Harvard
Business
Review

Age And Generational Issues

Build a Family Business That Lasts

by Josh Baron and Rob Lachenauer

From the Magazine (January–February 2021)

Courtesy of Jorge Mayet and Richard Taittinger Gallery, New York

Summary. Judging from how they're portrayed in the media, it would be easy to dismiss family businesses as hotbeds of power-playing, backstabbing, and favor-currying, ultimately destined to fail; think of the Murdochs and News Corp, or the Redstones and National... **more**

Given their portrayals in the media, it might be easy to dismiss family businesses as hotbeds of power playing, favor currying, and back-stabbing—preoccupations that can hurt the company, the family, or both. Think of the Murdochs and NewsCorp, or the Redstones and National Amusements, to name just two. But despite the headline-grabbing tales, many family businesses have enjoyed success for decades, even centuries. For instance, the

Italian winemaker Marchesi Antinori, established in 1385, has thrived as a family business for more than 600 years. Similar examples can be found across the globe just within the alcohol business; they include Gekkeikan in Japan (founded in 1637), Berry Bros & Rudd in the United Kingdom (1698), and Jose Cuervo in Mexico (1795).

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So which is it? Are family businesses prone to dramatic implosions, or are they some of the most enduring companies in existence? The answer is both. They can be much more fragile or much more resilient than their peers. Given that family businesses—companies in which two or more family members exercise control, concurrently or sequentially—represent an estimated 85% of the world's companies, ensuring their longevity is essential. The United States alone has 5.5 million of these businesses, which employ 62% of the workforce, according to the research and advocacy group Family Enterprise USA.

To explain the difference between those two fates, we'll delve into an area rarely explored in business schools or the media: the impact of ownership on a company's long-term success. Ownership of any asset confers the power to fundamentally shape it. Think of a professional sports team. Within the rules of the league, the owner has the right to make essentially every important decision, including whether to fire the coach, which players are on the roster, where the team plays, whether the franchise seeks to maximize wins or profits, and whether and when to sell it. The teams with the best track records have great owners at the helm. If your favorite team has an ineffective owner, you are probably doomed to disappointment.

The owners of family businesses wield profound decision-making power. We know of sizable companies in which not a dollar can be spent without their approval.

In a widely held public company, the owners are mostly investors. Their influence is limited. They typically let the board and management run the business; when dissatisfied, they "vote with their feet" by selling their shares. Ownership of a family business could not be more different. It rests with a relatively small number of people, who are related. Their ability to shape the company is profound and is itself shaped by their relationships with one another. That's a potent mix, creating the extraordinary highs and lows we see daily in our work advising the owners of family businesses.

Five core rights accompany family ownership—the right to:

- *Design:* What type of ownership do you want?
- *Decide:* How will you structure governance?
- *Value:* How will you define success?
- *Inform:* What will—and won't—you communicate?
- *Transfer:* How will you handle the transition to the next generation?

Understanding and effectively exercising these rights can lead to long-term success. Misunderstanding or misapplying them can destroy what a family has spent generations building. In this article we explore the five rights and offer battle-tested approaches for exercising them well.

What Type of Ownership Do You Want?

Family businesses are often lumped together as if they were all the same. But four fundamentally different types exist, distinguished by who can be an owner and how owners share control. If you want your family business to last for generations, you need to understand the characteristics of your type and the strengths and challenges associated with it. The choice of ownership type isn't a mere legal formality; it can define or restrict various members' involvement and may loom as an unrecognized source of conflict.

Sole owner. One family member owns the company and is responsible for all decisions. This works best when the business requires decisive leadership and creates enough liquidity to satisfy nonowners (or when nonbusiness assets can do so).

