



Building The Capacity To Manage Conflict Within Asian Family Firms

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INTRODUCTION

Conflict among enterprising families is a major issue in Asia today as we see the first generation wealth creators start to pass on. Most frequently these conflicts seem to arise in Asian business owning families once they reach the sibling generation. Culture plays a large part in the origin of these conflicts, including a hierarchical family culture, a communication gap between generations, and first generation business founders who have not modeled accountability for their children. Many business founders have also made the mistake of not cultivating in their children the ability to work together as a collaborative team of shareholders. The solution to avoid destructive conflicts in Asian family firms is to actively pursue the adoption of best family firm governance practices, preferably while the first generation can participate.

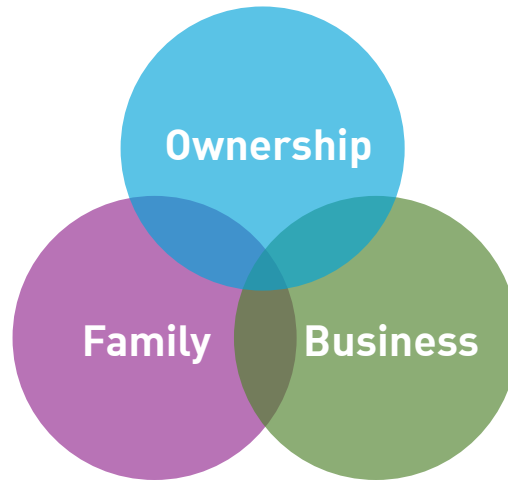
CONFLICTS & THE FAMILY BUSINESS: FIVE KEY POINTS

- *First*, the majority of Asian family owned businesses are likely to fail because of internal challenges with the key one being destructive family conflicts.
- *Second*, the majority of family firm conflicts are actually predictable.
- *Third*, many conflicts in family businesses are caused by the different perspectives that come from the different positions that family members occupy in the “Three Circle Model” (see below).
- *Fourth*, conflicts in family businesses are inevitable – so if a family wants to pass a successful business on to the next generation they need to start developing their own Tools for managing conflicts as early as possible.
- *Fifth*, conflict avoidance (i.e. not discussing it) will do more harm to a family than facing conflicts; it is very important to have an agreed process for working through conflicts (a “conflict resolution process”).

WHAT CAUSES CONFLICTS IN FAMILY BUSINESS? THE “THREE CIRCLE MODEL” (Davis & Tagiuri 1982)

- A family business can be analyzed as a complex system comprising of the overlap among a family emotional system, an ownership system and a business (or management) system. This popular model of family businesses is usually depicted as a Venn diagram of three overlapping circles: a family circle, an ownership circle and a business circle.





- The Three Circle Model can be used to predict the majority of the conflicts that will occur within any family firm, anywhere in the world.
- Family values and business values are very different. Conflicts will arise when there are poor boundaries between the family circle and the business circle. Conflicts can be reduced by strengthening this boundary.
- It is predictable that there will be conflicts caused by the different perspectives of family members who are in the family and ownership circles (“outside shareholders”) and those who are in management roles (“inside shareholders”). Over time, ownership will “pull away from” management. Family firms need policies, agreements & outside directors to help balance these two different perspectives.
- Each circle needs its own forum for communication & decision making. If there is no forum for family or ownership issues to be discussed then this is another source of conflicts. Holding proper family meetings helps to address this.
- The Three Circle Model shows that family businesses are very complex systems – conflicts often arise because of role confusion and a lack of a clear agreed upon understanding within the family on the different roles that exist. Therefore, defining and clarifying roles is a critical process.
- Finally the family circle, the ownership circle and the business circle are always changing with time – and times of change are often times of increased anxiety for a family and anxiety brings conflicts.

TEN EXAMPLES OF COMMON FAMILY BUSINESS CONFLICTS

Conflicts over Employment

- Many families fight over the topic of whether or not their children are entitled to work in the family business, or whether jobs should only be offered based on merit.
- A family employment policy can help resolve these conflicts.



Conflicts over Compensation

- Many family firms will start off by following the rule that all family members in the business get paid the same. This approach might work to start with but it starts to break down once you have some family members who own shares but who do not work in the business.
- Over time it helps to start to differentiate between dividends and compensation for work and to move to a system of paying an arm's length compensation for the role and for performance.
- Distinguishing between dividends and salary means that not every family member is forced to work in the business.

