Strategies for Growing Multi-Generational Family Wealth

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There is a saying in Chinese 富不过三代 (wealth does not exceed three generations). This is a global phenomenon. Many countries have different versions of the same saying. Passing significant wealth to grandchildren without significant loss of the wealth due to irresponsible over-consumption or bad business judgment is so difficult that it poses a universal problem for wealth holders who are unprepared.

This problem is especially acute in China today because the fast pace of economic growth that "lifts all boats" has created many newly wealthy families within a very short amount of time. The number of HuRun (胡润富豪榜) listed billionaires in China grew from three in 2000 to about 600 in 2015. Few Chinese families are prepared to deal with this sudden wealth. They need answers to important questions, such as: "What should we do with this wealth?" "How should we educate our children about this wealth?" and "How to perpetuate this wealth?"

富不过三代 IN CONTEXT IN CHINA

First, in global finance: the recent boom and bust in the Chinese financial markets this year adds to the anxieties of wealth holders about how much financial risks their families are exposed to.

Second, in the family: the one child policy in China and the lack of a large pool of well-trained, professionalized senior managerial talent means that entrepreneurs are faced with serious succession problems. Who in the family is competent to run their companies when the founders step back (as they should) to focus on innovation and higher level strategic questions? They ask, "What if my child is not capable enough or willing to take over the business?" They wonder, "What will happen to the company and legacy that I spent my life building?"

Third, in business: industry lifecycles are getting shorter globally. Do industries perish? Forbes developed a list of the 100 largest American companies for the first time in 1917. Forbes compared the original 100 list with the 1987 version 70 years later. In a 95-year period, 99 companies out of the leading 100 companies in the U.S. went out of business or fell by the wayside. At the business strategy consulting firm Baldwin Bell Green, our colleague Tom Steiner and his team conducted an extensive analysis of the top 500 U.S. companies from 1955 to 2012. In 20 years from 1955 to 1975, 44%—220 companies—did not survive. Between 1975 and 1995 the pace of competition sped up. Sixty-one percent—306 companies—did not survive the 20 years to 1995. Since 1995 the pace has picked up yet again: 35 companies—75%—dropped off the list by 2012.

Industry lifecycles in traditional manufacturing in China, where many entrepreneurs first made their wealth, are experiencing this pressure of shortening lifespan. As the country transforms its manufacturing based economy into higher-value-added business activities, the Chinese economy must transition from growth led largely by export and infrastructure investment to growth led by consumer markets inside China. As a result, many companies (especially private companies without the market protection of some state owned enterprises) will need to transform in order to survive.

These contextual factors heighten the stress levels of business families and make them reactive. *It is impossible not to be reactive* to the dizzying number of new government directives the government issues to achieve important socio-political economic goals, ranging from cracking down on corruption to jump starting the overall Chinese economy.

But our research shows that "wealth will not pass three generations" in families that are reactive to short term fluctuations instead of focusing on long term trends. How can Chinese entrepreneurs and wealth holders in established business families *learn to become proactive?*

Thankfully, this is not an impossible challenge. We advise that families begin by changing their mindset. As Lao Tzu wisely noted: "Watch your thoughts; they become words. Watch your words, they become actions."

FROM REACTIVE TO PROACTIVE: GET STRATEGIC

It is important for business families to take some time out from their daily routines to survey their surroundings and prospects from a higher level. Taking a strategic view prompts them to ask, "What are we proud of achieving recently? What do we want to achieve with this new wealth in the future? Why are we working so hard to preserve or create more wealth? What is our mission for our family, for our business and for society?

The only way to adapt to the uncertainty of accelerating change is to stay focused on a clear family mission. We ask business families, "What is your mission? Where do you want to go?" Many are unsure. Like the Cheshire Cat in Alice in Wonderland, they make the mistake of thinking that "If you don't know where you are going, it doesn't matter which road you take." Even if you are unsure of your *exact* destination, it does matter which road you take. If you take a road leading in the right direction (knowing that many things may change over time) you are more likely to meet your goals. If you take the "wrong" road, you will need to recover from that mistake. A series of wrong turns generally leads to misfortune and sometimes even demise. For example, wealthy parents intuitively know that kids shouldn't be spoiled with money. They may not be able to foresee what career their kids may take up or what spouses they will end up marrying, but they do know that the road of over-consumption does not lead to continued wealth creation.

