Innovation and family firms do go together

The best way family-run enterprises can safeguard their assets from turning into liabilities is to institutionalise innovation. BY MORTEN BENNEDSEN

THE words "family firms" and "innovation" seem to be at odds. Family firms smack of tight control, risk aversion, lengthy CEO tenure, existing in traditional industries and products. Some research has even gone as far as to say that family ownership harms innovation for these very reasons. Others say it benefits innovation. But both arguments miss a fundamental variable that determines the innovative edge of a family firm: its "family assets".

Family assets can be defined as value-creating resources, such as name, reputation, legacy, networks and cultural and family values. As Nicolai Foss, professor of strategic management at Copenhagen Business School, and I point out in our paper, *Family Assets and Liabilities in the Innovation Process*, such assets are capable of attracting employees, boosting motivation, increasing stakeholder loyalty and building valuable networks.

This is why I argue that family firms have an edge when it comes to innovation. Resources such as "family values" cannot be controlled by non-family firms. They are also able to command loyalty from suppliers less likely to drive hard bargains because of long-term relationships. Their ability to base business and innovation strategies on these kinds of resources is what makes them different.

What makes them innovative?

First, and particularly useful in an innovation context, is network advantages. Family networks tend to have an edge over non-family firm networks as they are able to combine their values and reputation with their contacts. Family firms have a lot more at stake and honest dealing for the long-term defines key relationships.

A concerted effort to put family members into relevant circles also helps. Family members of German technology company, Heraeus, for example, have a long family tradition of acquiring doctoral degrees and holding high-level research positions in chemistry and physics, which gives the firm privileged access to the latest scientific knowledge.

The second reason family firms are strong innovators is loyalty. Family members are much less likely to sell or exit their businesses, which means they are forced to innovate when faced with industry roadblocks. Dutch trading company Van Eeghen is one such example.

In the late 18th century when its trade in Western Europe was affected by the French revolution and the campaigns of Napoleon, trade with England was paralysed. Van Eeghen redirected trade to North America, using the opportunity to buy land and put down roots there.

The company continues with this approach which it calls "functional adaptability". The most recent development is a new operating company founded in 1998, focused on nutritional health and food fortifying ingredients. It has exited commodity markets of coffee, cocoa, hides and tobacco.

Third, families have an edge when it comes to motivation. Behavioural economists and social psychologists argue that work motivation is highly context-dependent. Research shows that coordinated efforts can motivate people in complex situations, such as innovation, but this motivation often decays over time unless strong supporting structures exist to maintain it. Family orientation provides this, supporting knowledge-sharing and interrelating, easier among kin than unrelated individuals.

However, the characteristics that make family firms innovative early on can often become liabilities to continued innovation. The loyalty of stakeholders mentioned earlier can mean a family firm has to be too loyal to maintain conducive business conditions in the community where it was founded. As part of its turnaround after 2004, Lego had to work hard to keep a large part of its production facilities in Billund, Denmark, while other companies outsourced to cheaper labour locales, gaining cost advantages.

Family firms can also find themselves tied into suppliers that might be providing inferior products or inferior organisation. They can also rely too much on one another, unwilling to let outsiders into the circles of power, even if a non-family member might be a more effective change agent.

Institutionalising innovation

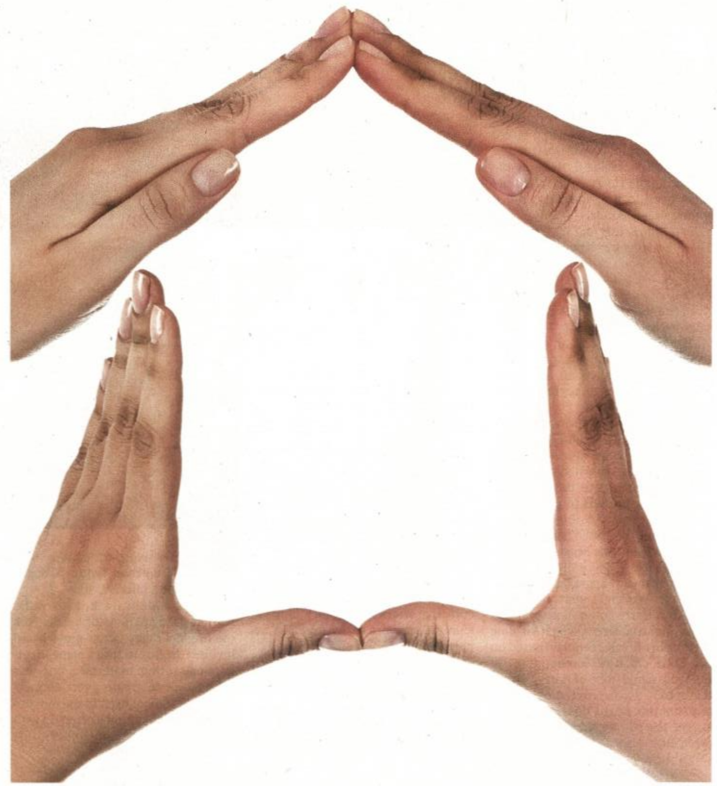
So how can a company keep family assets from becoming liabilities to their innovation? By institutionalising innovation through family and corporate governance and incentivising key individuals.

For a look at this in practice, let's take the Mulliez family, which founded Auchan in 1961 and has now become one of the biggest supermarket chains in the world. It also owns more than 20 other retail brands and has 800 family members, 550 of which are owners of the family's cluster of firms.

With such a rapidly increasing family size, the Mulliez family invented a new organisational structure that, among other things, would help new generations to be innovators, a crucial step to maintain succession and longevity.

First, to finance new business ventures, the family restructured ownership and created a private equity company within the group. The fund received cash from operating companies. It then developed a dual governance structure and gave a family board power over the boards of operating companies, with a clear and transparent guideline for future generations to follow. Third, a family pact was defined that outlined values to bind family members together. Fourth, a formal educational system was developed that all young members had to enrol in to be able to propose new entrepreneurial ventures to join existing companies. Fifth, as a principle, all family members hold shares in the holding company, not the operating companies to tie their incentives together.

This approach enables the family to expand its business without seeking external capital, transfer family assets across generations and align incentives. Being able to identify and finance potential innovators within the family increases the likelihood that the firm will keep its innovative edge.



By institutionalising innovation through family and corporate governance and incentivising key individuals, the family-run enterprise ensures that it can expand its business without seeking external capital, and most importantly, identify and finance potential innovators from within the family. PHOTO: FREEIMAGES

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