Family Legacy Asia

Transforming the relationship between Family & Enterprise

"We work with successful Asian families to help them establish communication platforms and decision making structures for both the family and the family enterprise."

Family Business Questions & Answers

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"Is succession planning the biggest issue facing family business today?"

Yes. And No. Let me explain. Asian families traditionally do not do formal succession planning. However that does not mean that they do not do succession planning. There is often an informal management succession plan in place, determined by the business founder.

However too often there is a lack of an integrated transition planning, that takes into account the impact of business leadership succession on the ownership system and family system and that takes into account that things will be different when the founder is no longer around e.g. that a sibling partnership works differently from a founder controlled firm.

Unfortunately the founder often does not think about whether the shareholders in the future can work well with the selected successor. He often takes this for granted. The founder usually does not model accountability so there can be problems where the successor behaves as though he is not accountable to shareholders.

Creating a family governance system, which includes carefully defining the ownership role, the role of the board, and the role and authority of the CEO, is a way that families can start to address family firm succession in a more integrated and holistic fashion. A family governance system will help address the question of ensuring proper accountability.

"Are family businesses good at promoting their family values in the business?"

Yes. And No. On the one hand, family businesses in Asia are heavily influenced by the culture and values of the controlling family. In the Asian context the norm is to see family members in key management roles. The concept of the family moving out of management up to ownership roles is not that common in Asia.

On the other hand, there are several common challenges.

- First families are often not very good at integrating in laws – but in laws will provide 50% of the children's values.
- Second, families are often not very good at incorporating the next generations' values. A common issue in many Asian family firms today is a values conflict between Western values (that the next generation pick up when getting educated or working overseas) and traditional Asian values.
- A third challenge is that by the third generation of an Asian family firm the outside shareholders will often not support the management of the business. This points to it being important to make the outside shareholders the stewards of the family values.

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"Are family businesses well governed?"

No. Not in Asia. In terms of corporate governance, Asian families tend to be "closed systems" and are very wary of bringing in outside directors. Boards are often only comprised of executives and with a heavy concentration of family members. Even in listed companies non-executive independent directors tend to focus on the issue of protection of minority shareholders rights, which means the controlling shareholders are possibly missing out on some valuable third party input. In the context of a family firm, one of the key roles of the Board is to ensure that the family has addressed the issue of succession.

Except for a few leading families, formalized family governance (e.g. based on having an operational family council, family constitution and family business policies) is practically non-existent. In many Asian families there are no boundaries between ownership and management. Often (but not always) there are confused boundaries between family and business. However poor boundaries between family and business issues will result in family conflicts.

Striking the right balance between accountability to shareholders while letting managers get on with their work and manage the business is a common challenge for many Asian family firms. However Asian family firms that are serious about long term continuity need to find a way to achieve this balance. The solution lies in having a proper family governance system.

Asian families can start creating their own family governance system by setting up a family council, or holding regular formal family meetings to define the ownership role and to talk about the relationship between the family and the business.

"Do family constitutions help family businesses to transcend the generations?"

Yes. I look at a family constitution, not as a set of agreements and policies, but as a process for solving problems together. I believe a family constitution is a vehicle for improving family decision making, communication, and planning. This is all key. It is encouraging to see that some leading Asian families are starting to form family constitutions and family councils.

Families need to understand that developing a family constitution is a process. This process includes examining the family's values and principles and whether there is a "Shared Dream" for the future. This process also includes identify issues and working out how the family can overcome those issues. There is a risk that people will hear the term "family constitution" and think of it as being a "new product" that can be "sold" to a family, and this approach would be very counterproductive.

Families need to remember that with a family constitution, the key thing is the process.

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“Do family businesses do enough to encourage the next generation?”

No. What I mean by “no” is that in Asia, because of the strong family culture, it is not uncommon to come across families where the assumption is that continuity of the business is dependent on the next generation coming and working in the business, and so the moment they have finished school, the next generation are told they have to come back and work in the business straight away. In an Asian context, working in the business can in many cases be more a matter of family obligation, and not a question of encouragement.

However it is actually very counter-productive for Asian family firms to miss out on the opportunity of giving their next generation a chance to get outside work experience before having the option to work in the family firm. By missing this step the family business system remains as a closed system, missing out on the input of the new ideas and energy that could come from allowing the next generation to first work somewhere else.

Ideally business owning families should have a family employment policy which provides clear rules governing entry into the family business; after a specified period of outside work experience.

“Are businesses stronger when family members are involved?”

Yes. Family members understand the family values. Family members can work exceptionally hard because it is their family firm, and the responsibility of their family.

