MANEL SRINIVAS NAYAK MEMORIAL BESANT INSTITUTE OF PG STUDIES

MSNM Besant Campus, Bondel, Mangaluru - 575008
(Affiliated to Mangalore University, AICTE Approved and NAAC Accredited)

✓

NATIONAL CONFERENCE
on
Family Business: Opportunities Challenges and Issues

Certificate

This is to certify that

Prof/Dr/Sri/Smt/Ms Praveen B. Asst. Prof., PES Institute Advanced Management studies has participated as a Resource Person/ Chairman/Rapporteur/Delegate in the **National Conference** held at our Institute on **Friday 3rd November, 2017**. He/She has also presented a paper titled Corporate governance in family business.

The Paper has been co-authored by

ISBN- 978-93-5288-384-4

4/11/17

Ravisha B

Prof. Ashalatha, Prof. Ravisha B, Prof. Suresh Shenoy
Conference Conveners

Dr. Narayan Kayarkatte
Director & Conference Chairperson

Scanned with CamScanner

Abstract

Family businesses are one of the foundations of the world's business community. The family business is the most frequently encountered ownership business model in the world and their impact on the global economy is considered significant. It is estimated that the total economic impact of family businesses to global GDP is over 70%.

FAMILY BUSINESS
Stories of Enduring Success and Innovation

Increasing growth and globalisation has brought many challenges for family businesses and many of these challenges can be tackled by adopting sound corporate governance structures. Corporate governance creates a solid organizational structure that clarifies roles, reporting lines and delegation of responsibility. The purpose of this study was to investigate whether a corporate governance structure is a must for family businesses. The main question with respect to whether good corporate governance practices can lead to improved performance of family businesses or not.

Keywords: Firm's Survival, Economic Shocks, Risk Attitudes.

*****

Introduction

Family businesses are one of the foundations of the world's business community. As family businesses are an important component of every economy and play a critical role in promoting growth of a country's economy, as they grow, they face same challenges and pressures as any major corporation.

Corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. Good corporate governance strengthens and clarifies the activities of the family firm while improving its competitiveness.

In any organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economic shocks. The health of the organization depends on the underlying soundness of its individual components and the connections between them. Good corporate governance therefore contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

Family owned businesses are often regarded as the dominant form of businesses around the world. Ranging from small family businesses to large business entities employing hundreds, or even thousands of staff, they can encompass sole traders, partnerships, private companies and public companies. As a matter of fact, family ownership is prevalent not only amongst privately held firms but also in publicly traded firms in many countries across the globe.

Literature Review

According to Ward, family businesses, over the world, represent a prevalent and prominent form of enterprise in the economic and social landscape. Some researchers estimate that, today, family-owned businesses comprise over 95% of all business establishments in the worldwide.

Today, the scope of family businesses has expanded to include some of the world's largest companies and their economic weight remains massive. In all markets, family-owned businesses form the bulk of the economy and in terms of numbers of individual enterprises they account for a significant proportion of GDP in their markets.

How can Corporate Governance help?

Many countries are realizing the fact that, as business grows and needs external finance to pursue its expansion, then non-family investors will only be attracted to the business if they see that their interests are safeguarded. Therefore, they are looking towards the Corporate Governance resort to force companies introduce transparency in their records as well as to protect investors' finances.

Many of the world's most famous large corporations of today have started as family-owned businesses, examples include, Acer Computers, Wal-Mart, Ford Motor Company, SC Johnson, Tetra Pak, Anheuser-Busch, Cadbury... etc.

Corporate Governance helps countries and companies to attract investment around the globe as investors consider companies practicing good governance being safer. It also strengthens the foundation for long-term economic growth.

Following are some of the requirements of Good Corporate Governance and their effects.

1. Transparency: Corruption and non-transparency drains a company of its image as well as long-term prospects, while driving investors away. Therefore, by demanding transparency in corporate transactions, Corporate Governance attacks the core of corruption and is a major source in eradicating it from its roots.

2. Improving Management: Corporate Governance helps managers to make sound business decisions and formulate strategies that are in the best interest of the organization and the stakeholders. This improvement in decision making and managing helps companies to attract investment on favorable terms and enhances performance of the company.

3. Standards and Procedures: Corporate Governance favours formulation of standards and procedures to deal with crisis that hit capitalist economies after every decade or two. By adopting standards to deal with investors and creditors, this prevents banking crisis as well as business failures.

4. Safeguarding minority shareholders: For countries that are trying to attract small investors (foreign or local), Corporate Governance matters a great deal on getting the finances out of their pockets. Research has shown that countries with stronger corporate governance protections for minority shareholders also have much larger and more liquid capital markets.

Hence, Good Corporate Governance:

- Reduces risk
- Stimulates performance
- Improves access to capital markets
- Enhances the marketability of goods and services
- Improves leadership
- Demonstrates transparency and social accountability

Why is Corporate Governance critical for FOBs?

