“An exploration into family business and SMEs in South Africa”

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An exploration into family business and SMEs in South Africa

Abstract

The South African government recognizes the importance of entrepreneurial activity as a means of energizing the country's economy and encouraging growth and development. The rapid growth in family businesses in South Africa can be attributed to the rationalization process taking place in many large organizations, as well as to the growing inability of the informal sector to create new jobs. However, the contribution of family businesses to socio-economic growth has never really received sufficient attention. This article expands on the work of previous family-business literature in South Africa. From the literature, there is evidence of family-business failure which is due to challenges that these businesses face. The aim of the research is to explore family-business challenges and small and medium enterprises in South Africa. A conceptual framework is provided, while secondary data were obtained from books, articles, reports, and electronic media. The units of observation are from experts in the entrepreneurial and family-business disciplines. Family businesses are faced with challenges such as market conditions, government policy and regulation and infrastructure. Other challenging areas include management and governance structures, succession, planning, cash flow and cost control, family-business relationships and skilled labor. Recommendations and family-business research areas are also presented.

Keywords: family business, SMEs, entrepreneurship, challenges, South Africa, job creation.
JEL Classification: L26.

Introduction

Small and medium enterprises (SMEs) are becoming increasingly central to government growth strategies (Lint, 2012). There are three areas where SMEs are expected to contribute: creating jobs, promoting economic growth, and reducing poverty in poor countries (Lint, 2012). There exists a positive link between entrepreneurship and economic growth (Deakins and Freel, 2012). The SME sector in most countries includes a preponderance of family businesses (Nordqvist and Melin, 2010). The importance of family businesses cannot be understated (Deakins and Freel, 2012). The Family Firm Institute of Boston (USA) estimates that 30% of family-owned businesses survive to the second generation of family members, while only 12% survive to the third generation, with a mere 3% surviving to the fourth generation and beyond (Byrd and Megginson, 2013). In South Africa, family businesses account for 50% of the economic growth of South Africa (Fishman, 2009). The rapid growth in family businesses in South Africa can be attributed to the rationalization process taking place in many large organizations, as well as to a growing inability of the informal sector to create new jobs (Van der Merwe, Venter and Ellis, 2009).

The South African government recognizes the importance of entrepreneurial activity as a means of energizing the country's economy and encouraging growth and development (Maas and Diederichs, 2007). However, the contribution of family businesses to socio-economic growth has never really received sufficient attention in South Africa (Maas, 2014). The gap identified in the literature supports the notion that family entrepreneurship as a field of academic study is relatively new (Zachary, Rogoff and Phinisee, 2011), while the Global Entrepreneurship Monitor (GEM) data do not directly focus on family businesses (Zachary et al., 2011). Nicholson (2003) identifies three areas of concern for family businesses, namely succession, insularity, and family conflict and governance. Additional problem areas include relationships within the family, intergenerational changes, and sustainability of the family business (Nordqvist and Melin, 2010).

1. Literature review

1.1. Economic overview. Family businesses account for 80% of all businesses in the United States of America (USA) and are responsible for nearly 50% of gross domestic product (GDP) (Family Firm Institute, 2014). Family businesses in Europe represent between 60% and 70% of all SMEs, and contribute between 45% and 65% to the continent's gross national product (GNP) (Maas and Diederichs, 2007). In Germany, for example, family businesses represent 79% of all businesses and employ 44% of the working population. In Italy, India, and Latin American countries, 90% to 98% of all businesses are family businesses, accounting for approximately 80% of all employment (Poza, 2014). Most entrepreneurial businesses start with financial support from family members (Astrachan, Zahra and Sharma, 2003). This is especially true in developing economies that cannot rely on sophisticated regulatory systems or systems that provide financial support and venture capital. Family businesses are also often a substitute for a lack of regulation by financial markets in developing economies and are found to offer effective protection to minority shareholders (Bertrand and

Schoar, 2006; Khanna and Rivkin, 2006). Furthermore, emerging economies are volatile and fragile, which endangers the survival of entrepreneurial ventures, including family businesses (Astrachan, 2010). In South Africa, no reliable database pertaining to family businesses exists. However, estimates indicate that family businesses are the predominant form of business. They comprise about 80% of all South African businesses and 60% of the companies listed on the Johannesburg Stock Exchange (JSE) (Maas and Diederichs, 2007).

