Openness: Taking Family Business to a New Level

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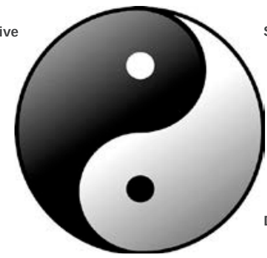
The 2012 annual Family Business Forum in February brought together more than 170 family business owners, employees and other stakeholders from 35 countries at IMD. This year, IMD faculty members shared their views on how being open can be beneficial for family businesses.

The specificity of a family business is the "family." As Bernard Firmenich, eBusiness Director and member of the founding family of Firmenich, IMD-Lombard Odier Global Family Business Award winner 2011 said, "Family matters are always delicate. The emotional bonds almost always add a level of complexity to communications and decision making."

In a world of increasing complexity and constant change, how can family businesses link short-term performance to long-term sustainability by leveraging the family's identity? Professor Schwass remarked that family businesses *can* be more resilient, more adaptive and more sustainable if they adopt a mindset for dichotomies and are prepared to embrace the new era with openness.



A mindset for dichotomies

Lack of openness: When the mighty fall

Why do market leaders stumble? Failing to be open to and recognize the importance of new ideas has precipitated the demise of many a previous market leader. In early 2012 Eastman Kodak pulled out of its Oscars sponsorship deal after filing for bankruptcy protection, which resulted from its failure to transition from film to digital photography. The company has been around for more than 130 years and not only invented the first hand-held consumer camera but also the first digital camera. However, it opted not to commercialize its digital camera for fear of cannibalizing its film business. Computer manufacturing giant Digital Equipment Corporation (DEC) faded into history in the late-1990s because it failed to see the opportunity in personal computers and did not react to market trends fast enough. And Research in Motion (RIM), the maker of the Blackberry, which used to be the "must-have" accessory of business users, is in trouble because it failed to keep up with the iPhone and Android handsets.

All these companies dominated the market for decades before they were challenged by a "game changer" that disruptively revolutionized the industry, a phenomenon called "discontinuous change." Professor Enders and Dr König pointed out that established players often fail to enact internal change in the face of significant external change – and in particular discontinuous change – because of "incumbent inertia," which refers to a delayed response, resource rigidity, routine rigidity and lack of stamina in the face of disruptive environmental change. In fact, discontinuous change presents a huge opportunity for growth, but many businesses find it difficult to respond to. Thus, while DEC succumbed to incumbent inertia, IBM overcame it by successfully transforming itself from a hardware company to a service one.

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Openness to external change

While some companies failed to keep up with external change, others seized the opportunity and grabbed the market leader position by introducing new dimensions of customer value (Southwest Airlines), new ways of creating value (IKEA), or new revenue structures (Google Docs).

Of course, not every innovation succeeds. In fact, only a few make a real impact. Although it is difficult to predict the success of an innovation early on, participants agreed that it should make it difficult for established players to react.

Most long-standing family businesses are well-established incumbents. However, if they do not want to end up like DEC and others, they cannot afford to ignore potential industry game changers; they need to keep their eyes and ears open and adapt to the industry as closely as possible because, as we have shown, disruptive innovation can potentially destroy the competitive advantage of established players.

It is even more crucial for family businesses to be open to external information and change because they naturally tend to be discreet and conservative, and therefore perhaps less reactive to global trends. Encouragingly, though, some family businesses are demonstrating they can also be at the forefront of global change.[1] Professor Enders reasoned that the nature of family-influenced businesses – which are more focused on continuity, have high levels of command and strong connections, as well as a strong sense of community – tends to lead them to adapt to new technologies differently.

On the positive side, family businesses provide more room for non-formalized, long-term oriented market screening and R&D, as well as faster decision making, implementation and information sharing, particularly from the bottom up. Private family businesses also enjoy independence from external constituents. On the negative side, they sometimes tend to stick to an established identity and routines, which can make them more hesitant to invest and less willing to create ambidexterity[2] and ask for external advice. Professor Enders emphasized that the openness of top decision makers is essential to leverage the advantages of family businesses and avoid the pitfalls.

Openness to external executives and board members

Professor Cossin argued that nowadays the board is essential to business success. But it should no longer merely play the role of a mechanism to control chief executives; it should be actively involved in the value creation of the company and drive strategic innovation. It can be a company's competitive advantage if the board members can provide an outside view, overcome blind spots in the strategy, raise awareness of external risks, connect with governments, society and other stakeholders, give credibility, and build trust in ways that executive teams cannot.[3]

Barriers to and enablers of change

The reasons why businesses – or rather the people that run them – may be unwilling to change are many. Behavioral barriers may include a lack of skills or a confirmation bias. It is easy to miss things we are not looking for, and without the appropriate training and knowledge there are things you simply cannot see because you do not know what to look for. Newspapers are a good example of judgment biases. We tend to read newspapers and magazines that interpret events according to the way we already think, and we usually avoid those newspapers that do not share our viewpoint. Not having an open mind prevents us from seeing the complete picture and thus leads to misinterpretations. So biases can be barriers to change. Other barriers include political views or identity. A strong company identity is important for success but it can also prevent businesses from dealing with change.

Enablers of change include ambidexterity and external advice, which means being able to think in an ambidextrous way, by preserving the core activities but also exploring new areas that may completely clash with the existing business. After all, when we are ill, we go to the doctor for expert advice before deciding what to do, so why not apply the same principle to business?

[1] For more information, see "Family Business at the Forefront of Global Change," insights@IMD, August 2011.

[2] Ambidexterity refers to a company's R&D effort both in exploitative research and explorative research.

