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The family-business factor in emerging markets

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Family-owned businesses are a large and growing force. Organizations that want to collaborate—or compete—with these companies in emerging markets must first understand them.

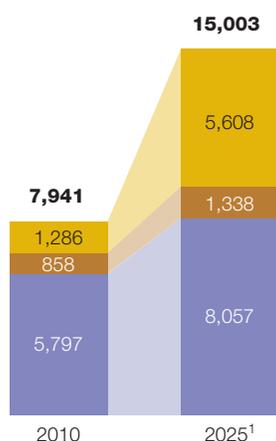
The industrial titans of the Gilded Age were largely family businesses. But today, in most developed nations—particularly the United States, the United Kingdom, and Japan—the largest, industry-leading companies are typically held by a broad, dispersed mix of shareholders. Less than one-third of the companies in the S&P 500, for example, remain founder- and family-owned businesses, meaning that a family owns a significant share and can influence important decisions, particularly the election of the chairman and CEO.

So far, the picture is quite different in emerging economies. Approximately 60 percent of their private-sector companies with revenues of \$1 billion or more were owned by founders or families in 2010. And there are good reasons to suspect that these companies will remain a more significant part of their national economies in emerging markets than their counterparts in the West did about a century ago. As brisk growth propels emerging regions and their family-owned businesses forward, our analysis suggests that an additional 4,000 of them could hit \$1 billion in sales in the years from 2010 to 2025 (Exhibit 1). If that's how things shake out, such companies will represent nearly 40 percent of the world's large enterprises in 2025, up from roughly 15 percent in 2010. Developing an understanding of them, therefore, is fast becoming a crucial long-term priority—not only for global companies active in emerging markets, but also for would-be investors that must ultimately decide whether and how to support this fast-growing segment of the economy.

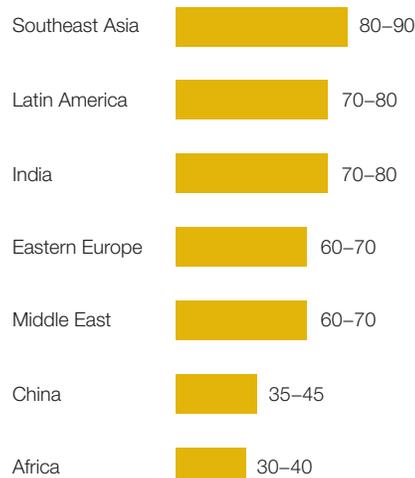
Exhibit 1 A growing number of family-owned businesses in emerging markets could hit \$1 billion in sales in the years from 2010 to 2025.

Companies with ≥\$1 billion in revenue,
number of companies

- Emerging-market family-owned businesses
- Other emerging-market companies
- All developed-market companies



Share of large companies that are family owned,² %



¹ Projection based on city GDP forecasts.

² As of 2013 or closest available year, captured at headquarters location.

Source: Bloomberg; *EXAME* magazine's 2013 Melhores & Maiores list; *Jeune Afrique* magazine's Top 500 African companies; Kisvalue; Mexico's Secretariat of Finance and Public Credit; PRIME news agency's rating of Russian family-owned businesses; Prowess; Zawya; company websites; McKinsey Global Institute analysis

¹ For example, across Asia, businesses owned by families or founders have increased their share of total market capitalization since 2008, while state-owned enterprises have ceded share over the same period. For more, see "Avoiding the dinosaur trap," *Economist*, May 31, 2014, economist.com.

Why past may not be prologue

The starting point for many family-controlled local companies is a demonstrable, even dominant, "home field" advantage; they have a deep understanding of their countries and industries, as well as considerable influence on regulators. They derive all this from years of personal relationships with stakeholders across the value chain. Many have proved resilient through times of economic crisis.¹

The very fact that they are *family* businesses may be advantageous in an emerging market. Where the conventions of commercial law and corporate identity are less developed, doing business on behalf of a family can signal greater accountability—the family’s reputation is at stake, after all—and a stronger commitment. Indeed, we have observed circumstances where a personal commitment from the owner of a family business was as powerful as a signed contract.

Local philanthropic efforts reinforce this signaling. In the Philippines, the Ayala Foundation—a nonprofit branch of the Ayala Corporation, the country’s largest conglomerate and a family-owned business—states its mission as improving the quality of life for all Filipinos by eradicating poverty. Similarly, in India, the GMR Varalakshmi Foundation, an arm of the market-leading GMR Group, strives to “develop social infrastructure and enhance the quality of life of communities” throughout the country. Companies such as these work within and for their communities.

