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Current and future challenges of family businesses

1. Introductory overview

Family businesses are the engine and backbone of many leading economies (i.e. Germany). They make an essential contribution to fostering the competitiveness and innovation of an economy and make a significant contribution to job creation, which makes them an important job engine (May 2013, 21). The entrepreneurial landscape is characterized by a large number of traditional family-owned companies that can look back on a long success story. Traditions that have been built up over generations and that combine aspects such as trust and reliability play an important role in family businesses. Despite this traditional orientation, family businesses are often characterized by features such as innovativeness, foresight, long-term focus and flexibility. However, both the family businesses and the entrepreneurial families themselves have some weaknesses that must be considered. They also have to adapt to changed framework conditions and challenges – among other things due to digitization, internationalization and demographic change – and they have to develop appropriate solutions in order to be able to survive permanently and successfully in the market. Though the high relevance of the family to the company involves opportunities – for example, when, based on the family, a family strategy with clear values, roles and goals is defined. In addition, the development of so-called family governance is of great importance for the success of family businesses and keeping the company in family hands.

The aim of this paper is to describe and analyse the current challenges of family businesses. Therefore, a normative and literature-based research is conducted to show the impact of the digitization on as well as the importance of innovation for family businesses. Moreover, we will highlight the topic of management.

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succession as a key challenge for family businesses and discuss the various factors that contribute to the success of family-owned businesses.

2. The impact of digitization on family businesses

Digitization is becoming increasingly important and is influencing different areas of the economy and everyday life (BMWi 2017 35/98). The digital transformation is observed everywhere, and therefore family businesses must deal with it (Cravotta et al. 2018, 10). Digitization is leading to a radical revolution in all sectors of the economy (Weissman and Wegerer 2018, 11) and the success and future potential of companies highly depends on its positive implementation (Kreide 2016, 71). Digitization holds great potential for family businesses. This potential must be identified and exploited (Astor et al. 2016, 2).

In order to successfully implement digitization in family businesses, this topic should be integrated directly into their corporate strategy or a concrete digitization strategy should be developed (Weissman and Wegerer 2018, 8). A specially formulated digitization strategy has many advantages, as companies with a digital strategic focus generally have better economic processes and greater connectivity, distinguishing them from companies without such a strategy (Icks et al. 2017, 39). In addition, a digitization strategy allows a more effective control of business activities (Hille et al. 2016, 27). In numerous family businesses, activities to implement the digital transformation are located in the IT department (IfM Bonn 2017, 18). However, it is not advisable to place digitization topics and the development of digitization strategies exclusively in the IT department. Rather, they have to be placed with senior management so that the entire value chain and the potential changes in business models can be continuously managed and monitored (Weissman and Wegerer 2018, 7). Even though providing the necessary infrastructure for digital transformation is within the remit of the IT department, it is essential that the IT department considers the needs and requests of all players involved. With this in mind, it is very important for family businesses to understand that digitization is a development that will affect all sectors of their business (Hille et al. 2016, 52). To succeed in digital transformation, family businesses must therefore undergo a cultural change (Bartels et al. 2017, 4). When implementing their digitization activities, they always have to take into account their specific orientation, for which

- loyal employees,
- long-term planning,
- extensive control processes,
- a comprehensive culture of errors
are characteristic (Windthorst 2018). It is also important that family businesses stick to their values and goals that are an essential part of their corporate culture. This means that the interests of the entrepreneurial family must be considered in all decisions (Kreide 2016, 70).

Digitization poses major challenges for family businesses in particular because it must be brought into line with the specific characteristics of family businesses (Hille et al. 2016, 7). Family-owned businesses typically have a long-term organization characterized by trust and based on fixed values and goals. In comparison, digitization is characterized by features such as dynamism, innovation, speed, and real time (Bartels et al. 2017, 4). The task of family businesses is therefore to tailor their business models to the changing circumstances and demands of the digital age. Above all, the transition from one generation to the next offers great opportunities to advance digital transformation (Hille et al. 2016, 7), as the older generations make targeted use of the skills of the next generation. Thus, the experience of older entrepreneurs is reconciled with the innovative ideas of their successors and they will benefit from the creative ability and trustworthiness of the younger generation (Bartels et al. 2017, 12).

