McKinsey&Company

Åsa Björnberg,
Ana Karina Dias, and
Heinz-Peter Elstrodt

Fine-tuning family businesses for a new era

Organization October 2016

Family businesses were the particular beneficiaries of three decades of favorable global economics. Now operating *a la familia* should prompt soul-searching about how they manage their unique strengths.

It was, in many ways, the best of times. For the past 30 years, the rise of new consumers around the world, declining input costs, and the expansion of global supply chains have lifted multinational corporations to their longest and most powerful run of profit growth in the postwar period. From 1980 to 2013, global post-tax corporate earnings rose from 7.6 percent of world GDP to nearly 10 percent, outpacing GDP growth by 30 percent. Corporate net income rose even faster, surpassing GDP growth by 70 percent.[1]

Family businesses did especially well riding this rising tide. Propelled by fast growth in the emerging world, their share of the companies in the global Fortune 500[2] grew from 15 percent in 2005 to 19 percent in 2013.[3] Five years ago, founders or their families owned some 60 percent of emerging-market companies with sales of $1 billion or more. By 2025, an additional 4,000 companies may join the list, so that family-owned businesses would then represent 40 percent of the world's large enterprises, up from roughly 15 percent in 2010, according to McKinsey research and expert projections.[4]

For companies of all types of ownership, this remarkable era may be drawing to a close. There are now twice as many multinationals as in 1990. Many are from emerging markets and compete in the tech sector. These companies are expanding aggressively, focusing more on revenue growth and scale than on profit margins. Meanwhile, the prospects for global growth and opportunities to exploit supply chains are dwindling, and falling costs may have bottomed out. Many of these trends were already visible in the past decade; as they gather pace over the next one, they could dramatically slow down the growth of profits. Real growth in net income could fall from 5 percent during the past 30 years to 1 percent in the next decade. As a share of world GDP, profits could decline to 7.9 percent—undoing, in a single decade, most of the gains of the past 30 years.

For family businesses, the changing environment poses distinct opportunities and challenges to a business model that has delivered outsize gains during a protracted period of economic expansion. These companies have long been active in Europe, but today they have an

[1] Richard Dobbs, Tim Koller, Sree Ramaswamy, Jonathan Woetzel, James Manyika, Rohit Krishnan, and Nicolo Andreula, "The new global competition for corporate profits," McKinsey Global Institute, September 2015, McKinsey.com.

[2] We define a family-owned business as one in which a family owns a significant share and can influence important decisions, such as the election of a chief executive.

[3] Fortune 500 list, 2014, fortune.com; and McKinsey analysis.

[4] Åsa Björnberg, Heinz-Peter Elstrodt, and Vivek Pandit, "The family-business factor in emerging markets," *McKinsey Quarterly*, December 2014, McKinsey .com.

even larger presence in some emerging economies, such as those of China, India, Latin America, and Southeast Asia, where they account for roughly 40 percent of total revenues. They tend to predominate in consumer-facing sectors (such as retail, consumer goods, and automobiles) and are less prominent in infrastructure-intensive ones (such as transport and utilities). Family businesses are also less common in innovation-intensive, asset-light sectors (like pharmaceuticals, IT, and finance), whose share of Western corporate profits has nearly doubled since the turn of the century.[5]

Overall, family businesses deliver returns on assets that are comparable to or even higher than those of state-owned or widely held companies. But what's noteworthy about their performance is asset productivity and brand value: their asset turnover, or ratio of revenues to invested capital, is roughly twice that of other companies, and they account for 80 percent of the brand value of the world's most valuable labels. These attributes are especially strong in family businesses from developed economies, possibly because many of those in emerging ones focus on rapid growth and expansion.[6]

Despite the growing power and influence of family businesses, executives and investors typically have a poor understanding of the unique attributes providing that edge. Indeed, it is difficult to parse the DNA of family businesses—a complex mix of family, management, and wealth creation, all overlaid with a rolling ownership dynamic that claims all but 30 percent of them by the third generation.[7]

To better understand the complex dynamics now at the heart of the most successful family businesses, we combined a series of interrelated research efforts to distill the unique elements that sustain their performance, as well as the factors that promote dysfunction and decline (see sidebar, "About the research"). We used surveys, more than 200 hours of interviews with family members and executives of such businesses, and a proprietary in-depth study of their health factors. These helped us to explore how the elements that influence their fortunes differed from those of other businesses and how they manage their unique challenges. We also investigated the options they can use to stay in the competitive sweet spot as the economic landscape shifts and as the complex tensions between personal and professional life—tensions that lie at the heart of the family business—continue to intensify.

