Inside family firms

The name, heritage and cultural legacy of a family business can be important assets in today's commercial landscape. We spoke to Professor Morten Bennedsen about his work in investigating what distinguishes family businesses from other companies, and in quantifying the value of these seemingly intangible assets.

Many major companies across the world are family-owned, including Hermes, Cargill and Walmart, to name just a few of the most prominent examples. These companies differ significantly from businesses that aren't family owned, a topic of great interest to Morten Bennedsen, Professor of Economics at the University of Copenhagen. "A family firm is owned or managed – or part-owned or part-managed – by a group of family members," he outlines.

A number of the world's biggest companies are family-owned, but this structure is particularly predominant among small or medium sized enterprises (SMEs). "Across the world there are far more owner-managed and family owned businesses than companies with other structures. Of the top 500 companies in the US, around 40 percent are owned by families, while in the UK and Europe it's around 50-60 percent," says Professor Bennedsen. "In parts of Asia, Africa and Latin America, the proportion is even higher."

Family businesses

As the Principal Investigator of a research project looking at family firms, Professor Bennedsen aims to probe deeper into what distinguishes these companies from other businesses. Professor Bennedsen and his colleagues are gathering data from a wide range of sources and running projects looking at a variety of different questions. "For instance we're interested in what goes on in SMEs, which you can find anywhere in the world," he explains.

One part of the research involves looking at data from an entire population of firms in Denmark, from which Professor Bennedsen can then look to draw wider conclusions. "Privately owned or managed firms are very similar across different countries, thus we can derive insights that are relevant beyond the Danish context," he says. "Some projects have been addressing issues like; can we measure values in family firms?"

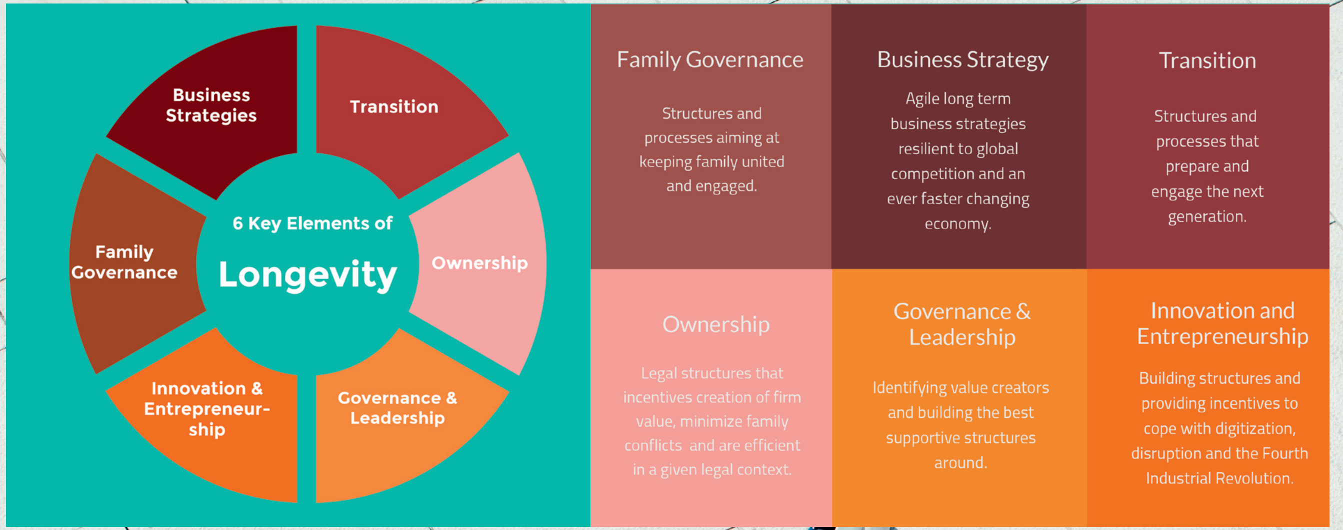
The values and heritage of a family-owned company can be major assets, as they create value in the business and can be integrated into the commercial strategy. However, at the same time these companies also need to adapt to changes in the marketplace if they are to attract customers. "This can be challenging, because family firms are so used to things working fine," points out Professor Bennedsen.

The example of Japanese construction company Kongō Gumi, founded in 570, shows that a long history is no guarantee of continued commercial success. "Kongō Gumi built Buddhist temples, but went bankrupt in 2006 after over 1,400 years in operation," says Professor Bennedsen.

This story provides some important insights into the factors that may affect the longevity of a family-owned business, another major area of interest in the project. While Kongō Gumi were well-known for their role in building and re-building some of Japan's most famous landmarks, the company diversified into property investment in the '80s, sowing the seeds for its eventual demise.

First of all, which culture survives in this type of situation? Is it always **those who buy other firms** and **import their culture** who **survive?**

The first Buddhist temple in Japan, Shitennō-ji, in Osaka. Construction was said to have begun in 593 by Kongo Gumi. GNU Free Documentation License. Source: 663highland



The Six Key elements of Longevity in family firms.

"In January 2006, Kongō Gumi went into liquidation having run up arrears of $340 million," says Professor Bennedsen. "No family firm can take survival for granted. Each generation has to create value and fight to deliver the business to the next. Most long-living family businesses that go out of business do so because the business becomes irrelevant, or the family leaders make bad business decisions."

