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Discussion-Opinion-Editorial™

Family Governed MOGI and SAM Businesses: Are they ready for the Challenges of Transition, Depressed Market and Increasing Competition?

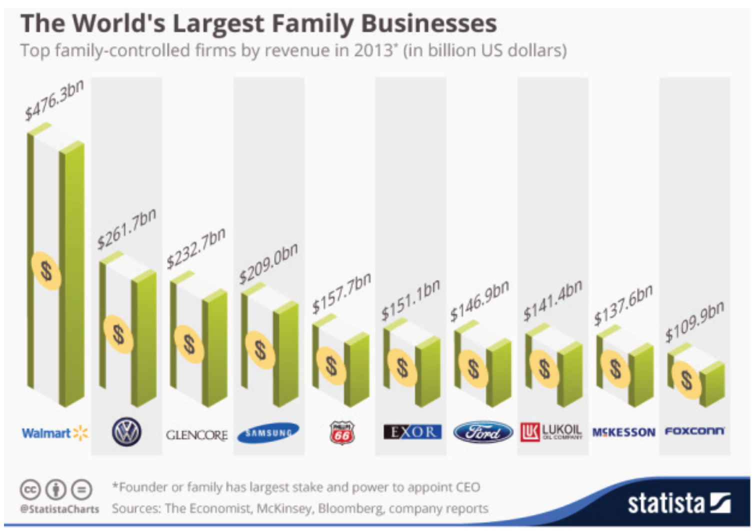
(Part-II)

Founder's Dilemma

Founders' sincere desire "to be fair" wreak havoc on family relationships. In one case, two brothers grew up in a business-owning family, but only one of them came into the company and committed himself to taking it over when their father was ready to retire. With good wishes all around, the other brother moved out of state and started his own business. But then the founder-father died unexpectedly before removing a provision from his will that divided the company's stock evenly between the brothers and imposed strict buy-sell controls. The brother who stayed with the family business had his ownership and compensation tied to his continuing success in running the company. But the out-of-state brother, whose own venture had collapsed, inherited the right to equal ownership and nearly equal income with no responsibility except to attend semi-annual directors' meetings.

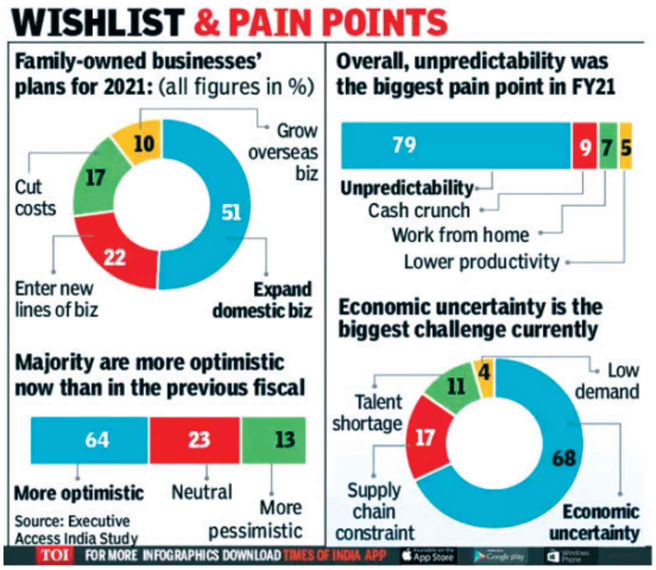
Hurt and angry, the CEO tried first to buy out his brother and then to break the will. The other brother, however, realized what a cushy deal he had and insisted on maintaining the status quo and collecting his checks. The father never imagined that his impulse to be fair would produce inequity that fostered passionate enmity between the brothers. On a consultant's advice, the company was sold.

Even when they're aware of the risks of distributing ownership without regard for management authority, some senior owners create bad situations because they're unwilling to make sound but tough succession decisions. Daughter Swapna, for example, was the best-qualified family member to



take over as head of the family company, and she needed to control a majority of the voting stock to do the job well. But her parents didn't want to show favouritism for her over daughter Radha. So with loud claims of fairness, they gave each daughter half of the company and left them to work out the leadership details between themselves. The sibling warfare that resulted fractured the family and scuttled the company.

Such situations, with effects ranging from corrosive to catastrophic, can be avoided with forethought and planning. The best avoidance mechanism is a management and ownership succession plan that's built on a thorough analysis of the business, the family and the long-term needs and capabilities of both. At the end of the day, the fairest action that senior family business owners can take is one that preserves the business for everyone's continuing benefit.



