



Maximizing family capital

The inner workings of the family-owned business

Nearly 30 percent of a family-owned business' sustainability comes from the strength of its intangible family capital. As one generation hands over to the next, it is vital to identify and manage the specific value that the family brings to the business to achieve long-lasting growth.

Driven by entrepreneurial vision and energy and with the accent on human, emotional and longevity factors, there is every reason to believe that family-owned businesses have a distinct competitive advantage.

But while family-owned businesses offer benefits to their employees and the communities in which they live and work, as well as create an impact in the marketplace, it is that same family dynamic that introduces additional complexities.

Many of today's successful companies start out as family-owned businesses. Indeed, despite humble beginnings, from developed countries to emerging markets, family-owned businesses wield a powerful influence on the global economy.

Even so, in line with the old maxim 'the first generation builds, the second expands and the third destroys,' 90 percent of family-owned businesses do not survive beyond the third generation.

We wanted to know what makes the remaining 10 percent survive and grow, in some cases beyond the sixth or seventh generation. We identified a core set of factors that clearly contribute to the sustainability of a family-owned business over a period of time. Together, those factors constitute the unique family capital which can be measured and actioned.

Overall, we found that family-owned businesses perform better than non-family-owned businesses in

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both developed and emerging markets. Korn Ferry believes that if family-owned businesses are to thrive, it is vital that they acknowledge the strategic importance of family capital and how it can act as a differentiator to build a sustainable business for future generations.

What is family capital?

When it comes to baking in the kind of resilience that will see a family-owned business survive several generations, it is often less tangible elements that are important.

An ability to manage business operations and financial assets effectively is not the only driver of long-term success and profitability. The value of family-related intangible assets and how that value translates into business success and wealth creation is a crucial determinant of sustainability.

Family capital, therefore, needs to be fully understood to:

- identify and unlock the intangible value of the family
- introduce measures to safeguard next generations
- undertake smooth and effective transitions between generations.

The term ‘family capital’ is the distinctive contribution a family brings to its business. This ‘capital’ is made up of three integrated elements:

- **‘Heritage capital’** – the know-how, networks and reputation of the company built up over time
- **‘Kin interaction capital’** – how the family works together, the obligations and rights
- **‘Principled capital’** – which reflects the moral governance and ethics and how decisions are made

Korn Ferry has observed two critical conditions to increase the family capital of any family-owned business. Firstly, the family’s ongoing commitment to carry on as the owner over generations. Secondly, the family’s willingness and ability to address and nurture its intangible family capital to the same extent that it invests in its business and financial assets.

We’ve discovered that:

- nearly 30 percent of sustainability and long-term success stems from family capital
- higher family capital realizes a greater positive impact on short- and long-term business performance.

Heritage capital: Building knowledge

Heritage capital consists of know-how, relationship networks, and family identity; in essence, it is what the current generation of family owners inherits from the previous generations. Over time, a family accumulates deep knowledge on ‘how to make money’ in a given industry and geography, either working directly in the business or through their own management. This knowledge allows the family to make important investment or divestment decisions, recruit the right talent, guide the strategies or oversee day-to-day operations.

The most successful family-owned businesses are aware that such knowledge is a valuable asset that should not disappear with the current generation. On the contrary, they proactively nurture, activate and transfer their know-how to the next generations of owners and to their business managers. As an owner explains, to get to today’s sixth generation, we had to reinvent ourselves every 15 to 20 years. We eventually developed the know-how to do it.”



Another important component of a family-owned business' heritage is the network of internal and external contacts that are passed down from generation to generation for employees, suppliers, customers, and partners. One fourth generation chairman affirms that, "we only survived (the crisis) because of the reputation that the prior generations had built and the trust our providers and financial partners kept in us." Building a network of support and resources necessitates people and relationship-building skills that can be nurtured among family members and employees from an early age.

Heritage capital also involves the family identity, essentially the family brand, which plays a guiding and stabilizing role in allowing family-owned businesses to promote their uniqueness and competitive strengths to external stakeholders. In essence, heritage capital identifies: 'this is how we see ourselves and how we function as one common entity everywhere and all the time.'

Many family-owned businesses that have succeeded beyond the third generation consciously cultivate and highlight the legacy of the founder and other iconic family members who embody the heritage they wish to promote. These family members write books, produce documentaries, create schools and universities or launch special awards, time and again, to strengthen the foundations on which their family concern is built.

