

# Business Environment of a Family business

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# Learning objectives

- What is a family business
- Definitions
- Family business around the world
- Some interesting facts
- Theories of family business
- Three circle family business model
- Basic governance structures of family business system
- Conflict management in family business

# Family business

- Important for economies throughout the world and have **impact** on the **global economy** as well.
- In most countries family businesses represent **two-thirds** of all businesses (Howorth, Rose and Hamilton, 2006).
- **IKEA**, **WalMart** or **Haribo** are family-owned businesses and large corporations as well.

# Family business

- Family business is associated with small and medium-sized enterprises (SMEs).
- Family business **differ** from other SMEs in the way that they are **influenced not just by family**, but by **business objectives, values, and relationships** as well.
- Values, relationships and family history influence the **culture** and how **business operates**

# Definitions of Family business

There is agreed definition of family business by group of family business experts in Europe (Mandl, 2008):

The majority of decision-making rights are in the possession of the one:

1. who established the firm or
2. who has/have acquired the share capital of the firm or
3. their spouses, parents, child/children or their direct heirs.

# Definitions of Family business

- at least **one representative** of the family or kin is formally involved in the governance of the firm
- If the person **who established** or **acquired** the firm (share capital) or their families or descendants **possess 25 % decision-making rights** then we can define company as family firm.

# Family business around the world

- Countries with a **stronger collectivist culture** appear to have **more family businesses** relative to countries with more individualistic culture.

## Rates of Family Involvement in Entrepreneurship:

- In East and South Asia, Thailand shows the **highest total entrepreneurial activity** (TEA) with all established entrepreneurs involving family.
- In Europe and North America, family involvement ranges from **90% in** Poland, 60% in Germany, 95% in Italy, 70% in the UK.

# Family business around the world

- In Latin American and Caribbean economy, over **3/4** of entrepreneurs involve family in their startups.
- The **highest necessity motives** among family entrepreneurs can be found in two low-income countries: **Egypt (50%)** and **India (46%)**.
- On the other hand, Poland, Sweden, Switzerland, Luxembourg, Netherlands, and the United States—all high-income economies—report **necessity motives of 10% or less** among family entrepreneurs.



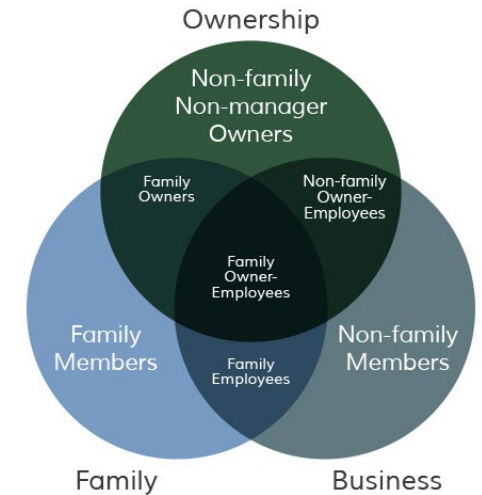
# Some interesting facts

- The oldest recorded family business in the world is Hoshi Onsen – keeping inns in Japan for nearly **1500 years, 40 generations**.
- In the UK, R. Durtnell & Sons the Britain's oldest builder established in **1591, 12 generations**.
- Family Whitaker in Lancashire has been farming since **12<sup>th</sup> century**.

