Family Business

Characteristics, Governance and unique challenges

Prof. Dr. rer. oec. h.c. Dr. phil. h.c. Adalbert H. Lhota
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Definition of Family businesses
as stated by the European Commission, 2007

The majority of rights in the decision making process is in the hands of the natural person that has founded the company, or with the natural person/s that has / have acquired the majority of share capital in the company, or with the spouses, parents, children or direct heirs of the children.

Family businesses can have a multitude of appearances: They can be small, medium-sized or large, publicly traded or not.

To define the term „family business“, several approaches are being used.

The most significant difference to a nonfamily corporation is that the majority of shares are held by the founder’s family, so that external influences don’t play such an important role in the decision-making process within the company.

However, this does not mean that the management of a family business is exclusively in the hands of a family. There are many examples for companies that are mostly owned by a family but managed by nonfamily executives.

Typical positive characteristics of family businesses

- Short route to decision-making
- Closer ties and direct contact to customers
- Straightforward, level structures
- Better, more personal work climate
- Early takeover of responsibilities
- Preservation of traditions and heritage
- Sustained operations and heatlthy growth in the interest of the next generations
- Willingness for innovations and diversification
- Loyal to employees and shareholders
- Close ties to home region

Ideal case

Here you will find some examples for characteristics often attributed to family businesses in comparison to large, public conglomerates.

Of course, these characteristics are not fitting for all companies owned by families.

Rather, this is an overview of how those companies are often seen in public – more or less the ideal picture.

University graduates also often have this opinion about family businesses and many decide for these reasons to prefer a family business as a first place of work to start a career.

Typical negative characteristics of family businesses

- Frequently smaller businesses
- Less career opportunities
- Job assignments frequently for family reasons, not qualification
- Avoiding business risks, little growth
- Loss of entrepreneurial potential over generations
- Lower entry level salaries
- Caught in traditional business thinking, little dynamics
- Rather active regionally than globally
- Secrecy, avoiding the public, having little shine and glamour

Often reality

However, contrary to these positive notions, reality is often different.

These are some typical examples of opinions derived from practical experiences gained in family businesses.

In fact, there are a number of problems that often occur in family corporations and it takes diligent preparations for these businesses to avoid these typical pitfalls.

We will now look at some examples and see that some companies manage to overcome these difficulties quite successfully, while others don’t.

Examples of successful family companies

The world‘s oldest company

- Founded in 705
- Hotel in Hayakawa, Japan
- Guinness Book of Records entry as the oldest existing and still operational business in the world
- Run by the founder‘s family since its founding
- Today run by the 52nd generation after founding

Our first example is this Japanese hotel.

This small company has been owned by the founder’s family for more than 1300 years and is now in the hands of the 52nd generation.

With that, it is the oldest still operative business in the world and a perfect example of characteristics often attributed to family companies: durability, preservation of traditions and adherence to the basic business idea.

Previously, the world’s oldest business was a Japanese construction company. That one had been founded in 578 and remained in the hands of the family for 1428 years until it was sold to a large corporation.

Examples of successful family companies

The world’s largest private employer

- Founded in 1962
- Initially only one grocery store
- Worldwide expansion through acquisition of other retail chains
- Today world’s largest corporation by revenue
- Largest private employer in the world
- Publicly traded, but founder‘s familiy holds more than 50% of the shares
- Founder‘s oldest son is chairman of the board

Walmart

The world’s largest company by revenue and number of employees is also a family business. The founder died in 1992 and since then, his children have taken over the company’s management.

The Walmart example demonstrates that a family business may well be a publicly traded company. However, the founder’s family retains the majority of shares and by that remains the decisive factor in decision making processes.

The operational management in this case is in the hands of nonfamily executives.

Examples of successful family companies

One of the most courageous diversification strategies

- Founded in 1938
- Started as a trading company
- Large-scale diversification in the next decades
- After founder’s death in 1987 split into four conglomerates
- Today active with 74 companies in electronics, insurance, medic technology, shipbuilding and others
- Business units are controlled by various heirs of the company founder

SAMSUNG

Our last sample is a family company that indeed stands as a good example for many things.

Samsung is a great example for how extraordinarily successful family companies can be – the Korean brand is well known around the world.

Samsung is also an example for the fact that family businesses are sometimes more courageous than people say: The corporation operates in numerous, very diverse industries, into which it expanded bit by bit.

But finally, Samsung is also an example for the problems family businesses are often facing and which we are going to look at more closely now.