Kin interaction capital: Gaining family unity and commitment

Kin interaction capital encompasses the family's obligations, rights and social norms created through relationships and interactions among other family members. Kin interaction encourages harmony and reciprocity and sets the boundaries of acceptable - and non-acceptable - family behaviors.

Family social norms are customary ways of doing things that unify families to foster a climate of mutual understanding and commitment. Family social norms are developed over time through formal and informal interactions: they help ensure the maturity, cohesiveness and well-being of the family.

In addition to these norms, there are interdependent rights and obligations that come with being part of a family-owned business; that is, with every right that you enjoy as a family member, you must also meet an obligation. A fifth generation family member explains that, "as family members, we are merely stewards of the assets we inherited, to pass them through to the next generation in better shape than we have received them."

Too many family-owned businesses disappear because they have not paid attention to the quality of the ties that not only bind the family together but also connect it to their enterprise. Without recognizing these ties, detached or uncommitted family members may exploit the assets they have received until little is left for the following generation.

How to identify and leverage heritage capital

- continuously evaluate and plan how to use the intangible relational, human and social assets of the family
- train family members in the unique relational and business skills that their parents have developed overtime
- mentor potential successors before they officially assume their roles
- create positions, career opportunities and business processes to induce family members into the family-owned business networks
- discuss and renew the distinctive knowledge accumulated by the family and perpetuate the set of values that contribute to its success.



How to identify and leverage kin interaction capital

- ensure the family members know, like (or love) and trust each other from an early age, even in large families
- develop learning mechanisms so that family members grow and mature through conflict
- engage in family, values-related conversations and discuss ‘rights and obligations’
- involve next-generation family members into business and not-for-profit activities to instill a greater sense of service and responsibility
- discuss and enforce clear principles to access, and dispose of, family assets
- align behaviors, expectations and boundaries of older generations within the family.

Principled capital: Creating a sound governance framework

Principled capital refers to the values-driven and ethics-centered framework needed to govern and ‘make the right decisions’ to grow the family-owned business and assets. Principled capital identifies the need for robust governance, taking into account the set of values, processes, customs, policies, laws, and institutions affecting the way a family-owned business is managed.

Principled capital clarifies the inter-generational work ethic and encourages the development of policies that avoid preferential terms for certain family members. For instance, one particular family-owned business had a specific protocol in place that stated family members could only work in the business after the age of 35, and if they had been to a business or engineering school and worked in two other companies outside of their own business. The protocol also stipulated an age for retirement.

When family-owned businesses expand in size and financial numbers, the complexity and reliance on the family’s solid ‘moral infrastructure,’ for example, how decisions are made, and money or contracts are handled, similarly increases. Families must take responsibility for the actions that influence their business and that connect them to the environment and society.

How to strengthen and leverage principled capital:

- create a ‘family charter’ to maintain family-owned business processes according to strict ethical standards
- create protocols and processes to maintain the family’s continued ownership and control, in addition to financial health
- formalize governance structures and practice agreed-upon decision-making rules
- set up and apply guidelines to address and align interpersonal relationships among family members and with non-family members.



How much is family capital worth?

We have developed a standard Korn Ferry Family Capital Index to systematically measure the intangible value of the family-owned business. Family members willing to understand and grow their family capital may wonder where to start or if there is a way to measure progress over time. Leveraging our research and longitudinal testing, we have created a robust measurement process and a single, integrated metric to assess the value the family brings. The Family Capital Index helps family owners:

- measure the value of their family capital
- understand their global and local position vis-à-vis a relevant group of peers at a similar stage in the family development cycle
- identify the right levers and practical actions for the current generation to increase the family capital and pass on the business and other assets to the next generation.

While developing the Family Capital Index and thoroughly understanding how it correlates to performance and sustainability, we discovered that some of the three capital dimensions of the Family Capital Index are more important than others, relative to the current status of the family generation.

Sustainable value

Understanding the value the family brings to the business and acting on it in a conscious way is essential if the owners are to continue to develop their business into a viable, ongoing concern, without relying exclusively on the wisdom of family members.

By working together to enable family owners to more accurately determine their family capital, we inspire rich conversations and decisions that build key family strengths. In this way, we help to not only address areas of concern, but accelerate the family journey toward a sustainable, next-generation family-owned business.

About Korn Ferry

Korn Ferry is a global organizational consulting firm. We work with organizations to design their organizational structures, roles, and responsibilities. We help them hire the right people and advise them on how to reward, develop, and motivate their workforce. And, we help professionals navigate and advance their careers.