Spending time in a disciplined way on finding the right path is important for individuals, families and organizations of all kinds. In business, we accept this principle. We use formal processes for strategic planning. We analyze our industry and our company's place in it. We develop a sense of mission (our purpose) and a vision for our company (what we want to achieve within a specific time period). We define our core values. We set important goals and measures of success. And we create a strategy (what actions to take over time) for pursuing the company's mission, achieving important goals and realizing our vision, acting according to our values. In large companies, whole departments of people facilitate this work. The strategic plan is the map for the company. Can you imagine a driver without a map? Or a pilot without a flight plan?

It's not a big leap to argue that business families also benefit from the same process. How families set their course has important consequences for everyone who depends on the family to act as responsible owners and leaders.

The objective of strategic planning for the family business is to get alignment among the missions and plans of the business, the family owners and the other family members. When these three groups are mutually supportive, each group advances toward its goals with less friction among the parties.

We have worked with hundreds of business families and gotten to know thousands of other ones globally over the 35 years of collective experience working with a wide range of family enterprises, from the largest family companies in the world to small ones with big ambitions. Most of them wish to pass on their wealth and legacy to the next generation. Most of them have the ambition to become a multi-generational family of significant wealth.

The first thing we advise families to do is to take some time off with family members—in a retreat setting, for example—to look at where you are, where you would like to go, and what are the obstacles you may face on your journey from a very high (strategic) level. Your goal is to get a completely different perspective from the one you have in day-to-day operations. From this high view, like being 30,000 feet above the ground in an airplane, does your journey look interesting, achievable, or risky?

So while you are planning your own family retreat, we would like to share some thoughts with you about how to organize and plan so you can achieve the multi-generational family business success you want.

After working with and conducting research on many multi-generational families, we boiled down the secret of success to three key elements:

1. Clarify your family's mission to support family unity;
2. Develop your next generation; and
3. Grow your assets

We will discuss each element further to help you understand why this makes up the trinity of multi-generational family business success.

CLARIFY YOUR FAMILY MISSION TO SUPPORT FAMILY UNITY

For first generation entrepreneurs, getting up early in the morning, rushing through the day busy with work, and never stopping until late at night has become second nature. They have built so much muscle memory to keep going at this pace, year after year, that they do not even stop to think about why they are doing this. For the next generation who grew up in wealth, however, this drive is neither inborn nor learned from observation of their parents or other forebears. They often need something they are passionate about to get them up in the morning and inspire them to focus on the tasks of the day. They won't care deeply about achieving goals unless they are passionate about why they must achieve them.

We often meet entrepreneurs who have built successful manufacturing companies in China with plants in remote locations, where operations are cheaper. The kids are simply not interested in spending their lives on the road or in the air, traveling from one remote place to another to oversee the factories. They prefer living in luxury, with the amenities and excitement of the first tier cities. Whether opportunity knocks in the city or in the countryside, the business of managing and creating wealth is hard work, even after the family has made its first bucket of gold. The next generation needs a compelling reason for taking on this hard work. The family's job is to cultivate the internal motivation that drives offspring to take on this responsibility.

Internal motivation is generally sparked by a mixture of passion for the things we love or want and and competence in what we aspire to succeed in. Competence is also the key ingredient in self-esteem, which has been studied extensively for its effects on success in leadership, on teams and in social networks.

A passion for money alone rarely produces the level of internal motivation needed for next generation success. While we all need money, it is difficult to fall in love with money. The allure and power of money are so often valued merely in the things money can buy. Once we have enough things, the allure dims. More things do not generally bring us more pleasure, meaning, or fulfillment. This is especially the case when the next generation grew up with a lot of money.

After careful analysis, we have also seen that founders themselves are not generally driven by the love of money. More often, they are driven by the personal passion to solve a problem through business. Or by the fear of poverty. In China, since the beginning of economic liberalization during the 1980's, most Chinese entrepreneurs we have studied have been driven by the fear of financial insecurity. Now the leaders in families of wealth, founder-entrepreneurs need to engage with the next generation to understand the new context and mentality that shapes that generation. This understanding is critical for shifting the family's collective mindset away from consumption and developing the internal motivation of wealth creators to come. We cannot overemphasize how important it is for the whole family to work together to discover the collective reason for continuing the hard work of creating wealth. This process of discovery creates family unity between senior and next generation.

Finding that collective family passion, which leads to a family mission, takes effective communication among family members. It is best achieved outside the day to day routine, but even then, effective communication is not easy for most families. Contrary to popular belief, effective communication in families rarely come naturally. Thankfully, it can be learned. Most importantly, it needs to be practiced by all. Seniors will offer their wisdom and experience. The next generation will contribute new, fresh ideas. Both perspectives are important in building a compelling family mission, commitment of all family members, and family unity.

