Family Business Survival: Understanding the Statistics

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Perhaps the most quoted statistic in the world of family business is this one: 30% of family businesses make it to the second generation, 10-15% make it to the third and 3-5% make it to the fourth generation. Thousands of newspaper, magazine and journal articles have reported this statistic (although almost never cited its original source). The marketing materials used by the burgeoning family business consulting industry are rife with those numbers.

Indeed, we don't argue with the numbers. We just have a few quibbles with how they are presented. The meaning of the statistics is hard to fathom without defining family business (when we use the numbers it means family business leadership and control, therefore excluding such successful ways of "making it" as transfer of ownership to employees, becoming part of a roll-up, cashing out to a competitor's strategic acquisition, or even a carefully planned gradual liquidation of a business in a dying industry). Another small quibble is that, in fact, 30% make it "through" the second generation, not "to" the second generation. We know these things because the original research leading to these conclusions was conducted about fifteen years ago by our own John Ward on Illinois manufacturing companies. The numbers have been replicated globally both by research and experience.

But we have a very serious argument with how the statistics are used. A brochure we received recently from a family business consultant is typical: "Only 30% of all family businesses make it to the second generation. And a meager 5% make it to the fourth generation." There is a judgment implied in descriptors like "only" and "meager." Generally, people using these statistics imply, suggest or out-right state that the numbers indicate a sorry state of affairs. But how do we know whether a 30% "make it" rate is bad, good or just plain normal?

I was speaking at a family business conference in Monterey, CA over a decade ago. On the morning before the presentation I was visiting Monterey's magnificent aquarium, (supported largely by the Packard Family's foundation whose family business -Hewlitt-Packard - arguably failed to "make it" to the second generation). At the aquarium I learned that it takes 250,000 starfish eggs to produce one mature starfish. I wondered whether that was good, bad or just plain normal, and if there were starfish survival consultants bemoaning this horrible performance and offering their services to help fix the problem. Only a small percentage of humans live to be 100 years old. Is that percentage good or bad? And how can we judge?

One way to put family business performance in perspective is to compare what we know about family businesses with other kinds of businesses. As we have often reported previously in the Family Business Advisor, most such comparisons give the edge to family firms. So maybe their survival rate is higher too? But how to compare? Because publicly-traded companies with dispersed ownership naturally turn over share ownership, one cannot speak of a "survival" rate that includes an ownership dimension, and if we can't include consistency of ownership across generations, we are not talking about family business. How can so many people use terms like "only" and "meager" when comparisons are impossible?

I found an opportunity for comparison by accident (as I had learned about starfish eggs). In 1996, the Dow Jones Industrial Average (DJIA) celebrated its 100th anniversary. Its 30 companies represent the largest, best capitalized paragons of U.S. industry. And yet, only one company originally included remains on the list today.

I did some quick arithmetic. A hundred years at 25 years per generation represents four generations. About a third of family businesses survive in each generation. With 30 companies on the DJIA, and a one-third survival rate defined as continuing on the DJIA for four generations, we would predict that one would still be around. The "survival" rates of the companies comprising the DJIA and of the Family Businesses in general turns out to be the same!

The single company from the original list that survived the century is General Electric. GE is generally considered to be one of the best managed and capitalized companies in the world. Recently, its market value has been surpassed by Microsoft, but it is valued at about $360 billion, and has assets of $356 billion, over $100 billion in 1998 sales, shareholders equity of $38.9 billion and $9.3 billion in profits (for a 24.2% ROE). CEO Jack Welsh is considered among the best in the business and GE is famous for providing other major companies' CEOs.

According to statistics, your family business has the same chance of survival as General Electric. Does that suggest that a four-generation, 3-5% survival rate is "meager"? It suggests to me that, rather than bemoaning family business survival rates, we should judge them as somewhere between normal and extraordinary.

Indeed, given the strengths of GE, I'm wondering what strengths family businesses have that allow them the same probability of survival as this admired industrial giant. What do family businesses have that most of the DJIA component companies lack?

What distinguishes family businesses, of course, is family. Adding family values, loyalty, pride, cohesiveness, meaning and all the other strengths of family to business ownership and management seems to provide sustenance not available to other enterprises. Given an economy that chews up and spits out whole industries, technology evolving at unprecedented rates, Wall Street probing every niche to "unlock" financial value, global competition, instantaneous communication which makes secrecy much more difficult to use as a competitive advantage, the alternative opportunities open to well-educated offspring of business-owning families, competition that drains margins as distribution channels are re-engineered, and the social and cultural pressures that make successful family life increasingly challenging, I believe that a 30% generational survival rate among family businesses is incredible testimony to the positive power of family when applied to business. I believe that these oft-cited statistics offer yet another reason to celebrate family businesses.

And besides, no one other than those of us who seek the repeal of death taxes has taken on the specific task of improving overall "survival rates" for family businesses. Those of us who work with and for family businesses, seek to help one family at a time to achieve its goals.

Which, oddly enough, takes me back to starfish. A story is told of a father and a daughter walking on an isolated beach at dawn. As the sun rose, they came upon a galaxy of starfish left by the tide and, for the most part, still alive. The young girl immediately began to throw the creatures back into the sea. "Don't bother with that," said her father. "There are too many. You can't save them all. It won't make any difference."

"But I can save some of them," she said without pausing in her work. And she didn't even know that each starfish she saved took a quarter million eggs to produce.

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