Characteristic challenges for family businesses

Samsung's Chairman Is Battling His Own Siblings For The Family Gold

Bloomberg BLOOMBERG
JUN. 7, 2012, 10:44 AM 1,389

Battle over billions: L'Oreal heiress says her daughter is disturbed

Feud that has torn apart family behind luxury hotels

A father and son, who built up one of Britain's most famous hotel chains, will go head to head in a law suit at the High Court this week

GLOBAL BUSINESS

Feud Among Samsung Descendants Heats Up

By REUTERS NOV. 14, 2012

Walt Disney Family Feud: Inside His Grandkids' Weird, Sad Battle Over a $400 Million Fortune

Family disputes also are often – and rightfully so – attributed to family businesses.

The reason is simple: Public companies can just fire or transfer an executive that doesn’t fit into company culture, family companies always have to consider family ties, hierarchy and heritage.

Things like this can even cause serious difficulties to world-famous companies such as L’Oréal or Samsung.

In Samsung’s case, for example, the company founder’s children fought a ruthless fight in courts, because their father had not left a last will.

How successor generations can destroy heritage

A grocery store founded in 1917 by a Greek immigrant in the Northeastern USA developed into a successful chain with large revenues in the first successor generation after the founder.

The third generation however slapped each other with countless lawsuits and legal fights about the company shares and influence spheres of the family clans between 1990 and 2014.

While the family fought legal battles, the employees went on strike and picketed the company headquarters

Strikes and protests led to revenue losses in the amount of $ 583 million

The public fights caused a considerable reputation loss for the company.

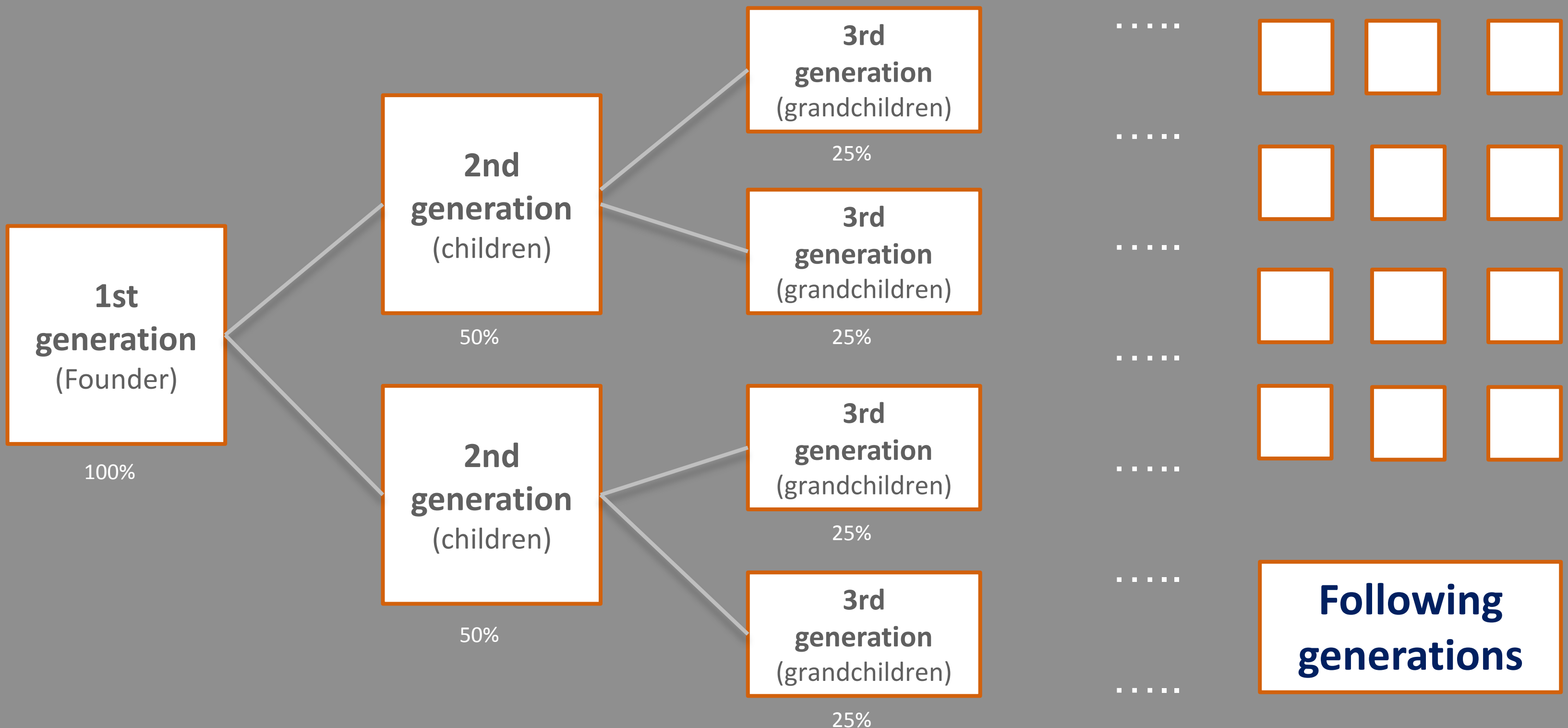
The questions of the inheritance of company shares and the degree of influence on the company's management area frequent issues of family disputes.

