"SHIRTSLEEVES TO SHIRTSLEEVES IN THREE GENERATIONS"

- How to increase the odds of long-term survival through Corporate Governance

It is often said that family-owned businesses usually do not survive beyond three generations. Have anyone ever wondered why.

Unique Challenges of Family-owned Businesses

It is pertinent to note that a typical family-owned business faces unique challenges in the forms of rigidity of the family hierarchy and a tendency for overlapping family life and work life, etc, which are not common in non-family run companies. It is therefore necessary for businesses which operate in a family-run environment, to consider placing more importance towards inculcating proper corporate governance into the business in order to maintain stakeholders' confidence, promote business sustainability and ultimately, generating value for the business.

For most family businesses, the irrational fear of losing control can be a main obstacle to the adoption of proper governance practices. This has to be viewed and reconsidered carefully in view of the changing landscape. One has to view practically and acknowledge that good governance is now necessary as people become more sophisticated in their decision-making process. Potentially there are two critical issues that are commonly encountered by family-owned businesses – *internal conflicts and succession planning.*

A Harmonious Family Breeds Prosperity

Family harmony and business prosperity goes hand in hand and hence, having an appropriate framework to ensure that these could be achieved is important.

The standard model for a family-owned business consists of three key players: the family, the management and the owners. Acknowledging their respective presence, segregating their roles and recognising the interplay between these three key players is an ideal situation, which is unfortunately, easier said than done. More often than not, the three groups overlap and intertwine, thereby creating confusion. The lack of communication arising thereof could inadvertently lead to conflicts and an emotionally charged environment. This would, in turn, affect problems solving and future strategic planning. This is a pitfall that family-owned businesses should try to avoid.

A simple example of such a conflict which is commonly encountered in a family-owned business is a case where there are family members who are solely shareholders and those who are also employed in the company. Both groups can have very different views on the level of dividend to be declared. Both views are generally valid and thus, the conflicting views must be managed and reconciled in a respectful way in order to set a right direction for the business as well as to preserve the harmony within the family.

Since the management of these conflicts is critical to the success of the business, an attempt should be made to separate business issues from those of the family in resolving conflicts. It will be helpful if all parties could put things on the table, have an open discussion on all contentious issues and come to an upfront agreement in setting some basic rules based upon the principles of fairness, transparency and consistency.

A Harmonious Family Breeds Prosperity (continued)

A good governance framework for a family-owned business should include:

- A form of written constitution stating the family's principles, setting clear rules/directions and protocols as well as defining roles of the key management;
- A family forum (preferably with an independent/third party as mediator) for communications, consultation, planning and dispute resolution;
- A formal conflict resolution mechanism; and
- A system of evaluating and succession planning.

Succession Planning

Succession planning should be at the heart of the family governance system. The lack of or weak succession planning is the main reason for the high rate of family businesses mortality. Succession planning is a process rather than an event. It is not one-off but requires proactive planning, careful deliberations and adjustments. It often affects all parties, including the owners, management and family. As such, succession planning is difficult as it takes time, skills and requires high level of objectivity.

Effective governance happens when the right people are in the right roles with clearly defined goals and effective decision-making responsibilities. In order to support effective succession and to mitigate the transition risks, advanced preparations and arrangements need to be set in place. Some of these arrangements include:

- Having a clear and open family employment policy and/or screening process allowing only committed and qualified family members to be employed;
- Implementing a proper training or mentoring program to prepare the next generation of senior management; and
- Subjecting employed family members to regular non-biased performance appraisals.

Surviving the Transitions

Unfortunately, there is no one system that fits all. What works for one family may not necessary work for another. Similarly, what works now may not necessarily be appropriate next year. Hence, being able to remain vigilant and adapting to constant changes and adjustments are critical factors to the growth of the business. These governance arrangements need to be dealt with considering the unique challenges of conflict resolution and succession planning.

For families that are currently not encountering these challenges and in a harmonious state, this is the best time to plan ahead to avoid the potential pitfalls. It will be prudent to fix the roof before the arrival of the sudden storm.

If you wish to understand more on the topic of good corporate governance framework, please approach any of the partners below:

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