# The Five Habits of Highly Successful Business Families

John A. Davis, Cambridge Institute for Family Enterprise

CAMBRIDGE
Institute for Family Enterprise

Successful families tend to decline—along with their businesses—within three generations. This axiom is enshrined in the so-called Three-Generation Rule: "From shirtsleeves to shirtsleeves in three generations," and it's supported by my research. The decline of family companies is due to tendencies that I call natural laws because they are so common and difficult to avoid.

To counteract these common, natural tendencies, families, owners and their companies have to do uncommon, unnatural things—because they are not easy to do. This path is "the road less traveled" because it requires persistence, hard work and sacrifice and means that from time to time, leaders have to make tough decisions that displease some owners, managers or family members. But this path isn't only one of responsibility and sacrifice; families that pursue this path also reap rewards of accomplishment, pride, loyalty, financial wellbeing, and personal growth.

And here is a finding that might surprise you: Ultimately, the practices that lead to the success and sustainability of the family business depend on the principles and practices of the family behind the business. The way the family chooses to live and the consistent choices it makes—its habits—determine much of strategy of the family business. Like two hands with interlacing fingers, five habits of families address the five natural laws and nurture successful family companies.

## NATURAL LAWS AND UNNATURAL HABITS

**1.** *Families grow faster than businesses.* So successful families put business financial needs first—make them more important than individual family member needs.

Over generations, families naturally grow at a geometric rate. The growth of the family hopefully expands the family talent pool but definitely produces more mouths to feed, which puts pressure on family companies to produce more dividend income. But over generations, businesses also require significant reinvestment so families and businesses often compete for the profits a business produces. If a family strips capital from the business, its business will wither. Remember the story of the golden goose? Successful families remember the story and protect the goose. How?

I'd like to advise you, just have smaller families, but business leaders and family leaders don't have much control over this outcome. China was only partially successful in implementing a "one-child" per family policy and parents aren't that powerful. Families can limit the size of the ownership group (and the number of mouths to feed) by periodically buying out some owners, but this is usually expensive and reduces the funds available for dividends. But if you can afford to prune the ownership tree in each generation, do it.

For a business to provide a constant per capita dividend for a growing number of family owners, the growth rate of its profits (after reinvestment) must equal or exceed the family growth rate. This requires aggressive investing, prudent risk taking, sensible diversification, and industry awareness—hence, a professional, externally focused, well-funded business. But ultimately it requires putting the financial needs of the business above the financial needs of individual family members. If you don't, you starve the business of capital and weaken its aggressiveness.

Successful business families make *putting the business's financial needs first* a habit by developing a family principle that enshrines this orientation, teaching the principle to family members, and reinforcing it when setting dividend levels.

**2.** *Family lifestyle expectations go up over generations.* So successful business families focus on *creating things of lasting value and make wealth, comfort and status low priorities.*

With each passing generation, wealth, comfort, and social status become increasingly important to successful families and families tend to spend an increasing amount of money on their lifestyle (at least until the money runs out). I am not against families enjoying the fruits of their labors. On the contrary, living well, having nice homes, enjoying creature comforts, being able to send your children to good schools, are healthy activities—as long as those desires don't define your life. It's easy for that to happen. When you have money, you can have servants and professionals taking care of the details of your life and managers taking care of your company. You can become detached from many of the common challenges of life that are good teachers. Wealth, comfort and status can become shields and narcotics. Once families feel entitled to these trappings, and they want to compete in society for higher status, the family business—the source of their wealth—is in danger.

> Successful families commit to building things of lasting value.

Most of the successful business families I have known and served have had significant wealth and enjoyed their wealth, but what excited them, what got them out of bed in the morning, was their interest in *building things of lasting value*—a good family, a growing business, their art or profession. Most of the family members in a successful family in fact lean toward being workaholics and are a little paranoid about not working hard. They even teach their children, "We could lose everything if we don't work hard." I'm not advocating workaholism, but I know that successful families in business love working at things as much as they enjoy accomplishing things. When a family is committed to building things of lasting value, they are unlikely to make wealth, comfort, and status high priorities. And they are aware of what has built the wealth they enjoy and make choices to protect the goose.

**3.** *Families become financially dependent on the business.* So to protect the family business from unaffordable family financial needs, *families control their financial expectations from the business.* Business families benefit from understanding the limitations the family business has in meeting the family's financial needs. Develop a financial plan, based on the strategic and investment needs of the family business, and review it with the family owners. Then show the owners what will happen to the business if the family continues to grow and continues to spend on its lifestyle as it has: usually this is a wake-up call to change family financial expectations. Families that survive in business for generations usually learn by generation three to tell the next generation that they will need to largely support themselves and to get a job.

**4.** *Families put all their eggs in one basket.* So to generate some of the income the family needs, *smart families diversify* their investments. Diversification should be driven mostly by well-researched opportunities for investment but providing some family income and generating assets for future inheritance are realistic motives for diversification. Smart diversification takes time and outside advice because what the family knows well is their family business. There are important strategic issues to solve such as should we diversify in the family business, in the family holding company, at the individual level, etc. The biggest obstacle to diversifying outside the family business generally comes from family business leaders who can treat suggestions about diversification as statements of disloyalty or heresy. Successful business families see the long-term picture and deal with these resistances.

**5.** Despite the positive forces of a successful family tradition and social pressures encouraging family unity, *families tend to become fragmented and less united over time* making all of the above issues difficult to address. So successful business families *build a governance system that builds family unity while ensuring that tough decisions can be made in a timely way.* All of the above forces that erode the long-term survival of a family business can be overcome if the family can stay relatively united, committed to its enterprise, and able to openly discuss these issues. Good governance can help a lot to achieve these conditions—through a good board for the company, a clear and fair agreement among the owners, and strict family policies along with a group to discuss the important issues facing the family. Good leadership in the business, ownership group and family is always essential, but good governance helps select and support good leaders, so start there.

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The natural laws I describe here aren't inevitable but they need to be managed in order to survive and prosper. Families and family companies that maintain their success over generations are to some extent lucky, but they also recognize the power of these natural forces and manage their business, ownership group, and especially the family to limit the impact of the negative tendencies and build on the strengths of a family. There are business families that are taking the uncommon, more difficult path I describe here. They'll be around in the next generation too. Will your family?

## ABOUT THE AUTHOR


### Professor John A. Davis

Founder and Chairman, Cambridge Family Enterprise Group
Faculty Director, Family Enterprise Programs, MIT Sloan School of Management


John A. Davis is a globally recognized pioneer and authority on family enterprise, family wealth, and the family office. He is a researcher, educator, author, architect of the field's most impactful conceptual frameworks, and advisor to leading families around the world. To follow his writing and speaking, visit johndavis.com and twitter @ProfJohnDavis.

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The Cambridge Institute for Family Enterprise is a global research and education institute dedicated to the real issues facing family enterprises. It is a place where progressive members of family enterprises come to learn, exchange ideas, develop themselves and position their enterprises to be not only successful, but sustainable over generations. Its sister organization, Cambridge Advisors to Family Enterprise, advises multigenerational families around the world on strategies to sustain their success over generations.