Lebanese Association of Certified Public Accountants

Governance and Succession Planning

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AUB American University of Beirut الجامعة الأمريكية في بيروت
OSB SULIMAN S. OLAYAN SCHOOL OF BUSINESS

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Sustainability through Governance
#National_Interest

The family business is one of the most enduring institutions in human history.

***B*efore the multinational corporation, there was family business.**

***B*efore the Industrial Revolution, there was family business.**

***B*efore the enlightenment of Greece and the empire of Rome, there was family business.**

William O’Hara, Centuries of Success

The Oldest Family Businesses

1. Hoshi Ryokan - *Founded: 717*

The oldest hotel still in operation, Ishikawa – Japan. A 100 rooms hotel which began as a SPA on an underground hot spring built by the Hoshi family.

2. Fonderia Pontificia Marinelli - *Founded: 1000*

A Bell foundry founded by the Marinelli family in Agnone, Italy.

3. Barone Ricasoli - *Founded: 1141*

A Wine and Olive oil producer located in Siena, Italy.

4. Barovier & Toso - *Founded: 1295*

A Glass production company founded by the Barovier Family on Murano Island near Venice, Italy.

35% of Fortune 500 U.S. companies are family businesses

Some of the top 30 OECD's largest corporations:
Wal-Mart, IKEA, Groupe Auchan, Reliance Industries, Tata Motors

Regardless of their size, all family businesses face significant challenges of continuity, longevity, and ultimately success.

The Oldest Family Business

The End of a 1,428-Year-Old Business

The Japanese temple builder Kongo Gumi

- In operation under the founders' descendants since 578.

- The world's oldest continuously operating family business ended its impressive run in 2006.

How do you make a family business last for 14 centuries?

1- Operate in a stable industry.

2- Be flexible in selecting family members

- Choose the BEST (Responsibility and talent for the job) *rather than the oldest son.*

- ***Not necessarily a SON (****daughter, or even sons-in-law taking the family name).*

Reasons for failure

1- Risk taking and burst of the bubble:

During the 1980s bubble, the company borrowed heavily to invest in real estate, which shrank in value in 1992 recession.

2- Social Changes and lack of flexibility

The Company did not manage the declining contributions to temples.

Family Business Feuds

The old adage says:

"Never do Business with Family."

Keeping business and personal matters separate has almost always proven difficult, especially when it comes to family.

When the business is large, the disputes tend to be as well, and so does the publicity.

Puma and Adidas

Brothers Adolf and Rudolf Dassler founded a shoe company in Germany, in 1924.

The brothers had different personalities, and tensions between the two came to a boiling point during World War II.

The brothers split in 1948:

- Rudolf founded Puma
- Adi founded Adidas.

The Gucci Family

A producer of leather goods in Italy since the 15th century.

Guccio Gucci founded Gucci brand in Florence in 1906.

His sons, Aldo and Rodolfo took over and grew the company.

Family disputes grew over the years.
Paolo Gucci, a designer, filed suits against his father, Aldo, and other relatives and the company.

Gucci family members eventually sold nearly a 50% interest in Guccio Gucci S.p.A. to Investcorp in 1988.