Four dimensions emerged as sources of differentiation and tension among these businesses. *Entrepreneurial vision*—in particular, a long-term orientation and a diversified portfolio—is a hallmark of successful family businesses. But this advantage is often jeopardized by emotional attachments and risk aversion, which stifle innovation just as it is becoming even more critical to corporate success. The top-performing family-owned businesses use a *governance approach* that regulates company, ownership, and family topics, thereby avoiding too much or too little formality. *Family capital* builds remarkable organizational cultures that speak to both the hearts and heads of employees—unless its elements are overdone and promote a dangerous introversion.

[5] Richard Dobbs, Tim Koller, Sree Ramaswamy, Jonathan Woetzel, James Manyika, Rohit Krishnan, and Nicolo Andreula, "The new global competition for corporate profits," McKinsey Global Institute, September 2015, McKinsey.com.

[6] Ibid.

[7] Christian Caspar, Ana Karina Dias, and Heinz-Peter Elstrodt, "The five attributes of enduring family businesses," *McKinsey Quarterly*, January 2010, McKinsey.com.

About the research

McKinsey's Family Business Practice set out to answer three questions that have long confounded experts on family businesses. Does their ownership confer an advantage? What drives their performance? How do they solve their specific challenges? To address these questions, we teamed up with family-business experts from four business schools to design a research program that we conducted over two years.

In reviewing existing research, we noted that most studies predominantly included the owning family as participants, that a majority of longitudinal studies were based on databases and not actual field data, and that the case studies generally were not sufficiently detailed. We saw an opportunity to probe deeper and ask the people in these companies questions that would help us develop a more comprehensive perspective on their inner chemistry.

This research program evolved to comprise a number of methods, groups of participants, and samples. Our methods included the following:

1. In-depth interviews to map family-business solutions. We conducted more than 200 hours of interviews with 120 family members and business leaders from 15 companies (based in ten different countries) with total revenues of more than $60 billion and 400,000 employees around the globe.
2. A quantitative field survey to investigate drivers of the performance of family businesses. Our sample comprises 1,200 respondents from participants at the companies we interviewed. They include family owners, board members, nonfamily executives, other nonfamily employees (extending several levels into middle management), close advisers, and next-generation family members.
3. An analysis of the McKinsey Organizational Health Index database to establish the comparative health of family-owned and other businesses. The OHI database contains 114 surveys of family businesses and 128,000 respondents who work at them, as well as 1,200 surveys (with 1.2 million respondents) of nonfamily companies.
4. An analysis of the Fortune 500 database to establish the longevity of family companies and their share of all companies. We collected and analyzed data from 2005 through 2013.

Our work continues. We aim to build a global best-practice database, starting with 20 family-owned businesses and expanding it to more than 100 in coming years.

Perhaps the number-one worry we encountered in conversations with family owners was the challenge of *developing the next generation* as motivated and responsible shareholders. Addressing this topic, which is critical to the long-term sustainability of family businesses, calls for both a technical and an interpersonal focus.

Maintaining entrepreneurial vision

The classic family enterprise starts with an innovative founder who leads it through some of its most dramatic growth years. It's increasingly evident that maintaining this entrepreneurial edge is critical for long-term survival. Creative destruction constantly churns the rankings of companies in the S&P 500 index of the largest US corporations. Renewal is a strategic imperative.