Take the example of the European glass making family Reidel. Founded in 1756, the company that bears the Reidel name has been led by 11 generation of family members through wars, economic recessions, and changing political boundaries in Europe. What has enabled Riedel to survive is the family's passion, not just for glass making, but for innovation. From glass windows to decorative glass to the award-winning wineglasses it produces today, Riedel has adapted its products to the times. Success during some periods called for scientific and technical innovations. During other periods, success depended on artistry. Over generations, the Reidel family has produced an equal number of scientists and artists to take up the torch and lead the company. Each generation of Riedels has put its own distinctive stamp on the legacy.

The Riedels faced critical challenges during World War II, when all assets were confiscated by the Czech government. Russia had captured and imprisoned the eighth generation business leader, Walter Riedel, renowned for his technical innovations in glass making. Walter Reidel spent many years in a Siberian prison before being released. When Walter was finally reunited with his son Claus, the family company was defunct. Walter and Claus restarted Riedel with the financial backing of the Swarovski family, of crystal jewelry fame, which had passed up the opportunity to buy a bankrupt Austrian stemware company. Instead, the Swarovskis offered the opportunity to the Riedels.

Father and son did not see eye to eye. Walter wanted to focus on a high volume business strategy of supplying commercial glass during the reconstruction of Europe. Claus wanted to focus on a consumer strategy of making glass stemware, reasoning that after the destruction of war, consumer lifestyles would shift radically leading to high demand for wine glasses. Beauty and relaxation were now what people wanted from life. Customers would demand well-made wine glasses, argued Claus, to share a drink with friends and family on a regular basis.

Walter Riedel decided to let his son pursue his artistic passion in glass making. Reidel's ninth generation leader created the egg-shaped wine glass that is so popular today. He also introduced the idea that the glass in which the wine is served impacts the taste and balance of the wine, moving wine connoisseurship to a more sophisticated level. These innovations have earned Claus's Riedel wine glass a place in the permanent exhibition at New York's Museum of Modern Art. Quoted in *Family Spirit: Stories and Insights from leading Family-Owned Enterprises* (**San Francisco: Chronicle Books, 2015**), Claus Riedel is famous for the advice he gave his own son, Max: "Stoke the fire, don't save the ashes."

The Riedel story shows that, contrary to popular belief, strong family missions can, indeed, be passed and refined from generation to generation. People around the world see the family as an "organic" group that develops naturally and uncontrollably. After all, people argue, you have only minor control over who becomes a member of the family through birth, adoption and marriage. You have very little control over who leaves the family and when—death being the ultimate authority. And you only possess limited influence over the education of children and development of family talent. Yes, it is undeniably difficult to manage the performance of relatives.

But as the Cheshire Cat implies to Alice in Alice in Wonderland, most people also want to know where they're going in life. High performing families in business leave little to chance. They define the success they aim for. They build confidence and competencies by developing a compelling mission that motivates family members along the way.

DEVELOP YOUR NEXT GENERATION

Developing your next generation is one of the most important elements of creating a multi-generational business family. Having psychologically healthy, functional, motivated, and capable next generation brings new energy into the business family. It maintains the momentum for growth. Especially important in Chinese families, it fuels the hope and reason to keep doing the hard work of creating wealth.

Developing the Next Generation during Childhood

Next generation development starts early, when children are pre-teens. Studies show that between the ages of six and twelve, children can learn and adopt two basic behaviors that are foundational for future success. First is delayed gratification. Wise and caring adults will cultivate the child's ability to resist the temptation of an immediate (often smaller) reward and wait for a later (often much bigger or more enduring) reward. Delayed gratification discourages impulsive behavior and encourages goal setting, planning, and self-esteem in being able to accomplish something challenging. Research has shown that delayed gratification is linked to other positive traits, such as higher academic performance, better physical and psychological health, and more social competence. Further, delayed gratification helps kids practice self-regulation of their body, mind, and actions by practicing skills such as patience, self-control, and will power. But delayed gratification is not always easy to instill. It is sometimes difficult for materially comfortable families with one child to train delayed gratification, since many adults in the family are focusing energy on indulging and doting on that single child. We advise families to make a deliberate effort to develop this behavior in children. It helps to give adult family members clear guidelines on presents, spending money, and other indulgences that can inhibit the learning and practice of delayed gratification.

The second critical behavior to cultivate is a strong work ethic. Developing a strong work ethic does not mean simply putting pressure on a child to work hard. The goal is to help the child develop the internal motivation discussed above. Wise adults will support a child's drive to work at something he or she loves and to derive satisfaction from that work. Coaching a child to develop a strong work ethic consists of three tasks. First, help the child discover interests that turn into passions. This will fire an intense desire for competency. Second, give the child opportunities to pursue this interest, *without putting pressure on them to perform*. Third, celebrate their successes and encourage them to try again when they fail.