1.2. Family business in perspective. The term 'family entrepreneurship' has many meanings and applications. However, it is used to describe the role of the family in entrepreneurial activities of all types (Heck, Poutziouris and Steier, 2008). Hatten (2012) defines family businesses as those in which two or more members of the same family control, are directly involved in, and own a majority of the business. According to Poza (2014), a family business is a unique synthesis of: *firstly*, ownership control (15% or higher) by two or more members of a family or a partnership of families; *secondly*, strategic influence by family members on the management of the firm, whether by being active in management, by serving as advisors or board members, or by being active shareholders; *thirdly*, concern for family relationships; and, *finally*, the dream (or possibility) of continuity across generations. The Family Business Association of Southern Africa (FABASA) defines a family business as *an enterprise in which the majority of the votes are held by the person who established or acquired the business (or by his or her spouse, parents, children or children's direct heirs); at least one representative of the family is involved in the management or administration of the business and where the company is listed, the person who established or acquired the business (or his or her family) possesses 25% of the voting rights through his or her share capital and at least one family member sits on the board* (FABASA, 2014b).

FABASA acts as the official mouthpiece of family-owned businesses in Southern Africa, while promoting their overall interests (FABASA, 2014a). FABASA's mandate includes assisting family-owned businesses with corporate governance and best practice and providing guidance with succession planning. Furthermore, it offers practical solutions to family businesses and highlights effective strategies to manage family businesses towards profitability and prosperity (FABASA, 2014a).

1.3. An entrepreneurial approach. Very little attention is being paid in the literature to how family dynamics affect fundamental entrepreneurial processes. The vast majority of businesses are family businesses, and research findings show that family and business dynamics are highly interrelated (Aldrich and Cliff, 2011). Enterprising families understand that today's dynamic and hypercompetitive marketplace requires families to act entrepreneurially. Family businesses must generate new economic activity if they intend to survive and prosper over long periods of time (Spinelli and Adams, 2012). Successful families use entrepreneurial action as a strategy for growth. They encourage innovation within the business as an extension of the family values that inspire entrepreneurship. Less successful family businesses have leader-centred cultures and lack world-class corporate governance, which are two flaws that limit entrepreneurship (Haar and Brenes, 2012). According to Danes, Lee, Stafford and Heck (2008), families and businesses provide resources for the entrepreneurial endeavours of family members in the form of social capital, human capital, and assets, including both financial and physical capital. *Social capital* includes the interrelations between and among family members. *Human capital* includes the human attributes of the individuals in the family, such as personal time and energy as well as emotional support. The concepts of *financial and physical capital* include money, credit and financial investments, as well as land, real estate and equipment.

Within a family business, entrepreneurial skills have to be managed within a continuing entrepreneurial culture. Too many businesses start off being entrepreneurial, but lose this drive as the business develops and stabilizes (Danes et al., 2008). In order to remain dynamic and entrepreneurial, the family business needs a challenging and realistic vision of its future (Maas and Diederichs, 2007). This vision should be a motivating and energizing statement, and should be spread throughout the workforce. This will enable all family members to contribute to the entrepreneurial character of the business (Maas and Diederichs, 2007). A family business usually develops as a result of true entrepreneurship, with many family businesses being founded to meet a demand for a specific service or product, while having developed the skill and know-how to deliver this (PricewaterhouseCoopers (PwC), 2013). South Africa lays claim to successful family businesses in various fields (KPMG South Africa Blog, 2014), while having the following in common:

- Customer-centricity: a focus on the consumer and the fostering of client relationships.
- Commitment to family values: family members may continue to hold the reins, but employees become 'part of the family'.
- An inspirational founder(s): these businesses have been built from the ground up by entrepreneurs of tremendous determination,

attitude, passion and energy, all the while leading from the front.

- Entrepreneurial spirit: the dynamism and opportunism on which the business was founded are given space to thrive.
- Solid, persistent marketing: the product or service offering is supported by quality and ongoing marketing efforts.

1.4. Family-business challenges. Family businesses are characterized by the concentration of ownership, control, and, often, key management positions among family members, even after the retirement of the businesses' founders. These types of businesses are generally found in countries with weak legal structures where trust among family members may function as a substitute for lacklustre corporate governance and contractual enforcement (Haar and Brenes, 2012). Issues pertaining to family relationships are a threat that influence the growth, success and survival of family businesses. It is from conflict-laden family relationships that many family issues emanate (Molly, Laveren and Deloof, 2010), while managing both the family and the business appears to be a constant challenge facing family-business owners (Schuman, Stutz and Ward, 2010). Some family businesses do not focus solely on 'business agendas' (profit maximization). Rather, some family-business owners place more emphasis on 'family agendas' and broader 'social agendas' such as social cohesion, protection of a local culture and/or a minority language, employment of local people, and the utilization of local suppliers (Westhead, Wright and McElwee, 2011).

