Managing Risk Aversion: Transformation Strategies for Family-Owned Businesses

By Dr. Thomas Hagmann and Thiemo Werner

Key Takeaways

- Family-owned businesses in Germany, Switzerland, and Austria are a linchpin in the region's export-driven economy.
- Once an advantage, family involvement and focus on legacy is now a potential disadvantage due to the "risk-aversion paradox."
- Three related approaches can help these companies overcome this paradox and develop rapid strategic responses to disruption.

It's almost impossible to overstate the economic and cultural importance of family owned and operated businesses in the Germany-Switzerland-Austria (GSA) region. Known colloquially as the Mittelstand, these companies account for an outsized percentage of the region's jobs while powering its export-led economy.[1]

But what makes them particularly unique is how so many of them have grown into multinational powerhouses while successive generations of the founders' families have remained deeply involved. This includes giants like retailer the Schwarz Group, Germany's biggest pharma company Boehringer Ingelheim, and media conglomerate Bertelsmann.

By taking a particularly long-term view and making family legacy a central element in decision making, these companies have shown an aptitude for developing greater clarity in their growth strategies. This has given them an advantage in outcompeting peers while contributing to their adaptability and resilience.[2] With their success over multiple generations, and penchant for reinvesting profits, they are seen in the region as a stable counterpoint to more short-term oriented publicly traded companies.

However, there are signs that the Mittelstand are losing their advantage. Studies show that companies in the GSA are trailing peers in investing in crucial areas like digital infrastructure, software and data, and business process improvements.[3] The recent sale of the Viessmann Group, a century-old global leader in industrial refrigeration and heating, is fueling speculation that the current generation of owners is inclined to cash out amid a rapidly changing environment.[4]

We've worked with multiple family-owned businesses in the region to develop growth and investment strategies that keep pace, navigating disruption and technological change. Despite a unique ownership structure that enables a long-term vision, these companies are increasingly constrained by risk aversion due to the overarching goal of protecting their legacy for future generations. This, in turn, has led to myopia and incrementalism, threatening their long-term prosperity.

We call this the risk-aversion paradox. The very thing that once conferred an advantage – family involvement and a long-term focus on legacy – is now increasingly a potential disadvantage in the face of greater complexity and need for rapid strategic response. The impact of this paradox can be profound, affecting decision making and culture throughout an organization. The stakes are high, threatening the legacy of businesses that in some cases have been around for hundreds of years, as well as potentially undermining the stability of the region's economy.

For instance, the owner of a European manufacturing company recognized that investing in a transformation strategy aimed at professionalizing business operations would likely dilute family control. The alternative was to preserve family influence but risk limiting growth. These unique complications are reflected in what is known as the three-circle model of family business, as shown in Fig. 1. The model reflects how there are distinct overlaps between a business's focus on growth and development; ownership's concern with wealth preservation and dividends; and a family's interest in its values, control, and social capital.

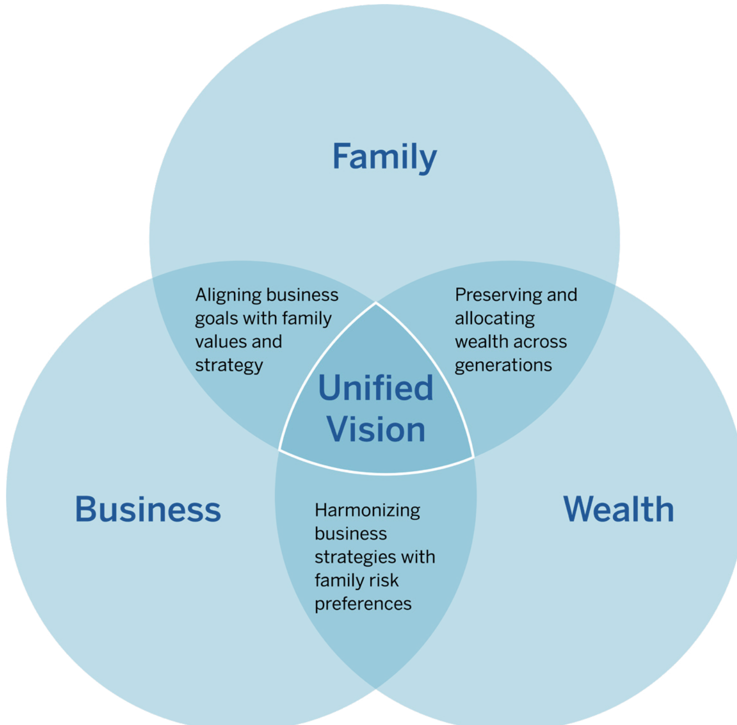
It's critical for family-owned businesses – especially those with successive generations of owners and third-party managers – to integrate these multiple perspectives into their strategy to ensure there's consistency and minimize resistance to change. Understanding how these dimensions produce interdependencies and tensions is crucial for aligning interests among and beyond owners.[5] There are strategies that can help companies manage these tensions and address risk aversion. We'll explore three of them here.

"Future-Back" Strategy for Consensus-Driven Cultures

One result of the risk-aversion paradox is strategy paralysis. This occurs when leadership teams in family-owned businesses generate multiple options but are unable to develop the necessary confidence to move beyond incremental steps and make bold decisions about their innovation capabilities.

To illustrate, an industrial company we advised was struggling to respond to threats and disruption

Figure 1: The Three-Circle Model of the Family Business System



from electrification and digitalization of its core industrial markets. The company had identified more than 100 potential priorities for remaking and repositioning its business and made several small investments in tech startups, but there was no coherence to its strategy.

