Bocconi on Management

Strategies for Longevity in Family Firms

A European Perspective

Guido Corbetta and Carlo Salvato

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Introduction: Strategies for Longevity in Family Firms

What is unique about strategy in family firms, and in European family firms in particular? If it is true that between 60% and 90% of all firms are family-controlled, as statistics in many countries suggest, the question should actually be reversed. We should be asking what is unique about strategy in *non*-family firms. Yet it is a well-known fact that strategic management developed both as a theory and as a management practice to address the specific needs of large publicly owned corporations, for two main reasons. First, these institutions are owned by a vast number of shareholders who are not directly involved in management. This means that sophisticated strategic theories and tools are needed to delegate and to control decision-making power. Second, these companies are managed by a category of professional executives who require sophisticated management practices to guide and to justify their behaviors to their more-or-less dispersed shareholders. In light of this, it is not surprising that strategy scholars and consultants have, over the years, devoted most of their attention to studying and advising large public companies and guiding their strategic behaviors.

However, family firms are different and manifest strategic needs that often diverge from those of public companies. A key differentiating factor, among those that we will explore in this book, is that the separation of ownership and management is far less pronounced in family than in non-family firms. Although, as we will see, different types of family firms show markedly different patterns in terms of shareholders' influence on strategic choices. But it is the impact of one or a small number of related families on a firm's decisions and behaviors that determines the highly specific strategies and requirements of family firms. As we will try to illustrate throughout this book, these differences are possibly even more pronounced in the European setting than elsewhere in the world.

In 2008, the European Commission, Enterprise and Industry Directorate-General compiled an "Overview of Family-Business Relevant Issues" in Europe (Austrian Institute of SME Research, 2008). This study was adopted as an authoritative starting point by the European Commission's Expert Group on Family Business in developing policy measures on European family firms (Family Business Group, 2009). The overview covered 33 European countries, highlighting some aspects identified by the Expert Group as specific to European family businesses or, more broadly, occurring more often in family than in non-family businesses. These aspects are summarized in Figure I.1, which provides a brief outline of the main reasons why strategy differs in family firms. Focus specifically lies on differences between European family firms and the stylized model of the North American public company that has inspired much strategy research and practice so far. A number of key features emerge that deserve attention here, although we will further expand on them in the chapters that follow, often providing a more nuanced and realistic perspective.

The key distinguishing feature of family firms, as highlighted by the European Commission Expert Group's overview, is the strong impact that the close family–business interaction has on strategy and governance. Indeed, in non-family firms focus is usually on the company as the entity determining key strategic choices, and on the interaction between dispersed owners and professional managers in determining how these choices are made. But in family firms, the family entity is center-stage in driving behaviors and outcomes.

The centrality of the family entity in strategic choices and behaviors is reflected by the dominance of family management and governance in family firms across Europe, as reported by the European Commission's overview (Austrian Institute of SME Research, 2008). Empirical evidence is quite consistent across European countries:

- In Austria, 75% of artisan enterprises have only one manager, and in 80% of companies with more than one manager all of them are members of the same family (Austrian Institute for SME Research, Economic Performance Database).
- In Cyprus, 77% of family businesses have exclusively family members as managers (Cyprus Chamber of Commerce and Industry, 2004).
- In Finland, over 60% of the board directors are family members. Almost 70% of the companies have a family member as the managing director and 80% have a family member as the chair of the board (Kansikas et al., 2007).

