In this article we'll explore how implementing effective corporate governance is of particular importance in protecting family-owned businesses and ensuring their longevity.

3 ways that corporate governance is crucial to sustaining family businesses.

Family businesses are the bedrock of the majority of Middle Eastern economies, with roughly two-thirds of businesses in the region being family-owned. As a sector, family businesses contribute around 60% of total GDP, and employ 80% of the region's workers—as we explored in our infographic on the topic.

But although the family business model is a successful one, at least in the initial stages, it can also be a precarious one. Only a minority of companies survive into the third generation, with many of the rest being dissolved, sold, or broken up.

A common cause is intra-family conflict, with only half of such businesses in the Middle East rating their family and business goals as being aligned (compared to an international average of just under 70%). Other factors include difficulties attracting inbound investment or capital, attracting and retaining outside talent, and professionalizing the business—cited as a key challenge by over half of family business leaders1.

While many of these issues can be mitigated or resolved with the introduction of an effective corporate governance structure, families have traditionally been slow to embrace such a change, perhaps out of a misguided concern that it will bring with it a loss of control or autonomy.

The truth is that implementing good governance is a positive development for family businesses, helping to address the specific challenges they face and reduce disruption, disputes, and disunity. Rather than reducing family control over their business affairs, a well-implemented governance framework places family values at the heart of how the business is run, now and in the future.

The results are improved performance, better growth prospects, and greater stability—preserving the business over the long term. Let's look at some specific examples of how corporate governance can benefit family businesses at all stages of maturity.

Reducing disputes

The classic model for a family business starts with a single founder who leads the business through the first generation. Executive and decision-making power is highly centralized, usually resting entirely with the founder, or perhaps shared with a core group of relatives.

However, by the second or third generation, as the business grows and more family members join the business, taking on their own areas of responsibility, this unity can become fragmented, leading to disorganization and disputes between members.

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It's a common story among family-owned businesses. Roughly 70% of such businesses either collapse or are sold off by the founding member during their tenure, never graduating fully to an independent second generation. Of those that survive, only around 5 to 15% will remain in the hands of the founders' descendants by the third generation.2

Implementing solid corporate governance can help provide much-needed structure, separating business issues from family matters and ensuring that family members at all levels of the business understand their individual roles and responsibilities, and how they fit into the bigger picture. This plays a vital role in reducing disputes born out of misunderstanding and helps to reinforce individual and group accountability.

Improving communication

In any business, growth can make effective communication more difficult. In family businesses this issue can be magnified as members in different roles, or at different levels of the business start to feel that their concerns aren't being heard, or they're no longer part of the inner circle when it comes to decision making.

Corporate governance can provide a foundation for unity and stability by ensuring that communication between all areas of the business is clear, regular, and open. There are several key areas where this can benefit family businesses:

Strategy - ensuring that all family members are aware of the values, mission, and long-term vision which underpin decision-making within the business.

Reporting - keeping all family members up-to-date with business performance, accomplishments or achievements, new threats or opportunities, and any changes in direction.

Policy - clearly disseminating the rules and policies which govern the business and directly affect each member's role, responsibilities, workload, remuneration and benefits.

Collaboration - putting in place official channels of communication to enable family members to input new ideas for the business, share any concerns and receive timely feedback on points raised.

Mediation - providing a structure in which any disputes or conflicts which might arise can be handled fairly and transparently, avoiding concerns around favouritism or discrimination.

Ensuring longevity

Effective corporate governance is invaluable in providing a stable framework for long-term planning. This is of particular importance for family businesses, where generational transitions can often introduce instability, and in many cases lead to the breakup or dissolution of the business.

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First-generation businesses, run by the original founders can benefit from implementing governance structures that map out their succession plan and document how power will be transferred, ensuring that all parties involved understand their position and role.

In the second generation, where executive power has moved into the hands of the siblings or children of the founder, having governance structures in place can help ensure that the original family values are maintained, even as the business expands to welcome outside talent.

As family businesses move into the third generation, characterized by the involvement of more extended family members in positions of responsibility, effective corporate governance is vital to maintaining good shareholder relations, providing a framework within which change and conflict can be managed, and most importantly ensuring accountability within the business—whether that's from family or non-family members.

Corporate governance: Strengthening the family business model.

Adopting best practices in corporate governance is a vital step for any family business wishing to build on the unique strengths of the family-run model and foster a culture of stability that will see the business continue to succeed over multiple generations.

Whatever stage your business is at, MEIoD can offer a range of resources, advice, and capacity-building programs to help you ensure good stewardship of your family business, preparing it to meet today's challenges and take advantage of tomorrow's opportunities.

References

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