Business Environment of Family Businesses

12. lecture

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SCHOOL OF BUSINESS ADMINISTRATION IN KARVINA

Ing. Šárka Zapletalová, Ph.D.
Department of Business Economics and Management
BUSINESS ENVIRONMENT

Introduction

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- Family business is unique in character and it faces many different and pertinent issues that are not encountered in corporate business. The unique feature of the family business field is that scholars focus on investigating and understanding the reasons, meanings, roles and impacts of the interaction between at least two systems: the family and the business.

- Family businesses have a great and substantial impact on the country economic development as well as on the global economy.

- Family businesses are crucially important for global business environment.

- Business environment in family business has some specific features. These specifics are given by blending or ownership factors, management factors and family factors.

Family Businesses in the World

- The vast majority of organizations in the world are owned or controlled by families. Family business is by far the most prevalent form of business in the world.
- As many as 80 – 95 percent of all companies in the USA are family owned or controlled.
- In Europe, the proportion of family business is approximately 70 – 80 percent (80 – 95 percent in the Czech Republic).
- It is estimated that in the Middle East about 75 – 90 percent of organizations are family owned.
- In Latin America, 70 percent of all organizations are owned or controlled by families.
- The Australian economy is controlled by family firms, estimated at approximately 67 percent of all organizations.
- Asia is dominated by family businesses: many of them Chinese family businesses (about 95 percent) that are based in other countries.

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Definition of family business

- It is „business governed and/or managed with the intention to coalition controlled by members of the same family or a small number of families in the way that is potentially sustainable across generations of the family of families (Chua et al. 1999, 25).

- The family member is chief executive and there are at least two generations of family control, a minimum of five percent of the voting stock is held by family or trust interest associated with it.

- One in which a family has enough ownership to determine the composition of the board where the CEO and at least one other executive is a family member and where the intent is to pass the firm on to the next generation.

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Definition of family business

- Family business is a organization with:
    - Ownership control (15 percent or higher) by two or more members of a family or a partnership of families.
    - Strategic influence by family members on the management of the firm, whether by being active in management, by serving as advisors or board members, or by being active shareholders.
    - Concern for family relationships.
    - The dream or possibility of continuity across generations.

Conceptions of family business

- Family businesses are backward and small scale with an inability to preserve financial capital.
- Family businesses can be unprofessional.
- Family businesses are:
    - Small;
    - Rife with conflict;
    - Unable to compete;
    - Nepotistic;
    - Often failing to succeed;
    - Financially underperfoming;
    - Unfavorable work environments;
    - Slow growing;
    - Supplying of dead-end jobs.

- Family business is a small family-owned business in which one family member berates another family member in front of customers or has acted in an unprofessional manner.

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Conceptions of family business

- The presence of the family.
- The overlap of family, management and ownership, with its zero-sum (win-lose) propensities, which in the absence of growth of the firm, renders family businesses particularly vulnerable during succession.
- The unique sources of competitive advantage derived from the interaction of family, management and ownership, especially when family unity is high.
- The owner s dream of keeping the business in the family.
- The strategic influence of noneconomic family goals and values.

Priorities of family business

- Family businesses are more likely to be concerned with the stability and continued family ownership of the business.
- Families often see employing family members as a priority.
- Families usually live and work in the same area, and their identity is often tied up in the business.
- Priorities of family businesses are social or community related rather than strictly business of financial.
- In a long standing firm, the family legacy is vitally important.

Categorization of family businesses

- ***Family-first*** – employment in the business is a birthright. The exists the stereotype of nepotism, which still dominates most people s views of family businesses.

- ***Ownership-first*** – investment time horizons and perceived risk are the most significant issues. When shareholders come first, the priority is risk-adjusted economic returns or owner rents.

- ***Management-first*** – the businesses are likely to actively discourage family members from working in the business and/or to require work experience outside the business as a prerequisite for employment. Compensation is based on responsibility and performance, not on position in the family hierarchy.

Family business system

- There are always two completely different and distinct systems involved in a family business. The first is the family system and the second is the business system. And that s the problem.

- When a family works together, it inevitably blends the two systems by imposing the family system onto the business. A family business is supposed to be a business, and as such it is supposed to be controlled by its business system.

- For family to be healthy, it needs to have a family system that operates in a particular way. The attributes of a healthy business system are usually at complete odds with the attributes of a healthy family system.

Three-circle family business system

- The three-circle model of family business describes the family business system as three independent but overlapping subsystems: business, ownership and family.

- Any individual in a family business can be placed in one of the seven sectors that are formed by the overlapping circles of the subsystems.

- The reason that the model has met with such widespread acceptance is that it is both theoretically elegant and immediately applicable. It is a very useful too for understanding the source of interpersonal conflicts, role dilemmas, priorities and boundaries in family businesses. Specifying different roles and subsystems help to break down the complex interactions within a family business and makes it easier to see what is actually happening and why.

