Corporate Governance

Family Business: To be or not to be?

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For centuries, family-owned companies have been the backbone of the global economy, which suggests the appropriateness of this form of business organization. Even with the advent of corporations, their ability to adapt has allowed them to retain influence. Today, successful family-owned corporations such as the Italian Exor Holding or the French LVMH choose management structures that are most adapted to the characteristics of the family business and the scale of their activities.

It is not uncommon for entrepreneurs to reach a point where they face a choice whether to pass on their business to the next generation. Some respond positively to this question and proudly add the "family firm" label next to their logo and send children to learn how to manage a family business. Others deliberately avoid turning their ventures into family firms and hire outsider executives or put up their companies for sale. Both have strong arguments in favor of their choices. Let's see how exactly "family" influences business development?

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On the one hand, "nepotism" implies a close overlap between business, family and property. In addition to providing financial income, family owners care about the so-called socio-emotional benefits, which include the development and transfer of business to future generations, maintaining the reputation of the family and dynasty. It is the intangible component that creates an advantage for family companies over their "non-family" counterparts. This advantage is especially pronounced in the context of a crisis or, when it comes to long-term results.

Usually, family wealth is closely linked to the success of the company. Low diversification of income sources encourages owners of family-owned companies to actively participate in the management of their business. Often, family members hold key positions on the board of directors and are part of the top management team. Business problems for them do not end in the office, but continue to be discussed at the dinner table or during family events if the company is owned by several generations or family branches. Each generation that follows the founder grows up in the atmosphere of business, and as a result has a deeper perception and an intimate knowledge of the firm, its environment and strategy compared to managers who do not have family ties with the business. Such awareness of family members in business issues, and their ability to influence decision-making, together help family companies make better decisions, as well as minimize the agency conflict between family owners and managers.

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On the other hand, it is no secret that it is not always possible to achieve balance between the needs of the family and ones of the business. The emotional component that contributes to the benevalence of family owners in relation to their company in making strategically important decisions is a double-edged sword. The desire to preserve and increase family well-being may sometimes conflict with the interests of the company and investors who do not have family ties.

Studies have shown that family-owned companies follow a less risky strategy, significantly limiting their upside potential. The desire to maintain control over the company in the hands of the family prevents leveraging the firm with equity capital, which is becoming increasingly important for a rapid scale up. The privileges granted to family members to advance swiftly to executive positions significantly limit the talent pool of potential candidates. Numerous studies show that each successive generation of owners after the founder is followed by a reduction of firm performance.

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Awareness of the shortcomings and risks associated with running a family business and the ability to reduce them will help their owners rip off the maximum benefits inherent in the concept of “familiness”. But not everything depends on the actions of the owners. The existence of functioning private property institutions is also important for the resilience and continuity of a family business.