[3] See "Most corporate boards are failing – Why boardrooms are in need of education," by Didier Cossin, *Financial Times*, 9 January 2012.

To achieve this, Professor Cossin stressed, board diversity is key. Board members from different industries and geographic backgrounds will enable the board to foresee disruptive industry shifts more quickly, external risks and opportunities. This diversity, combined with the enormous personal commitment and dedication of its members, is what makes a good board.

Non-family board members can greatly add to a family business board's diversity. Family business boards are often composed solely of family members in order to retain family control, but this does not favor external voices and therefore increases the risk of strategic myopia. Bringing non-family members onto the board can protect family businesses from "family group-thinking" and thus improve objectivity and rational decision making.

Openness and diversity on the board: Bringing the outside in

Firmenich shared its practices in terms of opening top executive positions to non-family members. Founded in Geneva in 1895, it is the largest privately owned company in the fragrance and flavor industry. Today in its fourth generation with 6,000 employees worldwide and more than US$3 billion in turnover, it remains 100% family owned. However, Firmenich is accomplished when it comes to separating family ownership, the family and the business. It separated its CEO and chairman roles in the early 1970s and introduced external board members in 1990. In 2000 it brought in its first non-family chairman, and since 2005 the majority of board members are external.

At Firmenich, there is a saying that "Only the best can make it to the top, and best is measured by external, independent experts." Family members go through the same recruitment process as external employees and are only hired if they are qualified. It is no wonder, then, that the family members consider it "a privilege to receive an offer from the company." The company believes that openness to external board members and employees is the secret of its consistent innovation, which is at the core of its corporate and family culture.

Openness to other cultures and mindsets

Mr Yao runs a printing and dyeing company with an annual turnover of $800 million, based in China and Europe. When he first entered Europe, he had found it difficult to find a partner because European companies largely lacked trust in Chinese entrepreneurs and it was a completely different market from China. Mr Yao finally hired a consultant with rich industry experience to act as an intermediary between himself and his business partners and clients in Europe. As trust improved and language barriers eroded, Mr Yao's business took off.

Based on his ten years or so of experience in Europe, Mr Yao has found that well-established European family businesses are focused and skillful compared to younger Chinese family businesses, which often lack focus and continuity. But because Chinese start-ups have often undergone rapid economic development, they are more flexible and adaptive to new environments. Mr Yao urges European businesses to approach emerging countries without fear and with openness – as the Chinese proverb goes, "A committed partner will bring twice the result with half the effort." "After all," Mr Yao said, "in terms of doing business, there is no difference between the Chinese and Europeans. The essentials of business – revenue, profit and partnership – do not change."

Guest speaker Gao Hao from Tsinghua University of China talked about the specificities of Chinese family businesses. The reform and opening

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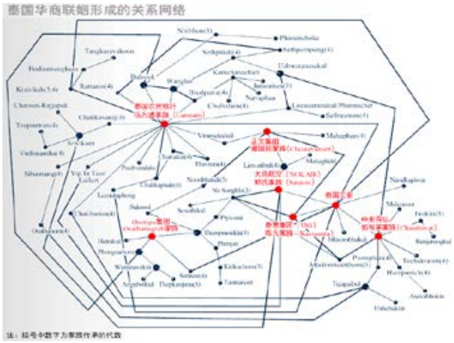
up policy in 1978, Deng Xiaoping’s southern tour speech in 1992 and the 15th CPC National Congress in 1997 are the three milestones of the development of Chinese family businesses. The number of Chinese family businesses has grown three-fold in 20 years. In 2009, out of the 6.6 million private companies in China, 85.4% were family businesses; and 36.2% of the non-state owned companies listed on the Shanghai and Shenzhen stock markets were family influenced businesses that outperformed other corporate governance structures in terms of profit growth (2008–2010), revenue growth (2008–2010) and ROA (2010).

Mr Gao explained that “The founders of these companies all have a ‘4S’ personality. They are Supermen, Strong minded, Street smart, and they Study hard.” He also thinks their political, business and family networks are highly valued as family assets. Moreover, these resources and networks of rich families are converging, creating a new social class through marriages.



Representation of a marriage network of overseas family businesses in Thailand

Source: Joseph PH Fan (CUHK)

The implication for European family businesses is that they need to be more open – open to new markets, new ways of doing business, new partners and new cultures. The current European recession could be the perfect opportunity for European family businesses to explore or exploit other markets. However, it is worth remembering that it is sometimes better to have local partners with local resources and networks than to send in a team from headquarters. Think global and be open.

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Openness to the family business community and family members

Those who best understand the complexity of family businesses are family business owners. When it comes to clarifying family, business and ownership, success, or family corporate governance issues, nobody understands better than your family business peers who are facing or have faced the same situations. One participant spoke of the relief he felt when he received advice from another family business owner who was facing the same dilemma.

Surprisingly, openness to family members, especially next generation family leaders, is another issue globally. Participants from different parts of the world all affirmed that next generation family members have a different focus and mindset. They are more ecological, more sustainability-oriented, more innovative and more self-centered. They perceive the world differently. Many next generation family members choose to start their own business – a decision “tolerated” by many family businesses with a long history. Alexander Scott shared his experience of selling his long-standing family business and then using the profits to create a new family business made up of several companies – a plausible action that to some extent represents the continuity of family entrepreneurship.

History demonstrates that family businesses hold the key to longevity: adaptation. Look at any long-lasting family business and you will find that its story is about constantly adapting to the external environment. In today’s complex business world, openness to external change, to external talents, to other cultures and mindsets, as well as to the family business community is the key to taking the family business to a new level of development.

You may be in a comfortable position today, but not moving is not an option when everything is moving around you.

Didier Cossin