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Life Cycle Trends Pose Challenges to Family Business Sustainability

Sustaining a family business over multiple generations has never been easy and several mega-trends are making it even harder.

First, there is the well documented decline in corporate life expectancy generally. A recent study by Fidelity Investments found that in the last 20 years, the expected life of public companies has declined from 25 years on average to less than 12 years. Private companies have a much higher mortality rate. Corporate "death" takes the form of business failure, M & A and other causes. The rising cost and the increased complexity of doing business as a result of globalization, technology and communication advances are all reasons for the increasing mortality rate.

Second, there are the demographic trends so well documented recently by the NIH's National Institute of Aging—the life expectancy of a 60 year old male is now 23 years. In 1960, a 60 year old male could expect to live 9 more years. Today a healthy male or female in their 60s has a good chance to live to 100 or more. For a multi-generational family business, this dramatic change in expected mortality has far-reaching implications. Not long ago, a family business involved two generations at most. It is now common to have three generations actively involved in the business. The fourth generation often exists or is right around the corner.

These trends—declining corporate life expectancy and the increase in human longevity—exacerbate the core dilemma of every family business: that is, how to match family growth with the growth of the business. If the family grows faster than the business, either the business gets sold or what constitutes "the family" must be redefined (i.e., shrinks). This has always been a major source of family business dysfunctionality since the typical family grows geometrically and businesses, unless exceptional, grow in line with GDP growth. This mismatch in growth rates has the potential to generate a lot of friction between the family and the business.

The Need for Growth

The need for faster business growth is particularly acute for businesses in the process of transitioning from sibling to cousin leadership and beyond. Given the boom in family business formation post WW II, this is a large subset of the current family business population. Many of these firms now find themselves at the juncture at which family business survival is most challenging.

Faster growth is the best answer to the challenges created by these two mega-trends. Family businesses looking for growth need actively to consider product line extensions, acquisitions of new businesses, innovation and more investment in research and development. All these growth strategies require more capital and greater focus on capital allocation. Pursuit of more growth increases the risk profile of the business and may cause some discomfort, but the alternative is not a viable option. The stakeholders need to buy into this.

Access to the private equity market is another alternative that more family businesses embrace today in their pursuit of greater growth. The private equity market now has many participants who are actively looking for family business growth equity opportunities. This can take the form of a direct infusion of growth capital to the core business or by the formation of a partnership with a private equity fund to acquire additional assets. It can also take the form of the family getting into the private equity business on its own and building its own portfolio of independent businesses. This requires the human capital to manage such a process and a funding mechanism for the additional required investment.

In addition to the focus on growth, the survivors of tomorrow have developed complementary best practices to address the threats posed by these mega-trends. Three in particular deserve special mention—they relate to the human resources function, succession transitions (management and control) and governance.

Human Resources

Investment in human capital is a key attribute of the survivors. This means greater and more specialized education for family members before they join the business. It also means better mentoring and evaluation of key employees once they are in the business. The human resources function—in name or practice—must now be a significant component of the leadership team. More family means more complexity and the need for more process and consistency in the hiring, training and performance evaluation of everyone in the business.

A more intentional management of the retirement of the older generations and faster incorporation of the younger generations into decision making roles is also necessary. Given the changing skill sets and technical expertise required today for business success, it is imperative to involve the younger generations sooner. If the family doesn't have the necessary talent, more outside professionals need to be brought on board.

Those responsible for the human resources function must also place increased emphasis on what is now referred to as "cultural fit"—this is the determination of how a particular job candidate will mesh with the family members and their values. This is a critical consideration when going outside the family to fill key positions. New hire interviewing and testing processes need to be more deliberate and comprehensive so the risks of hiring missteps are minimized. Most firms require that new family member hires be vetted in a similar fashion.

Succession Planning

Transitions in leadership and voting control of the business are always important but now need to be more actively managed as well. Not long ago, only one generational leadership and ownership transfer had to be effected within one's lifetime. Now, family members may need to take part in two such transfers. Succession choices in family businesses must be made and are never easy—getting the process right the first time will ease the burden on those involved in such choices as they need to be made in the future.

Major wealth transfer decisions and the actions required to implement them are always easy to defer to another time. But the traditional "I die, you inherit" approach definitely doesn't work in this new environment—you can't wait until you are in your 80s to pass on the control of the business to the next generation—at that point the "kids" are already in their 50s and 60s and they need to be thinking about turning over the business to the next generation coming along! The new demographic realities mandate a new approach to the timing and method of transferring control of the business.

Governance

As the complexity of running the family business increases, it is easy to understand why the maintenance of family harmony becomes more important. It is essential for everyone in the family—not just the direct equity owners—to be on the same page in terms of shared values, objectives and long term perspective. In this context, the family now includes the cousins who are coming along in the third generation and beyond. Family harmony among all the stakeholders in the family business needs to be a priority.

This is why today there is so much more emphasis on governance mechanisms such as mission statements, family constitutions and formal decision making and communication forums, such as the family meeting, family assembly and family council. Decisions about what is best for the family and the business need to be addressed independently and resolved in an organized and deliberate way. Conflicts need to be identified and reconciled. Conversations about sustainability and stewardship are imperative.

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The competitive advantage of family businesses is their resilience and adaptability in the face of challenge. These two life cycle mega trends—the acceleration of corporate mortality and the demographics of aging—need to be addressed by every family businesses today. Whether by instinct or design, family businesses will benefit by incorporating some of the approaches described above to meet these challenges.

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