Professionalising the Family Firm

A conversation about the opportunities and threats that spur families into action.

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The idea of a family firm often suggests iconic brands, like Hermès. Yet most don't stand the test of time. In fact, family firms fail at an alarming rate: Around **70 percent** go bust even before the second generation takes the helm. They flounder for many reasons, but it often starts with a lack of professionalisation, which includes defining corporate governance and perhaps welcoming external executives in to manage the firm.

What is a family firm to do? INSEAD Professor of Economics and Academic Director of the Wendel International Centre for Family Enterprise **Morten Bennedsen** had some suggestions for family leadership in a recent INSEAD Knowledge podcast.

"This process of shifting from family to professional leadership, sometimes back again, is probably one of the biggest challenges that family firms have today", Bennedsen said. An expert in the realm of family business research and a former advisor to the Danish Ministry of Business regarding family firms and succession politics, he spoke about the pitfalls and possibilities the professionalization process entails.

Professionalisation is "about having the right leadership skills at any level in the organisation and moving the family firm from a one-man band, from this famous creative person with very little corporate government structure, to the full symphony orchestra" – including a CEO and the board – of a well-managed firm. Bennedsen views the process as the development of an organisational structure that encompasses all the firm's human resources towards a common goal, like an orchestra.

Change is difficult, and allowing outsiders into a family enterprise can be a tremendous upheaval, often tinged with the ominous spectre of mortality. There is a sense among many owner-operators that hiring a manager from the outside is an admission that they won't be around to manage the firm indefinitely.

Some rare examples, like Hermès, have been able to successfully professionalise their leadership and later bring the CEO role back into the family. Bennedsen explained that when the luxury firm sought out a new CEO after a profitable 12 years under Patrick Thomas, it was able to look within the family for management. Professionalising was a boon for Hermès, and although the leader is part of the family, the hallmarks of adding transparency to the established firm continue to help it thrive.

The "why, when and how" of professionalising

Other family firms, like **Birkenstock**, professionalise and then take the further step of selling up. The sandal company, founded in 1774, had to hire its **first external CEO** in 2012 when internal family feuds were tipping into the business side. The €4 billion sale was announced in February 2021. Bennedsen described the sale as a clear benefit for the family – everyone was "very happy".

But for many family-owned enterprises, this is the stuff of nightmares, the idea that the professional CEO might sell the business that their ancestors created and built up right out from under their noses. To combat these fears, Bennedsen emphasised the importance of trust: "It's different to be a CEO, external CEO in a family firm than in a non-family firm. Idiosyncratic things matter. And what really matters is trust, that the family has trust in you … the family will have a lot of fear, particularly the first time they do this." Exceptional leaders make great professional CEOs in family firms.

Before they find the right leader, family members need to work out the why, when and how of professionalising.

Why

An owner-manager as the head of a family firm entails a certain amount of what Bennedsen referred to as "key personal risk". If that person is hit by a bus tomorrow, the impact is terrible not only for the family as a family, but also the family business. Minimising that key personal risk must be recognised when considering the professionalization process.

Meandering along without clear governance structure or transparency, family firms that lack professionalization may frighten away family members. And as Bennedsen pondered, it can also "frighten away the talented non-family members which every family business is so dependent on. If there's no clear prospect for good, non-family people in the firm, why should they stay?"

Succession, that constant thorn in the side of family enterprises, has grown more difficult in non-professionalised family firms as the traditional apprentice model of training the next generation is no longer the only option.

"If you are not Hermès, if you're just a normal family firm, it's not about which of your kids is going to run the firm, it's really about convincing *any* of your kids not to run away", he explained.

When

Family firms generally professionalise when they face opportunities or threats. Opportunities could be new business strategies, digital disruption or the possibility of opening a new market in a totally different part of the world. Threats have to do with poor financial performance or infighting. The more successful family firms professionalise when there are opportunities, according to Bennedsen, not when their backs are against the wall.

How

Once family firms have accepted professionalisation, Bennedsen suggested a three-step plan:

1. Develop long-term agile and resilient business strategies based on strong family assets. Some **family assets** are intangible, such as the family name, a history of survival, values-based leadership, skills and quality. Bennedsen said, "One part of professionalization is to be clear about these business strategies. So, it goes from just the stark feeling of just one person to something that the whole organisation understands and will internalise."
2. Develop strong corporate governance systems to incentivise and attract independent board members. The checks and balances associated with **strong corporate governance** can help diffuse key personal risk.
3. Find, integrate and incentivise the right top manager. He described some of the benefits associated with working with a family firm as a sense of freedom from quarterly reports and often a healthy amount of independence. Firms need to focus on the rewards that working with a long-established family name can bring, as well as the salary and benefit package.

Opportunities for professional managers

Family-owned firms are the bedrock for **swathes of the global market**. With America's **baby boom generation** considering giving up their owner-manager roles, perhaps now is the moment for these family firms to consider professionalization and for enterprising and empathetic leaders to think about joining a family firm.

Demographic changes, pandemics, digital disruption aside, "the only way you can convince the next generation and provide for a firm in a business world which has so many new demands is by professionalising. And most family owners understand that today", Bennedsen concluded.

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