One advantage that these businesses start with is their strategic long-term thinking. Nine out of ten family-business leaders and top nonfamily professionals who participated in our research underlined the importance of long-term thinking in decision making. That's quite a sharp contrast with the short-termism evident at many publicly owned companies. Sixty-three percent of more than 1,000 board members and C-suite executives from family and nonfamily businesses reported increasing pressure to perform in the short term. Armed with a long-term vision and less subject to market pressure, family businesses can make investments and undertake portfolio strategies that publicly owned companies resist.

But as family businesses grow through the generations, barriers to entrepreneurship and innovation creep in. These businesses are famously careful with their capital for two reasons: they are often not willing to dilute the family's equity stake, and they are risk averse about leverage. That attitude may not be as well suited to an era of profit constraints, when advantage is shifting to nimble, idea-intensive sectors revolving around R&D, brands, software, and algorithms. In our survey of board members, top managers, and family owners, 60 percent disagreed or strongly disagreed when we asked them if their companies took risks when situations couldn't be controlled.

The result is often a failure of renewal and resolve. A McKinsey study of 200 large companies over a ten-year period showed that those with passive portfolios—they didn't sell businesses or sold only underperforming ones under pressure—did less well than companies with active portfolios. The best performers systematically divested and acquired companies. Close-knit family leaders add to the problem of renewal by acting slowly—particularly when shedding underperforming assets. "The hard part is letting go," says one family owner. "We tend to decide by consensus, but that often means the lowest common denominator, not the best decision for the business." A similar perception exists for innovation: overall, respondents to our survey described their companies' approach to it as neutral rather than weak or strong.

The good news is that many close-knit family businesses have the ingredients needed to retain an entrepreneurial edge. Maintaining a long-term view is one critical factor. Tapping the inherent strengths of family capital (as we discuss below) can harness the trust and commitment of

both owners and top management. That kind of trust is often absent in more broadly held organizations. A third element is the highly educated and able cohort of next-generation leaders that almost all family businesses have. The ability to put family members into leadership roles early can provide a competitive advantage, particularly at a time when technological disruption rapidly reorders industries and consumer behavior changes dramatically with each new generation.

Sometimes the challenge of renewal calls for breaking with long-held interests. At one large European family-owned industrial conglomerate, the question was how to restructure its portfolio downstream into consumer-facing areas. While its traditional businesses were highly successful and profitable, the controlling family realized that, over time, it would not be able to expand both parts of the business, so it divested the one with the higher capital intensity. Another conglomerate systematically divested all businesses in which the family would not be globally relevant unless it diluted its ownership share.

Our research points to three mutually reinforcing approaches that successful family businesses use to maintain and, in some cases, restore their entrepreneurial energy and innovation. First, they align on an ownership strategy. Over time, different members of a family that owns a business will inevitably embrace objectives that require different levels of risk, and some will want mostly to preserve the family's wealth, while others want to enlarge it. Such differences can bog down strategy and decision making.

Aligning owners on one set of objectives and guidelines can reduce the tensions that plague all multigenerational family businesses. In one large third-generation conglomerate, the owners of four branches with very different growth ambitions and risk appetites had long found it hard to make decisions on possible M&A targets. Through negotiations and the extensive modeling of assumptions about growth, risk, and liquidity, the owners of the individual branches better aligned their objectives for the future. This, in turn, opened up a path to speedier decision making about M&A opportunities.

Second, we find that many family businesses sustain an entrepreneurial spirit by internalizing the market's creative destruction, which forces them to build, operate, and terminate businesses constantly. One approach is to divide the portfolio into three parts: a creation part, often represented by venture-capital activities; a core part, often run through a classic corporate center; and a trading part (with defined exit rules), often represented through private-equity funds. Some long-standing European family businesses clearly separate the components of their portfolios in this way to encourage a diversity of managers, performance metrics, and business cultures. The inherent long-term perspective of family businesses enables such a strategy in ways that companies driven by quarterly results have difficulty matching.

Finally, family businesses can boost their entrepreneurism by fostering the talent of the next-generation owners. Research shows that their "emotional ownership" is generally high, even

when they are not directly involved. Almost two-thirds of the next-generation family members we questioned said that they felt themselves to be part of the family business whether or not they worked for it.

