HARCOURT BOARDROOM RESOURCES

VALUE DRIVEN GOVERNANCE OF FAMILY FIRMS

"The most authentic thing about us is our capacity to create, to overcome, to endure, to transform, to love and to be greater than our suffering... Our future is greater than our past!"

BEN OKRI

THE BACKBONE OF THE ECONOMY

Civilization has always been driven by achievements of entrepreneurs. Strong, determined, risk taking individuals who have fulfilled their bold dreams (almost by default) with support and encouragement of their families. No wonder family firms constitute the world's oldest and most dominant form of business. Fascinating evidences of their accomplishments are observed since the very first commercial activities in ancient times.

Family controlled companies were furthermore the locomotives of economic development during the era of industrialization. Development of key sectors at the time - real estate, railroads, industries and banking were all deeply rooted in family clans. Even after the raise of the corporation in the 19th century (based on the separation of capital and management), owning families continued to direct and control their enterprises.

Family firms represent more than 80% of all companies worldwide, play vital role in economic growth, innovation, long-term employment, and contribute more than 65% to GDP. The far-reaching influence of family enterprises has become increasingly visible after the financial crisis. Family firms have reconfirmed their resilience. Responsiveness and flexibility have been success factors for steering economic vessels in troubled waters.

The governance of family firms has been undeservedly neglected and largely overlooked by mainstream literature and prominent researchers. It is equally true that family businesses are notoriously secretive and traditionally don't welcome "outsiders" into their system. The governance of publicly listed companies has been studied systematically and broadly, but that is not the case for family firms. The general understanding revolves around only three basic ideas:

1. Family businesses are (considered to be) small or medium size entities;
2. Their main issue is succession planning and only 5% survive into the 4^{th} generation; and
3. Complexity can be explained with three (family, ownership, business) circles chart.

None of these ideas are necessarily wrong, but they are all far from enough. The reality of governance in most successful family firms (Cargill, Mars, BMW, Arcelor-Mittal, Hermes, Samsung, Toyota, Fiat, Porsche, H&M, Lego, Tata, Wallenberg Group, Auchan, Maersk, Reliance, Roche etc…) is much more complex and sophisticated. Particularly having in mind segment of the most successful ones. Namely more that 1/3 of S&P 500 companies in the US, 40% of the largest companies in EU and over 60% in Asia and Latin America are Family firms.

VALUES THAT CREATE VALUE

The greatest Family businesses are highly diversified collection of gems, although there is a set of good practices that can be elicit by studying their "operating systems". Intelligent people all over the world seem to solve their problem in similar ways. In his classic *Anna Karenina*, Leo Tolstoy stated: "Happy families are all alike, every unhappy family is unhappy in its own way." Successful families seem to have common features, underlying patterns that might help us understand better their exceptional accomplishments.

Strong personal drive, typically recognized in founder's narrative: "I have always dreamt from my early childhood, that…." shows that initial motivation is rarely a desire to make a lot of money. Profit is a necessary factor for producing goods, delivering services and creating wealth – as a means, but not an end in itself.

Most successful family companies understand Governance! They embrace it as their key strategic leadership tool. They are fully aware that strong governance systems mitigate most significant risk – attracting best available talent. Both Family and Corporate governance are direct enablers of a level playing field as prerequisite for non-family executives to join. Top executives main concerns about joining family business are repeatedly defined as uncertainty about levels of autonomy, hidden agendas, lack of dynamism, fear of nepotism and irrational decisions that could affect their future prospects and development. Committing to sound decision-making and management practices is thus essential.

Despite separation of family and corporate matters, owning family stays firmly at the top of the process. Family businesses are not companies with faceless shareholders which vote with their feet. Owners of family businesses are real people with personalities that think long term, and are deeply concerned about the legacy they will leave behind.

Family council is as a sort of Board of directors for the Family and stands at the center of Family governance. Council members are carefully (s)elected by Family members to represent the Family, its identity and align interests around clearly defined values and common vision. A family council provides family members with a regular, structured forum for communication, expressing concerns, and participating in decision making.

Family Constitution (charter, vision and mission statement) determines the purpose and procedures of a family council. Family council should not be confused with a corporate board of directors. A family council deals with the "business of the family," while corporate board deals with the "business matters."

Board of directors, is the focal point of a corporate governance system. Strong, independent directors are the most important part of the structure since they balance family views and mitigate emotional dimensions in the boardroom. Family companies with strong boards have much less difficulty attracting top managers.

Greatest family firms understand the importance of succession planning. They aspire to find their future leaders early and invest in them generously (whether family or non family members). What they never cease to do is consistent and permanent transfer of values. What was initially seen as founder's principles gets converted into consistent family value system. The system, which defines the way family interacts with the business and sets the framework for organizational culture. The family values therefore become the bedrock of business's organizational culture and ethos.

In Family firms' selection process competence matters, but candidates get also evaluated on the basis of leadership qualities, which extend to the interaction with the family. Values match seem to be the acid test. Families look for the kind of person who will fit into their culture, which becomes more important than the job description. They try to find somebody who will speak the same language (often use the same words), have the same values and share the same vision. They focus on long term, considering next generation, not the next quarter. As an experienced CEO stated: "Quarter in publicly listed company means 3 months. In family business, quarter normally means 25 years."