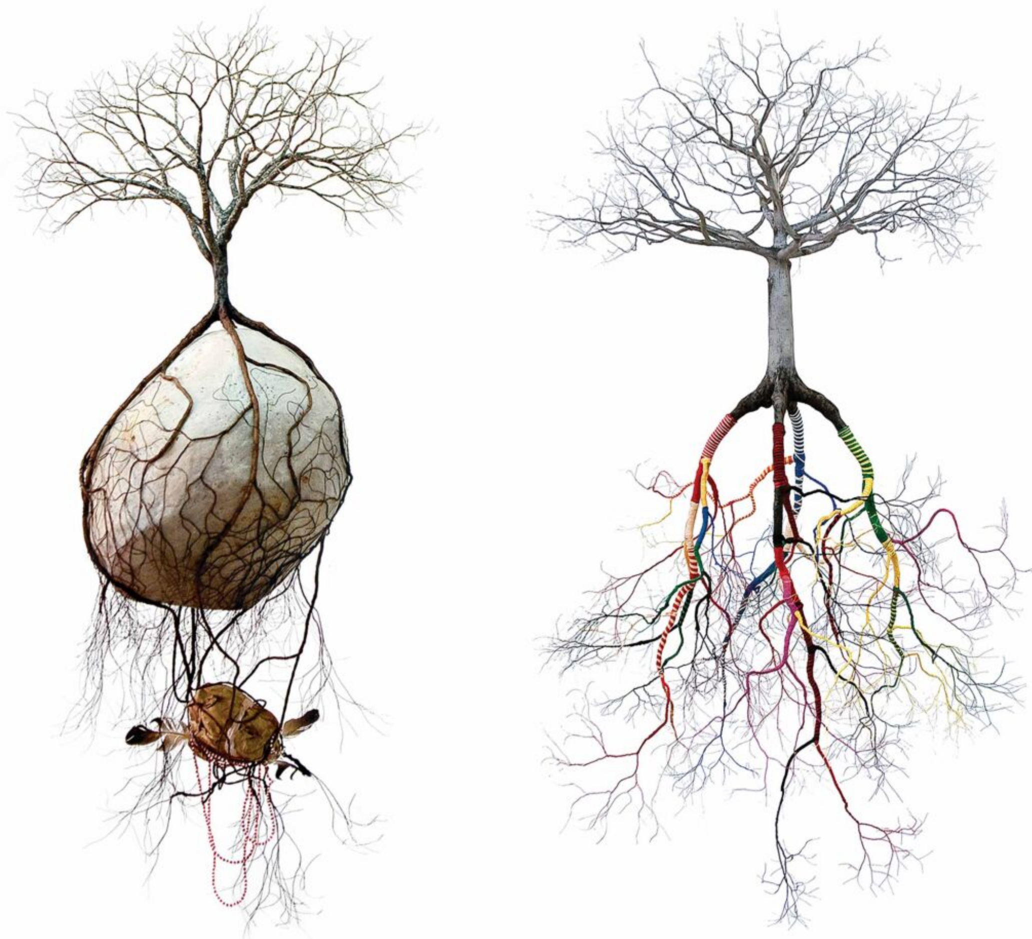
The French cognac maker House of Camus has had a sole owner since its founding, in 1863. In each generation, one member leads the company, buying out siblings' shares. The current owner, Cyril Camus, says this model has been essential to the firm's longevity. With no siblings or cousins involved, family conflict around the business is rare. Sole ownership has downsides: Succession becomes a central issue, which may be decided according to merit (as assessed by the current owner) or assigned by primogeniture or a similar rule, and the owner must wrestle with what benefits to extend to other family members. This model can be risky, because much of the family's capital and talent exit in each generation.

Partnership. Ownership is restricted to family members actively working in the business. This allows for multiple perspectives and requires clear rules governing how people can join or leave the ownership group and what benefits accrue to nonowners. The German-Dutch Brenninkmeijer family, sixth-generation owners of the clothing chain C&A, have chosen this type. Children of current owners are admitted to the partnership on a competitive

basis, after a rigorous evaluation and an apprenticeship. Like sole ownerships, partnerships keep family owners highly engaged but can be vulnerable to the loss of capital and talent. They are typically more resilient because they don't rely on just one leader, but they may face conflict over who is admitted to ownership.

Distributed ownership. Any family member may be an owner and participate in decision-making. This works well when most of the family wealth resides in the company, when it is mandated by law, or when it is expected by family culture. The Brazil-based conglomerate Votorantim has this type of ownership: In each generation, family members pass down their shares, usually evenly. With no need to buy out nonowner members, distributed ownership can keep family capital tied to the business. But owners may vary in engagement; aligning their interests and defining decision-making norms can be challenging, and resentment about "free riders" may arise if some are operating the business while others are "only" investors. Big problems may crop up if some members of the family want to cash out; having a clearly defined exit ramp reduces that risk.