If a company seeks to involve the next generation in the business more closely, one way is to segment its members by talent and to match them with components of a dynamic portfolio. In practice, this could mean that those who show an aptitude for entrepreneurship might run the family venture fund or build new businesses supported by the company. In a number of family-owned retailers, for example, next-generation leaders have separated the e-commerce arm from the core business. Another segment might demonstrate a penchant for corporate life, which could be pursued within the core business. Still another segment, with a talent for trading, might work in the private-equity arm.

Above all, the key to the ability of family businesses to thrive in an era of new constraints could be injecting the markets' dynamism into their ongoing business operations and mastering the expertise to operate and trade companies at the ownership level. The inherent aspiration to create something permanent gives these businesses an advantage as long-term thinkers. But in an ever-faster-paced world, many of them fall behind because they are excessively risk averse and too emotionally attached to legacy assets. Next-generation leaders can often play a critical role in making this strategic pivot when they get the responsibility for bringing expertise in new technologies to bear on the existing businesses. In other cases, we have seen new-generation leaders focus on venture capital to foster new opportunities that carry old-line businesses into the future.

Finding the right governance balance

The entrepreneurial drive and personal commitment at the heart of family businesses gives them an advantage over companies with a more fragmented shareholder structure. However, examples of family-owned companies with concentrated ownership, weak transparency, and a record of treating some investors unfairly are common. As a result, they face many unique challenges to arrive at a durable governance structure that can handle the needs not only of the company but also of the family and the ownership group. The task of finding a balance between the family's informality and a more rigid governance bureaucracy grows as businesses expand.

When we gauged a broad range of organizational-health measures, we saw that family businesses have particular governance strengths—for example, more delegation and empowerment than would be characteristic of companies that have a broader shareholder base.[8] They are also better at producing inspirational leaders, offering career opportunities to employees, and rewarding and recognizing them for good work. In addition, we identified superior practices for coordinating and controlling performance reviews and managing operations and finances.

[8] For the past ten years, McKinsey's Organizational Health Index has measured and tracked organizational health in hundreds of companies, business units, and factories around the world. Nearly two million employees have answered questions relating to the health of their organizations. We then produce a single score, or Organizational Health Index, reflecting the extent to which employees agree that their companies meet empirically derived litmus tests in each of nine dimensions of organizational health.

The healthiest family businesses, we found, emphasize building commitment and inspiring employees by giving them a sense of involvement, providing career opportunities, and encouraging personal responsibility. The least healthy[9] ones overemphasize an authoritarian leadership style, formal policies, and rules. Such traits encourage bureaucracies that often slow down decision making—traditionally, a problem for consensus-driven family businesses. When we asked 161 of their executives if they found it easy to make investment decisions, just 24 percent said that they did. Only 12 percent said it was easy to make capital-allocation decisions. Only 6 percent think that their companies make both types of decisions quickly.

In an era when agility is at a premium, the key challenge for many family businesses is finding the right path from an informal, centralized decision-making process to a more empowered top team. One way to speed up decision making is to concentrate shares in the hands of fewer stakeholders. In a fourth-generation European company, more than 15 cousins held similar numbers of shares but had different levels of interest in the business. Decision making therefore became increasingly complex. After five brothers bought shares from their cousins, the company could define new roles and responsibilities that speeded up decision making.

In our experience, the hallmark of long-lived family businesses is strong governance revolving around an active board of directors that steers the business, accompanied by a separate council to manage family matters. The trick is to avoid an excessively formal governance process and slow, difficult decision making. In our survey, nine out of ten family-business directors said they had a clear understanding of the roles and responsibilities of the board, were motivated to serve on it, and trusted one another. About eight in ten said that board members were aligned around the future direction of their companies.

However, other executives, especially nonfamily ones, see opportunities to improve these boards. “We need younger, new blood,” one executive said. “We need to have international experts to develop expertise in some key strategic areas.” Diversity is another issue: eight out of ten board members (all current family owners and top executives) said that the personalities of board members and executives were similar. Only 10 percent of the companies we surveyed have a woman on their boards.

