LEADER
ON
BOARD

Claudio Fernández-Aráoz is a senior adviser at the global executive search firm Egon Zehnder and the author of *It's Not the How or the What but the Who* (Harvard Business Review Press, 2014). **Sonny Iqbal** and **Jörg Ritter** are partners at Egon Zehnder and coleaders of its global family-business practice.

Leadership Lessons from Great Family Businesses

by Claudio Fernández-Aráoz, Sonny Iqbal, and Jörg Ritter

It's no secret that family businesses can struggle with governance, leadership transitions, and even survival.

Consider a few high-profile examples: Banco Espírito Santo was rescued by the Portuguese government last year following the resignation of its CEO, the great-grandson of the bank's founder, amid allegations of financial improprieties. The Doosan Group, a South Korean conglomerate, was thrown into turmoil when the clan that runs it replaced one brother with another in the chief executive role. Fiat, the Italian auto group run by the heirs of Gianni Agnelli, went through five CEOs and three chairmen in two years before bringing in an outsider to lead it. And in the United States the New England grocery chain Market Basket faced employee protests and lost $583 million in sales as two cousins—one a board member, the other the chief executive, both grandsons of the founder—publicly vied for control of the company.

Although we've also heard numerous family-enterprise success stories, cases of harmony, health, and longevity seem to be exceptions to the rule. According to the Family Business Institute, only 30% of these organizations last into a second generation, 12% remain viable into a third, and 3% operate into the fourth generation or beyond. Even those that do continue often see their value decline significantly when power changes hands at the top. Joseph Fan, a professor at the Chinese University of Hong Kong, tracked the market performance of 214 family-run firms in Taiwan, Hong Kong, and Singapore; he found that on average their shares dropped by almost 60% in the eight years surrounding a change of CEO. Leaders of family companies acknowledge the problem. In a survey conducted by the Harvard Business School professor Boris Groysberg and the researcher Deborah Bell, directors of family business boards gave themselves much lower performance ratings than members of nonfamily boards, especially in the area of talent management. Fewer than 10% said their companies were effective at attracting, hiring, retaining, or firing employees or at leveraging diversity in the workforce.

And yet family-owned or -controlled businesses play a key role in the global economy. They account for an estimated 80% of companies worldwide and are the largest source of long-term employment in most countries. In the United States they employ 60% of workers and create 78% of new jobs. These aren't just mom-and-pop shops either: In one-third of S&P 500 companies, 40% of the 250 largest firms in France and Germany, and more than 60% of large corporations in East Asia and Latin America, family members own a significant share of the equity and can influence key decisions, particularly election of the chairman and the CEO.

Imagine the benefit, then, if more of these companies mastered key people management, leadership development, and succession practices. How? By learning from the best in their class: large family-owned or family-controlled organizations that have prospered for decades, if not centuries.

With advice from Sabine Rau, a professor at King's College in London, our firm, Egon Zehnder, partnered with Family Business Network International to analyze 50 of these leading family firms. Each had annual revenue above €500 million, and together they represented all major industries in the Americas, Europe, and Asia. Although we did find a few cases of subpar governance and undisciplined succession at the top, most of these companies offer valuable

Idea in Brief

THE PROBLEM
Family-owned and -controlled businesses play a critical role in the global economy. But as a result of poor talent management, many fail to thrive or even survive.

THE RESEARCH
In search of best practices, Egon Zehnder and Family Business Network International interviewed executives and studied recent leadership transitions at 50 leading family firms around the world.

THE SOLUTION
They found that top family-led companies do four key things: establish a baseline of good governance, preserve "family gravity," identify future leaders from within and outside the family, and bring discipline to their CEO succession.

lessons for unlocking great leadership in family businesses. Through our interviews with both family and nonfamily executives, we uncovered several best practices: The most successful family firms establish good governance as a baseline, preserve "family gravity," identify and develop both family and nonfamily talent, and bring discipline to top-level succession.

A Governance Baseline

Family businesses cannot hope to manage internal talent (both family and nonfamily) or attract the best outsiders without establishing good governance practices that separate the family and the business and ensure oversight from a professional board. Even among the leading companies in our study, a quarter of the nonfamily executives we interviewed said they originally had governance-related concerns about joining a family business: uncertainty about levels of autonomy, hidden agendas, lack of dynamism, and the potential for nepotism and irrational decisions. "What would have absolutely stopped me from coming," said the CFO of a British investment trust, "would have been if I had a feeling that I could not be independent and the family was running the business rather than it being professionally run." The CEO of a U.S. consumer business who also proceeded cautiously before signing on told us, "I was making sure there was a level playing field in terms of future possibilities, growth, and advancement."

