# A GREATER ROLE FOR GOVERNANCE

THERE IS GROWING REALISATION AND ACCEPTANCE THAT WEALTHY FAMILIES IN ASIA ARE MORE LIKELY TO ACHIEVE HARMONY BY PUTTING IN PLACE CERTAIN FRAMEWORKS, POLICIES AND PROCESSES THAT PROVIDE CLARITY IN TERMS OF EXPECTATIONS AND GOALS – PLUS CREATE A CLEARER ROADMAP FOR THE SMOOTH RUNNING OF THE BUSINESS.

Albert Chiu

EFG Bank

"[Asia's first-generation entrepreneurs] are starting to get more focused on understanding how to be more efficient with their wealth succession planning"

Various research reports and studies consistently show that the majority of Asia's first-generation entrepreneurs cite business continuity as the most relevant and important indicator for them of achieving a successful transition between generations. The intent is typically to pass the business down to the next generation.

In line with this, there has been an increased willingness by Asian families to acknowledge succession issues and have more internal dialogue. And then formalise this.

According to Albert Chiu, chief executive of EFG Bank in Asia Pacific, they are starting to get more focused on understanding how to be more efficient with their wealth planning. "This is not only in terms of tax and trust structures, but also in relation to passing family values from one generation to the next."

The traditional cultural hindrances, therefore, are slowly fading away. This is essential given the different dimensions of what constitutes successful succession.

And taking the time to discuss and map out goals, objectives, ideals, values, cultural drivers and other key elements of what makes up an individual family is often the starting point.

That stems from the requirement for open, honest and clear communication among and between all members of the family.

"Increasingly families realise that to survive over time they must adapt their behaviour and adopt new standards," says Esmeralda Moreno, a managing director at Pictet & Cie in Hong Kong. For example, she explains, companies – especially listed ones – should no longer be viewed as an extension of their private wealth.

Regulators and minority shareholders insist on ever higher standards of governance, transparency and good corporate practices.

"In this regard, the younger generation can sometimes be better equipped than the founders," adds Moreno.

More fundamentally, the best way to prevent disputes, or manage the likeli-

## Tan Li-Lee

Appleby

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hood of them, between siblings, cousin groups or other family members is to ensure that relationships and expectations are managed from the outset. And while various formal structures do help in resolving disputes, a family constitution or charter which contains accurate information and has the buy-in of all family members is a critical first building block.

"Families need to take stock of the issues they face," says Vicky Wong, managing director and head of key client solutions at LGT Bank in Hong Kong.

"If they don't think that they can resolve them themselves, then they should consider involving external advisers," she adds.

## CLEAR DIRECTION AND COHESION

Formulating a robust governance framework can achieve the benefits of both strengthening the family culture and protecting the wealth.

"Rather than splitting into separate businesses and asset groups following the founder's departure, a family with clear governance rules is more likely to hold and grow its assets while also maintaining smooth relationships among the family members," says Tan Li Lee, head of private client and trusts at Appleby in Asia. She adds that clients are increasingly open to advice. "They are willing to be forthcoming and involved in this process, asking us to work with them for bespoke solutions," explains Tan.

This is a key step since it is difficult to find a benchmark for Asian family businesses to measure against. Further, every family is different.

Yet when talking about business continuity, one word that is often used is "stewardship".

"When you think about the word stewardship you also have to think about who are the stakeholders in the business," says Christian Stewart, managing director of Family Legacy Asia.

"With a family-owned business, it's very common to see that the owning family has a wide view of the stakeholders impacted by the business, to include the employees and the families of these employees and the communities in which they do business."

While lessons can be drawn from the experience of the third or fourth generation Anglo-Saxon industrial families, Bernard Fung, head of family office services and philanthropy advisory at Credit Suisse in Asia Pacific, says practitioners need to be mindful that each culture has its customs; each family has its own dynamics; and each founder-owner has his or her values that they would like to pass to the next generation if possible.

## KEY STAGES OF A MANAGEMENT SUCCESSION PROCESS

| Initiation | Development | Selection | Transition | Review |
|---|---|---|---|---|
| • Introducing the next generation to the business | • Training the next generation through education, experience and exposure | • Electing who among the next generation should continue managing the business | • Timely and orderly transfer to successor(s) of control and management | • Monitor and review succession plan and prepare for unforeseen situations |

Source: Asian Business Families Research Survey 2013, BFI-SMU Deloitte

"Wills, trusts and estate planning are necessary succession planning activities, but they may not be sufficient to avoid disharmony during generational transition," explains Fung, "particularly where large sums of money are at stake."

He says business owners which want to be pro-active in addressing these legacy and succession issues ahead of time, while they are still able to, should start by focusing on three areas:

- How a family interacts within itself, and with the family business
- How a family views and manages its wealth
- How a family maintains cohesiveness, beyond the business

"First," explains Fung, "a family should be quite clear on how it would like to interact with the business as the owner, over the long run." The latter is an important point. If a family is planning for success, what works for the business founder-owner may not work for the next generation or the one after that. "As the family business grows and fresh capital needs to be raised, the cash or liquidity needs and wants of different branches and levels of the family also need to be balanced."

