Is the backbone of our economy at risk?

Why trust in family businesses is eroding – and what is needed to reverse the trend

by Andreas von Specht

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The contribution of family businesses to the global economy is undeniably vast. In the United States alone, there are around 5.5 million family businesses, which account for 54% of the country's GDP and 60% of its workforce. Family firms have helped shape America's business landscape, influencing the culture, economy, and spirit of the communities where they operate. But it's not just the U.S. that bears witness to this phenomenon. Across the Atlantic, in Germany, over 90% of companies are family businesses. They provide 80% of apprenticeships – and well over 50 percent of jobs. In fact, last year, large family businesses created more new jobs than the DAX corporations. In many other countries, too, family businesses are more or less the backbone of the economy; they are seen as the antithesis of listed corporations, as exemplars of good business practice. And especially in the case of the model family businesses, it is true: they stand for long-term thinking instead of quarterly focus, for responsible sustainability instead of pure profit maximisation. They offer flat hierarchies and quick decisions instead of bureaucracy and ducking responsibility. They are the epitome of reliability, honesty, and predictability - in contrast to greed, power hunger and unscrupulousness. But several crises in direct succession have exposed a problem: alarmingly often, this no longer has anything to do with reality, because this pillar of the economy is eroding – many a family business risks gambling away the trust placed in it.

The past three years in particular have shown us one thing: In many family businesses, the special balance between values, the attitude (”purpose”), long-term objectives and predictability, as well as the ethical decision-making of the owners seem to be at risk. Three examples:

The fair-weather trap

The Covid crisis, the shortage of skilled workers, the war in Ukraine and the bottlenecks in the supply chain are mercilessly unmasking the ”fair-weather managers”– especially in family businesses. Seneca once mused: ”you only get to know a good helmsman in a storm”. This experience is now also being felt by numerous family businesses. Not every company manager is a storm-experienced and battlehardened entrepreneur in the best sense of the word like Erich Sixt, for example. He not only managed to successfully establish his company in the market, but also to pass the business on to his sons in good time and without a hitch. Establishing a business and, eventually, handing over the business – not many entrepreneurs manage both successfully. Because: too often, unqualified family members and fair-weather managers take a tradition-rich company to the brink of disaster, or are forced to sell out to financial investors.

The trust trap

With insufficiently qualified or over-burdened company managers, there is also a loss of trust in the institution of the "family business". This is all the more dangerous because trust is a critical success factor, especially in family-run companies. After all, strong relationships with employees, business partners and customers form the basis of success. And this is not only about "soft factors" such as empathy or affability. A high level of competence, integrity, the ability to take tough decisions and assert oneself, the ability to look beyond the horizon are also part of the equation. Trust is a special kind of relationship, equivalent to the binding effect of the handshake of honourable merchants in earlier times.

The future trap

What comes after I leave? Who will carry on my work? Many family patriarchs are driven by fear of a classical scenario becoming reality: the first generation builds up the wealth, the second manages it, the third squanders it. In many family businesses and family offices, entrepreneurial top talents are a rarity. And it is precisely this ‚rare species' from one's own family that often prefers to start up their own business or do something else rather than go into the parental business. We also increasingly observing member of the ‚next generation' who are very keen to take advantage of the benefits and amenities of shareholder status, but who do not want to be measured against the obligations and responsibilities of the shareholder role.

Succession planning as a fundamental challenge

With regard to a successful handover to a successor, there are basically two simple basic prerequisites: WANT and CAN. Even here, large parts of the generation of heirs already face an insurmountable hurdle. Neither the aptitude nor the inclination for an entrepreneurial role are automatically inherited, nor can they be simply imposed on the next generation. Of course, my partners and I also see exemplary cases where the generational change is planned well in advance and with a very high sense of responsibility – and the successors are carefully selected and prepared for their role (as shareholders or also as company managers).

Unfortunately, however, this is not the rule. Many a succession is delayed or postponed until at some point one can hardly speak of a ‚next generation' ("Prince Charles Syndrome"). The inability of entrepreneurs to "let go in time" has been observed for decades. There is often too much hesitation and too little courage to involve talented and interested children, nieces, or nephews at a very early stage – and to transfer responsibility and, if necessary, company shares in good time.

We are now often asked to act as objective assessors to support suitability decisions in succession situations. The mere fact that professional support is sought from outside for such an existential question is often a positive indication. The parents feel this themselves, at least intuitively – and in cases where the children do not have the entrepreneurial competencies, we must serve as the diplomatic messenger of a regrettable but clear message. Conversely, to help and develop genuinely talented successors is a pleasure and a privilege.

The problem here is rather the Gaussian normal distribution: in the case of well over half of potential successors, the picture is ambiguous. In some cases, there is a lack of experience which makes it difficult to judge the longterm suitability for entrepreneurial responsibility. In other instances, we may encounter ”decent average” – and then the big question is whether mediocrity is sufficient for the assumption of shareholder or even management responsibility. You can already guess – in some cases the answer must be simply ”no”, or at least ”not yet”.

The war for internal and external top talent

As soon as the question of ”want” is answered with a ”no”, and at the latest when the question of ”can” is settled in the negative, family businesses find themselves entering the ‚war for talent‘ on the market. Many shareholder families and their businesses are not sufficiently prepared for this either. Currently – to put it somewhat exaggeratedly – companies increasingly have to ‚apply‘ to top candidates and not the other way round. This is a paradigm shift. Those companies which cannot credibly communicate their competitive advantage, career attractiveness and professional governance will most likely lose out in the battle for top class talents.

And ‚professional governance‘ also directly addresses ‚family governance‘. It is not uncommon to see a toxic mixture of mismanagement and mediocrity combined with an arrogant sense of entitlement. As the icing on the cake, there may even be narcissistic or erratic behaviour on the part of individual shareholders, completely blocking family businesses or, in family offices, endangering the assets of shareholders. For the governance of a family business, this kind of mixture indicates that it will not be possible to survive with ‚fair-weather management‘ and sitting it out. The shareholder family, as responsible and ‚legitimate‘ owners, must at the very least influence the right strategy and provide first-class leadership for the business.

So more and more family businesses and family offices do not manage to conduct a successful handover to a next generation that is entrepreneurially well-qualified, or at least legitimised as the owner. What to do: succession is a long-term project. As a family business owner, get the NextGen on board very early on. Allow their fresh opinions, let yourself and your management be ”challenged” once in a while – and accept any deficit in entrepreneurial maturity that may still exist. Every study on good corporate governance now shows how important diversity in management is for success – and this is by no means just about gender but also includes age and perspectives.

Conversely, however, the following also applies: set high standards – both for the management of the company and for the assumption of an active shareholder role; this is not a right of inheritance. And admit to yourself and your family in good time if NextGen candidates are unlikely to meet the high bar for managerial succession. Be consistent in your evaluation of entrepreneurial performance – and, if necessary, get professional help to evaluate non-family and external managers objectively. I have just heard of another case where an unsuccessful manager was not replaced after two years, because that would have been tantamount to the admission of a mistake. Instead, it was somehow felt better to wait another four years – until the poor performance became so obvious that a tough restructuring expert will now have to be brought in.

The issue of succession is not necessarily always about succession of the management. In my own family there is a large, century-old business that is now managed operationally by non-family members. Since this happened, the influence of the family and thus certainly the ‚family feeling' in the company have declined noticeably; this is certainly a pity for the family, but it is also due, among other things, to poor personnel decisions taken many years ago. At the same time, however, the competitiveness and entrepreneurial success of the business have since increased significantly. It is possible to be a legitimate, professional owner without having to run the family office or family business yourself.

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