Concentrated ownership. Any family member may be an owner, but a subset controls decision-making. This works well when decisive action is required despite a multiplicity of owners, and it mitigates some of the challenges of distributed ownership. But the question of who will exercise control becomes more complicated with each new generation. Vitamix, the 100-year-old manufacturer of high-performance blenders, operates this way. Shares are passed down to descendants, but in each generation the CEO must own or control a majority of voting shares. Although the owners aim for consensus on big decisions, the CEO makes the final call. One of the chief risks is conflict over who will lead. Another is the possibility that those not in power will lose interest and sell their shares.



Jorge Mayet's sculptures draw from his experiences living as a Cuban exile in Spain. Suspended in midair, his photorealistic floating landscapes and uprooted trees offer ethereal, dreamlike visions of his homeland.

Courtesy of Jorge Mayet and Richard Taittinger Gallery, New York

Although hybrids exist, most family businesses fall into one of those four categories. (If a family business has some shares that are publicly traded, it may fit into any of them, depending on how the family has decided to handle its piece.) In a survey we conducted of family businesses of various sizes and across numerous industries and geographies, we found that 13% had a sole owner, 24% were partnerships, 36% had distributed ownership, and 27% had concentrated ownership.

The type of ownership needn't be a static choice. Be on the lookout for the need to make a change, which may arise when the next generation is joining, when the size or complexity of the business alters significantly, or when you're bringing in outside leaders. The Antinori winemaking family had a sole owner for 25 generations: Control passed to a male descendant, keeping the

business and associated land united. But Piero Antinori, who took the reins in 1966, has three daughters and no sons. He opted for a three-way partnership to succeed him.

How Will You Structure Governance?

The owners of family businesses wield profound decision-making power. We know of sizable companies in which not a dollar can be spent without their approval. When this power is channeled appropriately, it confers a major competitive advantage, facilitating the nimbleness needed to capitalize on opportunities as they arise. Many family business leaders we know can make big bets at a moment's notice, without having to run decisions through multiple layers of management and bureaucracy. "Speed of response is becoming more crucial, and we can put large projects to work quickly," says Alexandre Leviant, the president of the specialty chemical conglomerate ICD, which his father founded in 1952.

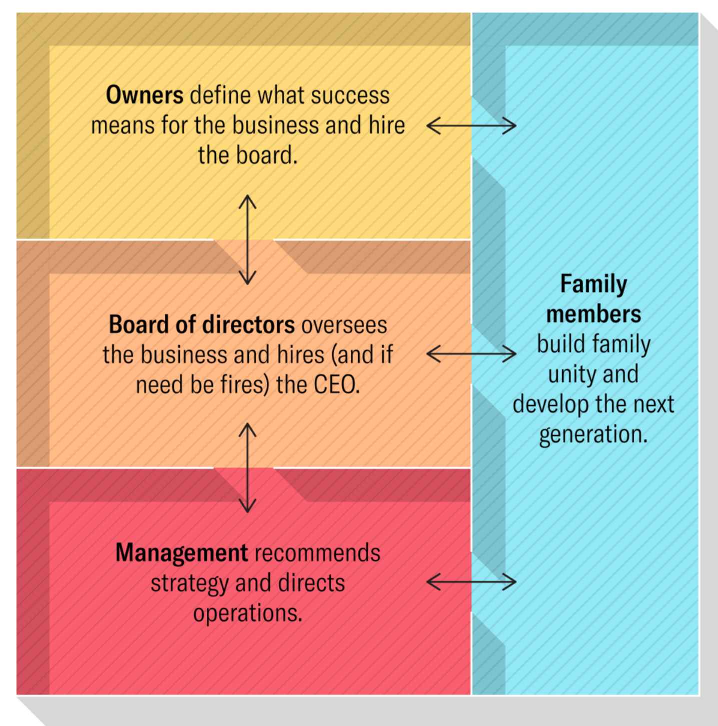
But if that power is wielded ineffectively, the business will suffer. Some owners exercise too much control, stifling innovation and making it hard to attract and retain great talent. Others step back from major decisions, leaving a vacuum that may be filled by executives looking to their own interests. We saw a number of family businesses nearly destroyed when decisions were left to nonfamily managers who wanted to run the company down and buy it at a fire-sale price.

