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The evolution of the family business model

Success is largely due to the “family” aspect

A recent Credit Suisse survey of 280 companies across 33 countries found that family businesses have been doing well in the current market environment. Close to 60% reported revenue growth of 5% or more in the prior year and the Credit Suisse Family Business Index has outperformed the market over the last five years by 8%. Looking behind the numbers, it's clear that this success is largely due to the “family” aspect, and that the model has been good for family members and investors.

A successful family business is one that works harmoniously through the four stages of its evolution: entrepreneurship, growth, governance, and maturity. Each stage has challenges and differentiating factors inevitably determining the long-term viability of the business, and it is helpful for entrepreneurs to understand the macro and structural issues at play.

The first stage, entrepreneurship, is when the family aspect first provides an advantage over non-family companies. In getting established the family is often the chief provider of labor and therefore more devoted to the company's success. During this stage some firms may also finance through the family, better aligning costs and benefits.

In the growth stage the company focuses on increasing its market share, bringing new and innovative products to market, expanding into other regions or geographies, increasing capacity, and attracting additional financing. Family businesses are commonly viewed as being risk averse but the Credit Suisse data indicate otherwise. All survey respondents have expansion plans, with small family businesses focusing on increasing capacity while larger ones are expanding into new countries and industries.

Family dynamics can play a large role in governance. Public firms may face agency costs if the interests of owners and managers are not properly aligned but the costs can be avoided in family firms where the owner-manager has more at stake. However that doesn't mean family businesses are immune to governance issues. They might result from things like favoritism towards other family members or failure to deal with discipline, but the company should have mechanisms in place to deal with such possibilities.

Succession is the final hurdle in the family business life cycle and it is when family relationships can be a problem. It is particularly challenging in the transition from first to second generations, when sibling disputes can override good sense. Unfortunately succession planning is often overlooked. A TD Waterhouse Business Succession poll found that 76% of our small business owners don't have succession plans. They are just too busy running their companies,

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with 45% still trying to determine what the plan would be. The other 31% just haven't got to it.

The Credit Suisse survey found that a poorly executed succession can lead to poor performance and possibly even cause a split within the family. This is when hiring management from outside can bring important benefits. Credit Suisse found that, of the family firms who chose outside help and wished to "bind" non-family executives to the business, 75% offered greater levels of involvement and shared decision-making, with 39% claiming they treated these non-family executives on a par with family members. A third offered above standard compensation.

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