3. The importance of innovation in family businesses

With regard to the particularities of family businesses, it is important to investigate to what extent these characteristics influence their innovation activity (Halder 2016, 65). A key factor involved and a significant differentiator to non-family businesses at the same time, is the unity of ownership and management (Werner et al. 2013, 1). This structure allows the resources needed for innovation to be made available by the family members, who are often senior managers at the same time. In this way, they can drive innovations in the company (Bauer 2013, 129). Above all, the uniqueness of resources in family businesses – which can be traced back to the interaction of the family, the company and the individuals – is a significant advantage (Heider 2017, 58). Furthermore, due to the long-term orientation of family businesses, it is reasonable to assume that family entrepreneurs are willing to invest heavily in innovation (Kammerlander and Prügl 2016, 7). However, in practice, family entrepreneurs are often characterized by a particular thriftiness, reflected in the fact that spending on resources is moderate, to ensure that companies are not exposed to excessive risk (Bauer 2013, 132). Even though investments in research and development are rather cautious, innovations are still playing an important role in family businesses (Kammerlander and Prügl 2016, 8). According to a recent study, innovation spending by family businesses is low compared to non-family businesses, but at the same
time they have a higher propensity to innovate (Duran et al. 2015, 1224). This means that they achieve more innovative outcomes than non-family businesses. This shows in their share of sales resulting from innovations (Kammerlander and Prügl 2016, 8). In addition, the long-term orientation of family businesses favours the development of expertise and its permanent manifestation within a company, which in turn has a positive effect on the realization of innovative measures (Werner et al. 2013, 32). Current studies show that the long-term focus and the striving for success of family businesses have a positive effect on their entrepreneurial orientation as well as their ability to innovate (Heider 2017, 216).

Furthermore, the corporate culture, which is fundamentally determined by the family, influences the ability of family businesses to innovate (Kammerlander and Prügl 2016, 26). Above all, the sense of togetherness between employees due to the cultural characteristics has a positive effect on the successful realization of innovation projects (Bauer 2013, 132). Moreover, one key factor influencing the innovative capacity of family businesses is company size (Binder 2014, 94). In general, the larger the family business, the smaller the family influence. Therefore, it can be assumed that with increasing business size, the innovation activities decline. The cause of this tendency lies within the shorter decision-making and the more informal organisational structure in smaller companies (Werner et al. 2013, 32). As a result, smaller family businesses tend to be more innovative than smaller non-family businesses and large family businesses are often less innovative than large non-family businesses (Heider 2017, 127).

In addition, regional orientation is another factor influencing the innovative behaviour of family businesses (Heider 2017, 129). The intensive anchoring in the region plays an important role especially if the companies have already been based in the same location for a long time. Often, longstanding individual relationships with stakeholders have been built up and the resulting expertise and information are a helpful support in innovation development (Werner et al. 2013, 32). In general, family enterprises rather than non-family businesses tend to integrate existing clients and markets at an early stage in the innovation process (Binder 2014, 94). However, they should also look for other markets where they are currently not active, but which open up sales opportunities for their existing technologies and they should bring their already existing technological knowledge into these markets (Hastenteufel and Staub 2019, 136).

A key challenge facing family-owned companies is that they can successfully survive in the field of tension between innovation and tradition (Felden and Marwede 2018, 60). Family businesses are characterized by a strong sense of tradition and deeply rooted values that are preserved and shared across generations. However, there is always a risk that this traditional bias may inhibit innovation behaviour. Family businesses that want to be successful in the long term must
be able to master the balancing act between traditional orientation and innovative development by maintaining the traditions necessary for their survival and responding flexibly to change (Hastenteufel and Staub 2019, 136).

4. Business succession as a major challenge for family businesses

Management succession poses major challenges for family businesses. Therefore, they have to start early with any succession plan in order to plan it comprehensively (Kenyon-Rouvinez 2012, 102). One of the biggest challenges of the succession process is that, in many cases, the former owners do not prepare for their succession in time and cannot find an adequate successor for their business. Another challenge is the strong emotional attachment of many lenders to their business, which makes letting go of their lifework difficult. Among the possible successors, the biggest problems are
- financing difficulties,
- lacking professional qualifications and
- the lack of suitable companies to take over (Evers 2017, 8).

Furthermore, in the context of company succession, psychological aspects are also very important. A profound emotional connection between the individual actors involved in the succession process leads to obstacles in the succession (Schlippe 2012, 170). For the former owner, the transfer of his business to a certain extent also means the passing on of his life’s work, for which he has worked hard over decades (Wiesehahn 2015, 32). Many old owners worry about the future and the existence of the company. Therefore, the entrepreneurs often have problems to free themselves from what they have built up with much effort and passion. Particularly in the case of family-internal successions, conflicts often occur within the family or between the different generations. These arise mostly when the interests of the individual family members are different, and several goals are pursued. Such differences often prevent a successful business succession (Hastenteufel and Staub 2019, 138). In addition to family disputes, many other reasons – e. g. inadequate preparation for succession, lack of capacity for potential successors, or lack of determination on the part of the owner to succeed – are responsible for the failure of a family succession (Steinbrecher and Hyde 2016, 32).