Conflicts over Entering the Business

- It is usually very helpful to encourage family members to obtain several years of outside work experience first before joining the family business.
- In some family firms, when the younger generation enter the family business, conflicts can arise because they are treated like they are owners of the business (e.g. the “son of the boss”) - a role which they do not have the skill or experience for at that early stage - when they should really be treated as having only a junior employment role. When you join the family business you are entering into a management circle role and having a step by step career path plan is very important.
- Conflicts can also arise if a parent of a young employee (a parent who is not working in the business or who works in a different part of the business) interferes in the working relationship between the young employee and their direct manager / supervisor. It is important that the parent should not interfere in the work relationship of their child.

Conflicts over Succession

- Conflicts will arise if the successor does not hold him or herself accountable to the family member shareholders.
- Conflicts will arise if the family stakeholders do not have a shared vision or dream for the future of the business.
- Conflicts can arise if some family members think that the successor should be determined based on hierarchy within the family, while other family members think the successor should be determined based on merit.
- Succession is best treated as a process and one that includes input from the other family stakeholders.
- Outside directors can help.
- First generation business founders can help prevent future family conflicts if they make an effort to teach their children how to work together collaboratively & by modeling accountability.



Conflicts among Siblings

- Siblings will often renegotiate their relationships once the founder passes away.
- It is not possible to change your siblings. The only thing you can work on changing is yourself and your own reaction to your siblings.
- It helps if you learn how to listen with empathy and to be curious about understanding how your siblings see the world.
- It helps if siblings can learn how to have adult – adult conversations together.
- It helps to define roles and responsibilities and accountabilities.
- It helps to agree to separate family issues from business issues.

Conflicts because of different Ownership Philosophies

- It is common to see conflicts arise – or families get stuck, because some shareholders see themselves as stewards of the family legacy, while other shareholders see their shares more in purely commercial terms, just like any other investment that they can realize if the return is not adequate.
- It is best not to force siblings (or other family members) who have incompatible ownership philosophies to stay together.
- It is important that family member shareholders understand each other's different ownership philosophies.
- Do not try to change the ownership philosophy of another family member. It won't work.

Conflicts between Inside and outside Shareholders

- Outside shareholders want more dividends; Inside shareholders want to reinvest. This is a classic conflict. A dividend policy can help.
- Outside shareholders might be suspicious of the remuneration and perks received by Inside Shareholders. A compensation policy can help & it is important to ask what would an arm's-length professional be paid?
- Outside shareholders and Inside shareholders might have different concepts of what is an appropriate risk level for the business.
- Family meetings, outside directors and a strategic planning process can all help.



Tensions between Spouses

- On Monday morning, two brothers go to work and fight. On Monday night they each go home and tell their respective spouses about the fight. On Tuesday the brothers go back to work and mend their relationship and go back to working together happily. They forget to tell their spouses. On the weekend the spouses meet at a family gathering and they start glaring at each other over the conflict between their husbands which they did not know had been cleared up last Tuesday morning!
- Conflicts & misunderstandings can arise where spouses are not kept as informed as the rest of the family members.
- Therefore it makes sense to find ways to include spouses in family meetings, so they can hear first- hand what is happening with the business and the family, and can ask questions.

Conflicts because there are too many family member bosses

- In some family businesses, each family member is treated as “the boss”; there is no clear structure chart or organizational hierarchy. One family member can walk in and tell the employees to “steer the ship to the left”; the next family member can walk in and tell them to “steer it to the right”.
- The origin of this kind of conflict is a family rule that every family member should be treated equally, which is a family system rule that is not appropriate for the business system.
- This could also be because of confusion between ownership roles and management roles.
- Clear boundaries would prevent this kind of scenario.

Conflicts over Strategy and Direction

- Where different family shareholders have different views on strategy and direction for the business, an Exit Plan (see Tools below) will help.
- Outside Directors will help.
- Agree on the process by which strategy is set & give all owners a voice in the process.
- A family leader who can listen to the family shareholders will help.