Governance in a family business is all about finding a middle ground between micromanaging and abdicating responsibility, and it becomes more challenging as the family and the business grow. We suggest a simple framework to guide decision-making: the *four-room model.* Imagine your business as a home with one room each for the owners, the board, management, and the larger family. The owners set high-level goals and elect the board; the board oversees the business and hires (and if necessary fires) the CEO; and management recommends business strategy and

directs operations. Because the board and management report to the owners, the first three rooms are in a row, with the owners' room on top. The family's room, which is critical for maintaining members' emotional connection to the business, sits alongside the other three, underlining the importance of family influence and unity throughout.

The Four-Room Model

Thinking of your business as having a separate room for every group of stakeholders—along with rules about what may be decided in each—clarifies roles and minimizes conflict.



Source: BanyanGlobal HBR

In a well-run family business, each room has explicit rules about who belongs there, what decisions are made there, and how. People's roles vary from room to room. For example, a nonfamily CEO can run the management room but shouldn't decide how the owners will use their dividends. Nonowner family members, for their part, can't walk into other rooms and make decisions. Governance based on the four-room model makes the hierarchy and boundaries clear.

Time and again, we've seen businesses slide into chaos for lack of a good decision-making process. Too often the problem becomes apparent only after disagreements have begun to destroy what years of collaboration built. At a regional retail chain headed by a family member we'll call Steve, the lack of governance let his self-described "cowboy" instincts run unchecked, sparking resentment in his sister and his cousin, who were equal owners. Once they all recognized the problem, they turned to the four-room model and created an owners' council, which Steve was required to consult for decisions of a certain magnitude. That allayed his co-owners' concerns while forcing him to plan big moves more carefully, and the business—along with the family—got back on track.

The four-room model helps owners maintain control over the most important issues and delegate other decisions. It establishes a process for revisiting decisions as goals evolve for the family or the business or both.

How Will You Define Success?

The owners of a business have a right to the residual value it creates. With that right comes the ability to define success. For widely held public companies, that's straightforward: They aim to maximize shareholder returns. But few family businesses we know would describe their primary objective in those terms. That's one of the best things about family ownership: *You* get to determine what matters most. No outsider can force you to value earnings growth more highly than, say, providing family members with employment, or can insist that you pursue opportunities that clash with your beliefs.

Effectively exercising this right can be an incredible advantage in making a business last. It enables a long-term, generational approach that contrasts sharply with public companies' obsession with quarterly results. But not all families are clear about what they value most. That lack of clarity can trigger battles over

priorities, missed opportunities, or a failure to retain talented employees. More fundamentally, if you are unclear about your objectives, you risk losing your raison d'être for being in business together, especially as the company grows and transitions to new generations. Your path may become a dead end.

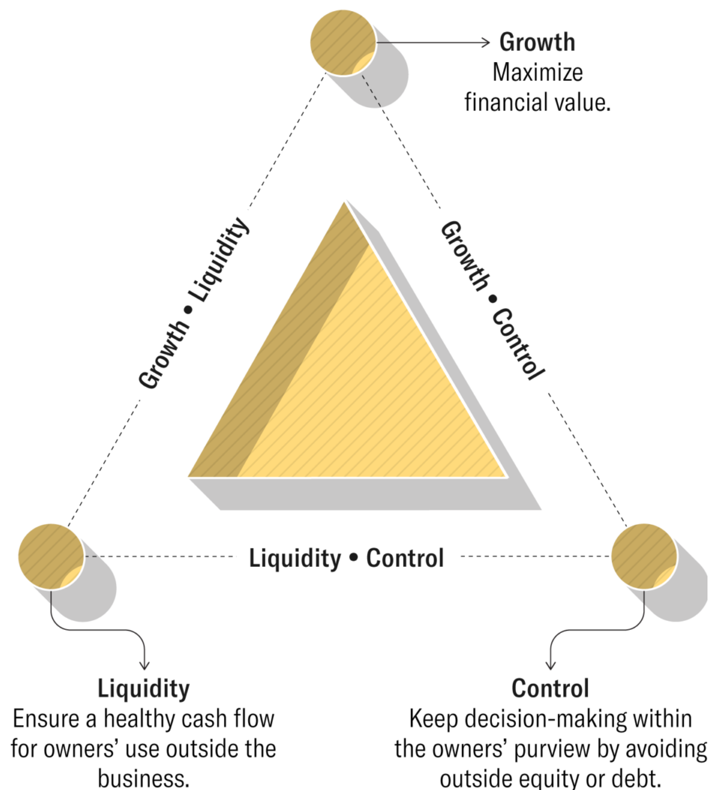
To avoid that fate, you need an owner strategy that identifies concrete goals and sets up guardrails.