The example of the US grocery store chain Market Basket shows that often all boundaries are overstepped when business families get into fights.

In this case, the employees realized the danger. With their protests, they finally managed to put an end to the long, expensive controversy.

All this happens although family businesses usually are well aware of what issues put them into trouble.

The Generations Board: Root of many problems

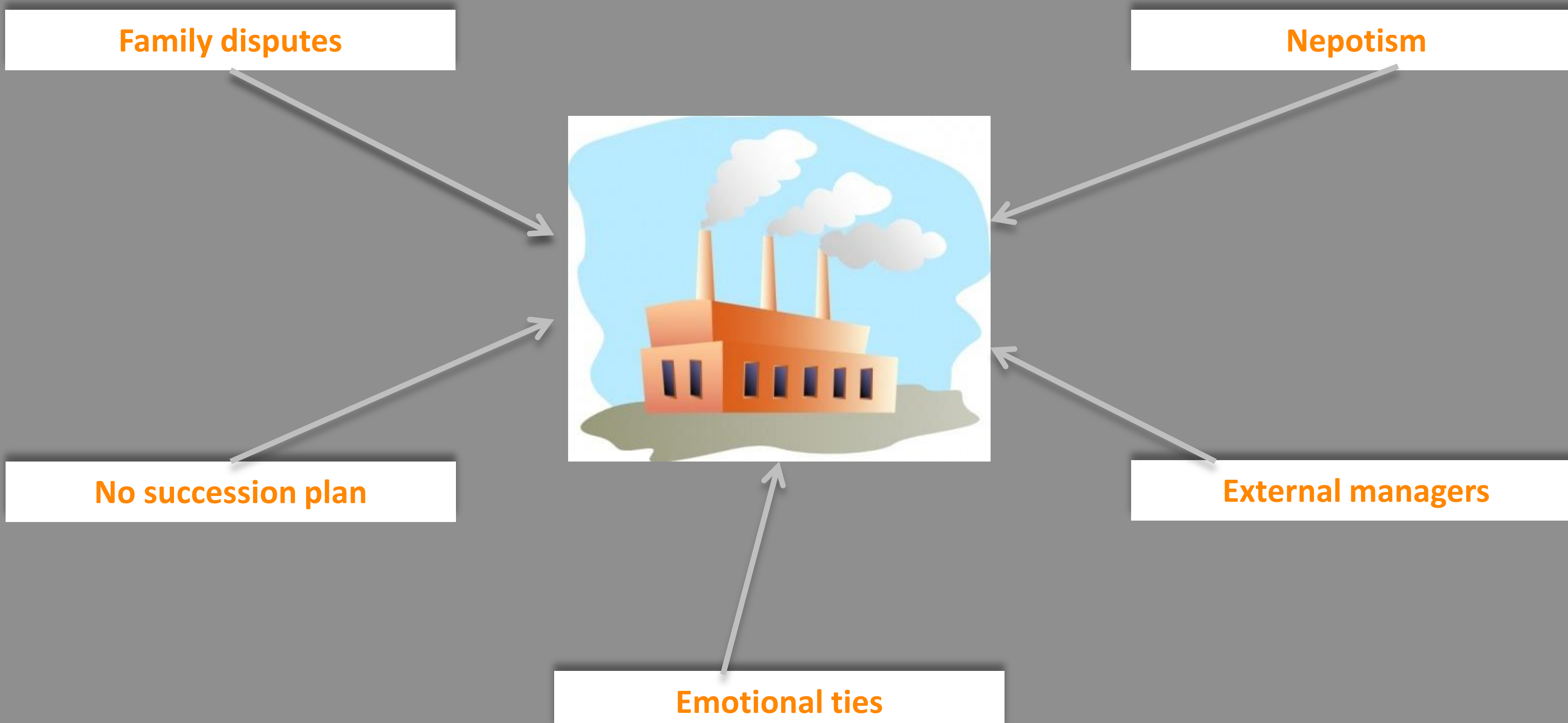


Looking at this simplified depiction of a board of generations in a business family makes it clear where the core problem is that most family companies will inevitably face.