Governance Issues

In family businesses (companies whose ownership is controlled by a single family) and other kinds of family enterprises including family foundations and family investment funds, the lack of effective governance is a major cause of organizational problems.

If you are in a family enterprise, you need to learn the basics of governance and apply the best practices that exist in family business governance.

Effective Governance Means

For any organization, be it a business, a family, a family foundation effective governance:

- Generates a sense of direction, values to live by or work by, and well-understood and accepted policies that tell organization members how they should behave or what they should do in certain circumstances. Examples of policies are hiring policies, promotion policies, debt policies, even fire emergency policies.
- Brings the right people together at the right time to discuss the right (important) things.

No organization is effective for long without doing these things. You should measure the effectiveness of your governance system by these outcomes, not by the boards and councils you can put in place. Effective governance can be done in an informal, casual manner. Or it might require formal structures (e.g. boards, councils) and processes (e.g. agendas, voting). The particular kinds of structures in your governance system can vary as long as your organization is producing the two outcomes described above.

If your organization is doing the above two activities in an informal, casual way, don't change. But if your organization does not have these outcomes – a clear sense of direction, clear values, well-understood, sensible policies, does not assemble the right people in a timely way to discuss and decide the big issues facing your organization – then your governance system is flawed, should be improved, and probably needs to be made more formal. Given how difficult it is for most people to confront especially sensitive issues and to plan ahead, some degree of formality often helps people focus on their issues, work toward their goals, and resolve their differences. What is clear in my work with family enterprises is that a few well-composed and well-managed governance structures greatly help your chances of being effectively governed.

The world of family enterprise generates a mixture of business, family and ownership concerns that can make these systems emotionally charged environments for planning and problem solving. In these systems individuals must manage issues within and across three overlapping groups: the family, the business, and the ownership group (Figure 1). The overlap among the three groups often leads to differing points of view among individuals depending on their location in the three circles. For example, family shareholders not employed in the business often have different views about the proper level of dividends than do their relative owners who work in the business. Both viewpoints are typically legitimate and must be reconciled in a respectful way to set direction for the enterprise and preserve harmony in the family. To effectively manage business, family and ownership concerns requires communication and decision making within and across the family, the business, and the ownership groups. The key areas where family run firms continue to face unique challenges are Family Wealth Management, Managing Family Relationships and Professionalization.

The future of the family business

Born between 1981 and 1996, millennials differ more from their parents than the last two generations, exhibiting a greater sense of purpose, willingness to move abroad and eagerness to explore new opportunities. This leaves aging parents who own family businesses wondering about the future of their companies. Family businesses, among the most common forms of organizations around the world, are firms owned or managed by one or more founding family members. Passing the business onto the millennial generation, however, appears to be more difficult than it was previously.

Despite being more educated, technologically adept and global in vision, only 4.9 per cent of millennials intend to take over their respective family businesses, according to 2017 research. Does the older generation need to urgently adapt, or should they leave the family business to outsiders? It depends. Millennial participation may actively rejuvenate some businesses, improving the agility of the company in the face of economic, digital and sociopolitical change. However, millennials with different ideas about how to run the business may also create unhelpful turbulence in the family and its company, suggesting they might be better off using their talents elsewhere. We therefore asked: Which types of transitions exist, and which one should families choose?

Millennial succession

Two dimensions that would matter for millennial succession:

1. Families that are more close-knit lean towards intergenerational collaboration, whereas more distant ones push generations apart.
2. The flexibility of incumbent leaders in family firms influences the freedom that millennials have in the family business. Less flexible leaders insist on maintaining traditional family practices. Others are more open to changing the course set by previous generations.

Four Family Business Transition Strategies

1. Rejuvenation: Embracing the family legacy

Families that succeed with a rejuvenation strategy tend to be close-knit across generations and inclined to follow the family tradition. Trust between generations encourages co-operation, and younger family members go along with the family's way of doing things, knowing that they are responsible for the future of the family firm. This transition is often the smoothest, supported by effective family governance, leveraging the strengths of multiple generations. Millennials are encouraged to stay close to the incumbent generation – even if this means giving up on personal aspirations. Incumbent family members may also support millennials in their pursuit of entrepreneurial projects when acceptable to the retiring generation. This transition strategy serves as a benchmark for most incumbent business owners.

2. Rebirth: Turning over a new leaf

Some close-knit families feature both incumbent and younger family members openly collaborating on major business decisions, displaying high levels of flexibility. Millennials in these families are generally inclined towards joining their parents in the family business. Incumbent family members are more open to their offspring's ideas both inside and outside the business, emphasizing that they do not want to burden their children with running the family business.