TEN TOOLS TO MANAGE FAMILY BUSINESS CONFLICTS

Family Meetings

- One of the single most effective practices that a family that work together can implement is to hold periodic family meetings.
- Holding periodic family meetings helps to ensure that there is a forum for family (and often also for ownership) issues to be discussed.
- A family meeting is actually the vehicle through which the family members can develop most of the rest of the Conflict Management Tools described below.
- A family meeting can also create a safe environment in which to defuse some family conflicts. The use of an outside facilitator is necessary.
- For the definition of a “family meeting” see below.

Shared Family Values, Shared Goals & Objectives

- Shared family values help to provide “family glue” and become a tool in joint decision making.
- Shared goals and objectives for the business put every-one on the same page together.
- Successful families are those that develop the ability to collaborate together, which will include a concept of “we” being greater than “I”.

A Conflict Resolution Process

- Conflict is inevitable. Families will have the best chances of successfully managing that conflict if they have a clearly agreed process for raising and working through conflicts.
- A common formal conflict resolution process will be an agreement to first attempt to resolve conflicts through the input of family elders; failing that then through facilitation; failing that the next step is formal mediation with professionally qualified mediators; failing that the next step is binding private arbitration; then if all else fails, the final step might be litigation in the court system.



An Exit Plan

- Here “Exit Plan” refers to a clear process by which a family member shareholder can sell some shares in the family business, reducing their stake or ultimately completely exiting from ownership.
- This is usually documented in a legally binding shareholders agreement.
- Having an Exit Plan is a way to “let off steam” and to allow shareholders who do not believe in the direction that the business is being taken to leave.
- An Exit Plan can prevent disagreements over the valuation of shares.

A Code of Conduct

- Especially in the case of siblings who have to work together it is very helpful to develop a Code of Conduct which specifies the behavior expected of family members. The Code of Conduct can also specify the ground rules for how to have a “fair fight”.
- Important Code of Conduct rules can include commitments that each family member will:
 - take responsibility for managing their own emotional reactions
 - invest time in the relationship with their fellow family shareholders
 - speak with one voice to the non-family directors, staff and the public
 - treat each other with respect
 - deal with each other directly in the event of any disagreements

Outside Directors

- One of the best ways of strengthening a family business is to ensure that there are several non-family, non-executive directors (“outside directors”) on the board of the company.
- Outside directors can help to bring an objective view, including with respect to the performance and skills of family members in management roles.
- Outside directors can help to mediate disputes between family members in management roles.
- Outside directors can help to balance the interests of those who are outside shareholders and those who are inside shareholders (i.e. those in management roles).



Family Elders

- In many Asian families, there is often a communication gap between the generations.
- A “family elder” is some-one who can be trusted by both the senior generation and by the next generation and who can help to bridge the communication gap between them.
- A “family elder” can be an uncle or auntie or an in-law; or they could be a very trusted non-family member.
- Family elders are typically respected for their wisdom and capacity to see the big picture.
- A family elder can help to mediate disputes between family members.
- Family elders can help keep the family united by reminding them of their shared values and family stories.

Family Education & Development

- Often siblings come into conflict because they are never taught how to work together as a collaborative team. This points to the importance of finding as many learning opportunities as possible for siblings to work together collaboratively while they are young adults, if they are all going to inherit an ownership stake in the business.
- Family members who are stakeholders together in a family business need to learn to differentiate among family, ownership and business, issues and they need to learn about the different roles responsibilities and accountability, that make up the governance system of their business.
- Family members who are going to work together should also invest time through attending external training and development activities to learn tangible skills including:
 - Listening skills
 - The ability to have difficult conversations (see Stone, Patton and Heen, Difficult Conversations, How to discuss what matters most)
 - Conflict resolution & negotiation skills
 - Understanding different personality types
 - Developing greater personal self-awareness
 - Understanding family dynamics
 - Understanding family owned businesses