When kids reach the teenage years (ages 12 through 20), it is important to encourage and support them in money making endeavors, even if they are unrelated to the family company. Some teenagers may be interested in the creative freedom and independence of starting their own business as entrepreneurs. Others may be more drawn to the structure of apprenticing in the family company. Both of these development trajectories should be encouraged. This is the beginning stage of cultivating a child as one of the family's new wealth creators, one who will take on the hard work of managing and keep creating wealth.

Developing an Entrepreneur

Here is an example of a wealth reactors' trajectory as an entrepreneur. One Latin American businessman started a woman's fashion shoe company in 1972. His oldest son grew up in the business and learned both the fashion and the manufacturing side of the trade, displaying great interest and intensity. When the boy was in his late teens, the patriarch hired a business professor to assess the type of business environments that would be a good fit for his son. After two months of getting to know the son, the professor recommended that the son should not work in the father's company. The father was stunned. Meanwhile, the advisor explained why his son would not succeed him in the organization. The son had a very strong desire for control, doing things his own way, and believing in his own intuition about fashion trends. The professor felt that father and son would have too many conflicts that would not be healthy for either man. Nor would constant conflict help the son develop into a business leader. He suggested letting the son start his own business if he was interested.

To his credit, the devastated businessman accepted the professor's advice. The son started his own shoe business at age 18 with a business loan from his father. The startup grew into a super luxury brand, with distribution at high end department stores such as Saks Fifth Avenue, Bergdorf Goodman, and Barneys New York.

After the son's business success, his father approached him to merge the two companies. After carefully structuring the merger together, father and son merged their companies, taking in external private equity investment to further grow their combined business. They took the family company public, and then transitioned to the son into the CEO role. This Latin American example is one of the best we know of a succession plan crafted by the outgoing leader, tailored to the personality and needs of the incoming leader. If the son had been developed inside his father's company, the outcome may not have been as successful.

Developing the Next Generation in Early Adulthood

When kids reach young adulthood in their 20s, it is important to give them space to explore the interests and passions they have already developed, and even to discover new ones. This is also the period when young adults must choose the type of lifestyle they desire. With enough freedom, healthy young adults will grow to understand themselves in terms of what they do and don't do well.—not in terms of what they use or have at their disposal. This healthy development path has a further benefit to the family. It reinforces the internal drive of the successor to take over the business and make the succession process their own.

Young adulthood is a key period. Wise adults will grant independence to young successors, remain curious about them, and stay engaged in their lives as they explore the world. Iphigene Sulzberger, third generation matriarch of the family that owns and leads The New York Times Company, was so beloved by her children and grandchildren as young adults that the clan credits her for inventing the "family glue" that keeps the Ochs-Sulzberger family together, committed to a strong family mission.

Kids generally want a relationship with their parents, but as they grow into adults, they need to become their own distinct person with control of their own destiny. Young adults who have been given the time and space to explore most often return to take up family responsibilities.

At the Families in Business Executive Program at the Harvard Business School where Dr. John Davis (the lead author of this article) teaches an annual, week long program introductory course to family business groups, he routinely asks the next generation students what the senior generation can do to help them develop. Every year, a majority of the next generation students answer that while they really appreciate all of the opportunities that the senior generation gives them in terms of education, internship at the family company, and more, it is very important for them to be able to make their own decisions about where to go to school, what to study, where to work, and the types of work activities that they are engaged in. This does not mean that these young adults do not appreciate advice or suggestions from the senior generation. It just means that they need to feel that their ultimate decisions about career and life planning are their own. Dr. Davis will ask Chinese students the same questions at the newly launched Harvard Business School Executive Education Program, **Leading and Transforming Family Businesses-China**, designed to begin exploring these issues within Chinese business families. This program will take place over three weeks from March through July 2016. We invite you to come join the dialogue.

Giving young adult the space to explore the world does not mean that the senior generation should be passive in the successor's development nor that the successor should have completely free reign. Young adults appreciate and will listen to advice and guidance. They just need to feel that they can make their own choices.

The ideal approach is for the patriarch to define some guidelines and expectations in terms of development goals, listen to the successor's aspirations, and then jointly decide on a plan that is comfortable for both. Some patriarch-successor pairs may prefer that the successor works directly for the family company after university. Others many prefer that the successor get some work experience outside of the family company before formally entering. In either case, career planning, business skills development, and feedback/evaluation process are critical. At this stage, it is important for the patriarch and successor to create an adult-to-adult relationship that lays the foundation of their successful business partnership.