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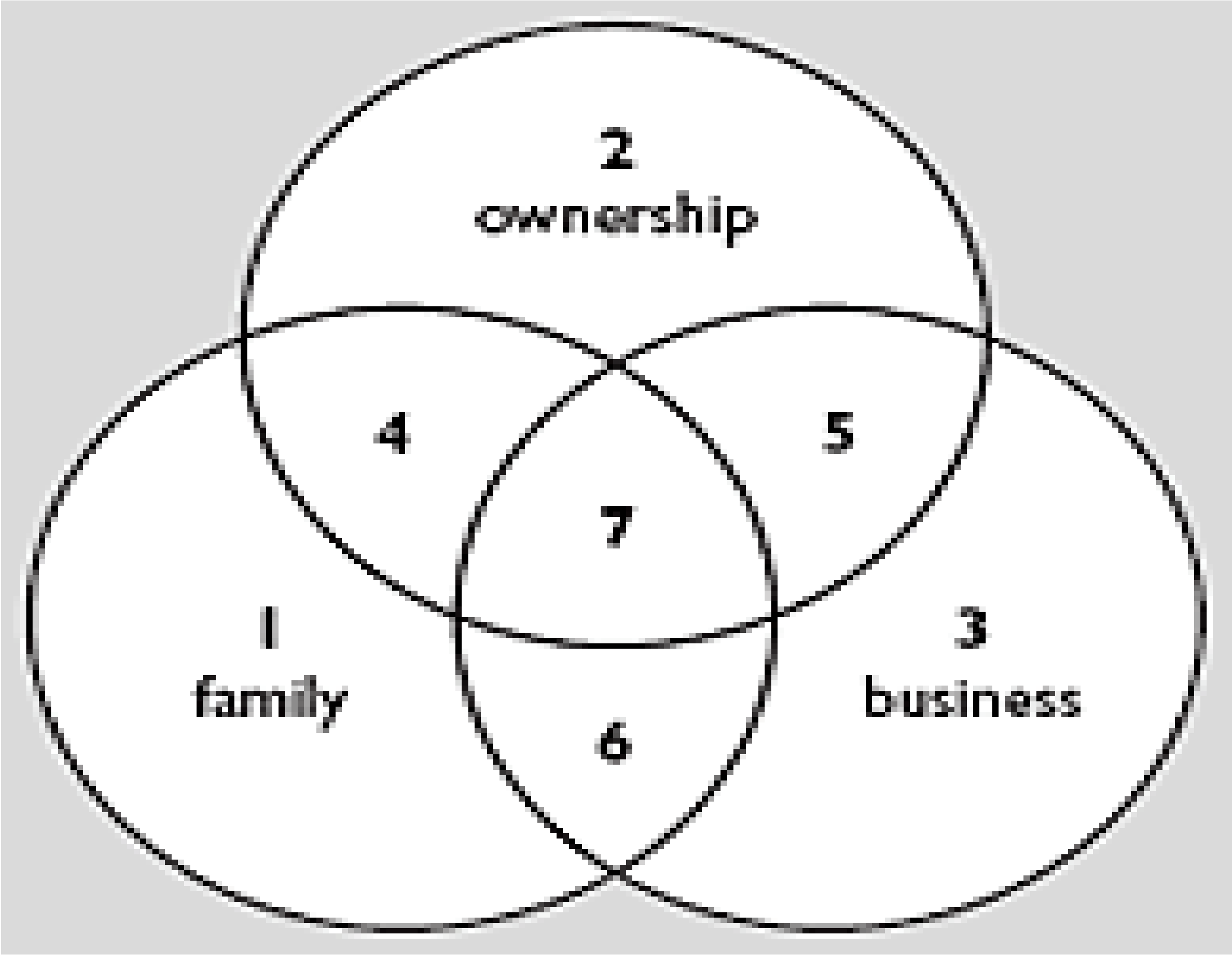
Three-circle family business system



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Business Environment of Family Business

- Family businesses are crucially important for global business environment.

- Business environment in family business has some specific features. These specifics are given by blending or ownership factors, management factors and family factors.

- Family-owned and managed business dominate the economies in most nations in terms of number of enterprises. The family business cannot be divorced from the business. Not all family businesses are the same. Not all families are the same.

- The modern family business is different from the traditional view within family business circles of the dynastic family with multigenerational ownership of a global conglomerate.

Family business governance

- Keasey et al. (1997, 288) provide one often quoted definition for corporate governance in general: „Corporate governance is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders".

- The Three-circle model (previously mentioned) helps clarify the tasks and purposes of governance in reference to each of the key subsystems, the essential work that governance must accomplish if the family business is to succeed, and therefore the basis for evaluating governance implementation in research and practice.

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Architecture of family business

- Architecture of family business consists: family structure, business structure, ownership structure.
- ***Family***
    - Family council (Family forum);
    - Family assemblies.
- ***Business***
    - Board of directors;
    - Leadership structure;
    - Management team.
- ***Ownership***
    - Shareholder s council.