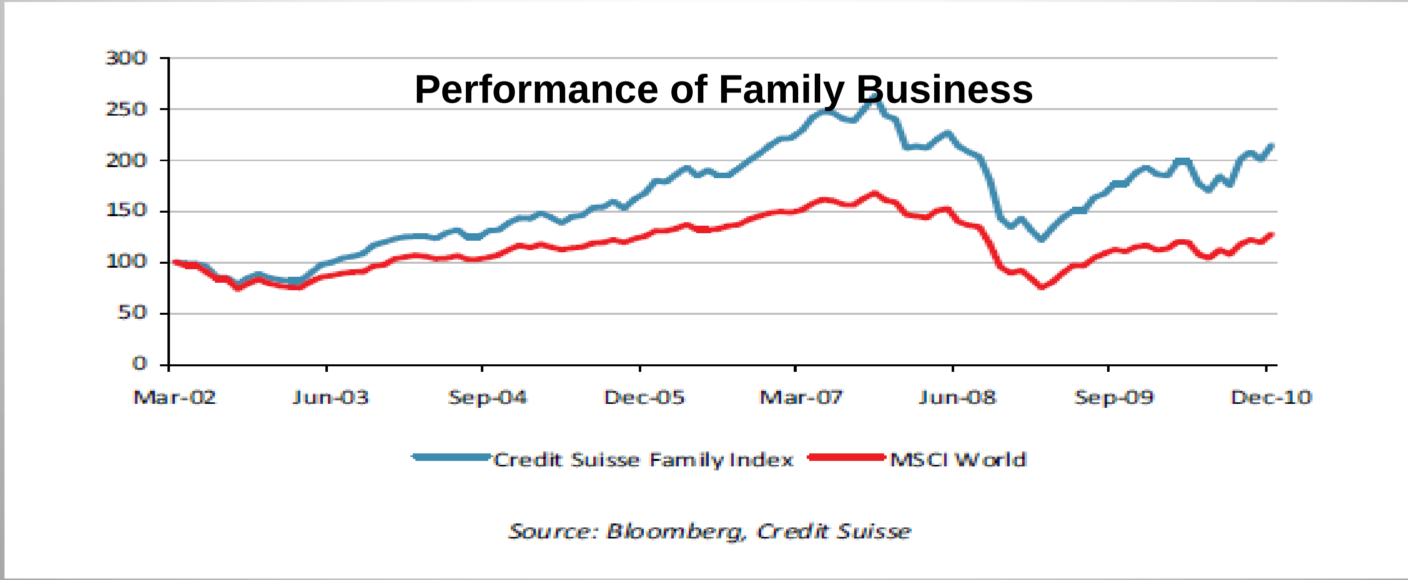
Conflict between family members

	MENA	Global
Claim Alignment between family & business strategies	53%	69%
Have at least one procedure/mechanism in place to deal with conflicts	75%	82%

Source: PWC

I. *What makes Family Business Different?*

What makes Family Business Different?



Why?

=> The family component can provide a significant competitive advantage.

What makes Family Business Different?

- A large number of businesses in developed countries are family businesses *(e.g. 3 out of 4 in Britain are family-owned,* 9 out of 10 small businesses in the US are either closely held or family run*).*

- Family businesses make a huge contribution to our economy
  - In the UK, “Family firms are more productive; on average they make £29,000 turnover per full-time member of staff as against £21,000 in non-family business” (Barclays Bank, 2003)

=> The family component needs to be understood and effectively managed

- The survival rate of businesses into the second generation and beyond is discouraging :
  - 30% survive into the second generation
  - 12% survive into the third generation
  - 3% survive into the fourth generation or beyond

So, why some family businesses struggle with the transition process?

II. *Main Challenges*

Lack of Succession Planning

For many business owners and founders the greatest dream they can have is to pass it to the next generation *(Succession)*

- However, there are still many pending questions:
  - Does that next generation have the desire, the talent, the dedication, to do what is necessary for long term survival?
  - Do you need to change the corporate culture to ensure success?

Lack of Succession Planning

Succession

	MENA	Global
No succession plans	91%	43%
Have/discuss succession plans	9%	57%

Source: PWC

In Lebanon, succession is not openly discussed.

Older generation owners tend to keep in management,

and they refuse to give the power as long as they can stay in business

Lack of Succession Planning

* Using a sample of 106 Lebanese Family Controlled businesses, Beyrouti (2010) shows that understanding and raising awareness of succession issues is an effective predictor of business performance.

* Using a sample of 114 firms with an average age of 33 years, Fahed-Sreih and Djoundourian (2006) show that ***Sustainable*** family businesses in Lebanon exhibit a variety of responses to the variables that are conducive to success. Older firms are more inclined:

- to use a participatory decision-making process, as evidenced by more reliance on advisory boards.
- To hold family meetings and have formal redemption and liquidity plans.

Lack of Good Governance

Family businesses are portrayed as being plagued by

- Intergenerational and sibling conflicts
- Fiscal irresponsibility
- Incestuous hiring and promotional practices
- Ongoing legal battles among shareholders

There is evidence of the negative effect of a controlling family on corporate performance (Morck et al., 1988) .

There is a risk of a non-professional managerial approach that attempts to protect the family’s interest (Claessens et al., 2000) .

Lack of Good Governance

- Using a sample of 178 Lebanese family owned businesses, Salloum and Azoury (2012) show that financial distress is less likely in firms with boards that have a higher proportion of outside directors.
- In another study, Salloum, Schmitt and Bouri (2012) show that CEO-board chair duality increases the probability of financial distress.
- Using a sample of 75 Lebanese businesses, Salloum, Bouri, and Samara (2013) indicate that family involvement in ownership and management has a positive relationship with the financial performance.