# Theories of family business

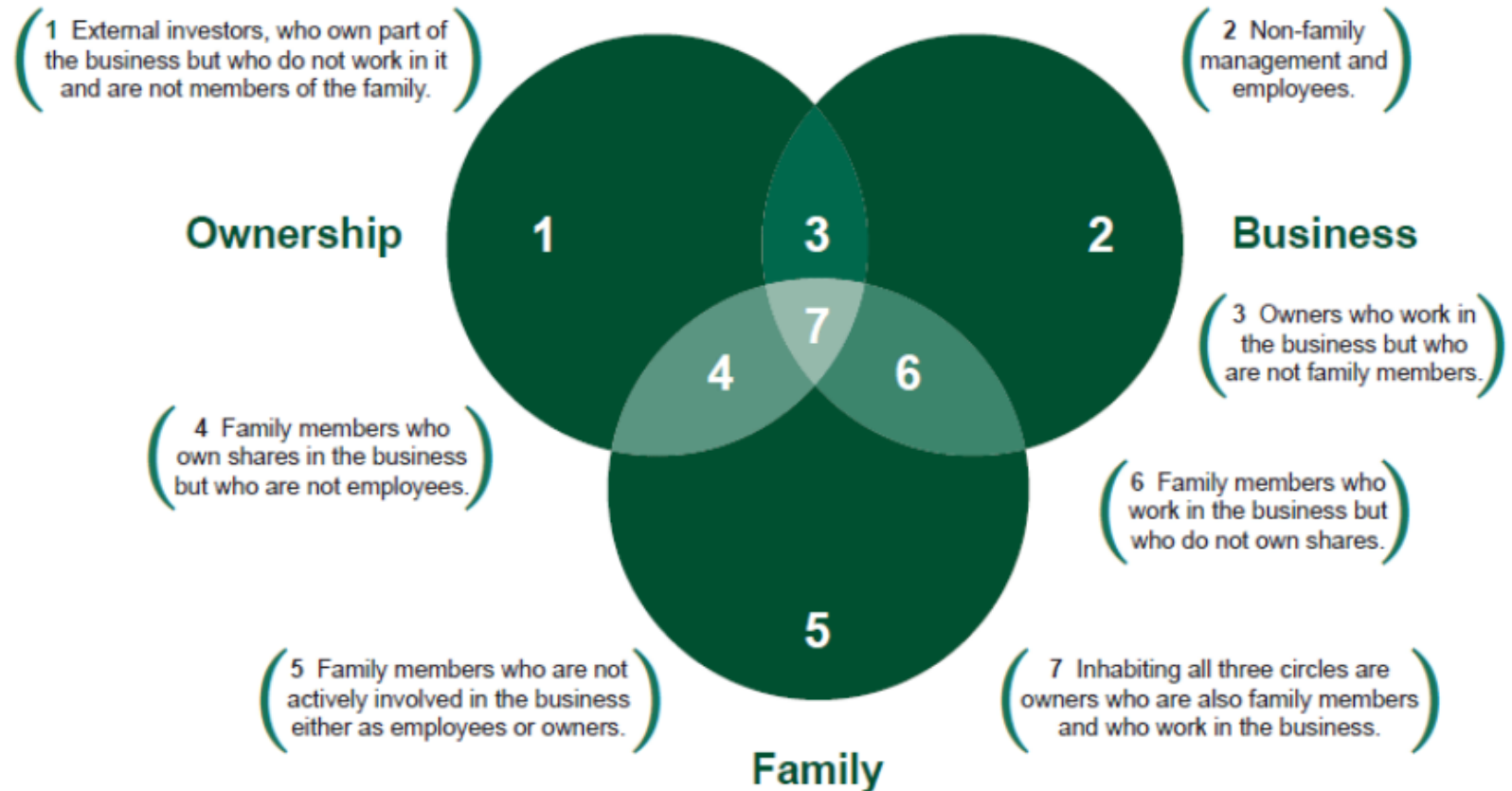
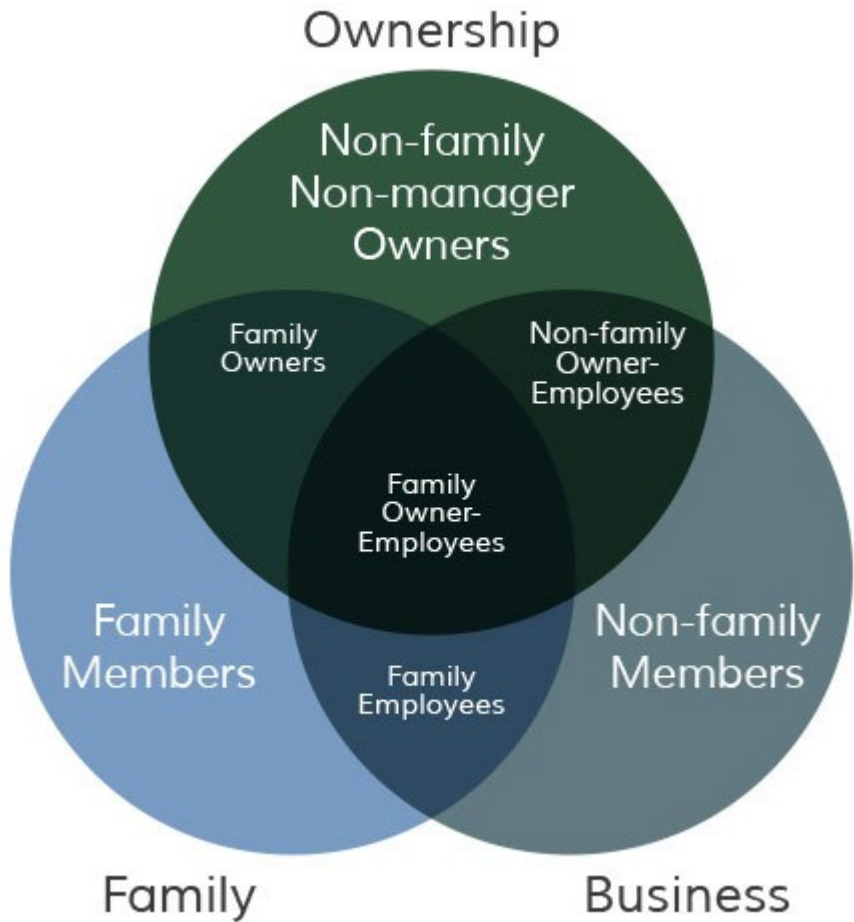
1. Three circles family business model
2. Typologies of family firms (Westhead, Howorth 2007; 6 types)
3. Johannisson's model of the three ideologies (paternal, managerial and entrepreneurial, the tensions between these).
4. the F-PEC model (scale of family influence, F-family, P-power, E-experience, C-culture).

