

The Quest for Longevity: What Can We Learn From Family Businesses About Long-Term Survival?

Being a multi-gen family business is no easy task. The “death rate” (either through merger, sale or other means) is so high that this may mean that there are no general rules for survival, only exceptions. The principle of Survivorship Bias also applies—is multi-gen survival in the family business context just a random phenomenon or the result of the adoption of best practices?

Before a company founder or leader sets out to seek “longevity”, someone needs to question whether being “perpetual” or multi-gen is an appropriate goal at all? ...what will be achieved from perpetual existence? Is this just about the current leader? Is it right for the family? Businesses come and go... fast growing businesses and large businesses become increasingly complex and, therefore, have increased risks of failure. Is what you are seeking realistic, sensible, shared? Is there a purpose to it?

Students of family business know that best practices among successful family business are highly differentiated. What works for one family may be an anathema to another. Yet, the collective best practices do form a mosaic from which some key strategies and themes can be discerned. It is certainly the case that implementing as many of these as is possible increases the odds of success. Here are ten best practices that should be considered.

1. Have a good business. All businesses need to grow to stay healthy, but family businesses have another reason to grow—they must grow faster than the family that owns them or what constitutes “family” needs to be re-visited. A slow, but steadily growing business in a defensible niche may be just the ticket. Family businesses tend to avoid cyclical industries and the use of leverage. Profitability needs to be sufficient to enable stakeholders to achieve financial independence outside of the business.

2. Have a purpose or reason for existence other than longevity itself. Family businesses that thrive over generations have a purpose that motivates all participants to work together for a common goal. Making more money is not a purpose. For families, legacy is often a driving force. Stewardship of this legacy is of the utmost importance.

3. For family businesses, family harmony is extremely important. Long-lived companies need harmony or a shared culture among ALL stakeholders, including spouses and the families of key constituents. If family members are unhappy, it can become contagious and destructive!

4. You need a mechanism to perpetuate ownership and control. Families benefit from having a built-in ownership succession plan which is simply the next generation of the family. This makes the quality of the “family DNA” a very important prerequisite of success. Timing is also very important. You need the next generation to be ready to take charge when the opportunity presents itself. Sometimes, the timing is far from optimal.

Non-family businesses must find a way to perpetuate ownership for the future—either through sale to

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management or other employees or donating stock to a non-profit entity or some combination of the foregoing. Someone who shares your vision must always own and control your business—not easy, but examples such as ESOP and other employee-owned firms exist. For firms that can go public, the two class (voting and non-voting) stock structure can be a means for the family to maintain control and have access to a permanent equity base of ownership.

There is a significant cost implicit in doing what is necessary to perpetuate control over long periods of time. Share transfer prices need to reflect appropriate discounts for illiquidity and minority status—a proxy for this is often a formula based on book value (not fair market value of the enterprise). Similarly, share payment terms need to be established in advance so funding the purchase of shares does not impair the financial condition or resources of the company.

In most multi-gen family businesses, shares typically pass by inheritance and are seldom, if ever, “purchased” by the succeeding generation. This a significant structural advantage, from a financial perspective, for a family business seeking longevity.

5. Know what the deal is. Is it a good idea not to sell or go public? Do family members have a preferred status in respect of employment opportunities or compensation? Stakeholders need to know what they are foregoing and why before they join the business. Revisit and analyze these issues on an annual basis. Make the stakeholders commit in writing to the plan and their expectations regarding what it means to be an owner.

6. You must plan for the predictable life cycles of business AND ownership. There will always be ownership and management succession issues—you must plan for them well in advance and have processes in place to address them. This also means you need to have contingency plans to address the unexpected loss of key personnel.

7. Strong governance is essential. This is a process, not just an occasion. There must be a Board of Directors and it must function! Having respected independent directors or advisors with relevant industry and leadership expertise often is very helpful. Having a compensation committee with outside experts on it can also head off disputes on this sensitive subject among family members. Good governance assuring alignment of interests of stakeholders and managers is essential.

8. A liquidity mechanism must exist for non-believers. No family can keep all of its members happy all of the time. A way to buy out family members on an acceptable basis (note: I did not say fair basis!) is almost always necessary. Likewise, family situations change and a structure that prevents exercise of free will is doomed to fail. An escape mechanism that is available, though never used, may be the key to maintaining solidarity.

9. Embrace “meritocracy” at all levels. This is particularly hard for a family business. You must have first rate HR processes. Emphasis on cultural “fit” is extremely important. You also need rigorous compensation and employee performance evaluation rules. For family businesses, the rules governing family hires need to be spelled out in advance and followed. Predictability and fairness are essential.

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10. Good Hygiene (and we don't mean in the personal sense). This means that ALL of the equity ownership is controlled by a single person or an entity that has a very long life. AND there are no forced sales of equity to fund estate tax liabilities or other third-party liabilities, such as a divorce. For family businesses, this is a sine qua non of multi-gen survival! Fight procrastination and get this done!

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