The New York Times

October 8, 2013

Avoiding the Pitfalls of Succession

By SONIA KOLESNIKOV-JESSOP

When the Hong Kong billionaire Li Ka-shing announced succession plans last year for his vast collection of business holdings, he set an example for other wealthy Asian families grappling with similar issues.

Under the plans announced by Mr. Li, 85, ownership and management of his Cheung Kong Group will be transferred to his elder son, Victor. Mr. Li's younger son, Richard, will receive funding to continue to build up his own assets.

Though Mr. Li, Asia's richest person, said he had no plans to retire, he also made it clear that the arrangement was made to avoid any "conflict" between his two sons.

Asian family firms whose founders are preparing to pass the baton to a new generation will all, sooner or later, confront the need to plan not only for management succession, but also for ownership succession. The two are not always the same, and decisions can be fraught with emotion and tension, according to financial advisers and private bankers.

Common mistakes family patriarchs make — and in this generation it is usually a patriarch — include failing to plan ahead, failing to appreciate that ownership and management succession are connected and must be dealt with in tandem, and lack of involvement of and communication between the generations.

"Planning succession is not a one-off exercise, but an ongoing process," said Mario Marconi, global head of family services at UBS Wealth Management.

"I think it's common sense, but you should start early and start pragmatically and learn as you go on," Mr. Marconi said. "Don't try to over-engineer." He cited the example of a family who came to him recently with a 40-page "family constitution, which clearly they hadn't fully understood," he said.

Families should “start simply and fine-tune as you go,” Mr. Marconi said, but they cannot avoid “the big decision” — whether the family business will be managed by a member of the family or by a professional, and who will be in charge.

“It doesn’t mean you need to decide from the start who your successor will be, but you need to have general structure in place,” he said. “You need to have some clarity.”

One of the most critical junctures for a family firm is the “need to distinguish and manage separately the family, business and wealth,” Mr. Marconi said.

Founders of family firms are used to holding a three-pronged leadership role: chief executive of the business, controlling shareholder and head of the family.

“As business families move into the next generation, it is common to see the founder seek to place the same three leadership roles on a single member of the next generation. But success here requires three things to be aligned,” said Bernard Fung, head of family office services and philanthropy advisory in the Private Banking Asia Pacific division of Credit Suisse.

“First, the person must be able and willing to assume the three roles. Second, there needs to have been a systematic preparation of the individual for the various roles well in advance. Third, the chosen individual needs to have the support of the generational peers to lead in all these areas.

“Founders fail to realize that if succession is to fall to an individual next-generation member, all three aspects of leadership are necessary — and that this is a highly idealized situation,” Mr. Fung said. “If one or more aspect is absent, this model of succession is unlikely to succeed.”

Another common mistake that founders make is trying to divide leadership responsibility equally among siblings by, say, giving each an unrelated business area or division to run.

“In such cases, there is the semblance of an orderly succession for a period of time and everyone is running their own area for the collective good,” Mr. Fung said. But “often the next-generation successors are unable to actually work together towards decisions — for example, to decide how family funds are to be deployed across various businesses that differ in return profile and demand for capital."

In some cases Asian family firms simply fail to pass the baton because the successors cannot make decisions together about the future of the business or because the owners reach a point where they stop supporting the new management of the business, according to Christian Stewart, managing director of Family Legacy Asia, a firm based in Hong Kong that provides advice to families on succession issues.

"The founder often doesn't seem to think about whether his children can actually work together in the future or not, and often they are not given a chance to learn how to work together," Mr. Stewart said. He pointed to the example of the Kam family's feud over Yung Kee, a Michelin-starred restaurant in Hong Kong, with siblings fighting each other in court because they were unable to agree on the running of the business after their father died.

Many business founders also assume that new family leaders will get along with new shareholders, Mr. Stewart said.

"Founders have usually never been accountable to anyone in their family, and so while they are grooming a successor to be a good manager, they are not always teaching them to be accountable to the future family member shareholders," he said. "I think that within a family firm, accountability to the family members as shareholders is a key component of a successful succession."

Similarly, many family firms do not take the time to prepare the next generation for leadership roles, Mr. Fung said. "They operate as if somehow a next generation is born with the knowledge and wisdom needed to preserve and grow the family businesses."

Worse still, he said, many of those placed on boards are assured by the prior generation that their elders will be there to support them. "Aside from any issues related to good corporate governance, this may actually hamper the development of the next generation in their long-term role," Mr. Fung said.

All that said, Mr. Fung says that more family firms are becoming more proactive in planning for succession.

“While not always a comfortable thing to do, they are sharing the issues and challenges with their peers, and also involving one or more trusted advisers who not only have a practical understanding of the issues but are also aligned to the long-term success of the family firm,” he said.

There is also an emerging awareness that the firm’s business is likely to evolve in the next generation — think of the plantation companies in Asia that are morphing into land banks for property development — and families are beginning to set aside capital to enable this evolution to take place more smoothly. This also allows the next generation to “try to create value for the family” while minimizing risk to the family firm, Mr. Fung said.

As the transfer of authority and ownership gets under way, keeping communications open between the generations is key, advisers say.

“The process will go more smoothly if you involve the various generations in your planning,” Mr. Marconi said.

Mr. Fung agreed. “As early as possible, the next generation should be exposed to the leadership and ownership issues that they will face, and also be given the opportunity to provide their appropriate input,” he said.

The elder generation should remain present in the firm, he added — but as “mentors, not as markers or checkers.”

“Its greatest contribution to the longevity of the family firm is to provide a safe environment for the next generation to try, to fail and to learn,” he said.