One of the most striking insights from our research into the elements that distinguish better-performing family businesses from the rest is the importance of informal, inspiring leadership that provides generous career opportunities for nonfamily professionals (Exhibit 1). The worst performers often have a rule-based, authoritarian governing style. The involvement of owners in top management holds the promise of dramatically boosting a company’s strategic agility, particularly compared with CEOs of publicly held corporations. The fact that a majority of large family businesses remain privately held underlines this point. When the need for a more formal governance structure arises, such businesses shouldn’t lose sight of the role leadership plays in maintaining the entrepreneurial spirit of the company founder.

[9] Defined as family businesses in the bottom quartile of McKinsey’s Organizational Health Index.

Exhibit 1

Family businesses outperform nonfamily businesses in motivation practices and results.

Gap between family and nonfamily companies (0 to 100 scale)

McKinsey&Company

The family-capital conundrum

Family capital, a bundle of unique resources, represents a true differentiator between family-owned businesses and companies with a fragmented shareholder base. In short, family capital expresses itself as the organization's culture, ethos, and network. While hard measures linking it to performance are elusive, it clearly conveys powerful advantages. For example, our Organizational Health Index database indicates that family-owned businesses enjoy a significant advantage in providing career opportunities to employees—a gap that grows even wider among family businesses in the top quartile of healthy companies. Family capital also conveys intangible organizational advantages, including a sense of belonging, loyalty, and commitment to the development of employees. In addition, it fuels a social conscience that extends to philanthropic engagement and fuels a virtuous cycle of family capital.

Our research unpacked the four distinct components of family capital: tribe, family identity, trust, and stewardship (Exhibit 2).

Tribe

Tribe is the sense of connectedness, shared culture, and support in the social fabric of a family business—beyond the immediate "clan," or owning family. It is expressed through a sense of closeness that nonfamily employees feel toward the owners. Around two-thirds of respondents in our survey said that they felt or strongly felt a degree of togetherness in their organizations and believed that the owning family would help employees in a personal crisis.

Vitabiotics, the UK producer of neutraceuticals, provides an example of this sense of connection in a first- and second-generation family business. Treating staff as extended family is a core company and family value. When a longtime member of founder Kartar Lalvani's administrative staff became ill, he provided her with treatment for several months until she recovered. Although the employee could not work full time upon returning to the job, Lalvani paid her a full salary for five years.

In another large family-owned business, family owners and the nonfamily CEO take to the road throughout the year to demonstrate a commitment to the wider workforce. In what an executive calls "management by walking," company leaders meet 7,000 employees each year, interpreting and espousing the family's values through engagement with the workforce.

Exhibit 2

Family capital creates a competitive advantage for family firms.

Bright side of family capital	Four factors a family organization has by virtue of its ownership	Dark side of family capital
• Closeness to family • Togetherness in organization	1 Tribe	• Less diversity in the organization • Culture of "fit in or fly off" • Difficult performance management
• Identification with family business • Family-ownership image • Family atmosphere	2 Family identity	• Introversion • Lack of innovation and knowledge-sharing culture
• High trust in family • Open environments	3 Trust	• Blind trust • Complacency
• Solid family values • Business's interests come first • Long-term view	4 Stewardship	• Authoritative leadership • Excessive attachment

McKinsey&Company

Family identity

The degree to which members of families that own businesses identify with them can vary widely. Family identity also extends to how consciously families decide to express their image through the company's brand and how much a sense of family promotes the family's legacy and visibility in the market. In our survey, 72 percent of respondents said that family values are incorporated into the business brands of their companies. Fifty-nine percent said that a sense of family atmosphere upheld the owners' visibility and legacy. Yet there is room for improvement. Overall, only 46 percent of respondents said that they agreed or strongly agreed that family identity was felt at all levels of the organization.

