

What Makes Family Businesses Different

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Family Business Solutions

There is nothing as practical as a good theory!

This article provides an introduction to the principal theory which has stood the test of time and practice in the field of family businesses. The key concepts are presented with the perspective of the family business owner, manager or advisor in mind.

Introduction

This article challenges the traditional misperceptions about family businesses - that they are just small or medium sized, or owner-managed, that they are inefficient, badly run and therefore they can not be expected to endure.

People who applying these assumptions are denying a different reality. Nearly twenty years of academic research has shown that the world is full of family businesses of all shapes, sizes and governance structures. They generally outnumber proportionally non-family businesses (on average 70:30 in western economies) and they have been shown to out-perform their publicly-quoted counterparts in more than four countries so far. Most of all, they last longer than non-family firms, which is good news for the employees and their dependents, for the shareholders, for the economy and for society in general.

So we need to think again about family businesses. They are not “bad” (of course, some can be). It’s more meaningful to think about them, as being “different” - in form, structure, goals and actions. We need to find an alternative way to conceptualise this specific type of enterprise, one which will demonstrate the differences between family and non-family businesses, and help us to understand how these differences lead to different (not “bad”) behaviour. To do this, I will introduce a simple model which forces us to appreciate the complexity inherent within the family business system.

An ordinary family business?

We know of a (family) business in the public domain which contains many of the features to be expected in family business case stories: complicated family structures where reconstituted (step) families are involved, the politics of power when dealing with strong entrepreneurial personalities, and gender stereotyping.

The father built up this particular business and controls it through a combination of the family's shareholding, his management influence and his dominant personality. He has soon to decide which (if any) of the three children from his second marriage (he has recently

remarried for the third time) should succeed him, or if a professional manager from outside the family would be a better successor in the interests of the business. His daughter (the eldest) performs an increasingly significant role in the business but many have tipped the middle son as the successor. The youngest son works in the business but is generally thought to be too laid-back to succeed his father. The daughter by his first marriage has not featured in the speculation.

There are many others who have a keen interest in the matter, although probably not much influence over the outcome. These include other investors and employees, suppliers, customers, banks, governments and the father's/managing director's/owner's recently divorced spouse and new wife.

The economic significance of family businesses

The challenges faced by News International are not often portrayed as **family** business problems. The same point can be further illustrated by other well-known family dynasties such as Ferregamo, Forte, Liberty, The New York Times, Great Universal Stores etc.

The people who provide advice to family businesses can be hampered by an insistence on classifying them by reference to trading vehicle (sole trader, partnership or company) size, (small, medium sized enterprises or listed) economic activity, in fact, in any way other than by reference to what they really are; a business which is owned and controlled by a family. Since many of the challenges faced by family businesses stem from the fact of being a business family, this lack of recognition is a serious impediment to the planning that people in family businesses have to do to perpetuate the business over the generations.

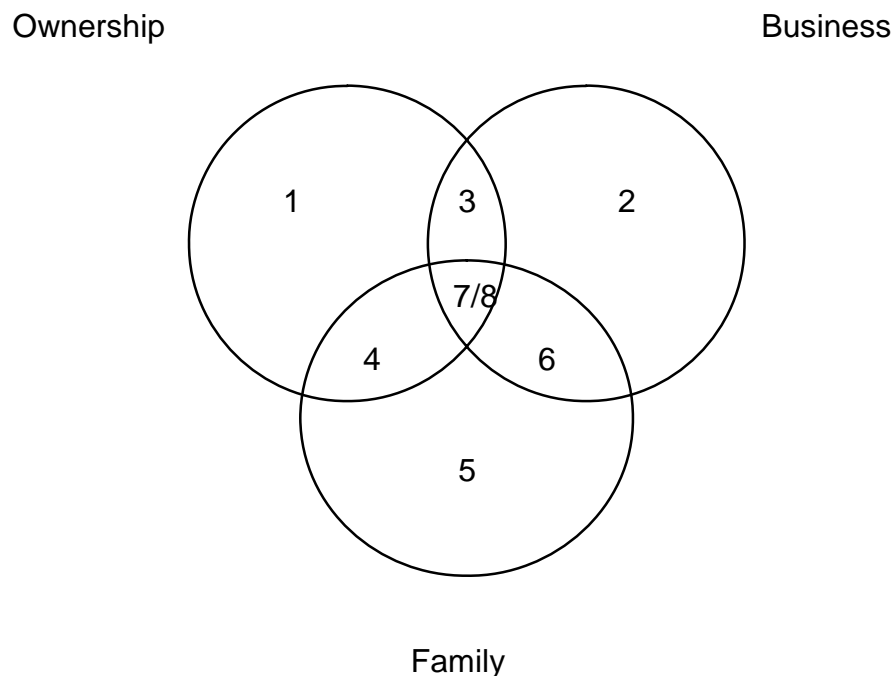
Three circles and eight segments in a family business system