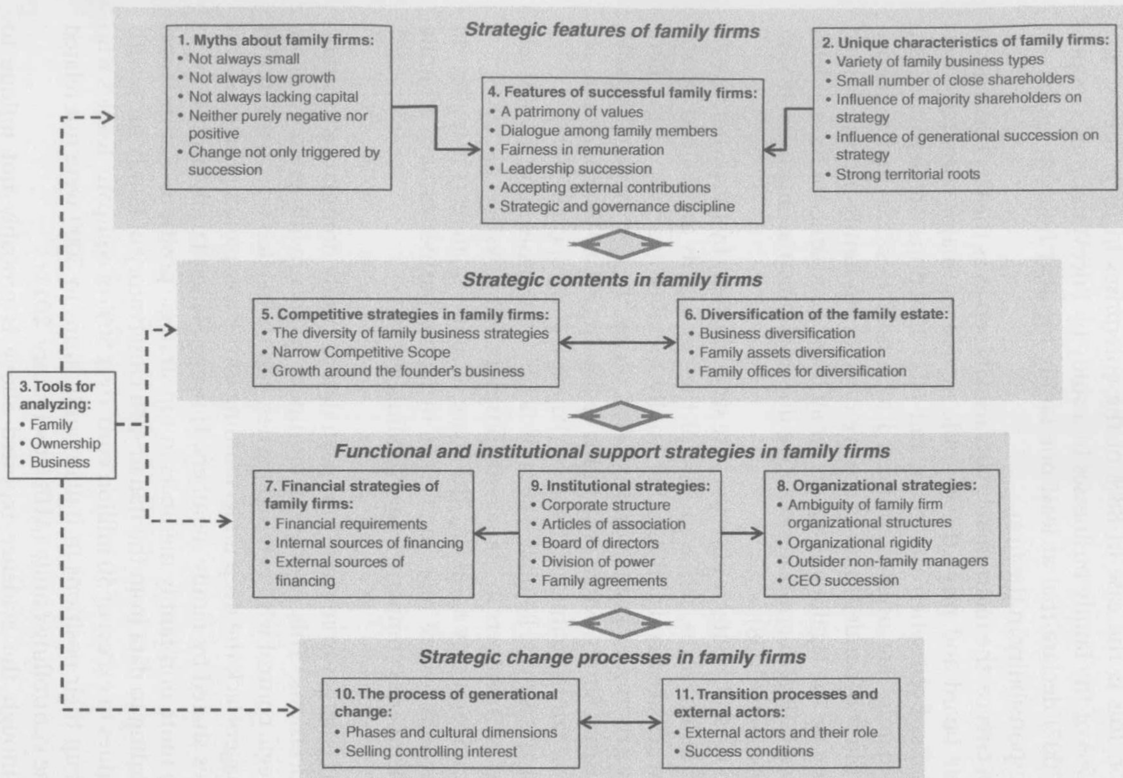

Figure I.1 Strategies for longevity in family firms: Structure of the book

- In France, 62% of the family businesses which are more than 20% family-controlled are managed by a family member (Allouche and Amann, 2002). According to the 2007 FBN International Monitor, this is the case in 88% of the enterprises in their survey, and 67% of the family businesses in a study by PriceWaterhouseCoopers (2007) declare that at least one family member holds management responsibility in the firm.
- In Greece, the main shareholder usually serves as the CEO or chair of the board and plays the key role in making major corporate decisions. Even when the chair and CEO functions are separate, the two roles are usually connected by family ties. External influence from independent non-executive directors in family firms is limited despite the legal requirement for all listed companies to have at least two independent non-executive directors (Austrian Institute of SME Research, 2008).
- In Poland, strategic objectives are set exclusively by the owner in 40% of family firms, while in 36% of the cases goals are defined by the owner after consulting other family members. In 16% of the family enterprises goal-setting is taken on by the owner together with his/her family, while only in the remaining 8% of the companies are non-family managers involved (Popczyk and Popczyk, 1999).
- In the Slovak Republic, 66% of family businesses have exclusively family members in managerial positions (Strážovská et al., 2008).
- Comparatively speaking, the share of family managers is highest in Sweden, where more than 90% of family businesses have a family member as company leader (Emling, 2000).

What emerges from these European data is family dominance in strategic decisions. This is often determined by an unwillingness to share strategic control with external parties, and the related fear that external managers lack the deep understanding of the company's principles and values shared by family members. However, larger family firms tend to have more non-family members in top strategic positions. For instance, according to data from the Italian AUB Observatory of family firms with revenues in excess of 50 million euro, over 50% of company leaders who took up their positions in Italian family firms in 2009 were not related to the controlling family (AUB Observatory, 2011).

Although the evidence reported above is probably not unique to European family firms, the controlling family entity has a central role in driving significant strategic dimensions of the business entity in Europe, as Figure I.1 suggests – that is strategic objectives and mindsets; strategic contents; and strategic processes:

- *Strategic objectives*. While the strategic behavior of non-family firms tends to be driven mainly by financial goals, family firms include in their choice set non-financial goals such as family satisfaction and sustainability of the business across the family's lifetime.
- *Strategic contents*. While strategic choices of non-family firms often tend to revolve around value creation and profit margins, the aim of preserving family reputation typically prompts family firms to include quality and long-term relationships with suppliers, customers and local communities as explicit contents of their strategic choices.
- *Strategic processes*. These tend to differ across the continuum of business types between the two extremes of family and non-family firms. The strategic processes of non-family firms tend to be driven by formal management and governance mechanisms, contractual arm's-length agreements, and rational agency-control mechanisms. In contrast, family firms are often motivated by trust-based mechanisms, cohesion, and a value-driven business orientation made possible by higher levels of goal alignment between owners and managers.

