Family business and public companies: what can each learn from the other ?

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Large public companies and medium-to-large family businesses (FBs) are two different forms of ownership and governance, both having strengths and weaknesses. Research over the last 20 years has demonstrated that neither of the two is clearly superior. Therefore, FBs and public companies can learn from each other how to overcome some of their specific limits.

What can large public companies learn from FBs? I see 3 main points.

1. The positive value of a close dialectic between owners and professional managers. As we know from agency theory, professional managers are often more propense to act in their own interest, than to fulfill the objectives of the owners who have appointed them. FBs show that a closer relationship between shareholders and professional managers is possible. Such relationship often results in a rich mutual exchange of partially divergent opinions on which solid and carefully thought-over strategies are based.

2. The positive value of long term commitment. In successful FBs, the owners and management often have a longer term managerial orientation than non-family firms, and "patient capital". Both could be very useful to public companies. Patient capital allows investments in strategic initiatives that have relatively lower, but more stable and durable results. Long-term managerial orientation typically results in longer tenures of both family and non-family managers and directors. As results of the AUB Observatory clearly show,[1] managers' best performances tend to emerge after the first 3-4 years of tenure. This tendency is corroborated by examples of large public firms such as IBM (Lou Gerstner, 9 years tenure – Sam Palmisano, since 2002) or General Electrics (Jack Welch, 20 years) whose fortunes where turned around by long-tenured Chairmen and CEOs.

3. A culture of "shared value". Public companies can learn a culture of "shared value" from FBs. This culture translates into policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which they operate. The long-lasting, intimate relationships most FBs have with their key commercial and industrial partners,

[1] The AUB Observatory, promoted by AIdAF (Italian Association of Family Firms), UniCredit Group and AIdAF-Alberto Falck Chair of Strategic Management in Family Businesses (Bocconi University), aims to represent the most comprehensive review of structures, dynamics and performance of all Italian firms with over 50 million Euro of revenues.

stakeholders and local communities signal their superior ability to “share value”. These relationships include FBs’ ability to build a “community” involving employees in developing a special “clan culture” that can be very powerful. The experiences of successful FBs can hence be useful to public companies that want to overcome a narrow view of value missing the most important customer needs and ignoring the broader influences that determine their long-term success.

What can FBs learn from public companies? We may focus on 6 points.

1. A culture of accountability. Public companies are typically driven by fact-based cultures. What matters is results and outcomes, rather than intentions. Sometimes there may be good intentions behind bad results. Nevertheless, what really matters are not only the intentions but also the practical consequences of behaviours and choices. This is particularly relevant to FBs, where family members will sometimes justify their actions by saying they were based on good intentions. In large public companies it is easier and more common to use evaluation systems centered on achievements, rather than on good intentions alone. Related to this, and with several exceptions in both directions, public companies tend to be more disciplined than FBs in transparently reporting their financial results to their key stakeholders (investors, financial institutions, tax authorities etc.). Disciplined and transparent accounting is essential to the ability of any firm to systematically access resources and, hence, to its long-term success and survival.

2. Ambitious strategies. Why do we often see that the first generation of a FB builds, the second maintains and the third is not so successful ? Our research suggests that mistakes in succession processes can explain only one third of the failure cases. The most important issue is that after having achieved success in the first generation, FBs are often more inclined than NFBs to pursue sub-optimal, non ambitious strategies. They do not perform to their ability. Within a few years, these companies become weak competitors. An impressive background is hence no guarantee of a bright future. To survive in history, each generation must be able to renew its activity and to adapt it to changing markets and times. Public companies, with their emphasis on shorter-term results, are forced to renovate their strategies.

The challenge of ambitious strategies is also connected with the issue of control. If a family is obsessed with keeping 100% ownership control, it can become more difficult to define and to realize challenging strategies, which often require substantial additional resources -both financial and entrepreneurial- to be implemented. The issue of control (majority control, in particular) is obviously less important in public companies.

3. Professional and disciplined governance. This means:

- maintaining a clear distinction between the roles of owners, directors and managers. Failing to understand that these roles differ in content, that they require specific

structures, practices and professional skills and that they are transmitted according to different rules can create the premises for serious managerial mistakes

- opening the Board of Directors to the contribution of heterogeneous competencies. This objective is not always easy: for example, in 2009 the boards of directors of 40% of medium and large Italian FBs were composed of family directors only. The contribution of non family directors is important because they can add knowledge, relationships and access to resources. Non-family directors may also play an important role in mitigating the emotions and conflicts that are typical of the decision making process in family firms

- designing and implementing committees that include non family members, devoted to some topic issues such as management compensation, recruitment and promotions, which in FBs often create deep tensions inside the controlling family

4. Meritocracy in management. I see two issues related to meritocracy.

4.1. Meritocracy inside the family: companies must be owned and managed by competent individuals. If family members are not competent, it is fair -both for them, and for the company- to look for alternatives. Without a merit-based culture, nepotism will prevail, starting a vicious circle with many negative consequences.

4.2. Meritocracy among managers: the issue is relevant when managers with proven external expertise are hired from outside the company (the “outsiders”). Outsiders bring in the company skills that non-family managers trained within the firm (the “insiders”) often do not possess. The presence of “insiders” who have contributed to the firm’s success in the past may hinder the process of professionalization of management. This is because they may worry about losing their power as a result of the entry of “talented outsiders”. Thus, the “insiders” are most likely, through their established fiduciary relationship with one or more members of the family, to activate defense mechanisms. Successful family firms will build management teams made up of a mix of talented family managers, non-family inside managers and non-family outside managers.

5. Clarity in organization. Sometimes in FBs there might be ambiguous leadership structures that require a careful assessment. One example. The AUB Observatory provides important evidence about collegial leadership in FBs: more than one third of these firms is led by a collegial leadership model. This model does not seem to guarantee better performance: between 2000 and 2009, FBs managed through collegial leadership showed a lower ROE than that of FBs managed through individual leadership models. This is particularly true when co-leaders are members of the controlling family, and when there is no clear separation between the respective areas of influence. As John Elkann recently wrote: "By clarity I mean that there must be a clearly defined chain of command, in the sense that business governance must be straightforward, with clearly identified roles and responsibilities".

6. Younger leaders. In italian FBs 45% of the leaders are older than 60 and 19% are older than 70. Older leaders seem to have a negative impact on performance, mostly denoting a “resistance” to growth which is natural for executives close to retirement. The presence of “experienced” leaders at the head of a firm is a trend that should be carefully monitored in all kind of firms, but particularly in FBs, in which average ages and tenures of leaders tend to be longer than in other firms due to the overlap of roles between ownership and leadership members, as well as difficulties related to “generational transition”. In public companies it is obviously easier to manage succession processes because a leader is usually not also an important owner. FBs can learn how to plan a succession process in advance from these companies by developing the right cooperation between the experience of the older leader and the energy of the younger one.