Survey of family firms shows institutionalisation enables them to overcome the third-generation challenge.

The prosperity of countries in Latin America is heavily dependent on companies that are owned and run by families. That’s because these companies make up 60 percent of the region’s gross national product and 75 percent of all companies worth more than US$1 billion.

As such, it is vital that family firms enact policies and procedures that protect their competitive advantage, foster long-term growth, as well as bolster their mission and values.

This process of institutionalisation is indeed crucial given that less than 15 percent of family firms are led by a third-generation family member, and about two-thirds of family firms will either be sold by the founder or go out of business. Such failures are usually caused by succession planning difficulties, talent management challenges, deficiencies in leadership and governance, and decision-making weaknesses.

What the study entails

The Institutionalisation of Family Firms in Latin America, a new report by INSEAD’s Global Private Equity Initiative (GPEI) and the Wendel International Centre for Family Enterprise (WICFE), looks at how institutionalisation can aid family companies in Latin America survive and thrive long into the future. For this purpose, INSEAD surveyed 131 family firms and interviewed private equity experts. The study was enabled by Clayton, Dubilier & Rice (CD&R) and Russell Reynolds Associates.

The study analyses the survey results, explores partnership opportunities between family firms and private equity investors, and examines areas of best practice that support sustainable value creation. The report – the second in a research series that began in 2017 with the study of family firms in Asia Pacific and the Middle East – includes individual case studies that can help family firms understand their own strengths and weaknesses, and learn from their peers. It constitutes a useful benchmark for all family firms in Latin America.

Survey findings

To assess the degree of institutionalisation of family firms in Latin America, the survey investigated six key attributes.

For the analysis, the researchers grouped first-generation, second-generation and third-generation family firms as “Ascendants” and older family firms as “Champions”. The difference between the institutionalisation scores of the two groups is defined as the “proficiency gap”.

Visit INSEAD Knowledge
http://knowledge.insead.edu
Growth capabilities

In Latin America, Champions outdid Ascendants with a proficiency gap of 28 percent in identifying and executing growth strategies. They executed significantly more mergers and acquisitions and showed slightly stronger organic growth. Champions were also less affected by regulations, government corruption and changes in macroeconomic policies.

Organisational design

In evaluating the systems and policies that govern daily operating activities, Champions fared better than Ascendants with a proficiency gap of 24 percent. That was because Champions had better human resource and spending policies. They also had generally stronger information systems, and followed more formal resource allocation and reporting processes.

Corporate governance and leadership

Champions drove the 20 percent proficiency gap in this category, but Ascendants scored higher in terms of their incentive schemes and the diversity of their management teams. Just 66 percent of Ascendants had a board of management, while all Champions had one.

Access to capital

The proficiency gap in this category was 17 percent, largely because Champions had greater access to debt finance while also having lower percentages of debt on their balance sheets. Slightly more Champions were publicly listed than Ascendants. They also had marginally better access to additional family funding. However, both groups were almost equally as likely to have raised equity capital from outside investors.

Intangible family assets

Champions’ family values, connections and heritage were of greater strength and importance, accounting for a proficiency gap of 7 percent. But Champions and Ascendants had a surprisingly modest difference in terms of shared mutual core values and family values with the current chief executive. Ascendants had slightly higher scores on ties with government officials and other business families. But Champions led on relationships with customers and suppliers.

Family ownership and succession

Champions fared only a little better in this category with a proficiency gap of 4 percent. That they did not have significantly higher succession planning scores was surprising. Compared with Ascendants, Champions had slightly fewer disagreements on this issue and were marginally more likely to have started discussing a succession plan. On the use of an indirect shareholding model, more Champions than Ascendants used trusts, foundations or family holding companies to house their equity stakes.

Latin America vs. Asia Pacific and MENA

INSEAD’s two reports on these regions show that Ascendants and Champions in Latin America have a smaller proficiency gap than in Asia Pacific and the Middle East. That’s because Champions in Latin America have lower scores than their peers in the other two regions, while Ascendants in Latin America have slightly better scores than their counterparts in Asia Pacific and the Middle East.

A deeper analysis of the data reveals that a few outliers with significantly lower scores pull down the average score of Champions in Latin America. Excluding them from the analysis brings the proficiency gap in Latin America closer to that seen in Asia Pacific and the Middle East.

What is clear from the two studies is that the distinction between Ascendants and Champions in the three regions is the same. Differences in the numbers aside, the contrast in the overall scores of the two groups reveals a clear institutionalisation gap. Ascendants often need help to actively institutionalise their business.

Decades-old Brazilian firm endures to the present day

The following case study underscores the importance of institutionalisation to family businesses.

In Brazil, an ongoing family firm in the property and forestry businesses has lasted several decades. A third-generation family member, who started his own business, acquired the family firm after buying out his uncles.

After merging his own business with the family firm, the new owner led the enlarged company through political and economic difficulties and transformed it over time.

As retirement approached, he passed leadership of the firm to a son, who sadly died a few years later, forcing the father to retake the company reins. At present, two members of the fourth generation and two members of the fifth generation are company directors.

As the family firm’s employees and stakeholders had grown accustomed to working with a strong
leader at the helm during the tenures of the owner and his late son, the four family members hired business coaches to provide advice on family and business matters, and to enact a new leadership model.

Aside from the four family members, the board of the firm includes two shareholders. It meets every month to provide updates and present results.

Ten to fifteen years ago, a family friend, who was highly experienced in running companies, joined the firm as an independent director. With his expertise and support in organisational design, the family firm was able to establish formal systems and processes in areas such as budgeting, review and human resources.

Today, the family firm’s culture and shared values are robust. Its deep commitment to its social purpose unites everyone and is a key driver of the family business’s continuity.

Alexandra Albers-Schoenberg is an Associate Director at the INSEAD Global Private Equity Initiative.

Claudia Zeisberger is a Senior Affiliate Professor of Decision Sciences and Entrepreneurship & Family Enterprise at INSEAD and the Academic Director of the school’s Global Private Equity Initiative.

Find article at https://knowledge.insead.edu/economics-finance/latin-american-family-firms-and-the-path-to-longevity-11331