Only a small minority of the companies in our study had no advisory or supervisory board, but all those were entirely family-owned, and some were considering instituting a form of independent oversight in the future. Meanwhile, 94% of the surveyed firms were controlled by supervisory or advisory boards of about nine members, on average. Family representation on these boards averaged 46% in Europe, 28% in the Americas, and 26% in Asia, but a clear separation between family and business existed in most cases. "We have an official governance structure, and this codifies the boundaries," reported the nonfamily CEO of a well-known consumer company in the UK. And the CEO of an American maker of high-performance materials explained his firm's explicit rules: "We have a supervisory board, and each branch of the family tree is allowed to send one member, unless the branch already has a member as part of management. For every family member on the board, one external, nonfamily member is also nominated."

Good governance is an obvious first hurdle for family businesses that want to hire and keep the best people and compete successfully over the long term. Committing to sound decision-making and management practices is thus essential, whether a company is publicly traded, partly owned by professional investors (such as private equity firms), or completely under family ownership.

Only 30% of family businesses last into the second generation; 12% are viable into the third.

"Family Gravity"

Although family businesses should match nonfamily ones in their governance structures and opportunities for professional growth, they must also be careful not to lose what makes them special. We call

THREE NONFAMILY CEO ARCHETYPES

A TRUE SUCCESSOR, WHO ACTIVELY PARTICIPATES IN SHAPING CORPORATE STRATEGY, WORKS AS AN EQUAL PARTNER TO THE LEADING FAMILY MEMBERS, AND, OVER TIME, REPLACES THEM

COUNTERPARTS WILL CREATE THEIR OWN MOMENTUM AND DRIVE CHANGE IN A FAMILY BUSINESS WHILE ALSO HELPING TO MAINTAIN ITS VALUES AND SKILLFULLY MANAGE IT

KEY TRAITS:
INDEPENDENT, CONFIDENT, PROACTIVE, AMBITIOUS

A MANAGER WHO IS NEVER ON AN EVEN PLAYING FIELD WITH THE FAMILY BUT ADDS ENORMOUS VALUE BY EXECUTING ITS VISION IN AN EFFECTIVE, PROFESSIONAL MANNER

STEWARDS ARE IDEAL FOR BUSINESS OWNERS WHOSE PRIMARY CONCERN IS TO MAINTAIN THEIR LEGACY AND KEEP THE EXISTING OPERATIONS RUNNING SMOOTHLY

KEY TRAITS:
RESPECTFUL, FLEXIBLE, COOPERATIVE, COMMUNICATIVE

A LEADER WHO RUNS THE BUSINESS WITHIN A CAREFULLY CRAFTED FRAMEWORK OF GOVERNANCE

GOVERNORS PRIORITIZE DAY-TO-DAY MANAGEMENT OVER PRESERVING THE FAMILY'S VALUES OR SPEARHEADING STRATEGIC MOVES. THE LEAST COMMON TYPE, THEY ARE USUALLY FOUND IN CONGLOMERATES AND COMPANIES HELD BY DISPERSED FAMILIES WITH LOW EQUITY

KEY TRAITS:
PRAGMATIC, OPERATIONAL, HARDWORKING

this "family gravity," and our research shows it's another critical factor in achieving long-term success.

The firms we studied usually have one key family member (but up to three) standing at the center of the organization, like the sun in our solar system. These people personify the corporate identity and align differing interests around clearly defined values and a common vision. They focus on the next generation, not the next quarter. They tend to embrace strategies that put customers and employees first and emphasize social responsibility. And they have strong personalities that draw talented people into their orbits and keep them there. One nonfamily CFO of a Japanese education company told us, "I decided to join because I fully respected [the family patriarch] from my heart." The nonfamily CEO of a Swedish media business expressed similar sentiments: "I liked the family. They were somehow real people with personalities that were exciting to manage." Other executives said, "My shareholders have faces" and "The beauty is that we think long term, about the legacy we will leave behind." When a single family member (or a few who are completely in sync) maintains the right presence in a family business, recruitment, retention, and results clearly benefit.

Finding Future Leaders

Companies with sound governance and gravity should have no trouble attracting managers—from within or outside the family. But how do you decide who is right for the highest-level positions in your firm? All talent, and especially family members, must be assessed on competencies, potential, and values.