THE FAMILY BUSINESS TREE

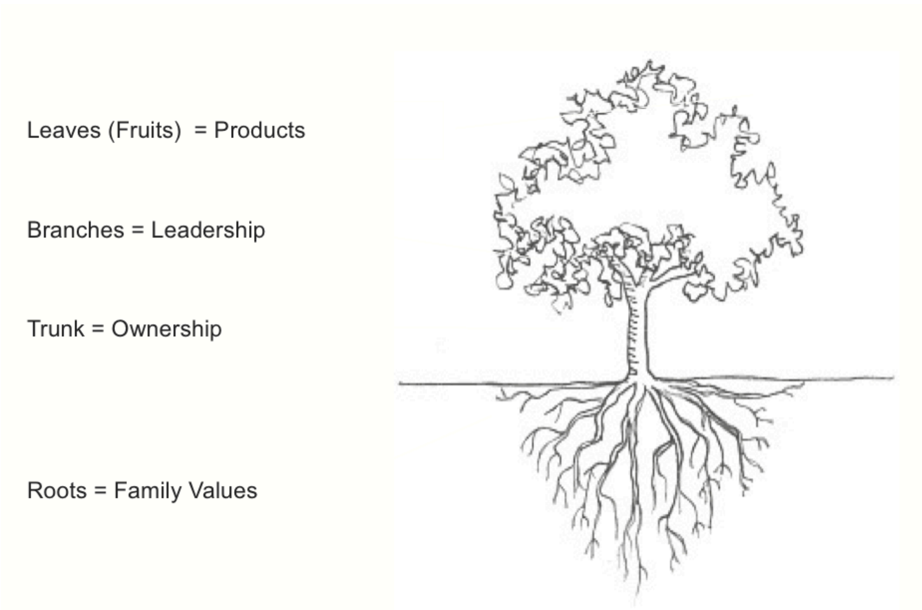
A tree carries a strong symbolism and is often used as personification of family business.

Everything starts from the roots (family values). They are vitally important for sustained survival, and the foundation for safe growth. As the tree *(business)* grows bigger and branches out in different directions (business entities, subsidiaries), all the most important resources keep coming from the roots.

Roots serve as anchor (*organizational culture*). As they penetrate the soil in search of water and mineral nutrients they secure the tree (*communication, education*). Roots also serve as storage for large amounts of energy reserves below the ground *(financial resources)*. Some trees have reserves which enable them to reemerge if they would be cut or burnt down.

Preparing the next generation is a critical. While seemingly inactive, the tree is preparing for new growth to come. With the first hints of warm weather, the leaves emerge from their buds, followed by the colorful blooms.

Slowly during the same process, a tree grows. The trunk (*ownership unity*) becomes column and supports the whole tree (*business group*). Size matters. Particularly in economic terms, where the strong ownership of family business is recognized as a comparative advantage. At the end of the process, we identify each tree by its fruits at the time of harvesting (products, profits).



RESPONSIBLE OWNERSHIP

Shareholders are the owners of the company. As etymology suggests, a shareholder is a person (or a legal entity) that holds shares. Although the definition does not answer the question of how long shares need to be held in order to be shareholder, history provides interesting insights. At the end of World War II, the average holding period for a stock of a listed companies was 4 years. By 2000, it was 8 months. By 2008, it was 2 months. And by 2012 it was 5 days. Some experts claim (based on the growth and volume of high-frequency trading) that the actual average stock holding period today is measured in seconds. From that perspective, the world of listed companies is very different from that of family businesses, where owning families hold shares for generations and continuously add value to their business.

In order to be able to define "responsible ownership", board members, CEOs and representatives of the owning families have been interviewed. Most frequent and meaningful answers received were:

1. Provide clear long term vision
2. Clarify, communicate and inculcate values and ethical standards for the business
3. Set overall objectives for performance and acceptable risk levels;
4. Ensure (and monitor) that management is aligned with the long term objectives and the values;
5. Delegate responsibilities to Board of directors (and management) and do not interfere;
6. Actively manage the family governance system (dividend expectation, liquidity of shares, investment, employment and compensation policies...)
7. Seek family harmony and unity;
8. Foster a climate of transparency, respect and trust;
9. Enable and grow emotional ownership (among the owning family next generations and non family employees)
10. Set in place measures for welcoming next generation;
11. Set and attend relevant educational programs (family and corporate governance, financial literacy...)
12. Maintain committed ownership in adverse economic conditions

At the core of enlightened, responsible ownership is the necessity to make it clear what are core values of the owning Family. What is the Family truly standing for? So the Board and management can understand and appreciate the "rules of the game" as is to be played.

Family values ultimately define corporate purpose and the later has a substantial effect on performance. They answer the most fundamental question of governance – why does the company exist? The answer to that question has the power to touch lives of people who are associated with the business. Embedding purpose into the structure of the organization is transforming a neutral (faceless) entity into committed institution.

Dubai, December 18, 2015