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Architecture of family business

- **Family council** is the board of directors for the family circle. It can be an all-inclusive, self-appointed or elected work group of family members, whose main tasks are to make decisions about the business of the family and to educate families about the business.The fundamental purpose of a family council si to provide a forum in which family members can articulate their values, needs and expectations vis-á-vis the business and develop policies that safeguard the long term interests of the family.

- Obviously this includes:
    - Family members who have ownership or employment in the business;
    - Spouses of these people;
    - Family members who have a interest in future employment or ownership;
    - Younger family members.

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Architecture of family business: Functions of family council

- Forging family consensus, counteracting declining family bonds, low identification with the business, as families grow and spontaneous social contacts among family members decrease.
- Articulating a family strategy for business and wealth management (including planning, rule setting, collaborative asset allocation).
- Limiting family conflicts that could negatively affect the business.
- Supporting succession planning, particularly in facilitating the family s exploration of their collective dream of continuity and in conveying a policy-driven, stewardship culture and enthusiasm for the business.
- Educating and welcoming younger generations as a forum for lifelong learning.

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Architecture of family business

- **Family assemblies** are the periodic (typically annual) gathering of an extend family.

- These events often include formal meetings where information is shared about investments and operating companies, speakers and facilitated discussions and other recreational activities that are common in family reunions.

- Family meetings can help families achieve consensus regarding family mission and family values for the sustainability of the family business over generations.

- Family assemblies are often recommended as particularly useful in large family groups with broad geographic dispersal, highly diffused ownership and a desire to sustain economic interdependence through subsequent cousin generations.

Architecture of family business

- In contemporary enterprise economies, nearly all legal systems specify some kind of **board of directors** as the ultimate governance authority in a company.

- ***Board size*** – has been relatively stable averaging just over 10 members, including the CEO and one or two other insiders. Lane et al. (2006) summarize a group of studies and conclude that the optimal range for family-controlled businesses is 7 – 12 directors.

- ***Categories of directors*** – optimal mix of directors from management, ownership and outside the company.

Structure of board of directors

- Board of directors consists usually of inside directors and outside directors.

- Inside directors consist of the CEO who is typically:
  - Family member;
  - Director elected by the Family council (Family forum);
  - Director elected by the Shareholder s council.

- Outside directors are business executives in companies that are currently of the size and organization that family business desires to be in the future. These outside directors are not, usually, the CEOs of other companies but they are at the second or even third tier of management.

- Board meetings of established multigenerational family businesses are best held quarterly even though it appears that more than 50 percent of all family business boards.

Architecture of family business

- The purpose of the family business **leadership structure** is to accomplish the following objectives:
  - Make sure that the company develops and successfully implements a long range plan through which it anticipates and creates the future.
  - Assure that all of the functional areas are operating effectively and in coordination with each other.
  - Maintain significant external relationships with the industry, customers, suppliers and the community.
  - Engender positive and productive employee morale throughout the company.
  - Be a guardian of the company s financial and human resources, protecting and allocating them.

- Typically, leadership structure incorporates a CEO or president and reporting to the CEO/president, one or more vice presidents and an executive vice president, or chief operating officer.

Architecture of family business

- The strategic planning process is implemented in family businesses through the **management team** (management structure).

- The management team structure consists of a number of specific management teams at various levels in a various places throughout the company. The top two or three executive levels often comprise the executive management team. Some of them establish management teams with managers and supervisors that report to them.

- Management team provides the support and channels of implementation needed by the leadership structure to assure that plans are carried out. The purpose of the management team is to make sure there is good alignment between goals, priorities and operations.

Architecture of family business

- **Shareholders council** representing the interests of owners in overseeing the well-being and management of their investment.

- Members of the Shareholders council are all those who own stock in the family business. In smaller owner-managed family businesses there is no need for a Shareholders council unless the owner is for some reason partial to meetings of one person. Even in a partnership of two family members, ownership issues are likely handled in more informal partner meetings over lunch or a cup of coffee.

- The Shareholders council typically meets only once a year unless more frequent or special meetings are needed to draft or revise the Shareholdrs s Agreement, deal with potential sale of the business, discuss a merger or major acquisition or respond to a crisis.

Conflict management in family businesses

- The success of family-owned company is evidence that orderly governance and resolution of problems within the family or in the family s relationship to the business were provided for before they overwhelmed the enterprise.
- Conflict is inevitable in families, and more so in families that live, work and control assets together.
- Significant problems addressed in family meetings are:
  - Frustration over alienation or lack of inclusion – source of the conflict is widespread as a result of the emotional distance between family members who are active in management and those who are not and between members of the powerful current generation and those of the significantly less powerful next generation.
  - Anger over unfairness of hiring practices, promotions, family benefits and other opportunities enjoyed by some but not by others.
  - Frustration over dividend policies and lack of liquidity.

Conflict management in family businesses

- In family businesses there are different sources and types of conflict.

- ***Sources and types of conflicts in family system:***
  - Source: family squabbles;
  - Types: usually emotion based, stay at home.

- ***Sources and types of conflicts in business system:***
  - Source: professional disagreements;
  - Types: usually logic based, stay at work.