Goals. These fall into three main categories. You can aim for *growth:* maximizing financial value. You can seek *liquidity:* prioritizing a healthy cash flow for the owners' use outside the business. You can look to maintain *control:* keeping decision-making authority firmly within the ownership group by avoiding outside equity or debt.

There will be trade-offs among these options. You might pursue only one goal, or you might decide on a combination. We have found that for most family-owned companies, this is a "pick two" situation, meaning they prioritize two goals at the expense of the third. That suggests three basic owner strategies—one for each possible pairing of goals, each forming a side of what we call the *owner strategy triangle.*

The Owner Strategy Triangle

Most family businesses choose to prioritize two of the three main goals depicted here to guide their strategy.



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Growth-control companies—the most common type we have encountered—focus on becoming bigger while keeping decision-making within the owners' purview.

Growth-liquidity companies also seek to become bigger, but they pay out considerable money to the owners and use outside equity or debt or both to keep the engine going—consequently relinquishing some control.

Liquidity-control companies are not concerned with rapid growth; instead they hope to produce a significant cash flow for the owners while retaining decision-making authority.

We know highly successful family businesses that have chosen each strategy combination. And these are broad strategies; companies can find spaces between them. What's most important is understanding the explicit and implicit choices you are making about what to prioritize; those should flow from your fundamental values. You should revisit your choices as circumstances evolve, whether because of external factors such as economic developments, industry consolidation, and regulatory shifts or because of internal factors such as generational transitions, family conflict, and changes to senior management.

Guardrails. Aligning on priorities is essential. But without concrete ways of measuring performance, it's just lip service. Guardrails can help ensure that those running the business day to day are directing their energy and resources toward what you as owners care about most. They allow you to delegate decisions more confidently.

Guardrails can be financial or nonfinancial. Owners should home in on a small number of financial ones—for example, minimum levels of return on invested capital or maximum levels of debt—and ensure that the company stays within them. Nonfinancial guardrails define outcomes for which owners are willing to sacrifice financial performance. The values informing them are often part of the glue holding the family together and a means of making the world a better place. For example, we work with a U.S.-based family business whose members lost relatives in the Holocaust. It invests only in countries with a high score in the nonprofit NGO Freedom House's annual ratings.

Having a clear owner strategy fosters longevity by ensuring that the business accomplishes the owners' financial and nonfinancial goals. Over the long term, families need an emotional connection to their company; they must be able to say, "We own this because

we want to make a difference" or "This represents what our grandfather sacrificed to give us a better life." Without an emotional connection, owners may be tempted to cash out.

What Will—and Won't—You Communicate?

Owners are legally entitled to know a great deal about their business, such as what's in financial statements, certain organizational records, and ownership documents. And except when they bring in outside investors, lenders, or board members, they are not obligated to share that information with anyone (other than the government). That means they control communication; nothing of consequence can be shared without their permission.

How owners exercise this right significantly affects the business's longevity. That's because effective communication is critical to building one of a family business's most valuable assets: trusted relationships. These are often underappreciated, but they help generate three important things:

- *Financial capital:* committed owners who have an emotional connection to the business and value long-term performance
- *Human capital:* engaged employees and family members, including spouses, who bring their full talents to their work and the family
- *Social capital:* a positive reputation with customers, suppliers, the public, and other stakeholders, which can help differentiate you in a crowded marketplace and build partnerships across generations

The impulse to keep things private is understandable. Privacy can protect the business and the family from outsiders. But if owners hold their cards *too* close to the vest, they risk starving the business of its ability to cultivate valuable relationships.

A business school professor we'll call Sophie married into a family with a fourth-generation media business in Asia. Concerned about what she saw as a casual attitude toward innovation, she began asking about the company's long-term strategy. The more questions she asked, the more information the executive team withheld, until it requested that her husband stop sharing financial reports with her for fear she would "rock the boat." Sophie became increasingly anxious about whether her children would inherit a business with any value. In the face of the stonewalling, she withdrew, even scheduling vacations elsewhere during the family's annual reunions. That deprived her children of opportunities to forge relationships with their cousins (and future co-owners), which could have a devastating impact on the business in the years to come.

