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Corporate governance and the family business: managing the paradoxes

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Corporate governance and the family business: managing the paradoxes

Abstract
When we did the primary research for our book Learning Family Business: Paradoxes and Pathways*, we talked to many owners of family businesses at different stages of the business life cycle. In the course of talking to them, we noticed that family business owners would say that their business was "just like any other business". But then they would always follow this with the word "except…" and then go on to describe something which suggests that family businesses are very unlike other businesses. This is not altogether surprising. After all, a family and a business are both systems that do not necessarily occur together, so running the two of them together is likely to create situations that make family businesses different from others. Moreover, the high level of interdependency between ownership and management in a family business creates forces which make executive and strategic decisions more complex and more subjective. When a family runs a business, major decisions in the family firm will affect both the family and the business systems, creating paradoxes about running family businesses that do not occur in non-family businesses. We saw this at all the successive stages of learning the family business that we described in our book: learning business, learning our business, to learning to lead our business and, finally, learning to let go our business.

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CORPORATE GOVERNANCE AND THE FAMILY BUSINESS
MANAGING THE PARADOXES

MARY BARRETT & KEN MOORES

When we did the primary research for our book *Learning Family Business: Paradoxes and Pathways**, we talked to many owners of family businesses at different stages of the business life cycle. In the course of talking to them, we noticed that family business owners would say that their business was "just like any other business". But then they would always follow this with the word "except…" and then go on to describe something which suggests that family businesses are very *unlike* other businesses.

This is not altogether surprising. After all, a family and a business are both systems that do not necessarily occur together, so running the two of them together is likely to create situations that make family businesses different from others. Moreover, the high level of interdependency between ownership and management in a family business creates forces which make executive and strategic decisions more complex and more subjective. When a family runs a business, major decisions in the family firm will affect both the family and the business systems, creating paradoxes about running family businesses that do not occur in non-family businesses. We saw this at all the successive stages of learning the family business that we described in our book: learning business, learning *our* business, to learning *to lead* our business and, finally, learning to *let go* our business.

These paradoxes include leaving the family business to learn how to manage and lead the firm. Going outside the business is necessary to eventually learning to run the business from the inside. Then, the leader needs to know not just how to run a business but how to recognise the specific values that are a part of *our* business, the family business. Once in the role of leader, it will be important for the leader to create and manage the business's broad strategies, structures and systems in professional ways. A pathway through the paradox at this stage among the successful family firms was their willingness and capacity to involve external individuals in their governance processes. So, for example, the leader will probably include external members on the board, where once only family members may have been represented. However, the leader will need to do this while still keeping the speed of decision-making and other advantages which are part of the family business culture. So the leader will need to lead by combining the 'ordinary' with the 'extraordinary', the external with the internal, the clear and strategic with the invisible threads of family business culture. Finally, in perhaps the best known problem of family businesses, the leader needs to learn how to *let go* the business, that is, to lead in ways which create a future for the family and the business without the leader while still exercising the leadership role.

The following is a distillation of best practices we observed among successful family businesses that highlight increasing levels of professionalism in their governance and management.

1. ***Clarity of roles*** of management and the board, leading to a *balance of skills, experience and independence*.

Leaders need to move the business away from the situation that probably prevailed when the founder started the business, where operational roles were only vaguely defined, and management, family and board roles tended to be combined. This works during the early stages of the business lifecycle, and easily fits with the ethos of a 'family' way of doing things. However, it does not work as the business grows and needs more formal management.

2. ***Management of risk*** and use of *formal mechanisms* to encourage board and management effectiveness.

Learning to lead the family business includes introducing formal management mechanisms such as an effective performance review system which ensures the competence of decision makers, and using external members on boards and consultants when an objective viewpoint is necessary. Fortunately, as we saw in our book, the fact of being a family business is a kind of risk management factor in itself, since the values associated with being a family business are themselves a source of financial value. Learning to lead the family business includes recognising the ways the family is a source of value to the business.

3. ***Timely and balanced picture*** of all material matters

Family members may think that, because of the trust that exists between them, it is enough to discuss all issues casually, 'on the run' and without separating family and business matters. On the contrary, as the business grows, it is important to have a regular, formal schedule of (different) kinds of meetings to discuss family matters and business operational matters. Family members also need to know in advance when members of the family will be invited to express interest in joining the family business and what the criteria for joining are.

4. ***Allocating appropriate rewards***

A potential paradox for the family business arises from the fact that families often think of their members as deserving equal rewards. However recognising the legitimate interests of all stakeholders does not mean these interests will be the *same*. People in the family business should be rewarded differently according to their type of contribution (for example in an operational role or as a board member) and commensurate with market rates. Fortunately, the family business presents some 'in-built' rewards, such as the sense of continuity that goes with being able to pass the family business to the next generation, and the reward that goes with working on something together into the future.

5. ***Integrity*** *in decision-making* and *integrity in reporting*.

While family businesses aim to keep the succession in the family, it still needs to be clear that selection decisions, and especially the all-important succession decision, are made on the basis of merit, i.e. capacity to do the job. Even when family members are appointed to jobs in the business, position descriptions should be drawn up by professionals, and market rate salaries paid.

As a further instance of these principles, decisions about paying dividends to the family need to be clear and justified.

6. ***Upholding the rights of shareholders*** and recognising the legitimate interests of all stakeholders.

As with any business, looking after the health and longevity of the family firm should dictate the size of dividends paid to family members and others. This principle extends to decisions about whether to sell the business when the founder or other leader retires. Again, the needs and interests of the shareholders will probably differ rather than be the same.

In summary, in leading a family business, external factors and family issues must be accommodated simultaneously for the firm to survive and grow. These factors mean that leaders of family businesses ('just like any other business') need to be able to run their businesses in an increasingly formal, professionalised way as the business grows, while at the same time maintaining its informal, family values (except…).

* *Learning Family Business: Paradoxes and Pathways* by Ken Moores and Mary Barrett, Ashgate, 2003. ISBN 0 7546 0940 5