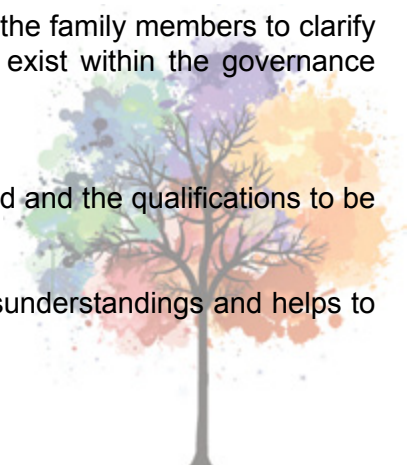


Family Business Policies

- Many family business conflicts are predictable conflicts and preparing written family policies is a way to specify how the family will resolve the conflict before it occurs.
- The best time to develop family business policies is before they are needed.
- Family business policies help to define the boundary between family and business, and to strike a fair balance between ownership and business.
- One important example is a Family Employment Policy which is intended to prevent conflicts from arising over the topic of who can get jobs in the business.
- A Dividend Policy will explain the process by which dividends are to be considered and calculated, helping to ease tension between “outside shareholders” and “inside managers”.
- A Liquidity Policy can help to outline other mechanisms for providing liquidity to “outside shareholders” when it is not feasible to declare dividends.
- A Compensation Policy can help outline a proper process for determining the compensation of family members who work in management or executive roles.

A Family Constitution

- A family constitution is a written document, developed collaboratively together by the family members, which would normally incorporate all of the above Tools.
 - Therefore a constitution is “the Tool for organizing all the other Tools”
- The family constitution can either include key family policies, or it can define the process for developing family policies.
- A family constitution should set out a fair decision making process for the family to follow.
- A family constitution would set out the conflict resolution process for the family.
- The family constitution would also refer to the ongoing family education and development activities expected of family members.
- The process of creating a family constitution will also provide an opportunity for the family members to clarify and agree on the different roles and responsibilities (and accountability) that exist within the governance system of the business:
 - It can clarify what decisions are reserved to family shareholders
 - It can clarify the role of the board of directors and the composition of that board and the qualifications to be appointed to the board
 - It can clarify the decisions that can be made by the CEO of the business
 - Having a clear written handbook that explains each role can help to avoid misunderstandings and helps to professionalise the business



HOW SHOULD A FAMILY DEVELOP ITS OWN SET OF CONFLICT MANAGEMENT TOOLS?

- The best way for a family to develop its own set of conflict management Tools as described above is based on having widespread input into the development of the Tools from as many different family member stakeholders as possible.
- If the process for developing these Tools is regarded as a fair one, then the Tools will have wide family support. If the Tools are imposed “top down”, they may not be honored by the family.
- To be effective the Tools need to be developed by the family members in an environment which has the right kind of foundation, which is the ability of family members to listen to each other very carefully and with empathy. They usually need to use a skilled facilitator.
- The Tools need to be internalized by the family members in order for them to be effective.
- If implementing these Tools represents a change for the family (and usually it will) then there needs to be a process of periodic follow up and maintenance to ensure that the change will stick. Their facilitator can help with the follow up.

WHAT IS A FAMILY MEETING?

- Not every meeting of family members can qualify as a “family meeting”. In this Guide the term “family meeting” has a special definition and it means a meeting where:
 - A safe environment is created making it possible to have important but perhaps difficult conversations
 - Where each person has a voice
 - Where relationships are horizontal not hierarchal
 - Where communication is honest, but respectful
 - Where each family member can “listen with empathy” to the others
 - Where the family can disengage & explore
- In practice, for a family meeting to be effective and to meet the above definition, expect that the family will require a neutral outsider who can facilitate the meeting.
- When do you stop holding family meetings? The answer should be “never”; business owning families should have an ongoing process of holding family meetings.



WHAT ABOUT TRUSTS & TRUSTEES? CAN THEY HELP TOO?

Can A Trustee help to avoid family business disputes? Potentially yes, if:

- The trustee encourages the family members to hold periodic family meetings and to develop the other Tools listed above.
- The trustee provides a director for the business (who does more than just act as an observer)
- The trustee is the one that is making or approving ownership decisions for the business, and in doing so they help to balance the interests of the “outside” family members with those who are “inside”
- Every trust is unique & so it is essential to study the relevant trust deed terms.
- However if the Trustee plays a hands off role vis a vis the ownership of the business, then it is likely the trustee cannot be relied on to help resolve conflicts that come up concerning the business.
 - Note that in Asia it is very common to establish family trusts with professional trustees affiliated with a bank, and in many of these structures, investment responsibility for the performance of the business is carved out and given to an investment committee populated by family members or advisors to the family.