British footwear-maker C&J Clark is an example of a company conscious of preserving a family identity in its business. Its leadership style, which relies on consensus to make decisions in board meetings, expresses the owning family's Quaker roots. Company leaders also made a conscious decision to keep the headquarters in the rural English village of Street, despite its remote location, to honor the family's origins. The physical attributes of the headquarters building manifest the family's culture and history, which includes an artistic vein. Paintings, sculptures, and idiosyncratic architecture selected by family members fill the building, and the original longhouse factory for making shoes by hand is maintained as a mini-museum in the otherwise modern and sleek headquarters.

Trust

In essence, family capital's trust element refers to the owners' reliability: the degree of trust the organization's members have in the ability of family leaders to improve the company's performance, to keep their promises to stakeholders, and to do what they say they will do generally. Our research finds that respondents have a high level of trust in family leaders.

Trust also extends to the broader communities where family businesses operate. At one Indian business in our sample's infrastructure-and-construction sector, the chairman uses the family

foundation to build trust in places where the business operates, since its large construction projects can disrupt them, and to instill his values of teamwork and respect for individuals into his employees. The foundation's efforts include operating mobile hospitals that treat thousands of residents, building free vocational-skill centers, and establishing village-level empowerment groups that help women build marketable skills. Employees are motivated to participate in this kind of community work by receiving three paid days off each year to devote to the foundation's projects.

Stewardship

In the chemistry of family capital, stewardship denotes the strength of family values, the idea that family leaders put the organization's interests above their own, and the degree to which they take a long-term perspective. Overall, our research found that large majorities of respondents, from board members to middle managers, believe that family leaders serve as good stewards. In our organizational-health research, family-owned businesses scored significantly better than other companies for shared vision and meaningful values. When we asked family and nonfamily members of these businesses to state their most important values, five led the list: a long-term perspective, honor, doing the right thing, fairness, and authenticity. In our experience, the vision of the founder is the unique source of values for family businesses.

Of course, the benefits of even a positive family-oriented network can go awry in the mix of personal and professional tensions that may characterize such a business. If applied in excess, the qualities that make up family capital can encourage overly authoritarian leadership and introversion, discourage diversity, and build a "fit in or fly off" culture. These weaknesses can make managing performance all the more difficult.

Awareness of family capital's dark side is the first step in controlling it. The second is a concerted effort to counter these negative effects by systematically sharing knowledge, encouraging innovation, and implementing solid talent- and performance-management systems. Family businesses are also extremely well positioned to counter a lack of diversity: half or more of their shareholder base is typically female. Yet only a tiny portion of our participating businesses have even one woman on their executive committees. McKinsey research finds that companies in the top quartile for gender diversity have returns on equity that are 47 percent higher than the returns of those with no women at the top. Including outside nonexecutive directors to challenge company leaders is another way to battle blind trust and complacency.

Family capital is the strongest intangible asset of family businesses. In the most successful ones, owners can always be seen to hold strong values, adhere to them, and pass them along to the new generation. In some companies, the processes to encourage this outlook are quite elaborate. Attracting, aligning, and motivating employees are necessary steps in building a strong culture—the inimitable, competitive advantage of any organization.

The next-generation imperative

Since so few family businesses survive to their third generation, it is perhaps not surprising that respondents to our survey strongly indicated that developing, engaging, and motivating the next generation of family leaders is their biggest challenge. The logic behind these sentiments is clear. Family owners want to keep the next generation involved to maintain the business as a source of family pride, to preserve the founders' legacy by keeping it within the family, and to better maintain the family's values and image in society. Accomplishing all this during a period of swarming new competitors and tighter profit growth is a challenging task.

Our respondents say that conducting generational transitions isn't easy, either for newer businesses or for those that have survived as long as seven generations. Survey participants cite the challenges of ensuring that values remain constant across generations whose lives can vary widely—compare the international MBAs of younger generations with the more home-grown experience of older ones. Attracting younger family members to a business is also difficult if they have competing job opportunities or their interests differ. When to begin a generational transfer is challenging, too, since it has no clear starting point. Finally, the transition is something that most families prefer to avoid because the change and loss it involves are difficult.

