



FAMILY GOVERNANCE

PART 2* | OPPORTUNITIES AND RISKS OF FAMILY BUSINESSES AND MODELS FOR ECONOMIC AND FAMILY STABILITY



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In our last newsletter, we described the characteristics of family businesses as part of our series on the successful management of family businesses with ‘professional family business governance’.

In this second part we will examine the opportunities and risks associated with family businesses in greater detail and show you models in which economic success and family stability in family businesses can be attained.

Benefits and drawbacks or opportunities and risks of family businesses

Are family businesses a separate type of enterprise differing in fundamental aspects from other businesses and what might these differential criteria be? Are they more willing to invest or are they more crisis-proof? Do they provide more stable jobs for their employees or is exactly the opposite the case, that they are more susceptible to crises as argued in the first part of this article because crises within a family always affect the business and can give rise to clan management or nepotism. These questions are currently the subject of ongoing academic research. Such research focuses on the interaction between family and business and the concomitant question of the influence of family behaviour on a business and vice versa. If a family is behind a company, stimuli originating from younger generations can be just as useful as the knowledge acquired over many years by more experienced family members. If there are a number of successors eager to enter the family business, it is advisable to lay down precise rules governing which successor can enter the family business. The social commitment of a family – keyword philanthropy – and the geographical roots of a family in a particular region all contribute to the stability of a family business. However, this should not lead the business to lose sight of the potential of market expansion.

Conflicts come to the fore whenever differing approaches and expectations arise within the family which have an impact on pending or urgent decisions in the business. The situation escalates when majority decisions can no longer be taken or when there are intransparent ownership structures. Emotions within the family end up affecting the company and blocking rational decisions. These situations are often triggered by trivial matters, such as the closer relationship of a descendant to the head of the family or non-acceptance of a new partner by the rest of the family.

If harmony reigns between the family and the business, the result is a win-win situation. The business obtains competitive advantages through stable ownership relationships, decision-making paths are non-complex and can be negotiated using the shortest route and long-term goals for successors and the family wealth can be attained. It follows that if the family enterprise operates with the business’s best interests at heart, implements financial plans using sound judgement and adopts a forward-looking approach both for the family and for the business, the latter is capable of weathering crises such as the recent coronavirus/COVID-19 pandemic, which has presented many small- and medium-sized enterprises with considerable challenges.

On the other hand, it is not uncommon for family businesses to break up in the second or third generation if the interaction between family and business no longer works. Generally speaking, it can be said that a family business is always at risk if family problems can no longer be resolved with appropriate conflict management at the root but are brought into the heart of the enterprise. This leads to the breakdown of the working environment, unsettles employees and diminishes loyalty towards the family and the business. The view into the future is distorted because of the emergence of micromanagement and secondary battlefields. The business suffers.

Different models for representing family – business governance structures

In recent times, family businesses have experienced a renaissance. Society in general has realised that they constitute the backbone of a functioning economy. This has led family researchers to develop different models in order to illustrate the interplay between economic success and family stability.

The first model is the 'stability model'. It shows how professional cooperation is a part both of management and the family. And that active control of processes, active decisions by company members and systematic attention to safeguarding the business's future are tasks for management and company members.

By adopting a strategic or business management approach (at family level), the foundations for functioning family and corporate structures can be laid. Management and family must work hand in hand. Active control of processes, active decisions by company members and systematic attention to safeguarding the business's future are tasks for management and company members.

This means that the success of a family enterprise is not only attributable to its innovative capacity, its market and environmental factors but also in large measure to the family. This can be visualised in the stability model for family businesses.



Fig.: The stability model. Source: Felden/Hack: Familienunternehmen aktiv managen, p. 206.

The second model relevant here is called the 'Three Circle Model' of the family enterprise system and shows three independent and overlapping groups: family, ownership and business.

A person in a family enterprise system occupies one of the seven sectors formed by these three overlapping circles. An owner (partner or shareholder) and only owners are placed in the upper circle. Family members occupy the left-hand circle and the persons employed at the family business the right-hand circle. If you only have one of these roles, you are only located in one circle. However, if you have two roles, you are placed in an overlapping sector and occupy a position in two circles simultaneously. If you are a family member working at the company but do not have any shares, you are placed in the lower central area. If you are a family member working at the company and also an owner, then you are placed right at the centre of the three overlapping circles.

The model shows the positions of the key persons in the system and clarifies the different roles of family members: as family owners or family members. These overlapping areas in the model show where there is a duplication of roles and potential confusion of roles.

Each of the seven interest groups identified by the model has its own standpoints, goals, concerns and dynamics. The model is a reminder that the points of view of each sector are legitimate and deserve respect. No standpoint is more legitimate than another, but the various standpoints must be coordinated, so as to define the future direction of the family enterprise system.

Hence the long-term success of family businesses depends on the modus operandi of each of these groups and the mutual support provided by them.

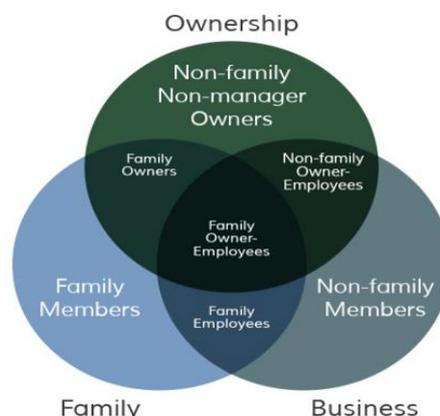


Fig.: Three Circle Harvard Business Model. Source: Cambridge Family Enterprise Group

If you have any questions on this subject or would like to implement family business governance concepts in your family business, please feel free to contact us.

**Prof. Dr. Nicole Conrad-Forker, LL.M. reports in our series of newsletters on the topic 'Successful management of family businesses with professional family business governance' and is gladly available at any time should you have any questions.*