When company shares are passed through generations, the number of people being interested in having something to say in company management grows increasingly. But the more people bring in their opinions, the higher is the potential for disputes and disagreements on the course of the company.

In addition, each new generation brings up the question whether there are family members who are qualified to take over leading positions in the company. There might also be some who are not interested in joining the company.

Frequent problems in family businesses



Here you will see some areas that typically cause problems in family companies. That these problems frequently exist is a major difference to public companies.

These problem areas must be anticipated by those in charge and they need to develop corresponding measures and action plans to counter these difficulties.

Let us take a look at possible ways to handle these challenges.

Frequent problems in family businesses

Family disputes

- Can be caused by business, but also by private reasons
- Often cause a lack of focus on operational and business tasks and may poison work climate
- Family members in the company must commit themselves to always prioritize business interests over family matters

Fights on a personal level are one of the most important problems for companies led by various family members.

These do not always have their roots in business decisions. The reasons for disputes often lie in old feuds between family clans or in personal dislikes stemming from the private area.

If the responsibilities and duties in the company’s management are spread among family members, it is absolutely necessary to have a manifesto that’s mandatory for everyone involved and that clearly states that business interests always come first before family matters.

Such a manifesto is also the only way to sanction – and to a certain degree avoid - professional mistakes resulting from family fights.

Frequent problems in family businesses

Nepotism

- Abilities, competencies and knowledge must always be decisive factors when hiring staff, even when family members are hired
- The company’s attractiveness as an employer for talents is diminished if positions are assigned regardless of qualification
- This will also negatively impact existing employees’ motivation, as the next career steps may seem unreachable for nonfamily staff

This is a problem in many family companies. Through heritage and family-internal transfers, the number of family members with an interest to influence company management grows further.

However, as being a member of the family doesn’t automatically mean that a person has the necessary qualification to fill a role corresponding to the amount of shares, appointing executives must follow the same process for all applicants, internal and external ones.

At the same time, in the interest of maintaining heritage and impact possibilities for the family, it is desirable that family members take over important positions in the company. For this reason, it is advisable to develop a qualification program for family members in order to prepare them for their work in the company.

Frequent problems in family businesses

No succession plan

- An agreed, binding succession plan on the company's top level is mandatory
- Once a successor is selected, the future managers must receive dedicated training to prepare them for their task
- Experts estimate that in at least 50% of all cases, transitions at the uppermost level in family businesses cause severe problems

The transition of responsibility from one generation to the next is one of the most important moments in the entire company history. In this situation, many companies encounter difficulties so severe that they do not survive it.

The succession in company leadership thus should be planned as early as possible. Also, it is vital to tie in all family members in these plans in order to avoid disputes from happening in the time when a new generation needs to find its way into the new job.

How important it is to think about succession plans as early as possible becomes obvious when the transition of power does not happen on a voluntary basis. If the company leader gets severely ill or even dies, a successor must be in place immediately to make sure the company does not get into difficulties.

Frequent problems in family businesses

External managers

- Many business families decide on an external, nonfamily CEO to guide and manage operations
- Even experienced leaders often find it difficult to act neutrally towards all family clans
- Over this effort, managers are in danger to lose sight on company interests as their highest aim
- When employees get in the middle of a family feud, there is a high risk of them leaving the company

In order to utilize the know-how of industry professionals and to gain a new perspective, family businesses often hire experienced executives from outside the family.

This is also a good possibility to keep internal disputes away from company management.

However, these managers often face special challenges. For example, they must be able to pursue their ideas even when confronted with opposition from various interests in family clans and they must have the stamina to enforce their own management vision.

As mentioned previously, external managers often see limited career opportunities in family companies as influential positions are often primarily assigned to family members.