They can also work fast. As one executive at such a company told us: “All the world is trying to make managers think like owners. If we put in one of the owners to manage, we don’t need to solve this problem.” An owner–manager can move much more rapidly than an executive hired from outside. There’s no need to pass decisions up a chain of command or to put them in front of an uncooperative board, and many of the principal–agent challenges that confront non-family-controlled companies are neutralized. Family-owned businesses can therefore place big bets quickly, though of course there’s no guarantee that they will pay off. Still, manager–owners are largely relieved of the quarter-to-quarter, short-term benchmarks that can define—and distort—performance in Western public companies, so they’re freer to make the hard choices necessary to create long-term value.

Indeed, the owners’ long time horizons and sense of mission often suffuse the whole organization. A McKinsey survey of businesses owned by families and founders showed that 90 percent of board members and top managers—family members or not—said that family values were present in the organization, and fully 70 percent said that they were part of its day-to-day operations. For the past ten years, McKinsey has measured and tracked organizational health in hundreds of companies, business units, and factories around the world. Nearly two million employees have answered questions that rate the health of their organizations. We then produce a single health score, or index, reflecting the extent to which employees agree that their companies meet empirically derived litmus tests in each of nine dimensions of organizational health. When we isolate businesses owned by families and founders in emerging markets—as we did for nearly 60 leading companies in Asia, Central America, and South America, with over 100,000 survey

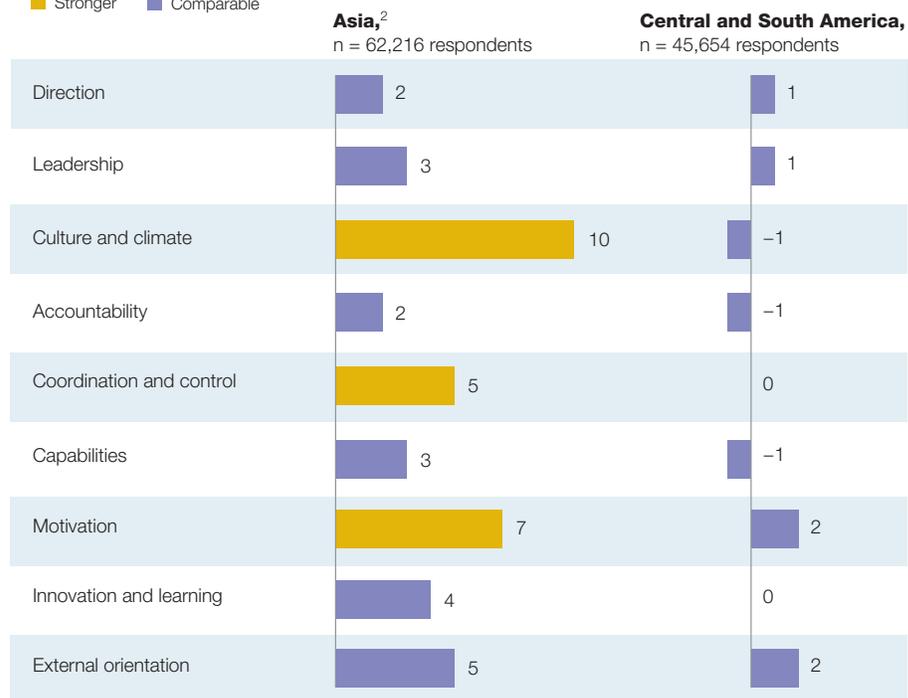
respondents—we see health outcomes that are better than or comparable to those of other companies in the same markets (Exhibit 2). Moreover, in Asia these companies are stronger than their non-family counterparts on several specific management practices, including shared vision, strategic clarity, employee involvement, and creativity and entrepreneurship.

Exhibit 2 Family-owned businesses in emerging markets have health outcomes better than or comparable to those of non-family-owned businesses in those same markets.

Gap between Organizational Health Index scores of family-owned and non-family-owned businesses

Statistical significance¹

■ Stronger ■ Comparable



¹ Difference statistically significant at 95% confidence level.

² Emerging markets only.

Source: McKinsey Organizational Health Index database, March 2014

For all these reasons, there may be little need for companies to jettison family-oriented governance to attract investment. In a world where free-flowing capital seeks out success, the emerging markets' strong-performing publicly traded family businesses will probably be rewarded. Market-leading ones can expect to be sought out by potential investors and venture partners alike, for success is a magnet.