=> Family managers in Lebanon act as stewards by considering the success of the company as their own, rather than agents seeking to achieve their personal benefit on the expense of the company.

III.Family Business Succession Planning & Governance

What is Succession Planning?

Succession planning refers to the process of developing a business strategy that provides prescriptions about how business transition can be effectively achieved.

Leadership is an important factor in the succession process. Unfortunately Leadership traits are not acquired all the time; they are born with the person because some people are classified from early careers as leaders or followers.

=> family businesses should focus on developing succession strategies and plans.

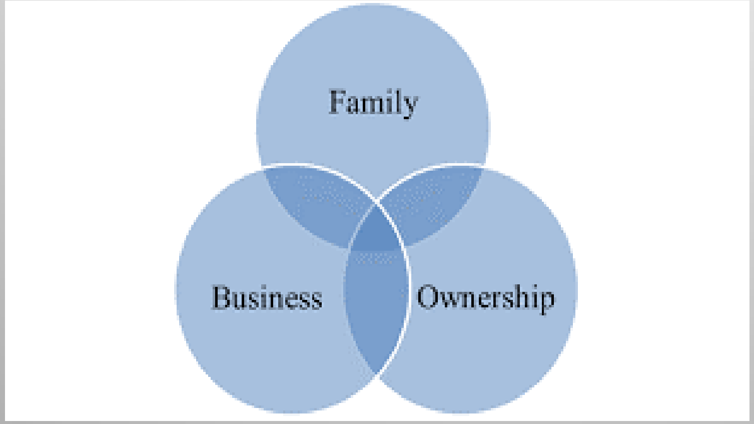
What is Succession Planning?

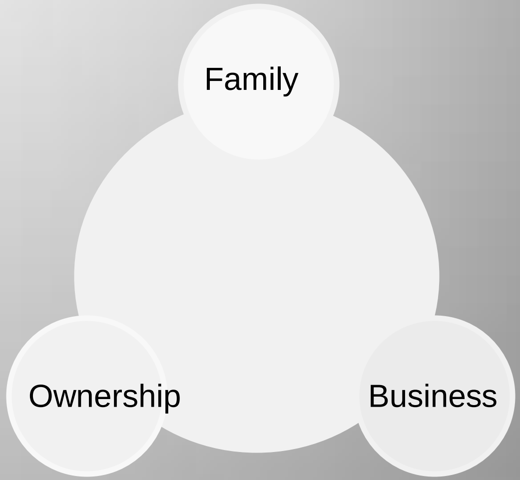
Family businesses should be focused on the following issues:

- Why should the family be committed to the succession process?
- What is the vision of the business after transition?
- Who should participate in the planning process?
- When and how should the successor be prepared?
- When and how should the incumbent retire?
- How will the family resolve conflicts on family and business sides?
- How to constitute and use the board of directors?

Development and Transition of Family Business Over Time:

Initial Phase Growth/Development Maturity





Founders Stage

Siblings and Partnership Stage

"Cousins" Confederation Stage

To renew and recycle to sustain

Source: Better Governance

Family Governance Institutions

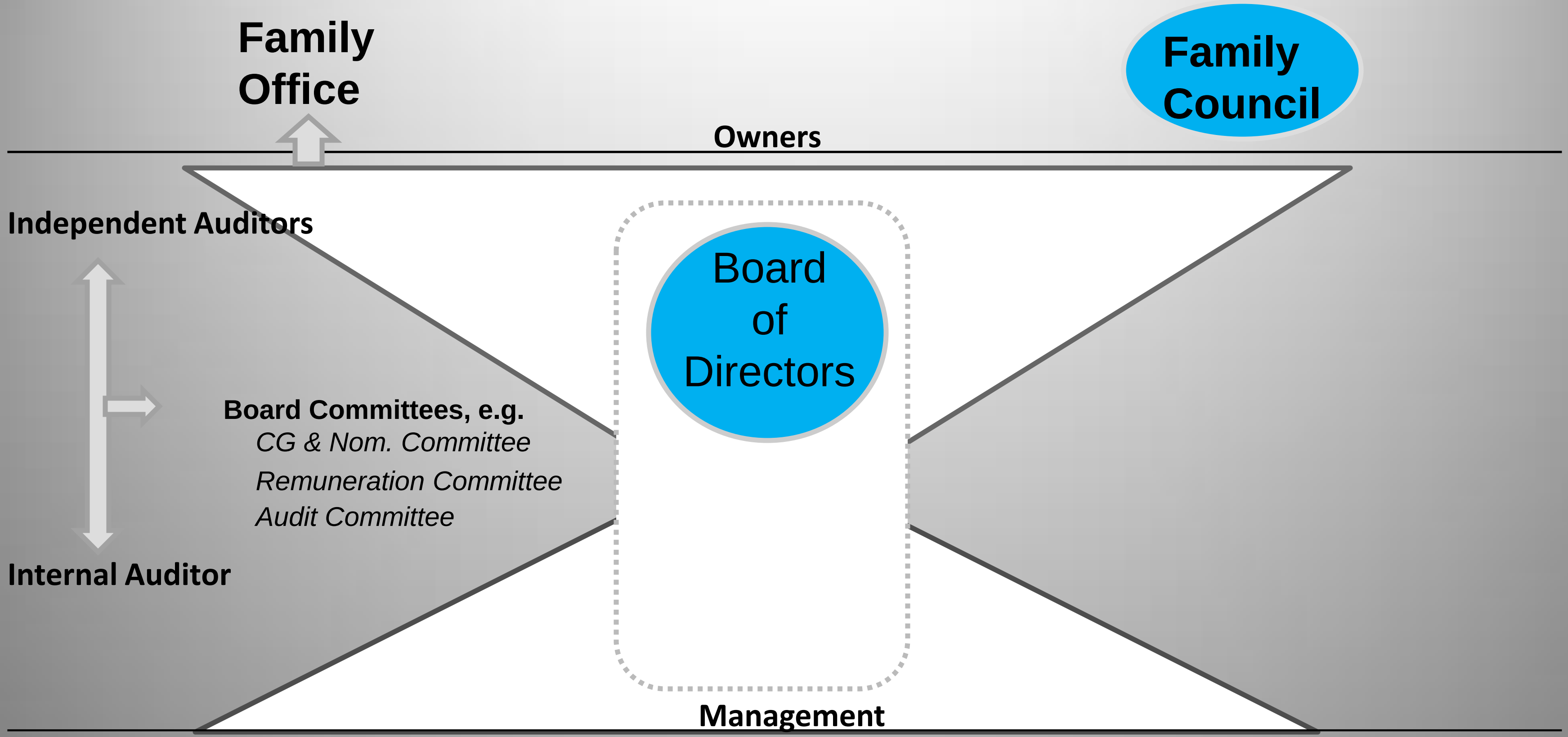
B- Governance *structures throughout the different stages of family business*

	Family Meeting	**Family Assembly**	**Family Council (Mature)**
Stage	Founder	Sibling/Partnership	Cousin Confederation
Status	Informal	Formal	Formal
Membership	Open to family (criteria for other members set by founders)	Open to family (criteria for other members set by family)	Elected family members by the family assembly.
Size	Small (6 to 12)	Depends on family size	Depends on criteria (6 to 12)
Number of Meetings	Depends on Business development stage (1 / Week)	1 to 2 times a year	2 to 6 times a year
Main Activities	* Communication of Values & Vision * Discussion of New Business ideas * Preparation Succession	* Com. & Disc. Vision/ideas * Approval of Policies & Proc. * Education on Business * Election of Family Council & other committees' members	* Conflict Resolution * Development of Policies & Proc. * Planning * Education * Coordination of work (Management & Family)