Despite their openness to contemporary ideas, the closeness of the family may still cause it to favour tradition. However, support from incumbent family members empowers millennials to enact more radical change – which can include the transformation of the family business in terms of business model.The choice to move away from older business models towards new goals may in fact be for the best, even if these new goals may only be marginally linked to the original business.

3. Exit: The world is an oyster

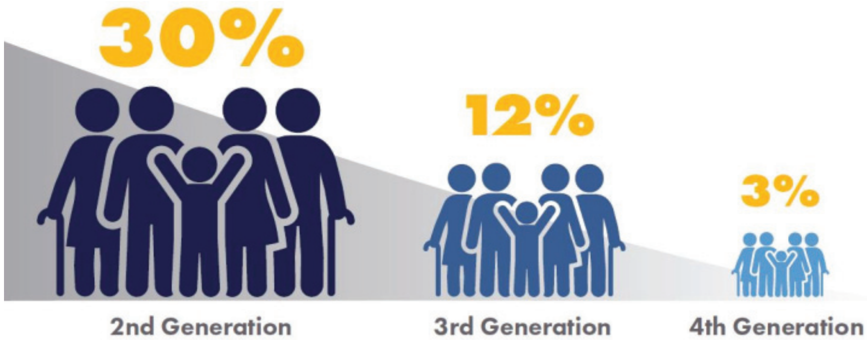
This strategy is often seen in families with low intergenerational cohesion and lacking flexible leaders. Incumbent leaders have often endured self-sacrifice for the family and business, and typically prioritize business over family. Millennials are detached from the business and may not identify closely with it or other family members.They have many opportunities to leave and few reasons to return – in fact, many seek to study or work far from home. Placing business needs above all else may place a psychological burden on the next generation, fuelling their desire to leave family and business behind. This, in turn, leaves older generation members scrambling to figure out a succession plan and pushes them to cling on to familiar traditions. This behaviour pattern can lead to even greater rifts in an already distant family, sometimes exacerbated by poor company performance. However, these businesses may be able to survive with very little family involvement by finding capable outsiders to take on business roles.

One example of exit is Italy's Merloni family, which sold its controlling stake in the family business – Indesit, the largest producer of household appliances in the country – to Whirlpool for 758 million euros amid rumours of disagreements in the family over strategy.

4. Exaptation: Out with old, in with new

Families with low unity but flexible leaders often see their children follow their own dreams. Greater parental flexibility reduces the pressure on millennials to inherit the family firm. Motivated by a need to step back and retire, family incumbent leaders see the business as a tool to support both themselves and the next generation. This support may result in the younger generation pursuing new entrepreneurial activities only loosely linked to, or even separate from, the original business. The older generation is perfectly fine with this behaviour and adopts a “hands-off” approach.

This is often portrayed in the media as the end of longstanding family business dynasties. However, the younger generation may build a different yet equally powerful legacy. The distance between generations allows millennials to pursue projects on their own terms, yet often with parents’ support, transforming the family legacy into something new.



According to the Conway Center for family business, more than 30% of all family-owned businesses transition to the second generation. When it comes to the third generation, only 12% succeed. By the fourth generation, only 3% will still be operating as family businesses.

All families differ

Every family is different – some are close, others are distant, still others are dysfunctional. Additionally, family business leaders also differ – some are flexible, others are more rigid.

Passing on the traditional family firm to a millennial, which we call the rejuvenation strategy, is not necessarily the best one. We argue that imposing a transition that is misaligned with family and leader characteristics is more likely to fuel conflict and, ultimately, fail.

Alternative options such as rebirth or exit may not always keep the old business in the family, but may be a wiser choice and could contribute more positively to the family’s legacy and society at large.

Final Word

Many family businesses in MOGI and SAM companies are reaching a critical stage in terms of succession and will have to call on next generation family members to assume more responsibility. In this regard, the survey showed that only 33 per cent of the respondents have documented and communicated a succession plan. The values hold family businesses together. It is particularly important in large families when the responsibility is passed on from a generation to the next and for the successors to follow a clear set of values. 75 per cent of the businesses are owned by families compared to 70 per cent internationally. Many family businesses in the Middle East are reaching a critical stage in terms of succession and will have to call on next generation family members to assume more responsibility. In this regard, the survey showed that only 33 per cent of the respondents have documented and communicated a succession plan.

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