The key to successfully involving family members in the business is to make sure there is a good boundary between family issues and business issues. A clear set of family policies and agreements will help to create an effective boundary. One example is a policy dealing with the topic of compensation of family members. The need for a boundary between family issues and business issues is something to be discussed at a family council or at formal family meetings.

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"Is the potential for conflict greater in a family business?"

Yes. Anywhere in the world, family businesses are extremely complex systems. I am a big believer in the "three circle model" and see it as a great way of explaining the role confusion and complexity and differing perspectives I see in Asian family firms. I also believe in the importance of having a process for dealing with family conflicts as well as an exit plan so that family members know how to leave if they need to.

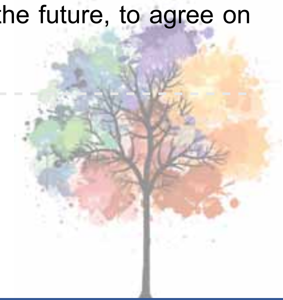
This is why a family constitution will help to prevent family conflicts in a family business. First, the process of creating a family constitution will help a family to clarify roles and come up with its own process for dealing with the complexity of the three circle model. Secondly, a family constitution will specify the conflict resolution process that the family have adopted. Families that spend the time to develop their own custom made conflict resolution process have the best chance of successfully navigating conflicts that do arise. Third, a series of on-going family council meetings will provide a platform for improving trust and communication within the family, allowing potential misunderstandings to be worked out before they ever become major issues.

"Do siblings work well together?"

It all depends on the individual family. This comes down to the question of family culture. The ability of siblings to work together is largely up to the business founder, which in Asian families is often the father. The way the father works with the siblings and the way the siblings learn to work together will also however be influenced by the multi-generational family system the founder grew up in.

When formalizing the family governance and corporate governance structure for a family it is always important to follow the rule "form should follow function". "Function" here includes taking into account how the siblings work together – what are the sibling dynamics? This rule should also be applied when designing a family trust structure to own the business.

In practice, when siblings have not had the experience of working together in a collaborative manner while the founder is still in control, forming a family council or holding regular family meetings can be a very useful exercise. These meetings can provide a platform for the siblings to improve communication skills, to talk about their dreams for the future, to agree on the "rules of engagement", and to resolve conflicts.



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"Is employing outside directors one of the best things a family business can do?"

Yes. Even in Asia. Independent directors are a secret weapon that Asian family firms don't yet know about (or resist). Asian family firms could do with an independent objective view, not just on the business, but on how the family members are performing. Outside directors can also help to play a role in mentoring and developing family members (which is very important if they did not get any chance to have outside work experience).

However to be effective, you need an outside director who understands that he or she is there at the discretion of the family shareholders. Someone who can give independent objective counsel, but who knows how to deliver this in a way that is going to be heard.

"Do family businesses make a big impact through philanthropy?"

Yes. Definitely. It is part of Asian culture that if you are successful, you will contribute to philanthropy.

The traditional approach is to do this through a family foundation that is separate from the business. However there is also another way. Family businesses are values led businesses. If the family are philanthropic (and organized) they can allow their business to be more philanthropic. There is a term called "creative capitalism" coined by Bill Gates that looks at the extent to which "for profit corporations" can find ways to do more good. Family firms are "fertile soil for creative capitalism".

The key to this alternative approach is to have a forum where shareholder level issues can be discussed. The shareholders should debate and agree on the specific values that they would want the business to be run in accordance with. If the family shareholders agree, they can request the board to manage the business in such a manner that the company finds ways to "do good" while making a profit.

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“Is the inability to choose between children a big contributor to family business failure?”

No. The mistake is more that the founder or first generation looks at their children and thinks that they can work together. Usually the traditional Asian founder knows their children well and will promote the one they see as the most capable, so that this child is set up for the management leadership role in the future. However in terms of ownership, the typical traditional Asian founder will often think in terms of giving all of the children an equal shareholding and they will also want the family members not to sell any shares. They want the family to stay united. They believe that the anointed heir is the best person to manage the business in the future, and assume that this heir will be happy to do so for the shareholders, and they assume that the shareholders will be happy with the decisions of the anointed heir.

When the founder dies, in some families, trouble arises because of conflicts between the “outside shareholders” and the “inside shareholders”; or because the shareholders cannot work together. In summary, the founder only looks at the management perspective and often makes the mistake of not considering the ownership perspective. However over the long run, ownership becomes more important than management. An effective family governance system will address the proper role of ownership in the family enterprise.

“Are there more opportunities for women in the family business than in non-family firms?”

Possibly. Ultimately this probably comes down to a question of the family culture of the particular family, but there are many Asian family firms where women do play key leadership roles.

Family systems thinkers say that birth order is actually more important than gender. I have seen some family firms where the family rule is “every-one works” whether male or female.

