



Ownership Of The Family Business: Is It Just A Question Of Managing Shareholder Relationships?

Introduction

The following notes have been written in the context of looking at the ownership role in a family owned business here in Asia. ¹ The goal is to provide a checklist of ownership issues to consider.

These notes make the assumption that there is a family objective of wanting to continue

¹ These notes do not focus on the purely financial family. However, there may not be a hard and fast distinction between the business owning family and the financial family. For example the logic set out in these notes probably applies if you have financial assets held through a family holding company.

the business as a family business; of keeping the business in the family across generations.

When Does Ownership Start To Matter?

If there is a full overlap between ownership and management then it might not make sense in practice to think about a separate ownership role. However it will make sense to think separately about the ownership role once you can predict you will have some family member shareholders who will not participate in management.

The Patriarch Does Not Think About Ownership

In Chinese families² there is a tendency for the first generation founder (often the patriarch of the family) not to think about the question of ownership (but at the same time there is a tendency to divide up ownership equally among the next generation³). The first generation patriarch has never experienced a split between the ownership role and the management role, so the impact of such a split in roles may not be an issue

² Overseas Chinese families.

³ Traditionally ownership was only divided among all of the male heirs in equal proportions. A variation on this was to see female heirs given a smaller interest than male heirs. This distinction based on gender is diminishing with a common scenario today being the division of ownership in equal shares among all of the next generation regardless of gender.

that the patriarch focuses on.

The patriarch may assume that the child who is going to succeed him in running the business (the future business leader) will enjoy the same degree of control that the patriarch has had. That the future business leader will have the support of the other family member shareholders is often something that is taken for granted. It may be assumed that if, for example, the eldest child is appointed as the next business leader, they can simply rule over their siblings because of family hierarchy. However in practice after the death of the patriarch, younger siblings may revolt!⁴

Leadership Succession & Voting Control

When you are thinking about who is going to succeed in the second generation as the business leader, one common question would be whether that future business leader needs to be given a bigger share in the company if not a majority vote. Another option to think through is whether to use voting and non voting shares (apparently a common practice in the US).

But You Can't Ignore Relationship Issues

However, these legal mechanisms do not rule out the need to think about the relationship issues. Even if you have, for example, a minority shareholder or a shareholder holding

⁴ Wong Siu Lun, Family Business Review, vol VI, no. 3, Fall 1993.

only non voting shares, you can still have relationship problems that upset the ability of the business leader to lead the business. Just think of the example of Sally Bingham⁵.

Professor Ivan Lansberg, author of Succeeding Generations,⁶ says that a question to think through is what is the impact of the planned ownership allocation going to be on the family system?

In addition, the research shows that (i) emotional commitment from shareholders matters in a Chinese family firm⁷ and (ii) shareholders who do not participate in management will have a different perspective than those that do⁸. Maintaining emotional commitment is an important concept here.⁹

If the goal is long term family business continuity it is clear you cannot afford to ignore the minority or the non voting shareholders.

Stewards Or Inheritors In The Next Generation?

Family governance expert James E. Hughes Jr.,

⁵ The Patriarch; The Rise and Fall of the Bingham Dynasty, by Susan Tift and Alex Jones. Also see Passion & Prejudice written by Sally Bingham.

⁶ HBS Press.

⁷ Wong Siu Lun.

⁸ Generation to Generation, Davis et al. HBS Press

⁹ Carlock & Ward: Strategic Planning for the Family Business, Palgrave.

author of Family Wealth: Keeping it in the Family, says that there is a threshold question in a Chinese family firm of whether the second generation shareholders see themselves as Stewards or as Inheritors. Stewards are happy to work together. Inheritors do not want to. Hughes says that you cannot convince an Inheritor to become a Steward. These two different archetypes just cannot work together.¹⁰

Can The Shareholders Work Together As Partners?

The other way of expressing this is there is the important question that needs to be address of “Can the shareholders work together?” “Do they want to work together?” If they cannot - or if some of them cannot, is there an exit plan so that people can sell out without having a dispute?

Redefining The Sibling Relationship

There is also the question of whether the siblings in the next generation need to learn a new way of working together as shareholders? Do they need to convert to a more participating collaborative decision making process? Do they need the eldest to lead this change in family culture?

Family business expert Dennis Jaffe, author of Stewardship in your Family Enterprise, believes that such a change in family culture

¹⁰ This is a topic I have written a separate note on.

will be required.

