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Leveraging the Strengths of Family Business Through Outside Leadership

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“That’s the way we’ve always done it!” So goes the dreaded phrase that stifles growth and insulates inefficiencies. And unfortunately, it’s an all-too-common utterance in the world of family businesses. The strengths of family-owned companies, particularly in the first and second generations, are significant, but they also face a unique set of challenges in today’s rapidly evolving business landscape. Owners need to ask themselves—with unbiased honesty—whether the right people are positioned to lead through these changes. In many cases, the best decision will be to leverage the strengths of a family business through outside leadership.

The Strengths of Family Businesses

In many ways, family businesses thrive on reputation—something that other corporations strive to earn but don’t always achieve in the same measure. Family business owners are seeking to leave a legacy through the way they serve their communities and treat their employees. They see themselves as “custodians” of the family reputation and strive to be “good corporate citizens.” They are known for safeguarding the family interests by building a robust governance structure that in turn creates a vital sense of stability. It is these values that secure trust and resiliency in their organization.

Resiliency has been top of mind for every company in the wake of the pandemic—but it is also fundamental to bouncing back after economic downturns, such as the 2009 financial crisis. A PwC survey highlights this resiliency, pointing out that in 2020, at a time of record capital investment for companies across the U.S., 79% of family-owned business reported no need for additional capital. Even more (86%) were highly optimistic about their future growth post-pandemic.

It's not just economic resilience that defines family businesses. Historically, they have had better retention rates than other companies, which gives them an advantage in protecting against the worst of the Great Resignation. Again, much of their retention success comes down to trust. The 2022 Edelman Trust Barometer revealed that for the last decade, family businesses have ranked as the most trusted type of company. Additionally, the pandemic forced them to lay off fewer people than non-family businesses—another win for employees who are seeking employers they can trust.

The Weaknesses of Family Businesses

When leadership roles in family companies are filled with first and second generation owners and family members, the business thrives, with a significant portion of new sales resulting from new innovation. However, an HBR study shows for third and fourth generation leaders, sales generated through new innovation are cut in half—regardless of the size and complexity of the organization. This is just one tangible indicator of generational decline—a familiar concept that haunts family-owned businesses.

The reasons behind this so-called generational decline are many; some point to a dilution of work ethic or misaligned values, while others highlight an over-cautiousness in protecting the benefits of the family-owned business.

Often, this deterioration goes hand-in-hand with company growth. Founders may not realize that as the company continues to grow and prepare for generational transition, there is also an evolution in the types of challenges that leaders are faced with and, indeed, in the type of leadership the company requires.

This is where that phrase “that’s the way we’ve always done it” is most threatening, inevitably leading to growing pains. A company’s infrastructure and processes under first and second generation owners may be stable and supportive, but with revenue growth, larger headcount, a broader customer base, and wider product or service offerings comes a need to reevaluate the founding infrastructure. And, frankly, some business owners are unwilling to do so.

The Challenges Facing Family Businesses

Today’s business landscape is particularly turbulent, with post-pandemic and geopolitical circumstances top of mind for many leaders, on top of emerging technologies, shifting consumer values, and persistently high quit rates and retirements.

Digital transformation accelerated exponentially when the pandemic first shut the doors of companies across the globe. Leaders who prioritized technology found it easier to pivot to remote work and serve their customers through digital means. But a PwC survey of family businesses revealed that only 38% report strong digital capabilities. This is significant, considering that stronger tech capacity translates directly to better performance, increased agility, and greater transparency. Family businesses that are struggling to adapt to digital transformation are at risk of falling behind as the world moves on without them.

Technology isn’t the only area where businesses are forced to keep pace: a growing demand for sustainable business practices—from customers and employees alike—is driving many leaders to spend more time and attention on their environmental and social responsibilities.

But only 23% of U.S. family businesses are prioritizing sustainability. That said, making a positive impact on their communities is an innate quality of family-owned companies—more than 80% already have social responsibility initiatives in place in their communities, particularly in the form of philanthropy. However, sustainability goes deeper than charitable giving and must become inherent to the way a company operates and delivers. This is a shift that businesses will need to embrace if they hope to see continued growth.

Finally, family-owned businesses are not immune to the Great Resignation and the increasing rates of retirement—even among their own family members. Their higher levels of trust and retention give them a leg up over other companies, but the fact is that only 30% have a succession plan in place. Succession planning is a sensitive topic for family businesses—and studies show that few survive the generational transition—especially by the third generation. Relationships are inherently personal, and conflict and trepidation are often unavoidable. Though there has been a significant uptick in formal succession planning since the pandemic—the percentage was just 15% in 2018—there is often the question of whether the next generation are the right leaders in the first place—and when to start recruiting external leaders instead.

How External Leadership Can Benefit Family-Owned Businesses

A family-owned company isn't just a business. It's often perceived as *the* most important family asset. As a result, it can be tremendously difficult for owners to recruit and trust external leadership to step into a family business. The passion and motivation of the founding CEO were driving qualities for the business in its first iteration, but as business grows and new generations are mentored, expansion inevitably leads to a complexity of decisions that require skills and experience outside of those initial leaders.

External executive hiring for family businesses represents a unique challenge—one that may require an executive search firm that has extensive experience in finding the right fit. After surveying many family businesses that have engaged outside leadership, PwC reports that candidates who are self-aware will be the most successful in using their outside perspective to drive growth. In particular, there are three categories of personality traits that are critical: Intellectual scope (curiosity and insight), inner strength (perseverance, resilience, and flexibility), and outer reach (strong people and relationship skills).

Of course, finding candidates with the right skills and experience isn't enough. They must share the company's values and be aligned from a cultural standpoint, ready to commit to the legacy the founders initiated. Ultimately, there's no "silver bullet" that works for every family business. This is further seen in the relationship that ensues after a candidate is hired; some external leaders are purely professional and stick to business, while others grow an intimate bond with the family. The dynamics of the company and the family itself will largely drive what that relationship looks like—are the founders and previous generations on board with the transition? Are they reluctant to allow changes to established objectives and processes? The best external leaders will know how to respond accordingly, guiding the business forward with compassion and strategic intention.

Finally, onboarding and integrating the right external leaders is a critical part of the process, but done well, the benefits are manifold. A family business with outside leadership is often more attractive to investors who want confirmation of alignment between the interests of the business and those of the family. It's also more attractive for the next generation of talent within the company—other external candidates will want to know that there's no "glass ceiling" for non-family members. Given the right candidate and a robust onboarding process, there is a huge opportunity to leverage fresh perspective, identify weaknesses, question the status quo, and introduce positive and lasting change—in other words, the right external leader is a catalyst for transformational change in a family-owned organization.

Ultimately, bringing in outside leadership takes self-awareness and trust on all sides. The founders started the company to create a sustainable legacy of generational wealth—and bringing in external leadership is essentially putting that inheritance in someone else's hands. But through collaboration and clear direction, external leaders in a family business can ensure that legacy endures for generations to come.