Source: IFC Family Business Governance Handbook

Family Governance Institutions

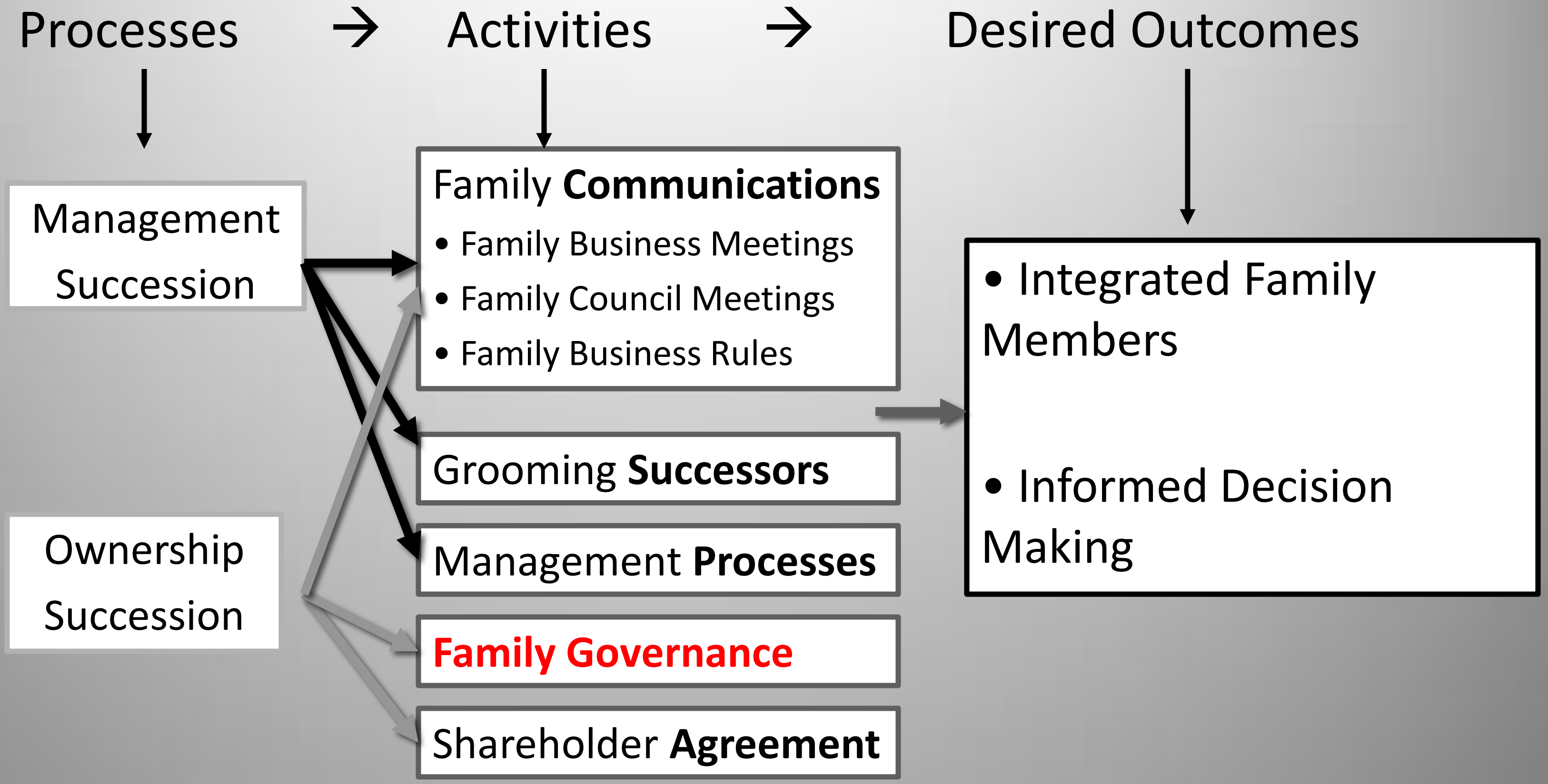
Governance structure of ***Mature*** *Family-Controlled Companies with Good Practices*



A Family Office: An Investment and Administrative Center that is organized and Overseen by the family Council.
It advises on personal Investment Planning, taxes, Insurance coverage, estate planning, career counseling, etc.

Source: Better Governance

FB Succession Planning & Governance



Source: KPMG

Preparing or procrastinating?

How the world's largest family businesses undertake successful successions :

- **Who is responsible for succession?** Board of directors (44%), Owners/family council (23%), CEO (22%)

- **Focus on next-generation preparation → *Educate and Prepare the next generation***

- **Nurture an entrepreneurial culture →** Promote informed risk taking, agile decision-making and rapid market response

- **Work to attract top talent → Use your advantage** over others because you value: *flexibility*, adaptability, speed of change, a human approach, long-term relationships,

→ **"the family business advantage"**

Note: survey based on results gathered from 525 of the world's largest family businesses (2015)

Source: EY – Global

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