The competencies most frequently required for success at the top of any sizable business include strategic orientation, market insight, results orientation, customer impact, collaboration and influence, organizational development, team leadership, and change leadership. In family businesses you should also look for people who understand the company's ownership dynamics, accept that responsibility for multiple generations comes with the job, and are able to manage social ventures and sustainable growth. Along with competencies, candidates must demonstrate potential—the capacity to change, learn, and grow into increasingly complex and challenging roles that we might not envision today.

But in the family businesses we studied, values seem to be the acid test. When we reviewed the transcripts of our interviews, we found a 95% overlap in the language that each firm's family members and nonfamily executives used to describe their corporate ethos: words such as *respect, integrity, quality, humility, passion, modesty,* and *ambition.* "We are working on the same page, in the same way, and he understands my commitment to bring the company forward," the nonfamily CEO of a German retailer said, referring to the group CEO. The family chairwoman of a Chinese consumer company reported, "We have the same values, the same vision. We trust each other."

Family members told us that when evaluating senior executive candidates, they considered cultural fit above all else: "He did not have all the operational requirements the board had asked for on paper, but he had so much more!" said the family chairman of an Indian consumer business, describing his nonfamily CEO. "He is the kind of person who just fits into our culture, and that is more important than the role spec." The family chairman of an American beverage company echoed those sentiments: "We evaluate people on the basis of leadership qualities,

which extend to the interaction with the family. That includes their values, which is very different from a résumé that says this person built up the Russian business."

With family executives, in whom cultural fit was more easily found, the key concern was development. More than 40% of the companies in our study included members of the next generation on their boards and committees in order to nurture their business and management skills. Younger family members also held positions such as head of U.S. sales, China country manager, and adviser to the CEO, and they filled roles at various levels in corporate strategy, innovation, product management, and the family office. At one U.S. consumer company, the CEO, a family member, told us, "We very consciously develop family talent with two to six interns every year. The culture used to be, Go out and make it on your own, and come in with a track record. Now there is more encouragement to consider working for the company [from the start]."

The best family firms find their future leaders early and invest in them—whether they are cousins and grandchildren, existing nonfamily employees who show promise, or outsiders with no previous connection to the firm. Likely prospects are carefully brought up through the business so that when they're ready for more-senior roles, the values and competencies match is a sure thing. "I prefer to hire and grow," the family chairman of an Indian consumer company told us. A top nonfamily executive at a Chinese business outlined his firm's approach: "We created a corporate university sponsored by the family, not the company, and educated 100 people at MIT and Stanford to prepare them for management."

Disciplined CEO Succession

The greatest threat to any large corporation is a failed CEO succession. In his analysis of once-great companies in decline, Jim Collins, a leading business thinker, found that all but one had experienced a problematic transition at the top, and Joseph Fan's research confirms the value destruction often seen in such scenarios. If there is one area in which most family businesses could stand to improve, this is it. Even among our exemplary sample, nearly 30% considered only a single candidate for their top succession, and about two-thirds didn't follow a properly structured selection process. Instead, a leading family member intuitively chose the successor, who was then formally approved by the supervisory and management boards and introduced to the rest of the organization. Sometimes the decision came about through inspiration or chance: "[Our CEO first] worked with us on a consulting project," said a family representative from an Indian consumer company. "Over that period of four months, I got to know him and his style really well." In other cases, recommendations were sought. At one Spanish company, a family member consulted a management professor he trusted and chose between the two people the professor recommended. At a Japanese consumer business, the board appointed a family member who had risen through the ranks. "He built up his career here and knows the daily operations and products very well," a nonfamily director explained.

However, ample research shows that CEO appointments are far more successful when they follow a disciplined search involving multiple candidates. The best family businesses in our sample addressed CEO selection proactively and strategically (see the chart "A Disciplined Succession Process"). In the initial stage, the supervisory board appointed a formal nominations committee to define the specifications for and conduct a broad internal and external

A DISCIPLINED SUCCESSION PROCESS

PHASE 1 DISCUSSION AND COMMITMENT BY THE SHAREHOLDERS

Briefing on succession by owner family and/or the board, and analysis of possible scenarios	Shareholder workshop to strategize about the future and design the succession process	Creation of an ideal successor profile based on strategic goals, values, and desired competencies

PHASE 2 CANDIDATE SELECTION

Identification and evaluation of a long list of suitable internal and external candidates	Short-listing and obtaining references for a select group of qualified candidates	Agreement on one or two finalists and contract negotiations with the chosen successor

PHASE 3 INTEGRATION AND DEVELOPMENT OF THE SUCCESSOR

Establishment of an agenda for the first six to 12 months and selection of the top management team	After 12 months, 360° feedback and, if needed, creation of a development plan to meet strategic and business targets after roughly two years	Discussion and decision about renewing the CEO's contract when due

About the Research

The businesses we surveyed were among the top three in their respective geographic markets and industries, with at least 50% of voting rights controlled by family members, most of whom were in the third or fourth generation.