'Hiring and firing' practices in the family business tend to be in the best interest of the family rather than the business (Fishman, 2009). A common family challenge is the expectation that the oldest child (usually the son) will take over the business (Fishman, 2009). Fishman (2009) argues that the appropriate successor needs to have a passion for the business, the aptitude to run it, a vision for future business growth and development, and an empathetic personality. Sensitive issues in the family business include salary differences, non-family members commitment and opportunities, disciplining relatives, or not hiring a child (Fishman, 2009). Relatively little is known about how family businesses share, disseminate and harness their knowledge to build and strengthen their technological capabilities. Even less is known about how family businesses successfully manage the process of knowledge-sharing (Zahra, Neubaum and Larrañieta, 2007). Family-business founders find it difficult to give up decision-making authority to family members, especially to children and grandchildren (Katz and Green, 2014). Human resource management issues that continually surface in family businesses are striking a balance between nepotism and meritocracy, and managing privilege. 'Nepotism' refers to a management philosophy of selecting and promoting people based on family ties, while 'meritocracy' is a management philosophy of selecting and promoting people based solely on them being the most capable persons for the job (Katz and Green, 2014).

Family-business owners in South Africa agree that compliance with the regulatory environment affects them to such an extent that they become uncompetitive, while the financial incentives and assistance afforded to them are not sufficient. Furthermore, many family businesses do not have the expertise or financial resources to meet the regulatory compliance requirements (Brink, 2014). This study included 1 952 international family businesses, including 100 South African family businesses, representing the manufacturing, wholesale and retail, automotive, agricultural and construction industries (Brink, 2014). Family businesses experience *external* economic environmental challenges such as market conditions – which include a lack of confidence in government, policy uncertainty and existing infrastructure (electricity, e-tolling and taxes), exchange rate fluctuations, and government policy and regulation (PwC, 2013). Broad-based black economic empowerment (BBBEE) is a particular challenge for family businesses in South Africa, especially with regard to the availability of qualified empowerment partners and the importance of a good 'fit' between the family-business culture and the culture of the empowerment partner (PwC, 2013). *Internal* challenges include a shortage of skilled labor and issues around cash flow and cost control (PwC, 2013).

Governance structures and a family-business constitution, advisory committees, family forums, proper succession planning, as well as business ethics and values remain vital for family businesses to succeed (Diederichs, 2014). Diederichs (2014) maintains that values include fairness – that is, a fair balance between the business and the family – and stewardship – that is, family-business leaders are true stewards when they believe that the businesses that they serve are 'larger than them'. The inadequate transfer of leadership and ownership from one generation to the next is a primary reason for the lack of longevity among small and medium-sized family businesses (Venter and Boshoff, 2007). South African family businesses generally do not engage in succession planning. Consequently, the majority of family businesses have no formal succession plan (Maas and Diederichs, 2007). A lack of proper estate planning has an impact on the succession plan and ultimately on the business (SME Toolkit South Africa, 2014). The transference of the family 'goodwill' is identified as a family-business challenge (HayGroup, 2014). Family 'goodwill' refers to the relational, human and social capital that typically contribute to the economic value of the business (HayGroup, 2014).

Maas and Diederichs (2007) identify the following areas hampering the success and growth of family businesses in South Africa: a lack of a sound system of business governance that is agreed upon and implemented by the family; a lack of knowledge regarding external environmental influences and their impact on the family business; a narrow vision of what a family business is and of what its objectives should be; and a reluctance to allocate sufficient time to the discussion of 'soft' issues such as the application of specific values and what each family member wants to contribute. Additional problems include (Maas, 2014): family members who are appointed without real concern for expertise; a lack of shared expectations; family conflicts not being addressed; repercussions of divorce that may lead to the destruction of the family business; and family members emigrating. A further concern is the level of family-business management skills, as the majority of heads of family businesses are not trained to manage their businesses successfully (Maas, 2014). According to Diederichs (2014), market demand and changes in the way business is conducted cause leadership to be less traditional and more adaptable. As family businesses grow into larger businesses, management teams from outside the immediate family assume broader leadership roles, changing inward thinking towards the family to outward thinking, especially towards customers and business opportunities.