Following this logic, in the following chapters we will explore how the centrality of the controlling family entity determines the *strategic features of a family firm* (Chapters 1, 2, and 4), choice of *strategic contents* (Chapters 5 and 6), *functional and institutional strategies* supporting the family business system (Chapters 7, 8, and 9), and *strategic change processes* aimed at adapting family business strategies over time (Chapters 10 and 11). Chapter 3 will outline some *conceptual and analytical tools* allowing managers and consultants to assess the family, ownership, and business features of family firms relevant to their strategies.

Chapters 1, 2, and 4 will provide an overview of the key features of family firms that are relevant to understanding their strategic orientations, behaviors, and performances. First, in Chapter 1 we will try to redress a number of myths and erroneous assumptions about family firms: the erroneous, yet widespread assumption that all family firms are and will always be small; the erroneous assumption that they lack financial capital due to a pathological unwillingness of the controlling family to open up ownership control to external shareholders; the erroneous assumption that family firms undergo significant change only as a result of generational transitions; and more generally, the wholly negative – or wholly positive – biases held by outright detractors and supporters, respectively. Next, in Chapter 2 we will highlight some of the unique features of family firms, which provide an essential framework for understanding the specificities of their strategic processes and outcomes. For example, we will explore the variety of family business types, which suggests we should avoid considering family firms as a monolithic entity, while recognizing the significant differences in strategic behaviors across different types of family firms. Other features we will discuss include the relatively small number of closely-related (Table I.1) shareholders, compared to public companies; the influence of majority shareholders and generational succession on strategy; and the strong territorial roots of family firms. Finally, in Chapter 4 we will try to isolate those specificities of family firms that are recurrently indicated by scholars, consultants, and financial institutions as features of successful family firms. Based on our own reflections, we will highlight a number of success factors. These include the availability of a set of values transferred across generations; effective dialogue among family members; fairness in remuneration of both family and non-family employees; effective leadership-succession practices; the willingness to accept external contributions, when needed; and a strong and widespread discipline in strategic and governance choices and behaviors. All these specific features of family firms and their strategies can only be assessed through a set of approaches and analytical tools that will be presented in Chapter 3.

Chapters 5 and 6 will offer a description of the typical contents of strategic choices made by family firms. Here we will focus our attention on the usually narrow scope of family firms' competitive strategies, and their tendency to grow around the core business established by the founder (Chapter 5). We will also discuss the typical diversification patterns in terms of both family wealth and assets, as well as controlled businesses, pointing out the growing role of Family Offices in organizing these choices (Chapter 6).

In Chapters 7, 8, and 9 we will look at the functional-level and institutional strategies that are essential to support competitive and corporate strategies. Here we will illustrate the typical patterns of financial requirements and related sources of capital available to family firms (Chapter 7), the most common rigidities of family firms' organizational structures, and tools that allow making them more flexible (Chapter 8). Finally, we will look at the family and business governance models

Table I.1 Main differences between average family firm and non-family firm rationales in Europe

	Family firms	Non-family firms
Focal entity	The controlling Family	Owners/Managers
Governance focus	The Company and the controlling Family	The Company
Main objectives	Both financial (profitability) and non-financial (sustainability, stability, family satisfaction)	Financial (profitability)
Mindset orientation	Transfer across generations, sustainability across the lifetime of the family	Value creation or business exit
Competitive strategy orientation	Quality, reputation, long-term relationships	Pricing and margin
Key assets	Financial, knowledge, social, cultural	Financial, knowledge
Company climate	"Familiness", trust, unity, involvement, commitment, engagement, enthusiasm, informality	Business goal orientation, formality, contractual agreement, distance
Main business orientation	Satisfaction of internal and external stakeholders (mainly family, clients, employees, local community)	Satisfaction of owners/shareholders
Management style	Value-driven, emotional goal alignment	Facts-driven, rational, agency control mechanisms
Allocation of profits	Focus on reinvestment	Focus on distribution

Note: "Family" and "Non-family" firms are the two extremes on a continuum in which actual firms usually fall.
Source: Adapted from Austrian Institute of SME Research (2008, p. 70).

and tools allowing family firms to manage and harmonize the various sources of decision-making power and to deal with conflict effectively.

Chapters 10 and 11 will offer an overview of the key change mechanisms that enable family firms to adapt their strategic profile to the dynamism of the industrial and social environments in which they operate. These mechanisms relate to both the transfer of power across generations of the controlling family (Chapter 10), and the possible gradual inclusion of different categories of external managerial and financial actors. In coupling family and non-family resources, the aim is to match, or even anticipate, environmental dynamism.

Overall, the strategic concepts and tools illustrated in this book provide a framework for devising and implementing strategies favoring longevity of family-controlled business entities. We will illustrate our arguments with examples drawn from our direct knowledge of representative Italian and European family firms. Yet we are well aware that the essential traits of this fascinating form of enterprise are shared by family firms worldwide.