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Is hiring a professional manager better than handing the family business to an heir? Is business performance affected when the family head stays on as CEO or adviser? A study of 2,000 listed Japanese family businesses yields some answers.

How Singapore's family firms can go the distance

By CHANG SEA-JIN
FOR THE STRAITS TIMES

FAMILY businesses in Singapore play a significant role in driving the economy. Among the companies listed on the Singapore Exchange, family firms feature prominently, comprising 60.8 per cent of all firms. They also dominate most industries, in particular, construction, hospitality, property, manufacturing, services and commerce.

As Singapore gears up for SG50 to celebrate its 50th year of independence, many local companies are coming forward to celebrate their success with the nation. Many of these family businesses have successfully transitioned to the next generation, and continue to thrive.

According to a study of locally listed family firms by my colleagues from the National University of Singapore Business School's Centre for Governance, Institutions and Organisations, some family businesses have hired outsiders to be professional managers, while others use a hybrid managing model comprising external professionals and family members.

Choosing a successor for a business is never an easy decision. It is, perhaps, even more difficult when the family business is seen as a legacy, or when the current chief executive is also the founder who is looking to pass on his life's work to someone else.

The business is highly personal, and the clan will inadvertently want to strike a balance between its desire to keep the top management positions within the family – in order to maximise its socio-emotional wealth – and profit.

Choosing an heir for succession is like the lottery. While some family heirs might turn out to be great business leaders, we must acknowledge that not everyone possesses the necessary and superior entrepreneurial skills and will be a capable business leader like the founder.

Professional manager or heir?

HOW can these companies that generated wealth for Singapore in its first 50 years continue to grow and set their sights for the next 50 years? As the global business landscape evolves, how can family businesses better prepare for the future?

When is it the right time for an external professional to lead the company, instead of someone from the family ranks? Would an external professional manager deliver better results? In which situations will the external professional manager perform at his or her best?

To answer these questions, I am going to refer to lessons from Japan, an industrialised Asian nation with a long history of family businesses.

I recently completed a study of more than 2,000 listed Japanese family businesses with my colleague Jungwook Shim from Kyoto Sangyo University, who was also involved in the earlier study of locally listed family businesses.

Only companies that have been operating for at least three years with the successor were included in the study.

We also excluded cases of interim professional manager transitions, which were there to temporarily run a firm until a family heir could take over. Cases where controlling families went bankrupt and had to exit the firms were also excluded.

Then, using ownership and board information available up to 2004, the research focused on 945 succession events that occurred between 1962 and 2001. This ensured that the sample size was large enough across different periods. The average family ownership in the sample was about 17 per cent.

The main performance indicator used in the research was the operating return on assets (OROA), defined as the operating income divided by the book value of total assets.

We found that family firms that converted to professional CEOs displayed substantial performance improvements, compared with those that opted for a family heir. The increase in performance was 1 percentage point in OROA, if we compare performances from one year before to three years after the transition, compared with those that continued with family management.

This was especially true for family firms where the founding families maintained a large ownership share.

This was because the larger the family equity, the better the families could monitor and control the professional CEO's behaviour. This reduced agency cost and improved post-succession performance.

What is the impact of these findings on family businesses here?

It is clear that family businesses should not omit external professional management as an option while they plan for a family heir.

Here in Singapore, a relatively younger country than our Japan sample, there are many family businesses that have succeeded with either model and are still going strong today.

Most Singaporean family businesses, such as the Hong Leong Group (Kwek family), Far East Organization (Ng family) or UOB Group (Wee family), are only in their second or third generation, and do not have as long a history as some of the Japanese family firms in the study.

This observation also allows us to draw valuable lessons from our Asian counterparts as we plan for succession in the long run.

Removing the family influence

ONE of the key points a family business should note when hiring an external professional is that the inherent differences between an "outsider" and a family member also mean that different environments are required for them to thrive.

Family businesses that made the adjustments and provided different organisational structures enabled their successors to maximise their strength, and succeeded.

Our study also found that while greater family equity contributed to better performance, the presence of the de facto leader (original CEO or founder) negatively affected the performance of the external professional.

In his capacity of chairman or adviser, this leader often micromanaged the new CEO (scrutinising his every move) and reduced the latter's role to one of a chief operating officer, rather than a CEO.

Mr Yoshiaki Tsutsumi, the owner of Seibu, remained chairman of the board until 2005. During this time, the company saw the transition of three professional CEOs. This co-habitation of former family CEO and professional CEO can foster mistrust and conflict.

Our study showed that professional CEOs can realise their full potential only when given the space to make real changes or implement new strategies.

We looked at the performance of two groups of companies: One where the former family CEOs stayed in firms as honorary chairman or adviser, and another where they left the firms completely. The result showed that professional CEOs outperformed family CEOs only when former family CEOs retired.

"Family legacy", or how closely a family business is perceived to be linked with the original founder family, also has an effect on how the external professional will perform. When the firms did not retain family names, we found that the performance improvement associated with the transition to professional management was stronger than those that kept their family names.

This is because family legacy, especially when the firms take founding family names, can effectively constrain professional managers when there are strong family visions and founding principles that they are forced to uphold.

Matsushita Electric changed its name to Panasonic in 2008, after experiencing many years of declining performance. By doing so, the professional managers were freed from the vision of founder Matsushita Konosuke, who had left a legacy which continued even after his retirement in 1961. The firm was then able to embark on a strategic reorientation that has led to its present day success.

Our study also revealed some commonly held views relating to factors and characteristics to be untrue. For instance, the hiring of a professional manager who graduated from an elite university did not warrant the ability of the professional CEO to outperform the family heir.

Another interesting finding was that the presence of institutional investors that maintained large ownership shares was not necessarily favourable to the performance of professional managers. The existence of large, non-family block holders did not always lead to better monitoring of founding families' influence and the professional CEO's performance.

Ultimately, as each succession looms, individual family businesses have to first make an objective assessment of their potential heirs before a decision is made on whether to keep it within the family.

Then, the business has to review its organisational structure to ensure that the new CEO is accountable, yet given the carte blanche to take the company to a higher level of success.

It is only with this discipline, and determination, that we can look forward to seeing even more local family-founded businesses celebrating their success with the nation at SG100.

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