A family should also be clear on how it would like to interact within itself.

This is particularly important the current generation business owner will not always be able to foresee or dictate the outcome of all possible challenges the family will face, explains Fung.

Secondly, he adds, a family should be quite clear on how its overall wealth is managed. "Families facing generational transition need to clearly know how they are going to track, manage, preserve and grow their wealth in a manner consistent with their respective risk appetites."

In addition, a family that perceives wealth beyond bank accounts will also focus on managing this wider aspect of wealth, by focusing on developing and preparing the next generation.

Finally, in relation to maintaining cohesiveness more generally, Fung says that if a family is able to keep the perspective that legacy and succession management are intense but relatively short phases of a family's overall life cycle, it will see that managing the family's cohesion and the development of its members in the longer term post-succession is its main responsibility.

"Encouraging the next generation to interact and work together is something that is entirely possible," he explains, "not just in the family's existing business – where we have seen that not everyone may be willing, able or capable to participate – but also in the areas of philanthropy or even new business creation."

Philanthropy is a particularly interesting mechanism, he says, because it focuses on upholding the family's reputation and shared values, and avoids the more competitive dimensions.

Further, parts of a family may even be able to explore investing together in new business creation. However, this should be done voluntarily, in a professional manner, with the lowest possible level of financial exposure, and certainly not be contemplated without the above areas addressed to everyone's satisfaction and affirmation.

"Whether these new businesses succeed or fail is not the main point – what is valuable is that the next generations get to explore risk-taking together and discover the entrepreneurial spirit that enabled their forefathers to build their legacy," explains Fung.

"After all, that's what started it all in the first place."

## FOUR KINDS OF FAMILY CONSTITUTIONS

**The "product"**

The family constitution that is a "product" designed by the "Expert" that is not created by the family and that does not fit with the dynamics of the family. High risk the family will reject this.

**Too much heart**

Family values can include love and caring for family members and treating family members equally. There is a role for such family values in creating a family constitution but when taken to an extreme this will not be sustainable either. These kinds of family values should be applied in the family circle and not within the business circle.

**The monument to the founder**

Some family constitutions are like a "monument to the founder" of the business. The focus is only on the business or the money and that tends to be overly controlling in nature. The message of this constitution is that future generations are not to be trusted. This kind of constitution can become a prison for future generations of the family.

**A family constitution that reflects wisdom**

The ideal family constitution is one that is based on an understanding of the character of the family, that can balance family values with protecting the business, that will help to avoid family conflicts and that is based on family members voluntarily agreeing to be involved together as part of the family, and that can evolve as the family evolves.

Source: Family Legacy Asia

Against this backdrop, it is important to remember that any family governance arrangement, and any family constitution, needs to be tailor-made to take into account the character, culture and dynamics of the particular family.

"There needs to be an assessment of the characteristics of each family before engaging in governance projects," warns Stewart of Family Legacy Asia.

"This is why governance arrangements should be evolutionary for the family not revolutionary. And this is why it's important to be building the skills and capacities of the family members in areas such as listening, conflict resolution and collaborative decision making," he explains.

A family constitution is, therefore, not a product. For family governance arrangements to be effective, Stewart says that the work has to be done by the family members themselves.

## SETTING A SUITABLE FRAMEWORK

Despite the obvious benefits from a governance framework of greater harmony and alignment of expectations, it isn't easy to get a family to understand why they should be transparent. Nor is it always possible to get them to appreciate the immediate need to make detailed succession plans.

"Sometimes it comes down to a matter of trust and confidence in the adviser, to encourage them to set up a suitable structure," says Danilo Larini, founder, president and chief executive officer of FACT Family Office.

"They are more likely to do this if they feel comfortable about the possibility of discretion."

It also tends to be the next generation which is bringing the "Western" concept of family governance to their elders in Asia.

"This is a good thing, as the opinions of a family member may resonate a bit more than those of external advisers on this topic," says Wong at LGT Bank.

Further, it is becoming a more fashionable topic generally, in industry and media and, as such, is being discussed more and more.

However families need to be a bit cautious. Not all of them need a complex governance structure. In fact, in many instances, the simpler the approach, the better.

"An appropriate family governance framework definitely doesn't involve a glorified structure which in reality is simply ignored and the patriarch makes all the decisions," says Marcus Leese, partner of Ogier.

## *Family firms as "hyper-agents"*

Given the extent to which many economies in Asia are dominated by family-controlled businesses, it's in everybody's interest to make sure these firms are successful, or at least they don't implode.

When a successful family is unable to continue its success into the third generation or beyond, there are repercussions for the society in general, because these wealthy families are known as "hyper-agents", says Christian Stewart of Family Legacy Asia.

"This means they can have a disproportionate impact on the communities around them, whether for good or for bad, he explains. "They have an amplifying influence."

If a hyper-agent family ends in family conflict, for example, Stewart says this can create shock waves that reach into the wider community. "If a hyper-agent family has found a way to get its own house in order, and if it has found a way to continue to generate new energy, then it has the potential to have a positive impact on the community around it, he adds.