"Creating mechanisms like family constitutions and family councils can manage corporate governance apart from the family so the business does not suffer. Additionally good governance practices can assist in creating a more sustainable organization by delineating methods for generational transitions and succession planning".

Corporate governance considerations for family businesses therefore involve thinking about family governance and business governance in stand-alone terms, but also about how to align the two governance systems in the best possible way in order to achieve a sound governance approach for the overall family business.

As family members often fulfill multiple roles within the family business, belonging to different subsystems can lead to internal conflicts of interest and requires governance structures to set out clearly the boundaries and responsibilities of the relevant position. Corporate governance thus enables transparency of decision making and clarification of the pertinent capacities in which the individual family member is acting. As highlighted above, depending on which subsystem individuals belong to, they hold different views and have different objectives, which can lead to conflicts. Corporate governance provides the tools for raising awareness of the causes for the different perspectives and supports their alignment or the achievement of a compromise.

Recommendations

The purpose of this study was to investigate whether a corporate governance structure is a must for family businesses. The main question with respect to whether good corporate governance practices can lead to improved performance of family businesses or not. To answer this question, we derived two major research hypotheses, each focusing on a different aspect presented in the frame of reference. The aim of this study was therefore to contribute to the on-going debates in the field of family business corporate governance. With this paper we advance the understanding of how and why family businesses set up their governance structures and consequently contribute to an area where a lack of qualitative research exists.

The study proves that the issues of family business corporate governance come to the fore when the business owners consider major transitions such as the sale of the business or succession planning. It was realised that although informal governance in some family businesses seem to work well, there is still a need to have a more formal corporate governance structure to plan ahead for the business. In most cases, major undertakings and decisions are made as a family, with the head of the family taking the lead. But as the business grows, the need for a more formal framework was required in these businesses so as to avoid overlap, confusion and possible disagreement. This study therefore proves the importance of a stewardship oriented culture and low agency cost for family businesses as a source of competitive advantage, which is based on informal governance structures. Indeed it is established that family businesses need a continuous communication culture, a transparent plan to follow and clear lines of authority. When they achieve this it helps to alleviate any problems within the family business due to emotions and confusion caused by the absence of it. It also comes out whilst that most family businesses recognize that governance structures are vital elements for their businesses, only a few manage to inculcate corporate governance into their systems and business structure.

It also came to light that the need for a governing board for family businesses is essential for the running of such businesses. A vibrant and effective board should be responsible for adding value to the business in three ways:

1) Presiding over the leadership, operations and finances of the business;

2) Ensuring that the business has a strategic direction by anticipating the need for change and identifying new opportunities for it;

3) Mediating among the needs of family shareholders, employees, other stakeholders and the business. For any family business board to be effective, the members should include family owners/shareholders, executive directors (employees) and non-executive directors (non-employees), and the board is bound to act in good faith, care and due diligence as they are appointed to look after the interests of the organization and its employees.

CONCLUSION

The objective of this paper is to justify the need for corporate governance guidelines aimed at family businesses. In conclusion it must be stated that the principles of corporate governance apply to both listed and non-listed companies and institutions in the private and public sectors. Good governance is a must for every business but for family businesses, corporate governance is a crucial paradigm shift, so significant, that it determines the continuity or growth of every family business. The main goal of good corporate governance is to give direction for families in the business as they move on to the next stage of development of their businesses, and its consequences on the family and the business as a whole.

The particularities of family businesses provide an important argument in favour of a need for corporate governance guidelines. Family businesses do not only have to sort their family governance and business governance, they also need to integrate the two governance systems in order to achieve a successfully running business while concurrently maintaining the family relationships.

Family business governance guidelines contribute to a better education of family businesses about their common idiosyncrasies and associated issues. Being aware of potential problems and having procedures in place when they actually arise, could be a crucial step in reducing the company law litigation arising from family business disputes.

******

Reference

- K. Mahayny, "Difficulties Facing Family Owned Businesses in the Arab Region", A paper presented to the conference "Business Development & Family Businesses: Managerial Foundations & International Accounting Standards", Arab Tax Society, Cairo, Egypt (2007), 10-11 February, Nile Hilton.

- Berglof, E. and Von Thadden, E.L. (1999) The Changing Corporate Governance Paradigm: Implications for Transition and Developing and Countries. *Annual Bank Conference on Development Economics*, Washington DC, 28-30 April 1999, 135-162.

- Sharma, P. (2004) An Overview of the Field of Family Business Studies: Current Status and Directions for the Future. *Family Business Review*, **17**, 1-36. http://dx.doi.org/10.1111/j.1741-6248.2004.00001.x

- **Open Journal of Business and Management, 2016, 4, 14-35** Published Online January 2016.