Other points to remember about trusts that hold shares in a family business

- Make sure there are family meetings to talk about the trusts and how they will work in the future.
- Make sure family members are provided with an education on the roles involved and an understanding of the trusts.
- Make sure there is a family governance mechanism for the trust.
- As a rule of thumb, give each sibling their own trust.
- Just because the business is owned under a trust, this does not mean the family do not have to do succession planning and it does not mean the family can avoid conflicts.
- You cannot use legal structures to bottle up or repress family emotions.
- It will cause conflicts if family members are put into legal relationships together that they do not have the relationship skills to make work.



WHAT IS THE BEST WAY TO HANDLE FAMILY BUSINESS DISPUTES?

- If a conflict among a business owning family cannot be resolved through the involvement of Family Elders, or facilitation, then a formal mediation process should be the next best step in order to resolve the conflict.
- Mediation is a confidential process.
- In a mediation process the parties to the dispute are the ones who make the final decision on how to resolve the dispute. The mediator helps facilitate the resolution of the dispute by the parties involved.
- Mediation is a preferable form of conflict resolution process for family business conflicts when compared to arbitration and litigation because mediation offers the ability for the parties to find their own win/win solution and leave family relationships and communication intact.
- For mediation to be successful in a family business context it is important to engage a professionally qualified mediator or mediation team with experience in family business conflicts and family dynamics.
- The mediator has to be a neutral party.

WHAT IS MORE DANGEROUS TO A FAMILY BUSINESS THAN FAMILY CONFLICT?

- *Conflict avoidance* (i.e. ignoring the issues) which leads to apathy and false harmony – and the potential for things to explode later. Family firms need a conflict resolution process so that conflicts can be addressed constructively as they arise.
- If the outside *shareholders lose their emotional commitment* to the business and stop supporting the decisions of the family managers. Keeping emotionally committed shareholders requires:
 - Planning for family participation
 - Ownership education
 - Have an Exit Plan so that family members stay in of their own free choice



AS A FAMILY OFFICE EXECUTIVE WHAT CAN I DO TO HELP MY CLIENTS?

- Review the above list of conflict management Tools with your clients.
- Encourage all of your client families to hold periodic formal family meetings with an experienced facilitator.
- If it does not already have this function, recommend that your Family Office should be providing support on Family Education and Development.
- Never become a “go between” between family members. Always encourage direct communication between family members.
- Stay objective and neutral; don’t take sides. In a family system, remember there is no room for blame.
- Learn to listen to your clients, with empathy.
- Don’t try to be an expert; instead help them to think things through carefully for themselves.
- Ask them questions that encourage them to separate in their own mind among family issues, ownership issues and management issues.
- Ask them “who are your Family Elders?”.
- If the family are going through a transition, encourage them to be aware of this change and to see the big picture. Ask them what plans they should be making to deal with the transition?

CONCLUSION

For Asian family firms, indeed for family controlled firms anywhere, the best way to develop the internal capacity to manage conflicts so that they do not become destructive is to build strong boundaries among the family circle, the ownership circle and the business circle and to make sure that each circle has its own forum for communication. There is a view (see *The Cycle of the Gift, Family Wealth and Wisdom*, by James E. Hughes Jr., Susan E. Massenzio and Keith Whitaker) that of these three circles, the most important one is the family circle, hence the critical importance of ongoing family meetings and the development of conflict resolution skills among family members.



About Christian Stewart



Originally a tax and trust lawyer from South Australia, Christian Stewart 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 family 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 that capacity he was responsible for representing JPMorgan's trust business in Asia.

Prior to joining JPMorgan, Christian was with PricewaterhouseCoopers in Hong Kong for 7 ½ years. At PwC he became a Partner in their Tax Practice specializing in Hong Kong estate duty planning and trust structuring, and he ran their Trust & Private Client team.

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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.

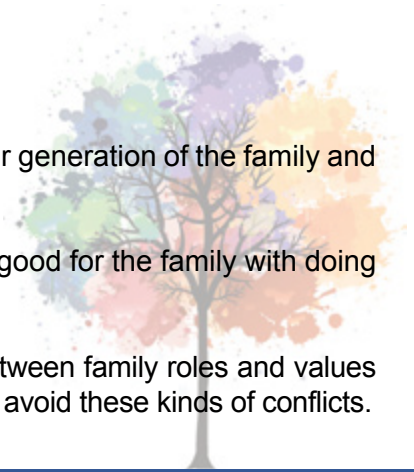
The process of creating family governance is a problem solving process.

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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