2. Research methodology

The objective of the article was an exploration into family businesses and their challenges, as well as entrepreneurship and SMEs in South Africa. The method used for this article is classified as content analysis and involved obtaining information from the literature. The literature gave an overview from both an international and national perspective, with academic books, journal articles, reports and electronic media being used for this purpose. The authors acknowledge that only limited, recent academic literature is available on family businesses in South Africa. However, the authors attempted to consult the most relevant available literature from researchers in the SME-, entrepreneurship-, and family business-related disciplines. This article seeks to contribute to the existing literature on family business in Southern Africa and to present future study and research areas.

Conclusion

This article established some challenges faced by family businesses in South Africa. From the literature, it is clear that SMEs are recognized worldwide as a vehicle for stimulating economic growth, thereby creating job employment. Research has proven that the majority of businesses are owned by families or groups of relatives and that these businesses make an important contribution to an economy. Research on family-owned businesses in South Africa is still in its infancy, which includes research into the problems and challenges that beset these businesses.

Recommendations

Managerial implications. All members of the family business, whether active in management roles or simply silent owners, should have an open and ongoing dialog about the strategy, goals and operations of the business. Although family members usually share a set of basic values, there is some diversity in motivation and personal goals. Diversity could have the advantage of bringing new thinking to the management of the business. On the other hand, it could be a source of divisiveness which can lead to a failure to cooperate or to confrontations to the point of mutual lawsuits among family members (Katz and Green, 2014). Business competence, governance experience and decision-making expertise are critical matters for the selection and election of family members. The role of an outgoing chief executive officer (CEO) is important, as he or she may act as an advisor or mentor to a new CEO. The founder should impart his or her unique knowledge, skills and experience that have made the business successful. Working in another business provides knowledge and skills that cannot be provided solely from within the family business. Family members should therefore seek new pastures and different areas in which to work. Dividing responsibilities according to expertise is an important way of acknowledging respect for each family member's talents and abilities. Shared values create a sense of direction for the family business. Values and beliefs about people, work and money could shape family members' behavior towards the business.

Structural implications. A leadership organizational structure needs to be developed, as well as a charter (or constitution) of roles and responsibilities. Family councils are charged with the responsibility of writing the family-business constitution to guide the business through times of crisis and change, including the succession process. The focus of council meetings is the business–family relationship. Meetings are a good platform where issues such as role expectations, commitment, and personal responsibility could be handled. Coaches and mentors, both inside and outside the family, could be appointed to oversee procedures and policies in the family business. Outside directors (or an advisory board) are in a position to suggest non-family executives, consultants or other candidates, or to recommend expertise through their extended networks. In developing the management succession plan, the transition should be structured so as to minimize the impact of estate, gift and inheritance taxes on family members and the business. A risk management strategy could include insurance as part of the management succession plan, for example to minimize estate taxes.

Limitations and suggestions

This article was based on conceptual ideas and secondary data only. Furthermore, the authors identified a lack of recent literature and statistics on family businesses in South Africa.

Implications for policy on family-business growth in South Africa

- The implications of changes in management and the disruptions that these changes can cause to the dynamics of the family that owns the business.
- Leadership and management abilities: to manage, lead and train in the family business so that there is responsible ownership for the future.
- The relationship, intersection or overlap of entrepreneurial and family domains in the context of small and/or family businesses.
- Entrepreneurial and strategic abilities: to recognize and seize opportunities and to be an active and entrepreneurial owner.
- Socio-historical changes in the family such as household counts, size and composition, as well as the roles and relationships within the family that impact on the family and its possible motivation to create new businesses.
- The importance of focusing on family members from the different generations, as well as an understanding of their perspectives. (The research can focus on three areas: the desirable successor attributes from the leader's perspective; performance-enhancing factors; and the reasons why these family members have decided to pursue a career within their family businesses.)
- Communication and social aspects: networking, establishing and maintaining contacts, communicating with key stakeholders, and handling of conflicts as a responsible family-business owner.
- The extent to which the family is used as a business resource: the extent to which family resources and business resources are indiscriminate for family businesses.
- The role of women in family businesses: in terms of operational and emotional family support, as control, decision making and management are not always exclusively the domain of males in the family business.

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