Successfully managing the development of the next generation as motivated and responsible shareholders requires both a technical and an interpersonal focus. A critical element is providing new family executives with support to manage their careers. Our research points to three important guidelines for family businesses engaging the next generation and preparing it for succession.

1. Build emotional connections. The survey revealed high levels of emotional ownership in the presiding family group and the next generation (Exhibit 3). Seventy-seven percent of these respondents rated their emotional ownership as high or very high. But when asked if the older generation was very responsive to the needs of younger ones and took a close interest in their activities, 36 and 30 percent of next-generation respondents, respectively, disagree or are neutral. "Communication is difficult, especially across generations and borders," says one younger family executive. "We live in quite different worlds."

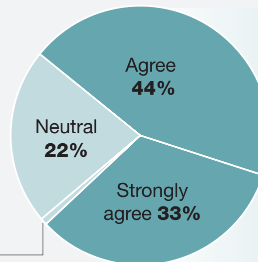
The gap highlights the need for more active, clearer communication by older leaders, as well as support to promote active and emotional ownership among younger family members. By keeping them informed about what's happening in the business—for example, arranging regular meetings and promoting family rituals—the current leadership can stimulate communication to engage them and transmit family values.

2. Develop responsible shareholders. Our survey revealed that next-generation family members are willing to take on more responsibility in running the family business but lack the confidence to do so. Two-thirds of them would like to have more responsible ownership roles,

Exhibit 3

Emotional ownership for the next generation is high.

Respondents, %



McKinsey&Company

yet only 30 percent feel confident about making decisions involving the family business. Just 30 percent feel that they manifest active ownership in it,[10] compared with 94 percent of family members who work there.

Developing responsible shareholders is thus a top priority for family leaders to uphold tradition and increase the company's value for the future. "It is essential that the next generation understand the importance of our legacy," says the chairman of one family conglomerate.

Preparing the next generation to engage more deeply in the affairs of a family business begins with a concerted communications strategy to engage younger members. Engagement has to go beyond family newsletters and assemblies. The best advances come when the next generation takes charge of its own personal development. In one such business, younger family members shaped their own shareholder-education program and hired professionals to help them run it—with the seniors' blessing, of course. Another family focuses on creating mechanisms to help it make the best decisions for the broad family group, whose leaders have set up a venture fund that teaches the next generation to make business decisions collaboratively. Families achieve the highest level of engagement when their members work together in the informal and relaxed way that younger people value.

3. Establish clear rules and career paths. A leadership position is not the only role for members of the next generation. There are several important roles to be played above and beyond full-time employment, including work as advisers, board members, family-foundation leaders, and responsible and active shareholders. It's critical to develop the paths available and to explain how family members can embark on each of them.

An open-door policy for family members is common in the first generation, to reflect the wide variety of career paths in the working world. We have found that clear guidelines and guidance are necessary for those who want to join the business. These include clear rules about meritocracy, explicit entry and exit requirements, and conditions (such as feedback from managers and coaching) for development.

This is a long game to play, but family businesses are uniquely positioned to succeed at it. Many owners have grown up with a stewardship model that calls on them to give the next

[10] Active ownership encompasses elements such as a willingness to take risks for the family business, playing an active role in its decision making, and feeling confident about having sufficient knowledge to make these decisions.

generation something better than what they received. By focusing on family capital and making additional investments to support it, attentive owners can weather—and thrive in—an era of heightened constraints. □

Family businesses outperformed more widely held competitors in many ways during an era of expanding profitability. But a new era of profit constraints will test the strengths and weaknesses of a business model that uniquely mixes the personal and the professional. Family businesses that can pivot to greater innovation and savvy risk taking will continue to benefit from their unique strategic makeup.

Åsa Björnberg is an alumnus of McKinsey's London office, **Ana Karina Dias** is a partner in the São Paulo office, and **Heinz-Peter Elstrodt** is a senior partner emeritus.

The authors wish to thank Eleftheria Digentiki, Daniela Rosa, and Sree Ramaswamy for their contributions to this article.

Copyright © 2016 McKinsey & Company. All rights reserved.