Relationships With Family Shareholders Matter

Every family is different but at the very minimum, the family members who are running the business (the successor business leader) need to make an effort to maintain good relationships and good communication with their family member shareholders You might call this family "investor relations".

If you keep it at that level, with there being an objective of managing relationships well, this might lead you to think about doing work as a family shareholders group on communication and relationship skills. You could think of bringing in an outsider facilitator for training sessions.

Family businesses after all are relationship businesses and relationships need to be maintained.¹¹ You may think that the current relationships are on a good footing and need no maintenance work; but wait until there is a time of crisis and then see what happens to those relationships.

Good Fences Make Good Neighbors

However if you want to have good relationships with the family member shareholders, how can you do this without

¹¹ Getting along in Family Business; The Relationship Intelligence Handbook, Hoover & Hoover.

having clarity around the rules of those relationships? How can you have a good relationship with a shareholder unless the role of the shareholder is clearly understood.¹² There must be role clarity.

Institutionalizing Roles To Meet The Long Term Goals

And if the goal is a longer term family continuity, then this points to the need to institutionalize the roles - which is what family governance is about in the context of a family owned business. If you have a long term goal, how are you going to address that goal just by thinking of it in terms of the current shareholder relationships?

So a key question is do you think it is just about managing the relationships - or should you be thinking about governance structures and processes so you can institutionalize family control?

If you have the goal of long term family business continuity, the conclusion is clear; you need proper family governance for your family business.

Creating A Family Council

The starting point for family governance would be to create a forum for owners to talk about ownership issues and to exercise their ultimate control. In practice this would be

¹² James E. Hughes Jr. makes this point as do Hoover & Hoover.

called the family council.¹³

One of the goals of the family council is to build family commitment for the business and to have the family members “speak with one voice.”

In addition to the reasons given above concerning (i) the need to have clarity around the role of the shareholder, (ii) the need to institutionalize that role, and (iii) the need to ensure that family shareholders remain emotionally committed, there is another good reason for establishing a family council.

“One of the most pervasive lessons we have learned is that when the legitimate interests of ownership do not have a forum for expression, issues of control and return on investment will find a way to emerge in either the family or the operating business. When those issues do come to surface in the “wrong” circle, they are almost always disruptive – and sometimes destructive.”¹⁴

What Does The Family Council Do?

One of the first tasks for the family council is to prepare a shareholders agreement, so that there is a clear exit plan. Alternatively the details of the exit plan will be documented in a family constitution.

A primary task for the family council will be to

¹³ The assumption here is that membership of the family council is tied to share ownership.

¹⁴ Generation to Generation, by Davis et. Al.

ensure that emotional commitment for the family business is maintained. How do you maintain committed shareholders? By involving them and educating and developing them - and by giving them a real voice. If they are essentially powerless, they will not participate.¹⁵

What information do you need to feed to family shareholders on a regular basis?

Family Policies To Address Predictable Problems

In family business, here in Asia and elsewhere in the world, there are predictable problems. It is predictable that there will be differences of opinions between “inside” and “outside” family shareholders.

The simplest example of this is that inside shareholders may want to accumulate more profits for reinvestment while outside shareholders may want to maximize the dividend payout.

Part of the ongoing role of the family council is talk about how you are going to deal with these predictable problems, and to find solutions (and document them in family policies or a family constitution) before they ever become actual problems. This is the planning and policy making process of a family council.

How important is this planning and policy

¹⁵ This is the concept of “fair process”.

making? A study of some 50 South East Asian family firms concluded that the majority of Asian family businesses fail because of internal family feuds and conflicts.¹⁶ And most family business conflicts are role conflicts and are therefore predictable.

What Is Involved In Forming A Family Council?

When you form a family council you have to think about what roles it will carry out – what is its purpose – what processes it will engage in and what policies it needs¹⁷.

It involves a process of forming a group. Often the formation of a family council can mean the need to change the way the family shareholders make decisions and communicate among each other. It might also need to a need to change certain old practices. In short, often you are talking about making a change in the family dynamics. Accordingly the critical thing will be the implementation.

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¹⁶ Tong Chee Kiong, National University of Singapore, Feuds and Legacies, Conflict and Inheritance in Chinese Family Businesses, International Sociology, March 2005, Vol 20(91); 45-70

¹⁷ John Ward, The Family Business Consulting Group