Moreover, the personal relationship between the entrepreneur and the successor plays an important role in the successful creation of a management succession. It is often the case that potential successors do not meet the requirements of the family business owner (Spelsberg 2011, 16). The successful realisation of a company succession therefore highly depends on the person of the successor.
Cabrera-Suárez et al. (2001), for example, consider that the quality of the relationship between senior and junior is crucial for the successor to be able to develop his or her abilities and potentials freely under the given circumstances. The former owner must trust in the skills and competences of his successor and he has to believe that he will succeed in continuing the business (Pirmanschegg 2016, 160). At the same time, however, it also requires the will and determination of the junior to face the challenges of company succession (Schlippe 2012, 170).

In this context, it has to be borne in mind that the potential successor must have sufficient entrepreneurial qualifications in order to be able to succeed (Brach 2015, 223). In general, the successor has to be systematically familiarized with their upcoming role early in order to become familiar with their future field of activity and thus to be confident of his potential and abilities for the new position. During this transitional period, the successor can already gain the recognition of the existing workforce by, for example, working in different technical departments (Nagl 2015, 26). In addition, if there is a succession within the family, it must be checked whether a change in the partnership agreement and/or a restructuring of the company are required (Hastenteufel and Staub 2019, 138).

Furthermore, the entrepreneurial families have to deal with financial and tax issues in this context and there is a need to clarify numerous legal matters. In order to avoid disputes in this regard, the use of a mediator can make sense (Kempert 2008, 61).

In many cases, family entrepreneurs do postpone their succession planning until it is almost too late. In the case of unforeseeable events, such as sudden death, acute illness or an accident of the owner, the company succession is made considerably more difficult. In order to prevent the resulting consequences, the development of an emergency plan that is geared towards such situations is highly recommended (Papesch 2010, 71). A corresponding plan should contain provisions that describe measures in the event that the entrepreneur can no longer manage the company himself (Felden et al. 2018, 62). At the same time, it also serves to be prepared for the situation of failure of the planned successor. With the help of an emergency plan, the continuation as well as the ability to act of a company is guaranteed (Hastenteufel and Staub 2019, 138).

5. Family business governance as a possible success factor

Because of their specific characteristics, family businesses require different governance structures than non-family-owned companies (Felden and Marwede 2018, 62). This can be explained by the fact that family businesses generally have
a management structure consisting of family members with a high proportional stake, whereas non-family companies are mostly managed by external managers who are not necessarily shareholders (Welge and Eulerich 2014, 196). Therefore, to ensure the long-term success of a family-owned enterprise, both the entrepreneurial family’s and the company’s individual needs must be anchored within the company’s governance framework. This is a clear differentiator to the governance of non-family-owned companies (Felden and Hack 2014, 282). Above all, in order to do justice to the family goals and to create transparent structures, family businesses need a corresponding regulatory framework for the management and supervision of the company. In this context, some family businesses have implemented an extension of traditional corporate governance. It is referred to as family business governance (Lueger and Froschauer 2015, 67).

Family business governance consists of business governance and family governance. It offers family businesses the opportunity to stabilize their future orientation across generations (Koeberle-Schmid et al. 2010, 161). Moreover, it is an instrument setting the specific framework for both the family and the company. In general, a family business governance system aims to achieve the best possible governance by seeking to improve its economic and emotional value (Koeberle-Schmid et al. 2012, 29). This requires the establishment of appropriate bodies and mechanisms. Its operational activities should ensure cohesion within the family of entrepreneurs and at the same time create rules for the management and the control of the family business (Koeberle-Schmid and Koners 2018, 22). Business governance in family businesses lies within the responsibility of the executive board and the supervisory board and is supported by typical business governance instruments such as

− risk management,
− internal audit,
− compliance management and
− an internal control system (Hastenteufel and Staub 2019, 186).

At this point, the main task of business governance is to carry out management and monitoring measures (Süss-Reyes 2015, 14).

Family governance as a further component of family business governance is based on the specific family circumstances and must be adapted and developed individually to the framework conditions of each individual family business (Breyer 2015, 152). The goal of family governance is the creation of fair, transparent, verifiable rules for the family and their access to the company (Koeberle-Schmid et al. 2012, 29). Therefore, a set of instruments provides guidelines for the management of the family. In general, family governance promotes unity within the entrepreneurial family and the identification of family members with the company (Hastenteufel and Staub 2019, 186). In order to prevent family conflicts,
preserving traditions, transferring them to the next generations and strengthening emotional values in the family, the development of family governance structures in the family business is a great instrument (Canessa et al. 2016, 99). The task of family governance is, among other things, that the family members explicitly commit to the company and that clear rules for communication within the owner family are formulated (Hastenteufel and Staub 2019, 186).