Marcus Leese

Ogier

"An appropriate family governance framework definitely doesn't involve a glorified structure which in reality is simply ignored"

## COMPARING TRUST STRUCTURING WORK TO FAMILY GOVERNANCE WORK

| | Trust structuring | Family governance / family constitution |
|---|---|---|
| Who is the client? | The settlor (often the patriarch or matriarch) | The family |
| Who decides? | The settlor | The family council |
| The role of the advisor is: | To provide answers to the settlor | Provide framework, structure and examples |
| The advice given is: | Expert advice | Focused on process |
| Documentation involved | Trust Deed, letter of wishes | Various family policies, a family constitution crafted by the family, a legally binding shareholders agreement |
| Time Taken | From one to several months to implement | From one to two years to design, and the implementation is ongoing |
| The goal is: | Determined by the settlor | Defined by the family |

Source: Family Legacy Asia

Instead, it needs to be appropriate, suitable and workable for the needs of the particular family.

To achieve that, the framework needs to balance competing interests.

For example, explains Leese, the governance framework needs to be sufficiently "close" to the family so that family members feel that it is integral to them, but also be sufficiently independent so that all family members trust the impartiality of the decision-making process and don't feel that it has been "captured" or is controlled by a particular member or branch of the family or interest group.

"Similarly, the framework needs to allow and facilitate communication between family members and allow all relevant parties to have a voice," explains Leese.

But at the same time, it can't simply be a "talking shop", he warns, and there must be a clear mechanism for decisions to be taken. "Also, while there do need to be checks and balances in the structure, there can't be too many which might prevent decisions either being made at all, or being made quickly," adds Leese.

> "The governance framework needs to allow and facilitate communication between family members and allow all relevant parties to have a voice."

This is also where the value of processes come in.

While policies might be around topics such as the employment and compensation of family members, as well as conflict resolution, processes refer to ongoing family meetings, and family education and development.

"It's the processes which will bring the governance structures and policies to life," says Stewart.

"Therefore emphasis has to be put on the ongoing processes not just on the structures and policies.

Family members get busy either working in the family business or investing the family financial capital and, therefore, for the governance to be effective, they need ongoing support from their external advisers to ensure that the agreed governance processes get implemented on an ongoing basis."

For any framework, there is a need to review it regularly as the size, composition and needs of the family will change over time as well.

"What might have been appropriate when a family and its business interests were at a certain stage in terms of level of wealth and the relevant group of individuals, will change," says Leese.

## CONSIDERATIONS AROUND PROFESSIONALISING THE FAMILY BUSINESS

Despite the interest in the topic of family governance within Asia, family businesses should not forget about the importance of addressing corporate governance as well.

This is done, explains Stewart, by looking at the composition and functioning of the board of the family firm. "In the context of a family-owned business you can say that the role of the board is to ensure continuity of the business," he says.

"Asian families are often suspicious of outsiders and it would be fair to say that there is often reluctance to look at bringing in outside directors into a private company or group."

However, he adds, outside directors – if properly selected and properly managed – have a number of benefits for all family firms.

These include having a possible role to play in managing conflicts among family members, not to mention protecting family member managers from improper interference by family member "outside shareholders".

Indeed, the road-bumps which create challenges for the smooth control of the family business to the owner's children sometimes mean that the whole family might be better off by on-boarding professional managers.

"Families will benefit from more rigour and structure in the way they approach their succession planning," explains Moreno at Pictet & Cie.

While successful entrepreneurs are very good at founding and building a business, a different set of skills is required to sustain it, anticipate problems and overcome challenges.

"The emotional angle can sometimes get in the way of objective analysis and a fresh approach may be necessary," explains Moreno.

However, adds Clifford Ng, partner of Boughton Peterson Yang Anderson, they need to plan for a non-family exit. "In doing so, they are probably leaving the company in better shape for the family and can allow different family members to play different roles – roles suited to and desirable to them."

communication with each other, and this may take a period of time."

A few examples of the questions for a family to ask itself during such meetings include:

- Are there benefits in staying together as an enterprising family?
- Can the specific business be changed and also new businesses added?
- Are there family members who are interested in managing the family business(es)?

If the family is going to remain united as owners of a business or holding company, Stewart says there will be roles for family members who do not want to be involved in management.

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Stewart's advice, in relation to determining the involvement of the next generation in the family business, is for the family to hold formal family meetings. "The family in this scenario obviously has to negotiate a change," he explains.

"The older generation will have a dream of business continuity and their dream is tied to having family members inside the management of the business," he says.

"In Asia it does not seem to be as easy to professionalise a business by bringing in purely non-family professionals to take over the management role, as it might be in the West. Families change through the process of honest

"[They can] act as emotionally-committed owners of the business," he says, "possibly to sit on the board or to become involved in other roles such as in a family foundation, the family office or the family council."

This area of corporate governance has often been overlooked.

For example, adds Stewart, it might be common to see the shares in a family company being put into a trust structure, and a lot of work being done on the letter of wishes and the terms of the trust.

"But no-one is looking at the composition and role of the board of that company, yet this is such a basic point." ■