

Family Companies

The Challenges & How To Address it ?

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Definition of Family Companies

Family Business is a company in which family members have effective control over its strategic direction and the Business significantly contributes to the income, wealth, name and goodwill of the family members.

Definition of Family Companies

A company is Family company if one or more of the following factors are present:

- ❖ Family effectively contribute to the company's capital.
- ❖ Family members have the majority vote in the Board of Directors or the General Meeting.
- ❖ Family members have authority or influence on the strategic trend of the company.
- ❖ All or some of the family members actively participate in management.
- ❖ More than one generation involved in the company's management.
- ❖ Family members' desire or intent to continue as a family business.

Importance of Family Companies in World Economy

- ❖ The reducing role of the public sector in economic life and the growth of the privatization trend
- ❖ The role of socialist systems in political and economic life has diminished in most countries of the world.
- ❖ Combined revenues of 10th largest family companies is US 1.7 trillion.*
- ❖ Australia's GDP is US 1.5 trillion.*
- ❖ Combined revenue of world top 500 family companies exceeds half of the revenue of Fortune 500 companies.*
- ❖ Employment of top 500 family companies is three quarters the employment in the Fortune 500 companies. *

Importance of Family Companies in World Economy

- ❖ Indonesia, the family companies contributes 80% of the country's GDP (IFC 2009).
- ❖ In Taiwan the small and medium-sized family enterprise accounts for more than 98.5% of companies, 80% of employment and 47% of the total economy. (Gulzar & Wang, 2010).
- ❖ 95% of all companies in the GCC are family owned.(Global Risk Insights 2015)
- ❖ 80% of non-oil GDP in Middle East is from family companies. (Deloitte Consultancy)

Characteristics of Family Companies & its Challenges.

- ❖ The strong overlap between the affairs of the family and the company and the absence of separation between ownership and management.
- ❖ Family Companies focus more on long term sustainability than short-term profits.
- ❖ Trustworthy persons have priority in appointment over skillful and qualified ones.
- ❖ Family Businesses may have difficulties in attracting and retaining key employees.
- ❖ Core values of the business more linked to the presence of the founder than the corporate culture of the business.

Characteristics of Family Companies & its Challenges.

- ❖ Relative difficulty in obtaining finance.
- ❖ Inadequate Governance System.
- ❖ Less democracy in taking decision. Decisions are taken normally by the founder or owners
- ❖ No plan to find an alternative or successor to the president / founder upon his retirement or death.
- ❖ Generational disputes.
- ❖ Sibling rivalries,

- ❖ Strong family culture.
- ❖ Larger families.
- ❖ Male dominance.
- ❖ Lack of organization and formal legal structures
- ❖ More difficulty in attracting the right skills / talent.
- ❖ Lack of investment in technology.
- ❖ Family members from more than one branch.
- ❖ Role of friends in management or advisory role.
- ❖ Sensitivity in deciding between reinvestment of profits and payment of dividends.

Specific Challenges in China

- ❖ Professor Jean Lee, co-director of the Centre for Family Heritage at the Shanghai-based “less than half of the would-be second generation of family business leaders are willing to take up the reins”.
- ❖ One Child Campaign.
- ❖ Chinese Studying Abroad.
- ❖ Western versus Eastern Culture and freedom way of life.

Challenges Experienced by Family Companies' Auditor

- ❖ Project owners do not appreciate the role played by the auditor.
- ❖ Lack of strong internal control system.
- ❖ Management override of existing controls.
- ❖ More substantive work than systems testing (EA).
- ❖ Require to test large samples to have good coverage (EA).

Recommendations To Address The Challenges

Family Council

- ❖ Family Council is elected by the Family Assembly.
- ❖ Criteria for elections:
 - ❖ Representative from each family branch.
 - ❖ Representative from different generations of the family.
 - ❖ Representative from male and female members.
 - ❖ Representation from different background/skills & education.
- ❖ Primary link between the family members , the board of directors and the senior management.
- ❖ Family Council is an illegal body and is not a substitute for the company's board of directors
- ❖ Suggest and discuss names of candidates for membership of the board of directors.

Family Council

- ❖ Determine and review the strategic vision of the company and its mission.
- ❖ Determine and review family policy regarding the family members' employment, and their contribution to the company.
- ❖ Policy of distributing profits (balance between the material needs of family members and the financing needs of the company).
- ❖ Training needs of family members.
- ❖ Policy related to the purchase and sale of family shares.
- ❖ Discussing and selecting a shortlist of potential successors.
- ❖ Discussing and selecting the alternative to the current chairman when he retires.

- ❖ Determine and review the strategic vision of the company and its mission.
- ❖ Discussing the possibility of creating a fund to support and adopt any ideas or suggestions made by family members
- ❖ Discussing whether the company will continue , sold or have a private placement or public offering.

Definition of Family Constitution

- ❖ An official charter or book prepared with the cooperation of all members of the family to include the values , beliefs and objectives of the family in relation to their relations with each other and how they deal with the company or companies that they own (Ivan Lansberg)

Contents of Family Constitution

- ❖ Strategic objectives of the family.
- ❖ Values, beliefs, family mission.
- ❖ Family members employment policy.
- ❖ Method and rules for nominating a member of the family for leadership positions.
- ❖ Defining roles and responsibilities of family and non-family members.
- ❖ Method and way of trading shares of the company among members of the family and the basis of valuation.
- ❖ Process to resolve critical business-related family disputes.
- ❖ Time of accepting an external investors

Benefits of Family Constitution

- ❖ Preparation process could increase communication among family members their sense of belonging to the family and to the company.
- ❖ Set the guidelines for the behaviors of individual family members with respect to the company affairs.
- ❖ Avoid misunderstandings & disputes.
- ❖ Sets the expectations of the second generation and the third generation of family members in its proper framework and governs their intervention in the management

Chief Emotional Officer

- ❖ Who is the oldest /wisest member in the family.
- ❖ Who is the friend/member that majority family members trust and go to when there is a problem
- ❖ Women's listening skills better than men.
- ❖ Mom is often the peacemaker in the family.
- ❖ Mom usually has more leverage with dad than the kids.
- ❖ Mom is the glue that holds the business family together.
- ❖ They are the very heart of the family enterprise

- ❖ Good way to increase family members' wealth.
- ❖ Good way to reduce high leverage businesses.
- ❖ Good exit strategy for family members who do not want to continue.
- ❖ But has to be “Good Cultural Fit”.
- ❖ Listed family businesses actually perform better, as investments than companies with a broader ownership base (Credit Suisse).
- ❖ Required good preparation to maximize the value of business.

Founder's Role

- ❖ Many founders when speaking about death will not say “when I die,” but “if I die” (American Family Business Survey)
- ❖ Founders of businesses have a strong sense of invulnerability and immortality.
- ❖ Believe that he or she is mortal.
- ❖ The characteristic of a great leader is one who sets up the company to succeed after he or she is gone. (Jim Collins)
- ❖ Development of strong leadership well before leaving the business
- ❖ Dedicate time to think carefully about his successor.
- ❖ Genuinely handing control to the successor and supporting him or her.

Questions