In practice, family business governance can be implemented by means of various measures, and the design of which varies according to the individual characteristics of each family business. The extent to which family governance instruments are used in a company is fundamentally determined by the complexity of family structures and the relationship between the family and the company. In addition, environmental factors that affect the family business, the concept of man of the entrepreneurial family and the values they live are important (Hastenteufel and Staub 2019, 186). Key family governance tools in family businesses include:

− developing a family constitution,
− implementing family education,
− establishing family activities such as family reunions,
− setting up family offices (Welge and Eulerich 2014, 202).

6. Special conflict management in family businesses

Conflicts occurring in family businesses are very different (Neuvians 2011, 62). Problems usually arise, for example, from the fact that companies do not implement solid solutions to solve potential disputes (Caspari 2018, 29). On the one hand, the potential conflicts of family businesses are (sometimes) very complex and risky due to their structural characteristics (integration of the systems “family”, “property” and “company”). On the other hand, from this interdependence do also derive many opportunities (Hastenteufel and Staub 2019, 189). As a peculiarity of family businesses, it can therefore be argued that they often require separate conflict resolution strategies for both the company and the family (Schlippe 2009, 26).

Above all, due to the close integration of the family and entrepreneurial sphere, family businesses are highly susceptible to conflict, as a result of which the necessity of integrating active and preventive conflict management into the general management of a company becomes clear (Henseler 2006, 180).

7. Financial stability of family businesses

Securing financial stability is also an important premise for family businesses to maintain their independence. A large number of studies show that family
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Businesses do generally have high equity ratios, because entrepreneurial families usually seek to be as flexible and liquid as possible to be able to act (Schraml 2010, 268). In addition, it can be seen that the willingness of family businesses to react in times of economic difficulties was usually better than that of non-family businesses (Hastenteufel and Staub 2019, 189). In this context, it should be noted that family-owned companies have a high equity ratio compared to non-family-owned companies. This is explained in particular by the fact that the families regularly invest private capital in the company, as they want to be less dependent on external creditors (Ampenberger et al. 2011, 15).

In general, family businesses use internal sources of finance as a primary financing instrument, which is illustrated by a partial reluctance to take on debt (Achleitner et al. 2011, 11). One explanation for this is an increased risk aversion of family businesses (Ampenberger et al. 2011, 15). Furthermore, these trends can also be traced back to economically difficult times in which there are restrictions on access to debt capital. In particular, companies that are successful in the market have a low number of bank loans with at the same time high shares of equity (May 2013, 30). It is striking that family businesses tend to limit themselves to a number of different types of financing, so that their financing situation is manageable and better controllable, so that they are more independent (Hastenteufel and Staub 2019, 190).

8. Concluding remarks

The paper shows that, especially in times of globalization, digitization and increased innovation requirements, it is essential for companies to take on the tasks involved in order to be competitive in the long term and to be successful in the market. The specific challenges faced by family businesses are to position their business models in a field of conflict between a generally strong sense of tradition on the one hand and growing innovative developments on the other hand, so that their values are preserved and at the same time remain future-oriented. Besides, the leadership of the company by family members who tend to act in appropriate positions over a longer period plays an important role and is a major factor in securing long-term success.

However, family businesses are increasingly struggling with the requirements of careful business succession planning. Thus, it is highly relevant to implement appropriate preventative measures such as emergency manuals. In this context, it is evident that family-owned companies are, in principle, aware of the shortage of skilled workers and are paying more attention to follow-up issues, although they do often require a more intensive examination of this topic.
The success criteria of family businesses are based on the valuable resource “family”, their unique corporate culture as well as the firmly anchored values in the company and the family. In recent years, owner families have visibly understood that these traditions and values must be manifested across generations through the co-development of adequate tools. Therefore, family business governance mechanisms, which bring a multitude of advantages and can be designed in many different ways, must be implemented. In particular, the establishment of a family constitution, which is the foundation of the entire family business, is very important for the owner family. Companies must also consider the need for continuous adaptation and development to changing environmental conditions otherwise their future is at risk.

The implementation of a well-functioning conflict management is particularly important in the context of the increased risk of conflicts in family businesses. In doing so, they are resistant to any disputes and crises and can mitigate potential dangers. Furthermore, solid financing structures are also an important success factor of family businesses. Typically, they have a strong and exceptional awareness of how to maintain their financial stability, which is reflected in their preference for less risky financing strategies. This has proven to be very helpful, especially in economic difficult times.

References

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