In some parts of Asia, the culture can actually be matriarchal. Father and mother may start a business. Mother may retire from active work in the business as it gets larger and more successful. Later on, father dies or becomes incapacitated and the mother becomes the boss. This can happen in even in a country that is generally more traditionally patriarchal.

At the other end of the spectrum I have also seen families who take the view that daughters can be outside shareholders but the assumption is that they know nothing about running the business and so they cannot take on operational or board roles.

In this later kind of case, I think ownership education becomes a key task for the family to work on. It is a very dangerous situation to have key outside shareholders who have not been educated to be effective owners.

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“How do families manage as they expand in size from generation to generation?”

In Chinese family firms there is a tradition known as the “equal inheritance rule” whereby the founder of a family business is likely to leave his shares in the business to all of his male heirs in equal shares. In more modern times the daughters also get shares. Then when one of the sons dies he does the same thing and leaves his shares equally among all of his children. The end result is dilution of the share ownership. Research has shown that this process of share dilution can explain the failure of a Chinese family firm within three generations. The practice of “pruning the tree” is one solution that can help prevent this and to continue the family firm.

Setting up a trust to own the family firm might offer another solution, as trust ownership can keep the shares consolidated. However, it is clear that trusts do not avoid family conflicts, and family conflicts can still arise as the beneficiaries under the trust grow in number and diversity. Therefore it is still very important to have a governance mechanism, and ideally also an exit mechanism, alongside the family trust structure.

“Should shares only be given to those members of the family working in the family business?”

Yes. Ideally. It depends on the goal, but if the goal is to continue the business and to avoid family conflicts, the most likely scenario is that you will have family members in management roles. If there are other family members who are “outside shareholders” then this is a classic area for family business conflicts and unfortunately Asian family firms seem to have little concept of accountability to outside shareholders. Therefore without developing their own system of effective family governance, this can be an area which will cause conflicts. One way to avoid these conflicts is to leave the shares only to the “inside shareholders” i.e. those who are working in the business.

In theory another option is to give the inside shareholders shares which carry all of the voting rights, but this type of arrangement is not common in Asia and my view is that it does not avoid the arguments any way.

Research into long lived Asian family firms shows that the practice of pruning the family tree – i.e. consolidating ownership control – works.

If the family do not have the option of leaving the shares only to the inside shareholders (e.g. because there are no other assets available to compensate the other family members with) then still make sure you have a fair exit plan worked out – and a conflict resolution process.

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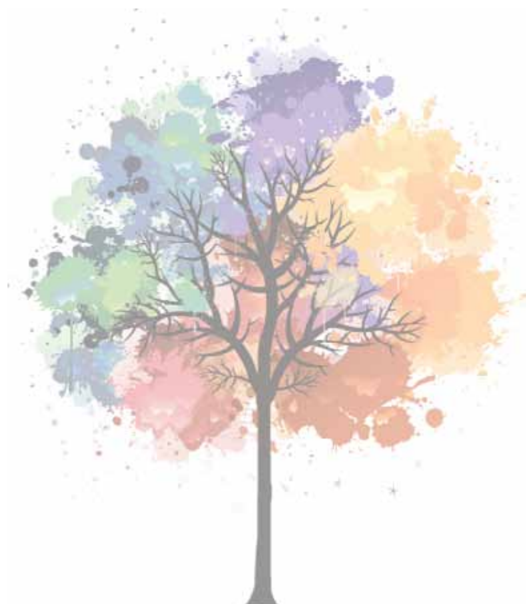
> "Is the reluctance of the retiring family member to step down really a big issue?"

Probably not. In a traditional Asian context, it is normal that there will be a tug of war between the founder and the adult next generation. The founder will not give up control until they are no longer physically capable of hanging on to it. Many Asian families seem to be able to work this tension out for themselves. As an advisor working with Asian families the rule I follow is "you don't fire the founder"!

The Western approach is to include the business founder in the family council meetings. The assumption here is that in the family council setting the founder should be on an equal footing with all other members of the family council. For an Asian family, they can consider setting up a family council for the sibling generation which does not include the founder. At least this will give the sibling generation a chance to form their own communication and decision making platform, even if the founder is not involved. This will help the sibling generation to get ready for the time when the founder is no longer in control.

Acknowledgement

The questions were posed by Paul Andrews of Family Business United, *www.familybusinessunited.co.uk*.
The answers are provided by Christian Stewart, Managing Director of Family Legacy Asia (HK) Limited.