> **Delaying or poorly planning a transition to the next generation can wreak havoc on the family and the business alike. You need a continuity plan.**

Early on in the life of your business, communication is likely to be informal, perhaps taking place over meals. As things progress, consider what meetings, policies, functions, or technological platforms could improve your dialogues. Start by aligning on what you will and won't disclose to each audience. In our experience, owners are often so worried about protecting details regarding their wealth that they fail to think through what they *can* share to help stakeholders feel connected to the business's long-term success. Such information might include your owner values and strategy, how decisions will be made, how you think about succession, and your passion for the business. If you decide to keep such information private, tell your stakeholders why.

We have seen cases in which the failure to communicate effectively was the single biggest reason for a family business's demise. We've also seen some in which skillful communication pulled the company through tough times. Wield the right to inform wisely.

How Will You Handle the Transition to the Next Generation?

The final right of owners is deciding how to exit. You can choose who will own the business next, what form that ownership will take (whether shares or a trust), and when the transition will occur. With this right come complex and difficult decisions. What will you do with the assets you worked so hard to build? How will you let go? What roles should members of the next generation play? How should you prepare them? Are the relationships among them strong enough that they can work through decisions together?

Delaying or poorly planning your transition can wreak havoc on the business and the family alike. A Boston Consulting Group study of more than 200 Indian family businesses found a 28-percentage-point difference in market capitalization growth between companies that had planned their transitions and those that had not. Family empires may be consolidated or squandered in the transfer of power across generations.

To execute a successful transition, you'll need a *continuity plan* that maps a path from the current generation of owners to the next. It should address three main challenges:

- *Passing down your assets.* Will you keep the same type of ownership (sole owner, partnership, and so on) or change it? Will you transfer ownership all at once or gradually (for example, by giving economic interests to the next generation while retaining voting control)? What tools, such as trusts and gifting, will you use to minimize taxes?

- *Handing off roles.* How will you create the glide path necessary for the current leaders to let go? How will you select successors across the four rooms in a way that feels fair and identifies the most-talented candidates? How will you ensure a smooth passing of the baton?
- *Developing next-generation capabilities.* What skills will each of the new owners need, whether they actively work in the business or not? How will you help them identify the roles for which they are best suited? How will you create opportunities for them to learn how to collaborate with one another?

Transition is a process, not an event—and the more the continuity plan resembles a discussion rather than an ultimatum, the greater the chances of success. The plan can't simply be dictated from one generation to the next; incoming leaders need to be prepared and aligned. To see what can happen when they're not, consider the Pritzker family, which built the business empire that includes Hyatt hotels. Jay Pritzker, the leader of the third generation, and his brother Robert gathered the family in 1995 and handed out a two-page document describing their succession plans. It detailed a complex web of trusts created to hold the family's assets, spelled out when members would receive distributions, and assigned leadership to a triumvirate. It was undoubtedly well-intentioned, but it didn't work. Just months after Jay's passing, in 1999, a series of lawsuits began. The family eventually decided to divide its holdings.

Oftentimes the biggest hurdle to continuity planning is getting started. When facing pressing concerns in the present, it can be tempting to put off cross-generational conversations that may be fraught with issues of mortality and identity. So put those conversations on your agenda (in your owners' room, with a designated continuity-planning task force, or through your board) and set some deadlines for them.

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We won't sugarcoat the bottom line: Without hard and smart work by the owners, other family members, and employees, family businesses often implode. Much energy is needed to keep the many competing interests from turning destructive.

There is no single way to survive, and there are few universal best practices. But by applying the five-rights framework, you can organize yourself for the work that family ownership requires. Ask the members of your business to individually assess your performance against each right. Then share the results and develop a plan that builds on your strengths and shores up your vulnerabilities. Only through such collaboration can you use the power of ownership to sustain your family business for generations to come.

A version of this article appeared in the January–February 2021 issue of *Harvard Business Review*.

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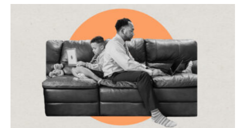

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