At the maturing adult stage in the mid-30's and beyond, successors' career trajectory, interests, strengths and weaknesses become clearer. This is the time to clearly define the aspirational role that is suitable for the successor within the family enterprise and the time table for accomplishing this plan. Achieving alignment and defining a collective family mission between the senior and next generation will achieve family unity and momentum towards building a multi-generational business family. In order to achieve success here, it is important for the senior generation to allow the next generation to define the family legacy and goals and be in the advisory role. That is when the next generation feels that they have control of their own destiny and be willing to take on responsibility of the business family.

GROW YOUR ASSETS

Successful multi-generational business families understand that they need to keep their balance sheets strong and their pockets shallow. Strong balance sheet means having enough capital to take advantage of down times to pick up good long term assets at a low price or to just have the ability to survive through bad economic times. Shallow pockets mean investing most of the cash that is generated every year into productive assets that will keep growing for the long term rather than keeping it in cash that can be easily spent in the short term on luxury.

In the first generation, a business family's wealth is determined by the success or failure of the original business. When the business is growing, the entrepreneur puts all of his limited capital into the business and hopes that the business makes it to wide adoption by its target customers so that the business gets to the minimum scale for it to be profitable. If he succeeds in doing that, at some point, the business starts to create extra cash flow beyond what is needed to support the current scale of operations.

At this point, the family's wealth accumulation may not necessarily have to be tied to the original business. The business family has three general options:

1. Further invest the extra capital generated by the business back into the business to continue growing;

2. Deploy some of the capital in other operating businesses with good growth potential and in which the business family has expertise; or

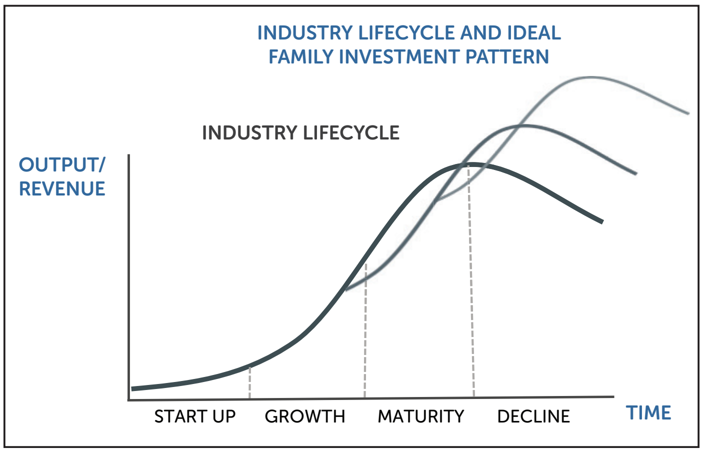
3. Create a diversified financial portfolio for wealth preservation

What is important here is to shift the mentality of the family from focusing on the success of the business as the measure of the family's success to focusing on the growth and risks embedded in the family's overall asset portfolio. The mentality should become how does the family growth its overall wealth over time and meet the family's needs and goals from generation to generation, rather than how does the family grow the company over time. This means that the family needs to rise above the company view to develop strategies for the family's wealth with the original company as part but not the entire strategy.

The main reason that this shift is needed is because once the family has accumulated some level of wealth, the original business may or may not be the primary driver of continued wealth accumulation for the family. Whether it is or not depends on many factors such as where is the industry along its life cycle, what is its competitive position within the industry, and are the next generation interested and capable of leading this type of business.

Every industry goes through lifecycles (See Figure A below). In the beginning, capital goes to innovation to develop and gain initial adoption in a production or service. Then it goes to growing the company's market position in the industry while the industry is growing. At this stage, the company's equity value (i.e., company owners' wealth) is growing quickly, but the company also needs a lot of growth capital and generates very little cash flow. Then the industry reaches maturity and eventually decline stage. During these last two stages, the equity value of the company grows slower, stops, or declines. However, the company generates a lot of cash because its cash generation level far exceeds capital investment needs. So the family feels rich because it has a lot of cash on hand. This is the time when the family has to be careful not to use the cash for consumption, but reinvest the cash into newer, growing industries or innovations within the same industry to continue creating wealth.

Figure A:



When families are flush with cash that they can touch and spend but experiencing wealth decline (because their company's equity value is decreasing) that is not as visible because private companies are difficult to value, the families are at an inflection point where they can be vulnerable. If they put the cash into new investments that work out, they have a new wealth creation engine. If they spend it or put it into new investments that do not work out, they have lost a resource for creating new wealth. Some bets will pay off and others will not. It is important to keep the entrepreneurial spirit and make a series of experiments to build up new capabilities in new industries or technologies. In sum, the family should always be looking for new wealth creation engines.

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