Family businesses fail because of no succession planning: INSEAD professor Morten Bennedsen

When Morten Bennedsen and Joseph P.H. Fan - professors at INSEAD and Chinese University of Hong Kong respectively -- started comparing notes on family firms in Europe and Asia, they realised that companies across these continents faced startlingly similar challenges. A common theme that stood out was that most family firms lost a significant amount of wealth over the course of a transition or succession. That was the starting point of The Family Business Map, a book which aims to provide a roadmap for family firms to work through generational shifts.

"There are two key things that define family firms that have lasted through several generations," says Bennedsen, Academic Director of INSEAD's Wendel International Centre for Family Enterprise. "They looked at the long term and planned for succession. These sound simple but so many family firms fail to do either." In Asia especially, it's not uncommon to find tycoons actively running their business well into their 80s, with 'succession' only taking place when the person actually dies.

While there are a number of businesses in Europe that have been around for over 200 years, the oldest documented family business in the world is the Hoshi Ryokan in Japan which has been managed by the Hoshi family for almost 1,300 years — or 46 generations. The need to understand what sets successful family firms apart from the not so successful ones becomes important when one considers that family firms make up two-thirds of all businesses in the world today contributing anywhere between 70-90% of global GDP. However, only 13% of family businesses survive to the third generation and 4% to the fourth. A study of family firms done across Taiwan, Hong Kong and Singapore over a ten year period found that businesses lost almost half their value or wealth as they underwent a transition.

One major cause is the lack of communication between generations. While the leader may have a clear vision for the business in his head, he often fails to communicate it to the rest of the employees, or even other family members. "Understanding expectations from both generations is important, but also a big challenge. In Asia especially, we see that it is particularly difficult for the generations to communicate. The children are well educated - often abroad- and they come back with a different set of ideas and we see a clash of cultures," says Bennedsen. They are often just told what they need to do and there is no clear career path so they start exploring options outside the firm.

The other challenge is for the second generation to be able to create value in the firm. The older generation has their strengths and family assets (like reputation and business and political networks) which the next generation should be able to tap into. Some of these assets can help the business deal with broader changes in industry which could otherwise threaten business.

Bennedsen admits that it can be very difficult for a family firm to remain competitive during a transition. "One reason is because tycoons continue to lead their business in their 80s and 90s and they never retire because they never plan. My advice is to be transparent on procedures. If you want proper governance with family management, write down the roles and functions of family and non-family members etc," says Bennedsen. He finds the younger generation of Indian family firms grappling with two issues. One, should they join the family business at all? Two, how do they communicate with the older generation?

On the other end of the spectrum are entrepreneurs who believe that next generation can learn all they need to, on the job. "Many entrepreneurs have little respect for formal education and external work experience. That's not how modern business works. Successful firms have heirs who have better educational qualifications and have worked outside, maybe even been boss elsewhere," he says. The quality of heirs plays an important role in determining whether the firm survives long enough.

While there are certain similarities between the East and West in terms of importance of networks and dealing with similar conflicts, there are some stark differences too. Family means more in the East and this impacts the business and cultural environments in which they operate. Often, the wife or mother plays a crucial role in negotiations between family members. "In environments that are high in corruption and low in structure, family trust becomes very important," says Bennedsen. While working in Africa, he noticed that because the degree of trust in outsiders was so low, companies often had a family member deputed in every new country they entered.

Bennedsen proposes a three pronged process to ensure that family firms get the long term planning process right. The first step is to identify the family assets, strengths, challenges and roadblocks, as this forms the base on which both succession and business planning will happen. Next, the leader needs to set long term goals or map the future, including whether it makes sense to remain in the business or to exit or go public. The last aspect is working towards making this happen, which Bennedsen compares to cultivating the tree. This is what you do every day over many years to ensure that your long term vision becomes a reality.