Frequent problems in family businesses

Emotional ties

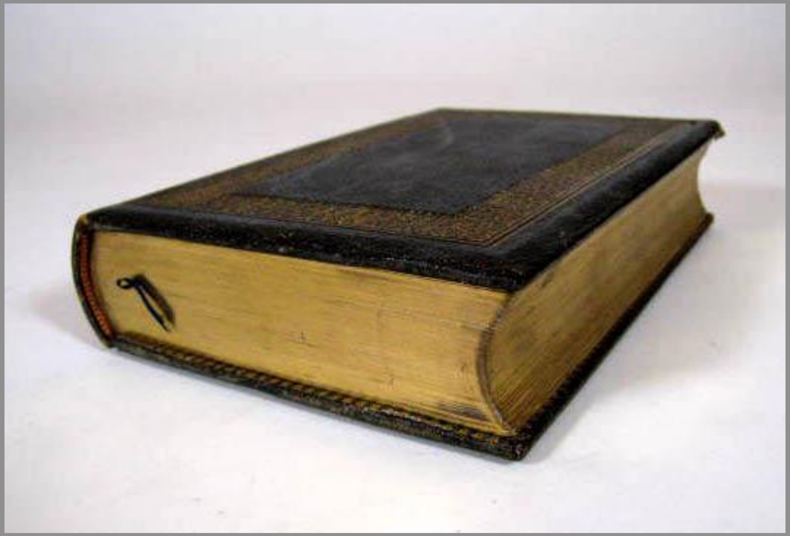
- The phrase „It‘s nothing personal, it‘s only about business“ doesn‘t work in family firms
- Family hierarchies are (too often) taken into account in appointing responsibilities
- Not only the company needs a management, the family needs one, too

Let us take another look on fights between family members. As a rule of thumb: The closer you are to another person, the likelier it is that a fight breaks out.

When businesses are set up and a structure is constructed, it is important to approach family aspects with great sensitivity. Questions like „How likely is it that the uncle takes orders from the nephew without protest?” must be asked and answered.

Many disagreements that might arise can be cleared up by an effective family management. For this reason, business families should not shy away from forming a family council that helps them design their relations between one another.

Family business governance



Conclusion: Each business family needs something like the „little black book“ containing all rules and agreements.

In family companies however, this is unavoidably rather a „big black book“.

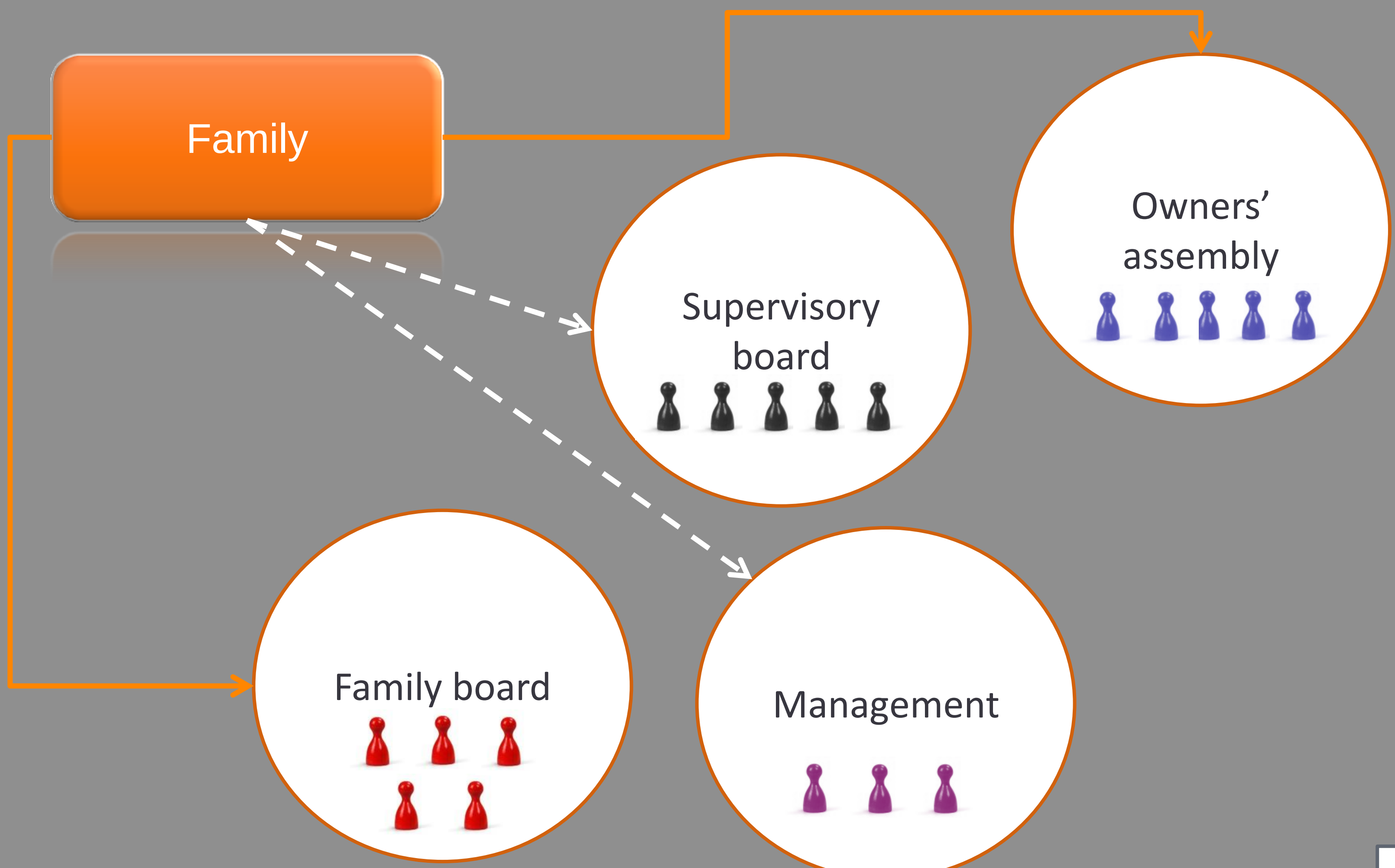
There are no laws governing the way a family should manage their roles as company leaders, owners and family.