Seventy-seven percent of the European companies, 48% of those in Asia, and 33% of those in the Americas were more than three-quarters owned by the family. In most cases, we interviewed at least one key family member and one key nonfamily executive, including 34 family chairmen, 12 nonfamily chairmen, 12 family CEOs, and 31 nonfamily CEOs. The interviews, conducted in person in the local language by Egon Zehnder consultants around the world, were audiotaped, translated into English, and coded. To analyze succession processes, we carefully reviewed the most recent change in top leadership, including the method of identifying the anointed person, the evaluation criteria, the family's role in the process, family members' perceptions of the successor, the successor's view of the family, the first 100 days of integration, and communication with the new leader.

FURTHER READING

For more insights on family-run companies, read these articles at HBR.org.

"Avoid the Traps That Can Destroy Family Businesses"
George Stalk and Henry Foley

"What You Can Learn from Family Business"
Nicolas Kachaner, George Stalk, and Alain Bloch

"Generation to Generation: How to Save the Family Business"
Boris Groysberg and Deborah Bell

"Conflicts That Plague Family Businesses"
Harry Levinson

search. This included outlining the ideal profile, developing a long list of candidates, and assessing all of them through behavioral interviews and reference checking. Next the committee selected a short list, agreed on a ranking, and presented it to the supervisory and management board members, who chose a finalist. Finally, the family members and the independent directors approved the selected candidate, although in most cases they had an informal yet significant veto power.

The former (nonfamily) CEO of a British construction company told us, "The process was handled very professionally. Initially, I was interviewed by HR and the third-generation family, then I had sessions with the leading family member, then with the brother, then with all five of the fourth generation together, and then I had one-on-one sessions with all the nonexecutive directors. All of them took references on me." At the Swedish media company, the family chairman led a similarly comprehensive assessment process: "I decided that seven elected board members would each get some time to interview [the prospective CEO], either by themselves or a few together. Then we compared notes and came to a conclusion."

Most of the companies followed a clear hierarchy when considering candidates, giving preference to family first, internal talent second, and external executives third. We enthusiastically endorse that practice, provided that the right assessment and development processes are in place. In family businesses, where culture and personal relationships are critical, internal hires stand the best chance of success. In the 50 firms we studied, 38% of CEOs were family members. Of those who weren't, 54% were internal appointees and 46% external. In those cases, we found three basic types of executives. The sidebar "Three Nonfamily CEO Archetypes" describes them and their suitability for particular mandates.

Of course, the initial integration period can make or break any newly appointed executive. On the basis of our experience, we estimate that the right transitional support can cut the risk of a failed hire or promotion in half. Especially for nonfamily CEOs coming into family firms, major conflicts almost inevitably arise in this phase, as we heard from some of the executives we interviewed. "The owners say that I am responsible, but the next day they move into this field and make decisions, and sometimes they don't even notice," the managing director of a German business told us. "It is impossible to become part of their world," said an executive from a different company. "I never got the feeling that it is my project."

To avoid these problems, family firms must ensure that new CEOs are given adequate time to get to know the organization and its key players as well as to meet and bond with important family members. "When we get someone in, we accompany him like a personal scout," one family CEO explained. "A director or board member introduces him, helps him, and talks to him regularly. The know-how is transferred personally." The family chairman of a Belgian food and beverage company described a similar approach: "He will have lots of contact with me, and I will make sure that I can show him what the family wants." A thoughtful onboarding process, along with a professional, fair selection system, can help a CEO succession unfold smoothly and effectively, creating value for the company rather than destroying it.

LEADERSHIP DECISIONS, particularly at the very top, can be a minefield for family businesses. But our research shows that companies can navigate safely and prosper for generations if they establish good governance as a baseline, preserve family gravity, identify and develop high-potential executives both within the family and outside it, and bring the right discipline to their CEO succession and integration processes. The payoffs are clear: Research by Ernst & Young, the Family Business Network, Credit Suisse, and others shows that large, long-standing, publicly traded family businesses grow faster than nonfamily companies, are more resilient, and outperform market returns by several percentage points. ▽

HBR Reprint R1504G