There are however many instances of family-owned businesses that have successfully adapted to changing market conditions. For example, there is a hotel in Japan called Hōshi Ryokan, which was opened in 718 and is still thriving today. "It is the oldest company in the world to have been run by the same family throughout its history and maintained its independence," says Professor Bennedsen.

Professor Bennedsen has identified six key elements – business strategies, transitions, ownership, corporate governance and leadership, innovation and entrepreneurship and family governance – which he believes are central to the longevity of a family-owned business. "For family firms, the secrets of longevity are bound up with the outcomes of these six elements, which overlap in time according to the challenges faced by each generation," he outlines. "However, the implementation of these elements will take many different forms, depending on the size, geography and age of the business."

Organisational structure

A further topic of interest in the project is a company's organisational structure, which is typically less complex in a family business than other companies. However, family businesses also have less checks and balances, so ensuring the right level of oversight on commercial decisions can be an important issue. "Some of the most short-sighted decisions that we've seen have been made by family businesses," says Professor Bennedsen. A good example is the Parmalat scandal, eventually resulting in the bankruptcy of the company, which involved the outright falsification of commercial information. "You would never be able to get away with that in a non-family business, because there would be a board there to prevent those actions," points out Professor Bennedsen.

The project is also looking at the working environment and remuneration culture within family-owned companies, which again often differs from other businesses. While family firms often pay lower wages, there are compensations for employees, a topic that Professor Bennedsen and his colleagues are exploring. "A non-family firm may pay more, but as an employee you've got less security and can be fired more easily. A family firm may be loyal to their workforce, but the cost is that they don't pay as well – we think of that as a kind of implicit labour contract," he outlines. Researchers are looking at the working environment in family firms and exploring what benefits employees enjoy in return for accepting lower wages. "They may get a better working environment and employment protection," says Professor Bennedsen.

The challenge is that **family firms can be too conservative, lack checks and balances**, and **take too many things for granted.**

Researchers are looking at these implicit labour contracts, aiming to gain deeper insights into the incentive structure and working environment within family-owned companies. While pay is of course a major motivation in work, Professor Bennedsen says that analysis shows that there are other factors that help family-owned companies retain staff. "Very often staff are loyal because the company provides better working conditions," he explains. These companies still operate in an intensely competitive business environment however. "There are competitors across the globe in today's market, and so the ability to communicate is increasingly important as the world gets smaller," continues Professor Bennedsen. "There is a lot of pressure on SMEs, and also on the growth prospects of a business."

An ambitious company with plans to expand may need to sacrifice a degree of control over the company in return for investment, which can represent a major dilemma for family-owned businesses. Meanwhile businesses that merge with another firm, or are acquired by another firm, may lose core elements of their identity and culture, another topic of interest to Professor Bennedsen. "First of all, which culture survives in this type of situation? Is it always those who buy other firms and import their culture who survive?" he outlines. These are important issues for authorities and regulators, who are often keen to provide the right kind of environment in which SMEs can survive and thrive. "What can we do as a society to promote these kinds of structures, or organisations?" says Professor Bennedsen.

This is a widely shared goal among governments across the world, regardless of political ideology, yet it remains difficult to develop the right kind of environment to support and encourage the development of SMEs. Professor Bennedsen hopes the project will make an important contribution in these terms. "This research could help us to identify how we can develop policies to promote these SMEs," he says. Debate also continues about levels of taxation and the rules around different classes of shares, which could affect the structure and ownership of family-owned businesses. "Some lawyers have argued that it should not be legal to have dual class shares, which hold more voting power," explains Professor Bennedsen. "This could change the ownership of larger family businesses in Europe."

The main goal in the project is to gain deeper insights into the nature of family-owned companies however, and research in this area is ongoing. "We are developing case studies on several family firms, and will publicise our work in research journals. I have written books, case studies, research articles and around 100 popular articles, which have been published in China, Singapore, Taiwan, Korea, India and other places as part of this project," continues Professor Bennedsen. "There is a huge well of knowledge about family businesses, as they are so common across the world, and we aim to tap into this knowledge."

The worlds oldest independent family firm today, the Japanese Hoshi Ryokan, founded in 618.

INSIDE THE FAMILY FIRM

Inside the Family Firm: How preferences and values cause differences in business organization, decision-making & outcomes

Project Objectives

The FAMBUSS research project investigate the interaction between ownermanaged firms organization and outcome and the organization, structure and dynamics of the family behind the firm. We look at intangible assets such as names, legacy, networks and values and investigate how they are transferred into firm strategy and corporate governance.

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Project Participants

• Bocconi University • INSEAD • The Chinese University of Hong Kong • Copenhagen Business School • Oxford University • Kenan-Flagler Business School • Cornell University • National University of Singapore • Columbia University • Michigan University

Contact Details

Principal Investigator,
Professor Morten Bennedsen
Department of Economics
University of Copenhagen Øster Farimagsgade 5, Bygn 26
T: +45 28 74 45 25
E: mobe@econ.ku.dk
W: https://www.economics.ku.dk/fambuss/

Professor Morten Bennedsen

Morten Bennedsen is Niels Bohr Professor at the University of Copenhagen and Hoffmann Chaired Professor of Family Enterprise at INSEAD. He obtained his PhD from Harvard University. He is an expert on ownermanaged and family business. He has published 1 book, 27 articles in top economics and finance journals, 200 global cases, reports and media articles on 6 continents and writes regular columns in China, Hong Kong, Korea and Taiwan. He served as an advisor to the Danish and UK Government, EU, private equity funds and the World Bank. He gives talks and consults with families in Europe and Asia.

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