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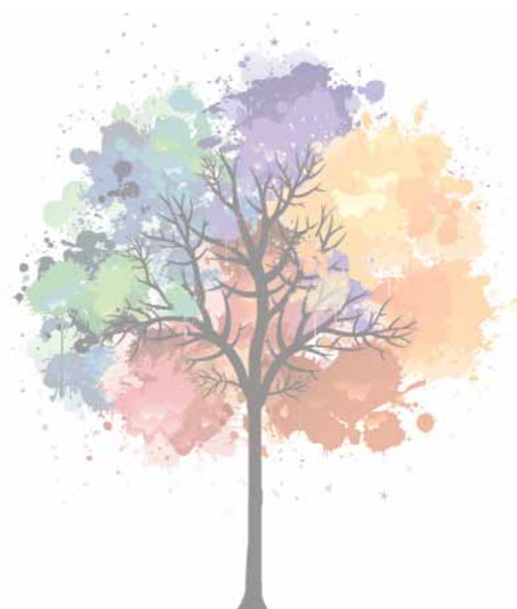
About Christian Stewart

Originally a tax and trust lawyer from South Australia, Christian moved to Hong Kong in 1994. In July 2008, he formed Family Legacy Asia to provide independent advice to Asian families on family governance. In this role he acts as a process consultant to help family businesses in Asia work together, through facilitating family meetings and helping the family to prepare their own family policies and constitution. He also advises several Asian Family Offices on trust and succession matters. He acts as an advisor on several Private Trust Company structures.

Prior to founding Family Legacy Asia Christian was a Managing Director and the Head of Wealth Advisory in Asia for JPMorgan Private Bank for 6 years. In this capacity he was responsible for representing JPMorgan's trust business in Asia.

JPMorgan recruited Christian from PricewaterhouseCoopers in Hong Kong in mid-2002. At PwC he was a Partner in their Tax Practice specializing in Hong Kong estate duty planning and trust structuring and he ran their Trust & Private Client team.

- For more on the topic of family constitutions see "The Family Business Constitution: A Roadmap for Business Continuity & Family Harmony" which is a whitepaper available on the Family Legacy Asia website www.familylegacyasia.com
- For more on the topic of sibling work relationships see "The Three Keys to Successful Sibling Collaboration" which is a whitepaper available at www.familylegacyasia.com
- For more on the topic of Creative Capitalism and family firms see the article "Looking at Creative Capitalism through the Family Business Lens" which is available at www.familylegacyasia.com
- For more on the topic of setting up a trust to own a family business see the articles "Trusts, Trustees and the Family Business" and "Using Trusts to safeguard the Family Crown Jewels" which are available at www.familylegacyasia.com
- For more on the topic of share ownership in Asian family firms see the articles "Steward or Inheritor" and "Ownership of the Family Business: Is it just a matter of managing shareholder relationships?" both of which are available at www.familylegacyasia.com



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About Family Legacy Asia

We work with successful Asian families to help them establish communication platforms and decision making structures for both the family and the family enterprise.We facilitate family meetings to help the family talk about their vision and values and the relationship between the family and the family enterprise.

We help them to create the “rules of the road” so that family members know what to expect in the future.

We believe that the key to passing on a successful family enterprise that will flourish for at least five generations comes down to the way in which the family members make joint decisions together, and this is called family governance.

While our approach is tailored for every family, we often use the process of creating a family council and family constitution to help build the “family team”, to strengthen family unity, and to help the family resolve the specific issues that they have been unable to resolve on their own.

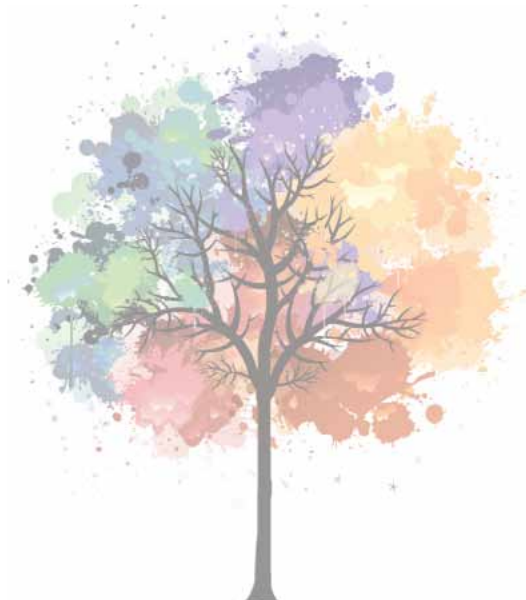
The process of creating family governance is a problem solving process.

Our process can help simplify the challenges of planning for family succession.

One of the benefits of our process is that it helps to build a bridge between the older generation of the family and the next generation.

Another benefit is that we help create tools for the family to balance doing what is good for the family with doing what is good for the business.

In many family controlled enterprises, family conflicts arise because of confusion between family roles and values on the one hand, and business roles and values on the other hand. We help families avoid these kinds of conflicts.



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