Playing by family rules

The resilience of family-owned businesses in emerging markets contains a paradox for global companies operating there. Many companies approach these markets in search of rapid growth, yet the family-owned businesses they're considering partnering with are balancing the importance of liquidity against an extremely long view. Founders and families hold their shares for decades, even centuries. "For us," the chairman of such a business explained, "short term is 5 years, and medium term is 20 years—that is, one generation." Multinationals that afford their country managers just three to five years (and sometimes even less time) to make progress are creating a significant mismatch.

Indeed, mismatches between the time horizons of country managers and businesses owned by families and founders can create tensions that undermine strategic partnerships. Exacerbating matters is the volatility of many emerging markets. Many country managers don't experience a full business cycle, so they struggle to understand and quantify risk, to form a "through cycle" view of the opportunities, and thus to partner meaningfully with their peers in family-owned businesses.

Moreover, many family-owned companies place a premium on building strong, well-diversified businesses—sometimes to an extent that conflicts with the developed world's conventional core competence-based strategies for value creation. As our colleagues have noted, for example, the largest conglomerates in China, India, and South Korea are entering new businesses (often in unrelated industries) at a startling pace, adding an average of one new-business entry every 18 months.² Almost 70 percent of these diversifying conglomerates are family or founder owned. In large part, they aspire to play the portfolio game, taking advantage of access to talent and capital, as well as allocating family assets across different industries. This is an appropriate strategy for preserving wealth over the long term—and one that, our research finds, is paying dividends for conglomerates in the BRIC³ countries. The implication for global companies and investors is that family-owned companies making moves into or out of seemingly unrelated industries can show up unexpectedly as competitors, partners, asset purchasers, or sellers, with varying degrees of success.⁴

² See Martin Hirt, Sven Smit, and Wonsik Yoo, "Understanding Asia's conglomerates," *McKinsey Quarterly*, February 2013, on mckinsey.com.

³ Brazil, Russia, India, and China.

⁴ To be sure, many founder- and family-owned businesses struggle in these circumstances. For example, one of India's largest such conglomerates has a long tail of value-destroying companies in sectors where more focused players have delivered higher returns. Ultimately, the fundamentals still apply: coherence in strategy, strong decision making, and the ability to realize synergies.

The wild card, of course, is succession. Fewer than 30 percent of family- and founder-owned businesses around the world survive to the third generation as family-owned businesses,⁵ and it's an open question whether those in emerging markets will fare any better. History suggests they won't. While statistics are scarce, analyses comparing the top 10 or 20 family-owned businesses in a given emerging-market country 20 years ago with today's leaders show great discrepancies. Nonetheless, there is some reason for optimism: the factors behind successful transitions are reasonably well known, and much can be learned from companies that failed the test. (Today's family-owned businesses in emerging markets are more likely than ever to engage in careful succession planning.) Still, the basic challenges—such as family feuds, nepotism, and the gradual loss of entrepreneurship when leadership passes on to new generations—will surely bring down many family-owned companies in emerging markets, as they have elsewhere.

Similarly, such businesses may create ownership models that are inflexible and lack transparency, drawing the attention of activist investors who see value in better governance, more disciplined capital structuring, and getting out of so-called hobby businesses that support family members. This strikes at the heart of the question: Is the family the best owner or manager of a company, or is it in business to support the family? Potential partners, investors, and competitors should carefully look at such a company's family tree, ownership models, and current succession processes before drawing conclusions about sustainability.

Finally, people who watch emerging markets should keep a weather eye on the role of regulation, as many governments in these countries are struggling to strike a balance between denying family-owned businesses excessive privileges and opportunities to make profits, on the one hand, and fostering entrepreneurship to promote their economies, on the other.⁶ Would-be investors ignore at their peril the potential of regulatory intervention to reshape the nature of competition in these markets quickly and dramatically. □

⁵ See Christian Caspar, Ana Karina Dias, and Heinz-Peter Elstrodt, "The five attributes of enduring family businesses," *McKinsey Quarterly*, January 2010, on mckinsey.com.

⁶ See "The new age of crony capitalism," *Economist*, March 15, 2014, economist.com.

For more on this topic, download the compendium *Perspectives on Founder- and Family-Owned Businesses*, on McKinsey's Private Equity & Principal Investors site, on mckinsey.com.

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