

Governance Challenges in Family Owned Businesses Entrepreneurs' Organization

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CHARACTERISTICS OF FAMILY OWNED BUSINESSES

Family owned businesses are characterized by:

- **ownership belonging to a single or small number of families**
- **substantial involvement in the direction and management of the business**
- **intention to pass on the ownership and the business to the next generation.**
- **Generational transfer of business values**

CHARACTERISTICS OF FAMILY OWNED BUSINESSES

A family business can be described as an interaction between two separate but connected systems—the business and the family—with uncertain boundaries and different rules.

FOBs – ECONOMIC SIGNIFICANCE

USA – Conway Centre for Family Business

- One-third of Fortune 500 companies are family controlled
- 70-80% of all business enterprises
- Upto 50% of GDP
- 60% of employment (non-agriculture)
- Return on Investment is higher

<http://www.familybusinesscenter.com/resources/family-business-facts/>

FOBs – ECONOMIC SIGNIFICANCE

Europe – Austrian Institute for SMEs

- **As high as 50% of GDP**
- **40-50% of employment**
- **70 - 80% of all business enterprises**
- **Some of the largest entities are family owned**

http://ec.europa.eu/enterprise/policies/sme/files/craft/family_business/doc/familybusiness_study_en.pdf



FOBs – ECONOMIC SIGNIFICANCE

Pakistan – Pakistan Stock Exchange/SECP

- **50% of the listed Companies are Family Owned/Controlled**
- **From July to November 2016 SECP has registered 2500 Private Companies (mostly family owned/partnership) bringing the total to 70, 500 Companies.**

FOBs BEYOND THIRD GENERATION

- According to McKinsey study, only 15% of Family Owned Enterprises continue to survive to the third generation. Of those that do last, 85% either disintegrate or completely vanish before the fourth generation takes the reins.
- In Pakistan too, amongst the so called 22 Families identified in the President Ayub, only a few have managed to retain their positions.



LIFE CYCLE - Generational

Characteristics of family owned entities evolve over their life cycle:

- **First Generation – founders as controllers**
- **Second Generation – siblings partnership**
- **Third Generation – cousins consortium**

LIFE CYCLE - Vision

1. To create wealth for family members; to be managed **only** by it.
2. To enlarge the size of the family's balance sheet and improve quality of family's human capital. To achieve that **begin to develop** a professional cadre of management.
3. **To create an organization** and develop competent family members from children and grand children and a professional cadre to run the business and also help build social enterprises.
4. To create an **institution** built to last and be part of the society, managed by competent professional with family members as investors and Board members.



LIFE CYCLE - Legal

- 1. Family owned and managed business**
- 2. Family owned and managed private entity**
- 3. Family controlled and managed public entity**
- 4. Family controlled public entity (lesser management role but controlling board role)**
- 5. Family Investment (with no management role & non-controlling board role)**



GOVERNANCE IN FOBs - WHY

- **Long Term Growth & Sustainability**
- **Increase in Family's Wealth**
- **Stakeholders Interest Protected**
- **Family relations protected**



PILLARS OF GOVERNANCE IN FOBs

- **Family Governance**
- **Organizational Structure**
- **Framework for Family Managers**
- **Conflict of Interest & Transparency**
- **Effective Decision Making**
- **Employees & Stakeholders' Rights**
- **Ethics & Disclosures**



Family Governance

Complexity of Ownership, Relationship & Management Role

- Ownership held by several family members
- Ownership held amongst several branches of the family
- Within a single branch of the family multiple generations are involved
- Not all branches or members have equal shareholding; thus minority shareholders.
- Certain owners might have additional relationships amongst themselves
- Not all owners have management role in business



Family Governance

Respect & Protection of Ownership

- Bring total assets and liabilities of business into the legal vehicle
- Document individual ownerships (inheritance law)
- Let every owner be in control of his / her ownership
- Facilitate transmission of ownership
- Take care of minority shareholders
- Respect and facilitate exit (time and value)
- Hold proper shareholders meetings



Family Governance

Minimize Grievances & Resolve Conflicts

- Balance between ambitions of executives and expectations of non-executives.
- Balance between the executive role of members belonging to different branches of the family
- Preempt potential conflicts and prevent them from affecting business
- Resolve conflicts through discussions



Organizational Structure

- Split the organization into functions on a logical basis
- Assign authorities & responsibilities for functional heads
- Standardize operating procedures



Framework for Family Managers

- Identification of family managers
- Allocation and rotation of roles
- Assignment of leadership role
- Remuneration of family managers
- **Succession planning**



Conflict of Interest & Transparency

- Avoid conflict of interest
- Be fair when dealing with any information or opportunity
- Proper Accounting practices
- Availability of Financial & Operational Information



Effective Decision Making - Board

FUNCTIONING

- Orientation
- Meetings of the Members

CAPACITY

- Number of Members
- Composition of Membership

STRUCTURE

- **Chairperson**
- Consensus on voting power
- Committees



Employees & Stakeholders Rights

- ❑ Recognition of Role of Management
- ❑ Merit based hiring (Non-family)
- ❑ Operating Policies and Procedures
- ❑ Fairness in Human Resource Policies
- ❑ Training, Evaluation & Career Planning
- ❑ Communication about unethical practices



Employees & Stakeholders Rights

Recognition of the role and rights of company's stakeholders created by

- Laws**
- Mutual agreements**
- Society**



Ethics & Disclosures

- ❑ **Business Practices**
- ❑ **Related Party Transactions**
- ❑ **External Audit**



IMPLEMENTATION

- **Provoke debate amongst family members**
- **Make a business case for governance reforms and develop consensus**
- **Propose necessary changes in the organization's structure.**
- **Define duties, roles and responsibilities of all stakeholders in the company.**



IMPLEMENTATION

- **Propose necessary changes in the company's policies and procedures.**
- **Make alterations in the Constitution Document.**
- **Engage outside consultants, if desired**
- **Do regular self and independent review**



CONCLUSION



Thank You

**For a copy of this Presentation and
Pakistan Guide of Corporate
Governance for Family Owned
Businesses, please visit
www.fudda.org**