

CHAPTER 1 - The Nature, Importance and Uniqueness of Family Business

A family business is a synthesis of:

- Ownership control (15%+) by two or more members of a family or a partnership of families
- Strategic influence by family members on the management of the firm
- Concern for family relationships
- The dream of continuity across generations

Wal-Mart	Ford Motor	Roots	Purdy's Chocolate
<i>New York Times</i>	Fidelity Investments	Labatt Brewing Company	The Thomson Corporation
<i>Wall Street Journal</i>	Marriott	Dare Foods	Mother Parker
<i>Washington Post</i>	Hallmark	George Weston Ltd.	Tim Horton's
American Greetings	Levi Strauss	McCain's	Lululemon
Bigelow	Kohler	Cavendish Farms	Rich's Foods
Anheuser-Busch	Nordstrom	Saputo International	Bombardier
L. L. Bean	Perdue Farms	Schneider's	Elizabeth Arden
Gap	Smucker's	Voortman	Magna
Timken	SC Johnson	Maple Leaf Foods	Power Corp. of Canada

"Business owners make up 17.9% of the population, yet account for 25% of all income and own 56% of all wealth."

Economic Impact of Family Businesses

Family businesses are the backbone of the world's economy and account for 80–98% of all businesses in the world's free economies.

In Canada, Family Businesses:

- Generate 60% of the GDP
- Employ more than 6 million Canadian employees
- Make 55% of all charitable donations

The Source of Private Capital and New Ventures

*Of the 286 million entrepreneurs worldwide who launched new ventures since the mid-nineties, only 19,000 were financed by venture capital firms.

*The equity raised through venture capitalists represented only \$59 billion, versus the \$271 billion provided by family and friends.

Family Firms Outperform

Family-controlled firms in the S&P 500 achieved 53% greater economic value added than their management-controlled counterparts

Family-controlled firms had a 6.65% greater return on assets (in EBITDA terms)

Canadian Business Statistics

- 80% of all firms in Canada are family owned
- Of these 1.84 million family businesses Ontario and Quebec have the greatest share
 - Ontario is home to nearly 700,000 family firms
 - Quebec has roughly 366,000 family businesses
- Average family business employs 18 people
- Total annual sales of Canadian family businesses is estimated to be \$1.3 trillion

The Bad News

In their first 5 years of operation, approximately 85% of entrepreneurial and family-owned companies disappear. Among those that survive, only 30% are successfully transferred to the second generation of the founding-family owners

Only 12% survive under current ownership to the third generation

Future of Family Business in Canada

While 66% of family businesses expect to expand in the coming year less than 50% of Canadian family business owners plan on passing their business to the next generation

Within 5 years 27% of owners are planning on changing ownership of their business

More than 50% are planning to sell their company to private equity investors or a management team

What Makes Family Business Different

- The presence of the family
- The desire to keep the business in the family
- The challenges and advantages that result from the overlap of family, ownership, and management

Succession and Continuity

The most prevalent reason that family businesses fail is lack of succession planning.

Three patterns of ineffective succession were identified in one study:

- Conservative
- Rebellious
- Wavering

Building Family Businesses That Last

Keys to Success include:

- Ongoing dialogue across generations
- Shared vision
- Leadership
- Management
- Governance practices
- Recognized tension between preserving core attributes while promoting growth and adaptation to changing environment

Theories:

Systems theory

Agency theory

Resource-based theory

Stewardship theory



SYSTEMS THEORY

The firm is a dynamic system in which integration is achieved by adjustments between family, management, and ownership subsystems

Individual perspectives of family and firm may differ, leading to overemphasis on one sub-system at the expense of others

Family-First Businesses

- Employment in the business is a birthright
- Members of the same generation are paid equally
- Perks that transfer from the business to family members are often extensive
- Financial systems may be obtuse by design, and secrecy is often paramount
- Commitment to continuity depends on the agendas of individual family members

Management-First Businesses

- Employment is on the basis of qualifications - family is discouraged from working in the business
- Performance of employed family members is reviewed in the same manner as the performance of nonfamily managers
- Compensation is based on responsibility and performance
- Conversation between family members is usually all business