The starting point is to identify the range of interests and concerns that can exist at any time and in any family business (regardless of size, organisation or type of business). In the early days of family business research and practice, family businesses were treated as dual systems comprising two subsystems: family and business. However, in their research at Harvard University in the early 1980s, Tagiuri and Davis [1] identified the importance of a third subsystem (ownership) which overlaps with the other two, but has a distinctly different purpose and agenda. Their "three circle model" helps to identify the range of self-interests inherent in family business systems by describing the family business as comprising three independent but overlapping subsystems; ownership, management and family [see figure 1 below]. Any individual in a family business can be placed in one of the eight segments in the model which can help to explain (and even predict) their motivations, fears and expectations. It also helps to explain why conflict is built into the structure of the family business: if everyone

sees the world differently and has different needs, conflict is inevitable [5] [see figure 2]. Owners, family and the business all naturally want different things and need access to resources the business generates to have meet their needs.

Figure 1

The three circle model



1. External investors

Those who own part of the business but who do not work in it and are not members of the family, (venture capitalists, banks and business angels) will be mainly concerned with return on their investment and they will expect business decisions to be clearly separated from family dynamics. However, surely this is expecting the impossible. Perhaps those in this segment should take a more active interest in family issues (including succession planning) than is often the case.

2. Management and employees

This group, who are neither owners nor family members, will have similar concerns to the external investors over the "threat" of nepotism. In addition they will be concerned about career prospects and job security. Many family businesses recognise the problems created by these uncertainties, including how to recruit and retain the best employees, but they still feel that sometimes family has to come first. Indeed if family strife occurs, the business can be overlooked and what appears to be irrational and emotional decision making can leave the business in crisis. Family businesses may then struggle to find and retain the right calibre of managers and directors required to sustain and grow the business.

3. Owner managers

Sometimes the response to the problem of recruiting and retaining key non-family employees is to give them shares or equity linked rewards. However these are usually small stakes and in private companies they are strictly controlled and not easy to realise. In addition the value of the investment is inevitably going to be affected by what happens elsewhere in the system.

4. Inactive or passive owners

The ownership of a family business that survives the first generation often passes from a controlling owner to family members who do not work in the business - the inactive owners. Their interests tend to be a mixture of the expectations of external investors tempered by a sense of family responsibilities.

The family stake in Sainsbury (which no longer has a family member on the board) is an example of this situation. No doubt the Sainsbury family members feel a considerable emotional attachment to the company, but given the company's recent performance, at what point will they want to realise some value from their investment? Their decision might be affected by whether family members view their shares primarily as a source of wealth or whether the inherited family values include a responsibility to pass these holdings to the next generation. (See the "family effect" in Francois de Visscher's article in this edition.)

5. Family

Every member of a business family has an investment "stake" in the family business, whether or not they are actively involved in ownership or employment. They all have "sweat" equity (the price of the family's sacrifice to keep the business going). They may be interested in the business for lifestyle reasons and because the business has an impact on the rest of the family such as the health and happiness of the present generation and the possibility of future career prospects for children.

With this in mind, why is it ever suggested that the first step in helping a family business is to leave the family out of it? The "let's deal with the business as a business" approach might work in some cases, but on most occasions the business family cannot be left out of the family business.

6. Family employees

Family who work in the business but do not own shares will be concerned with career development as much as the non-family employees in segment 2, but they might have

different expectations about the future. After all they could have grown up in the atmosphere of "one day my son/daughter all this will be yours".

One area of conflict in family businesses well illustrated by the model is between family employees in this segment and the inactive family owners in segment 4. The family employees' hard work and determination to grow the business might be tempered by the fact that their efforts will reap financial rewards for the inactive owners/relatives. Those in segment 6 might be expected to argue the case for profits being retained for reinvestment in the future growth of the business, whilst the inactive owners, who would not want to stifle growth, at the same time would expect to see a healthy dividend'

These feelings are sometimes caused by a blurring of the distinction between rewards for employment and return on investment. If arguments ensue about this issue, they may become personalised and attributed to personality, when in reality, those in each segment of the system are merely expressing their entitlement and rightful expectations.

