To Encourage Innovation, Tap the Next Generation of Leaders

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In these times of change and uncertainty, one thing is still certain: product-service innovation remains the lifeblood of family firms. Without innovating, pioneering competitors will make existing products and services obsolete or trap the family business in a constant game of catch-up.

Against this backdrop then, family businesses often need to change gears and switch up their innovation strategy. Past studies tend to show that family businesses are less innovative than their non-family counterparts. But in something of an ironic twist, family firms are also ubiquitous and generally outperform non-family firms (at least listed ones). So, the hidden question here is: *what allows some family firms to steer towards a more adventurous product-service innovation strategy over a more cautious one?*

In this short piece based my research with family business colleagues, I will explain the different types of product-service innovation strategies that family firms use, the factors that enhance the use of one strategy or the other, and the importance of planning the innovation path of a family firm. The key takeaway: involving younger generations can spur the types of innovation that both strengthen a family firm's existing products and services and also open it up to new opportunities.

Two Types of Innovation Strategy

Not all innovations are equal, and family firms deciding an innovation strategy are typically pulled in one of two directions. The first option is an exploitation-focused innovation strategy, which emphasizes refining products/services or the processes that underpin them, superior execution, improving cost efficiency or product/service quality, or adding incremental new features to existing products and services. Exploitation innovation can be thought of as a security blanket. It is a relatively safe and low-cost strategy but doesn't alter the firm's performance trajectory or "change the game."

The second option is an exploration-focused innovation strategy. Here, truly new product/service innovations originate from experimentation, play, discovery, and entrepreneurship with the intention of making a step-change or leap forward into new products and services, new technologies, new markets, and the like. This is riskier, but carries with it the potential for far greater rewards and new market leadership. Some family firms can even pursue both innovation strategies simultaneously by managing a phenomenon known as "ambidexterity." But both innovation strategies are opposites to each other, and different factors can be expected to enhance the use of one strategy over the other.

How Families Choose Their Strategy

This is a question Louise Scholes, Mike Wright, Alfredo De Massis, Josip Kotlar and I sought to answer in our research funded by the Institute for Family Business Research Foundation in the UK. In our study of 328 privately held UK family firms, we find that next generation involvement is essential to motivating either innovation strategy. Also, having a family council can help steer family business leaders away from a cautious, exploitation-focused innovation strategy and towards an exploration strategy. We know that exploration carries risk, but exploitation is also risky because it makes the business better at what it can already do well -- but at a cost of being more and more reliant on those activities and vulnerable to the innovation and entrepreneurship of its competitors. Surprisingly, having a family member as the CEO, more family members involved in managerial roles, and having family trustees did not effect which innovation strategy was favored; the involvement of younger family members was the deciding factor.

Thinking and Planning the Innovation Path

Our research provides two valuable lessons for family businesses.

First, family owners and managers should adopt family councils and involve next generation members in innovation activities. Both measures will make the family more likely to innovate, and encourage an exploration innovation strategy to form and take hold. Family councils can be especially helpful in encouraging sibling, cousin, and broader family groups or stakeholders to support the business and bring new insights and perspectives to decision-making.

Because an exploitation-based innovation strategy is often the "default mode" for many family businesses, it is particularly interesting to note that involving the next generation creates a stronger push for an exploration innovation strategy. Exploration is essential to longer-term sustainability and competitiveness, so businesses should capitalize on next-generation members to invigorate the innovation strategy by bringing fresh knowledge, fresh ideas, fresh insights, and fresh impetus to the firm.

We believe that next-generation involvement spurs an exploration innovation strategy because it brings a more liberal view of risk to the general family group. Younger members bring more optimism and a future orientation to the family firm, and can sway the group's risk orientation towards a bolder vision. Stated differently, they are less encumbered by the past while also capable of appreciating its innovation potential. Involving the next generation also potentially resets the mindset of family leaders towards a longer time horizon – envisioning their business under future generations. These circumstances may explain why next-generation involvement encourages investment into deeper innovation projects that may be more costly in the short term but pay off long term (an exploration innovation strategy).

Second, next-generation involvement also encourages the more familiar and safer exploitation innovation strategy. This is important because it shows that younger members are a vital catalyst for innovations that improve the standard of the business, the quality and cost of its product-services, and its temporary advantages against competitors. Exploitation innovation can build on the traditions and legacies of the family business. It is also valuable as the family firm can establish a market-leading position through this innovation strategy. However, in isolation, this strategy can make the family business vulnerable to a competency trap, where it becomes incrementally better and better at serving existing markets with existing products only to miss out on new market opportunities and trends or the breakthrough and disruptive innovations of its competitors. The benefit to the family business is that our results associate next-generation involvement with *both* innovation strategies, leading to more "ambidextrous" family businesses.

Learn More

While we cannot comment on the qualities needed in next generations, we recommend that those who are curious read "Developing responsible owners in family business"(https://familybusiness.org/content/developing-responsible-owners-in-family-businesses) and the Family firm Institute research report entitled "Professionalizing the business family: The five pillars of competent, committed, and sustainable ownership" (https://digital.ffi.org/pdf/ffi_professionalizing_the_business_family_v6.pdf) . Our full research article entitled "Family management and family guardianship: Governance effects on family firm innovation strategy" is published in the *Journal of Family Business Strategy (https://www.sciencedirect.com/science/article/pii/S1877858520301169?via%3Dihub) .*

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Listen to the Podcast

Link to video

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