# Three circles family business |



- Most commonly used model
- Captures **interwoven dynamics** of family and business
- It highlights the overlapping nature of **the three main groups** in family businesses – **the owners, family and managers**.
- It is used to examine and explain **relationships, motivations, communication, governance** and **decision-making** within family businesses.
- An example: family shareholders not employed in the business often have different views about the proper level of dividends than do their relative owners who work in the business.

# Three circles family business model



# Three circles family business model – an example of how to use it

- If communication is being examined, we plot first each person's location on the model and then
- examine how communication occurs in each of the circles.
- Communication about business issues often occurs within the family circle, in social settings, such as over the dinner table or at family events.
- If anyone is in the management circle, but not also in the family circle, they would be likely excluded from these discussions and could feel they are not involved in the decision-making, and this might lead to disengagement and reduced motivation and vice versa.

# Basic governance structures of the family business system

## Family

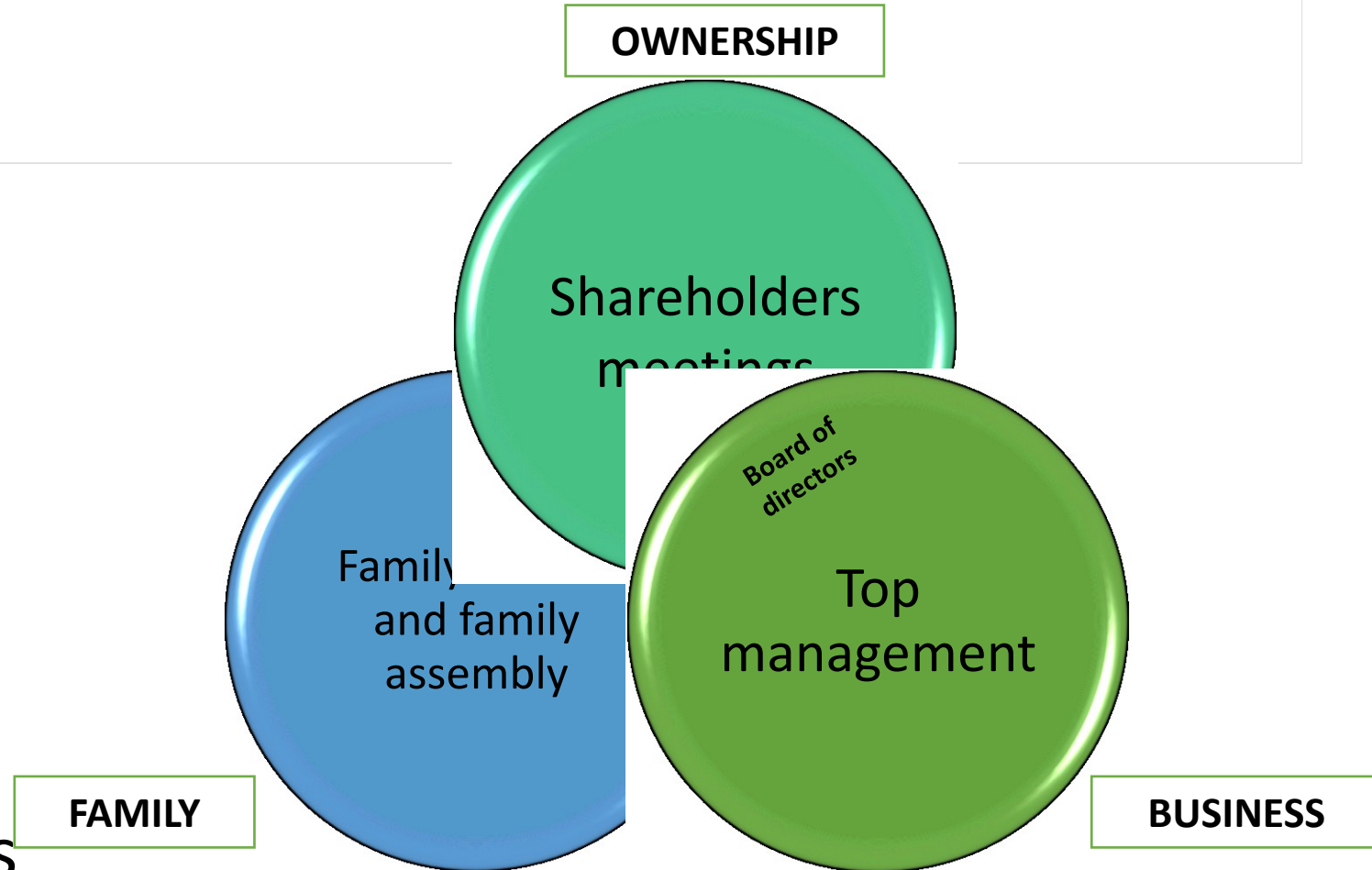
- Family council
- Family assemblies

## Business

- Board of directors
- Top management

## Ownership

- Shareholder's meetings
- Board of directors



# Basic governance structures of the family business system

Good governance contributes **three fundamental ingredients** for family businesses **to function well**:

- Clarity on roles, rights, and responsibilities for all members of the three circles;
- Encouraging family members, business employees, and owners to **act responsibly**;
- Regulating appropriate **family and owner inclusion in business discussions**.



# Family council

Family council is the **board of directors for the family circle.**

Family council 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.



# Family council

- 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 is to **provide a forum** in which family members can articulate their values, needs and expectations in relation to the business and develop policies that safeguard the long-term interests of the family.

# Functions of family council

- Establish family consensus, **counteracting** - declining family bonds, low identification with the business, as families grow and there is a decrease of spontaneous social contacts among family members.
