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What Family Firms Need to Ensure Longevity

The professionalization of leading family firms.

The importance of family business longevity extends far beyond family owners. Accounting for 70 percent of global GDP and 60 percent of global employment, family firms are among the main drivers of growth and innovation in today's economy. While strong brands, deep relationships and long-term ownership allow the best performing family businesses to adapt swiftly to an evolving competitive landscape, the family business ownership model carries with it inherent weaknesses.

Chief among these is the challenge of maintaining effective leadership over the generations. Indeed, family leaders often postpone or avoid succession planning, and next-generation family members may lack the expertise or desire to run the business. Family businesses also often suffer from suboptimal corporate governance – as studies show that they have less diverse and impactful boards than non-family firms – and often struggle to attract and retain top professional talent.

In our latest report, **"The Institutionalization of Family Firms"**, we surveyed 123 family businesses to understand the characteristics of successful family firms in Asia-Pacific and the Middle East. Outperformance of a subset of these family firms – the "champions" – underscores how introducing formal policies, procedures and professional best practice supports leading family firms' operations and long-term health.

The champions

The exhibit below presents the main takeaway from our research: the significant jump in institutionalisation between first- to third-generation family firms and fourth-generation firms and beyond. Each bar in the graphs shows the average institutionalisation score of our survey participants by generation, with the different colour segments of each bar representing the contribution to the total score of the six attributes measured in our survey.

Exhibit 1

To enable user-friendly analysis, we combine first-, second- and third-generation family firms ("ascendants") and fourth-generation and beyond ("champions") into two groups. In addition to outperforming in aggregate, champions outperform ascendants on each of the six attributes measured in our survey, underscoring the proficiency gap across business functions between these two groups.

So what caused this proficiency gap? Reviewing survey data by attribute, we found the following:

- Professional boards: 34 percent of ascendants didn't have a board and 21 percent had a board consisting only of family members. Champions were twice as likely to have boards with independent directors and appropriate sub-committees.

- External capital: 55 percent of champions had a public market listing vs. 18 percent of ascendants. Champions were also more likely to have raised equity capital from external investors, including private equity (PE) funds, strategic investors and high-net-worth individuals.
- Monitoring and information systems: Champions monitored KPIs every month on average – vs. quarterly for the ascendants – and leveraged enterprise resource planning systems more frequently. For example, 64 percent of champions used a customer relationship management tool vs. 31 percent of ascendants.
- M&A: 55 percent of champions had in-house corporate/M&A departments vs. 23 percent of ascendants. Champions were more than twice as likely to have completed an M&A transaction.
- Relationships and conflict resolution: Champions had more established relationships with government officials and other business families, and had formal conflict resolution mechanisms in place to diffuse disagreement over the direction of the family and the business.

Bringing in PE

Our study also examined circumstances when partnering with private equity can help accelerate institutionalisation at a family firm, drawing on interviews with 14 PE firms experienced in investing in family businesses. In the right context, an infusion of capital and expertise from a PE firm can help address common challenges introduced by the family business ownership model.

A case study in our report featuring a family firm in the logistics sector in Southeast Asia underscores the potential for such a partnership. Immediately following the PE firm's minority investment in the business, the company's founder and the PE firm initiated a series of concrete steps to improve the performance of the business.

The first thing they did was to install a professional board, separating the chairman and CEO roles (which the founder of the firm had held) and bringing in an independent director with deep sector expertise. The management team was also expanded so that the owner could spend more of his energy focusing on business strategy rather than the day-to-day decision making that frequently took up all of his time. The PE firm drew on its network and helped recruit these managers.

At the advice of its PE partner, the company invested heavily to exploit the booming demand for logistics services, expanding its trucking fleet by four times in a two-year period and diversifying into storage with the construction of an integrated warehouse facility. To drive new business, the firm professionalised and expanded its sales team, training them to sell services across the value chain. These initiatives have translated into a rapid growth in sales volume and revenue as well as a 10-fold increase in employee headcount.

To ensure that its supporting infrastructure would keep up with this growth, the company installed a range of information systems to track operational and financial aspects of the business. To oversee this expanded capability, the company hired an IT manager and an accounting team, positions that had not existed prior to the PE firm's investment.

Although only a first-generation family firm, this company presents many of the attributes of the champions we identified in our survey, underscoring PE's ability to augment performance of family firms in the region.

Food for thought for families

As leadership of a family firm is passed down the generations, selectively drawing on external resources – from independent directors to PE capital and expertise to non-family managers – can help infuse best practice and accelerate institutionalisation. This expertise can enable a family to make an incremental leap in its development and more efficiently compete in today's globalised, competitive marketplace.

__Bowen White__ is the Associate Director of INSEAD's __Global Private Equity Initiative (GPEI)__ and co-author of the recently launched book, __Mastering Private Equity: Transformation via Venture Capital, Minority Investments & Buyouts__. A companion book, __Private Equity in Action__, takes the reader on a tour of the private equity investment world through a series of case studies written by INSEAD faculty and taught at the world's leading business schools.

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