In order to create a framework of rules, most business families, often assisted by external advisors, usually create their own governance which addresses these perspectives and sets rules for them.

Such a document must contain many different aspects, perspectives and possibilities. Special emphasis must be put on the handling of crises. Creating a family business governance therefore is a very complex task, which may take several years to complete, depending on the extent of the family.

It is mandatory that the family doesn’t wait until an actual dispute has arisen before it starts working on it. Instead, a set of governance rules is a basic element of all family businesses.

Possible governing bodies in family companies



There are several ways to design a company governance in a way that pays sufficient attention to all existing interests.

Depending on the desired degree of the family’s involvement into daily business, family members can be deployed to the executive management or into the supervisory board. It is also possible that family members holds positions in both bodies.

In that case however, it is mandatory to make sure that the board maintains a control function at all times. This means that the same persons or family clans cannot be represented on both bodies as this would lend control to only a part of the family.

Contents of a family business governance

- Basic company philosophy
- Basic company strategy
- Filling of governance bodies
- Gradual introduction of the next generation
- Weighing of company shares in voting rights
- Regulation of share sales and exit
- Subscription rights and disbursement rules
- Appointment of positions in subsidiary companies
- Salaries for managers and executives
- Framework regulations for changes to the governance

This list contains some possible elements of a family business governance. It is however not a complete list.

It is important to set rules how voting and veto rights are attributed to the respective amount of shares held. Usually even family members holding only very few shares will agree that those with more share are allowed to send their representatives into the governing bodies preferentially.

A governance also serves to avoid possible conflicts. It should thus for example set rules for the preparation of the next generation in leading management roles.

It is also important to establish the industries the company is active in and what basic philosophy it adheres to. This manifests an important part of company heritage and identity.

Possible structure

A family business governance then sets a clear framework for the company, as shown here in a sample structure created by business consulting firm McKinsey.

This sample also shows that such a set of rules becomes especially important when the company continues to grow – which is the goal of everyone in participation. In the ideal case the governance is scalable and grows with the company.

In this context it is also important to regulate when, under what conditions and with which voting rights the governance may be revised or changed and adjusted, if necessary.

Human factor

With this picture, I want to finish our lecture by looking at the most important difference between public companies and family businesses: The people.

The decisions these people make in the course of their lives, the paths they walk will often not only have an impact on their private lives, but on business as well.

For this reason each and every family business governance must come to its limit at some point – not all developments can be foreseen, not all situations can be regulated.

This is of course also true for public companies, but in family business the human factor in interaction with the environment plays a much more significant role. This may be a reason why many people think that family firms are more human than others.

Thank you for your attention!

Discussion points:

- If you were able to decide freely, would you prefer working for a public company or a family business?
- In your eyes, is it a sales and marketing argument, if it is emphasized for a product that it has been made by a family company?
- Should a member of a business family have the right to sell her / his shares and exit the company at any given time?