The chief executive officer recognized that a significant part of the company's market could be lost to disruption but was concerned that making bigger, bolder changes would jeopardize the business and his family legacy. Complicating the path forward, the company had a very consensus-focused culture, like many family businesses, and strategic change required significant stakeholder coordination and buy-in across all levels of the organization.

To navigate this uncertainty, the company developed a "future-back" strategy to drive its transformation. Future back is both a way of thinking and a set of disciplined and rigorous processes to push beyond typical planning horizons and set ambitious, long-term growth goals with clear milestones to achieve them.

Through this approach, the company engaged in a cross-generational dialogue to establish alignment among family owners and address the risk aversion paradox directly. It developed a view of the future for its products and created an operating model and roadmap for pursuing six strategic focus areas, down from the more than 100 ideas it had before. It also made a significant financial commitment to ensure the success of its transformation strategy.

Aligning Family and Management Around a Vision

In our experience, leadership teams in family businesses are often divided by disagreement about the best path forward. A critical first step in creating a vision for the future is surfacing and sharing misalignment among the leadership team, creating a safe environment for individuals to take riskier stances, and working toward consensus.

As part of our work with a family-owned consumer goods company in Europe we introduced an exercise that surfaces misalignment among managers and owners and facilitates discussion around differences of opinion on matters like growth aspirations.

"Walk the Line" involves company leaders literally standing on a line of tape on the floor marked with different growth targets; the leaders stand on the number they believe is obtainable and try to persuade others to jump to their mark. The goal is to get the group move as closely to a shared number, generating leadership alignment around targets and expectations.

For the consumer goods company, the Walk the Line exercise resulted in a father and his children finding themselves at opposite ends about what long-term growth aspirations to set. The children advocated for a double-digit annual growth target, arguing that if the company wasn't growing enough, it couldn't attract the right talent. The father wanted to set a lower growth forecast, concerned that being too aggressive could endanger the company.

In the end, they compromised and came to a collective agreement, with the company establishing a realistic yet ambitious growth target for 2035. This enabled it to prioritize strategic focus areas for growth and develop transformative business models to support these new targets. At the same time, the company formed new partnerships and launched new products as it sought to expand beyond its core markets.

Risk-Reduction Strategies

Because they see themselves as custodians, leaders and stakeholders at family-owned businesses tend to be risk-averse in assessing options and decision making. When the rate of change in business is accelerating, as it is today, it amplifies this perception of risk. Counterintuitively, this often leads family businesses to make more incremental strategic moves by prioritizing efficiency-focused projects over larger transformations.

The goal in laying the groundwork for any kind of strategic or business model transformation is to develop a consensus around a company's risk appetite, making sure it is explicit right at the beginning of the process. This will essentially enable an organization to de-risk its transformation efforts, surfacing fears and other emotions that arise when considering the impact on family legacy and stakeholders, complicating decision making.

One powerful de-risking strategy is to establish goals and bounds that define what is "desirable," what is "discussable," and what is "out of bounds." This helps capture the perspectives of family stakeholders in advance of embarking on initiatives, which helps avoid discovering too late that a project might violate an unwritten rule.

Consider a dominant consumer brand in Germany that we advised. It had a global footprint and a healthy balance sheet but was facing slowing growth in its core market. After establishing a 10-years growth analysis, the company determined that its current offerings would not be sufficient to meet the family's and management's ambitions.

The company used a goals-and-bounds exercise to develop parameters around how it would expand and diversify, taking out the emotions and uncertainty that had been inhibiting its decision-making process. It determined it wanted to remain focused on products and not diversify into services, and then used goal-and-bounds as it evaluated the potential risk and reward for each new type of products it considered launching.

"Test and learn" is another strategy companies can use to de-risk bolder strategic choices and generate consensus around growth strategies. A client of ours struggled to introduce new products because tradition dictated it did so through longstanding distribution networks. Using test and learn, it established a new process outside those relationships to pilot and test critical assumptions about potential new products with target consumer groups, including variations in packaging and pricing.

Test-and-learn strategies also help family-owned businesses reconnect to their entrepreneurial roots and how these companies were initially built, ultimately giving them greater confidence in launching new products or making bigger and bolder investment decisions.

Family businesses in GSA face a critical challenge in transforming their operational and strategic approaches without losing their core values and identity. To overcome the risk-aversion paradox, companies can adopt forward-thinking strategies that align with both current market demands and future opportunities, building cohesion around an aligned vision while engaging in risk reducing approaches. By doing so, they can once again lead on transformation while maintaining their intrinsic drive to preserve family legacy.

ABOUT THE AUTHORS

Dr. Thomas Hagmann is a Managing Director at Innosight based in Switzerland.

Thiemo Werner is a Senior Director at Innosight based in Switzerland.

ABOUT INNOSIGHT

Innosight helps organizations navigate disruptive change and manage strategic transformation. As the strategy and innovation consulting business of Huron, we work with leaders to create new growth strategies, accelerate innovation, and build future-ready organizations. Discover how we can help your company own the future, instead of being disrupted by it. www.innosight.com.

Contact Us

ENDNOTES

1. Family Capital, "Top 500 German Family Businesses – the economy most dependent on family enterprises."

2. Marc-Michael H. Bergfeld and Felix-Michael Weber, "Dynasties of innovation: highly performing German family firms and the owners' role for innovation," Feb. 8, 2011.

3. European Investment Bank, "Who is prepared for the new digital age?"

4. Bloomberg, "Germany's Backbone of Family-Owned Firms is Up for Sale," March 9, 2024.

5. Hagmann, Thomas, "Understanding the impact of active owners in privately held businesses," March 31, 2021.