7. The Working Family Owner

When you share ownership of the business with your relatives, and you also work in the business with some of them, you have all of the above interests. Not all will be at the forefront of your mind all the time – sometimes your dividend is the most important feature, and other times you may be more concerned with re-investment in the business, or family harmony.

8. The controlling owner

Someone who owns a business and who also occupies the senior role in management and the owning family will face many conflicting choices during their business and private life, especially when it comes to succession. Should dad or mum do what is best for the business even at the expense of family discord? Can the future of the business and everyone who has a stake in it be periled on decisions that are based on family sentiment or expediency? If the business is deemed to come first, what should be done about family owners who want to realise their wealth? Little wonder that the leaders in family businesses often feel lonely –it's not easy to carry all these interests and responsibilities on your shoulders, and to have to deal with the people in other parts of the system who complain when their needs and interests aren't being met.

The above can be summarised in the following table:-

Figure 2

Constituent segments in the family business system	
Position in the structure	Self interest associated with this role
1. Owner only	Return on investment; liquidity
2. Manager only	Security; appreciation of family culture (i.e. reward/nepotism); career goals; satisfied with family direction of firm
3. Owner and manager	Return on investment plus security and some autonomy
4. Owner and non-working family	As 1 plus being informed; rules on access to jobs; entry/exit rules for owners
5. Family only	Family life in balance with business; prospects for jobs, ownership, wealth
6. Non-owning family and manager	As 2 plus appreciation of rules for entry to ownership; career/succession prospects. Reinvestment of profits (not liquidity)
7. Owner, manager and family member 8. Owner, Leader and family member.	All of the above; how to manage the conflicting interests and keep focused Managing your self and the expectations of others .

Self-Interests of Constituents in the Family Enterprise System [6]

(adapted from Davis and Tagiuri, 1982; Ward, 1987, and Gersick et al, 1996).

Family Businesses are Different

No other type of business enterprise has this structural form. It explains the complexity that goes with having a family system, a business system and an ownership system linked together through wealth, legal structures, employment structures and emotional / relational bonds. At first appearance, such a mix may seem daunting and undesirable. However, we can learn from family businesses who have done extraordinarily well over many generations how these overlapping interests have been managed, and indeed put to their advantage.

The three circle model offers the following themes relevant to family business owners, leaders and advisors.

- Family businesses - whatever their size, organisational structure or type of business - represent *families in business*. Do not try to take the business family out of the family business; it cannot be done. Ignoring the family ultimately leads to them withdrawing their labour, commitment and capital – leading to disintegration.
- Realise that family, business and ownership conflicts can naturally be expected to occur between people who are unaware that they are in different parts of the system and that these problems are not necessarily rooted in personality clashes.
- Technical expertise is important when advising family businesses, but these types of clients are more demanding and expect their advisers to help them find solutions that achieve a balance between the business family and the family business. Telling them to leave the family out of it won't work in the long run.
- Create a governance structure that embraces and balances the interests of family, owners and business, eg:
 - A professional board: to deal with the interests of management and the interests of the owners.
 - An Owners' Group: to manage and articulate the interests of owners: are they united by a common wish to support the business and keep their capital invested in the business? This is the place for discussing and debating their views on their investment, their desired returns, and their wishes for future involvement of family in the ownership of the business.
 - A Family Council: the place to manage the business of the family (dealing with matters that affect the business): policies for family employment, ownership, education, career development etc. Family involvement is predicated upon the family having a common enough dream for the business, which should be articulated.

Useful References:

1 Tagiuri, R. and Davis, J. A., (1982). Bivalent attributes of the family firm. Family Business Review Vol. IX, No.2, pp.199-208.

2 Gersick, K. E., Davis, J. A., McCollom Hampton, M. and Lansberg, I., (1997). Generation to Generation: life-cycles of the family business. Mass: Harvard Business School Press. (Page 7).

3 Stoy Hayward. Staying the Course. Survival Characteristics of the Family Owned Business.
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4 Dunn, B. Success Themes in Scottish Family Enterprises: Philosophies and Practices Through The Generations. *Family Business Review*, 1995 VII (1)

5 Lansberg, I., (1999), Succeeding generations: realizing the dream of families in business
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