Ownership-First Businesses

- Investment time horizons and perceived risk are the most significant issues
- Have shorter time frames within which financial results are evaluated

Blurred System Boundaries

Boundaries among family, ownership, and management systems may become blurred

- Problems determining if decisions relate to family, ownership, or management issues
- Family rules may overtake the business
- Problem-solving ability diminished by blurred boundaries

Joint Optimization Alternative

- Family employment policy guides the employment of family members
- Some family members are employees; others are responsible shareholders
- The performance of employed family members reviewed in the same manner as that of nonfamily managers
- Family members are encouraged to work outside the business to get experience
- When family members meet, conversation is both family and business oriented
- Families and firms have a commitment to family business continuity

AGENCY THEORY

- Traditional theory: the natural alignment of owners and managers decreases agency costs of ownership in family firms
- Recent research: the altruism of owner-managers leads to increased agency costs
- Agency costs can be controlled or avoided through the use of certain managerial and governance practices
- The board of directors is important in monitoring managerial behavior and controlling costs

The Strategic Perspective:

Competitive Challenges Faced by Family Businesses

- Shrinking product life cycles
- Intense cost competition
- Rapid change in distribution and value chains
- Increasing individualism of younger generations
- The entrenchment of the current-generation CEO

RESOURCE-BASED THEORY

- Resource-based theory highlights unique capabilities or resources that family firms convert into competitive advantage
- These resources are often referred to as organizational competencies
- The ability of a particular family business to capitalize on its unique advantages depends on the quality of the interaction between business and family

Core Competencies / Attributes Turned into Competitive Advantage

Overlapping responsibilities of owners and managers, along with small company size, enable rapid speed to market.

Other notable advantages include:

- A focus on customers and market niches
 - Longer-term commitment to investments in people and innovation
 - The desire to protect the family name and reputation
 - The nature of the family–ownership–management interaction
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- Family unity
 - Ownership commitment to support patient capital
 - Lower administrative costs
 - Skills/knowledge transfer across generations
 - Agility in rapidly changing markets

STEWARDSHIP THEORY

- This perspective claims founding family members view the firm as an extension of themselves and therefore view the continuing health of the enterprise as connected with their own well-being
- Owners inherit a responsibility to others, so that the enterprise may successfully pass on to the next generation
- As stewards of the firm, family owners often place individuals on the board that can provide objective advice and advocacy
- The independence of the board has a positive impact on the financial performance of the firm through its advisory role more than through its monitoring or supervisory function

Concentrated Ownership

Ownership structure impacts corporate productivity

Stock concentration is positively correlated with:

- Related diversification
- R&D expenses per employee
- Training expenses per employee
- Overall corporate productivity

Lower Overall Costs

The overlap between owner and manager or principal and agent allows family-owned businesses to enjoy lower administrative costs due to:

- Lower CEO compensation
- Reduced levels of supervision, and
- Reduced investment in financial systems and controls

Agility and Flexibility

*The greater flexibility of new manufacturing and distribution-retail-service technology makes smaller runs economically attractive

*Customization, changing consumer preferences, and shorter product life cycles reward agility

*EDI/Internet-based partnerships in the supply chain make agility possible across value chain

Patient Capital and Long-Term Perspective

*Average tenure of 18 years for owner-managers vs. 8 years for public company CEOs is correlated with commitment to the long term and making efficient long-term investments in the family business

*The company continually optimizes the mix among family, management, employees, customers, and ownership for higher long-term profitability

Family Business Research

Two watershed events played key roles in turning the study of family business into a field:

- The publication of a special issue of the journal *Organizational Dynamics* in 1979
- The launching of a specialized journal, *Family Business Review*, in 1986

Still, between 1975 and the early 1990s, most of the published work on family businesses was anecdotal, rooted in the stories of consultants and observers of these mostly privately held enterprises

Only in the past decade has research begun to struggle with this definition of the family business and address the unique characteristics of this form of enterprise