- Articulating a family strategy for business management (including planning, rule setting, collaborative asset allocation).
- Limiting family conflicts that could negatively affect the business.
- Supporting **succession planning** in facilitating the family's 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.

# Family assemblies

**Family assemblies** are the periodic (typically annual) gathering of an extended 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.
- can help families **achieve consensus** regarding **family mission** and **family values** for the sustainability of the family business over generations.
- 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.

# Board of directors

- 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** – Most experts agree that a family company board should be a relatively small group of about **five to eight** members.
- It should include the CEO of the company, a majority of external board members (meaning not family members or company managers), and a small number of family representatives.

**Board meetings of established multigenerational family businesses are best held quarterly.**

# Structure of board of directors

Board of directors consists usually of **inside 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.

## Management team

- Implement **strategic planning process** (management structure).
- The purpose of the management team is to make sure there is good alignment between goals, priorities and operations.

# Shareholders' council

- Shareholders' council represents **the interests of owners in overseeing the well-being and management of their investment.**
- **Members** are **all those who own stock** in the family business.
- In smaller owner-managed family businesses there is no need for a Shareholders' council.
- 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 Shareholders' Agreement, deal with potential sale of the business, discuss a merger or major acquisition or respond to a crisis.

# Conflict management in family businesses

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

**Conflict** is inevitable in families, and more so in families that live, work and control assets together.

## **Sources and types of conflicts in family system:**

- Source: family quarrels
- 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.



# Conflict management in family businesses

- Significant problems addressed in family meetings are:
  - **Frustration over isolation 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**.



# References

- Carter, S. (2012). *Enterprise and small business: principles, practice and policy*. Pearson Education.