication of the strategic plan to a broad cross-section of stakeholders is, again, another tried and true technique for converting outsiders and aligning them with your interests.

Deploy qualified outside resources. In addition to providing perspective, independent counsel can also help to catalyze your organization, introduce useful tools, and signal your commitment to investing in the organization's future. To raise the chances of success, collaborate with practical consultants[10] who have had experience and achieved good results coordinating strategy development within family firms, and who emphasize implementation.

In sum, characteristics unique to family businesses – the virtues of loyalty, focus, speed, deep pockets for growth, and follow through – often deliver superior performance. But as the siuxteenth-century philosopher Michel de Montaigne observed, ''. . . the best virtue that I have has in it some tincture of vice[11]'' – these same virtues, taken to the extreme, can seriously

Exhibit 7 Example strategic checklist

- ✓ We have a written, up-to-date strategic plan
- ✓ Non-family key managers contributed to the plan
- ✓ Key managers have access to the plan
- ✓ Key managers articulate our performance metrics
- ✓ We benchmark multidimensionally vs the competition
- ✓ Our board is diverse and active (2+ meetings/year)
- ✓ We formally develop high potential managers
- ✓ We allocate resources rationally, w/objective criteria
- ✓ We align our interests with key managers
- ✓ We balance inside and outside perspectives

erode the health and wealth of the enterprise. While no formula addresses all situations, adopting a balanced, strategic approach to managing the challenges of business in general, and family-businesses in particular, delivers positive returns, and enhances the chances of passing on the family business legacy (see Exhibit 7).

Notes

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