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Impact of Corporate Governance in Solving the Challenges Faced by Family Business Transitions: Case Study of Pakistan

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Abstract: This paper centers on the challenges faced in transferring and sustaining the family business to the next generations in Pakistan. Family businesses are mostly Small and Medium Enterprises SME's and our thought to be the backbone of every economy. This paper talks regarding the increasing number of family business in Pakistan. Family businesses are facing many challenges due to the rising growth and globalization of economies. The way businesses tackle with these challenges can be the reason for their success and failure. By incorporating good corporate governance framework and systems many of the challenges can be eradicated. In this paper, the significance of corporate governance in family owned business is identified. This study looks at the theoretical background of corporate governance and its inculcation in the family businesses of Pakistan. Family businesses play a major role for economic growth in Pakistan. This study aims to emphasize that for a sustainable family businesses and their perpetual growth, good corporate governance must be introduced in such entities. In addition to family owners more non-family employees and managers should be hired in the business, so that business is managed more justly and efficiently without any biasness keeping in mind the business laws and codes. Corporate governance will ensure that FOBs are transparent enough to satisfy its various stakeholders such as supplier's customers and creditors.
Keywords: SME (Small Medium Enterprise), FOB(Family Owned Businesses), Corporate Governance, Business Transitions, SECP (Security and Exchange Commission of Pakistan)

INTRODUCTION

Family business is a business where the main verdict and ready plans for the shift and substitution of leadership and control are under the influence of family members [1-2].. Main roles of the organization like ownership and management are handled responsibly by the family members of the business. In Family business all the assets are entirely accessible to families; At least one owner of the business needs to work in the business himself, no matter if he/she is already employed somewhere else they have to look on the family business matters on regular basis. In Researchers point of view only those family businesses tend to succeed where family entrepreneurs possess their business as a legacy and then transfer it to their 2nd and 3rd generations. Family business significance lies in its three dimensions business, family and ownership which if integrated properly can create synergy. Family business owners comprise of families, groups of relatives, with mixture of values, past history and their emotional bonding. Certain families tend to keep family joined and close to each other. The main distinction between family and non family business is the increased intricacy arising from family systems which compels the majority of them to act and decide their strategies in a different way. Some challenges faced by family businesses in Pakistan are sibling and cousin's rivalry, nepotism, letting emotions come between work, loss of non family employees, no plan of succession. Family business leaders should have sound knowledge of business management practices techniques and strategies along with family management. Historically, only 30% of family-run businesses make a successful transition from the first generation to the next [3].

Scope

The scope of this research is to increase entrepreneurship culture, increase in the number of private companies in Pakistan so that the figure of family business rises up. Hence, this study centers on the family businesses in Pakistan which have a proper agenda and plan to transfer their business on to their next generations. That is to say that they have spotted their current challenges in the transferring of their businesses on to the upcoming next generations[3].

Preparing Transition of the Family Business to the Next Generation

In its nascent stage a family business is started either by a single person or by the whole family. With the passage of time increase in family members is a natural phenomenon. The most important factor in a successful family business is to consider how the business would be transferred to and successfully run by the next generation. The business to qualify for transition to next generation must meet certain success criteria and then should be able to cater for needs and demands of growing family.

Many people start business but fail. Furthermore it is almost unheard of in Pakistan for a business to be successful solely on good ideas. In Pakistan success of a business depends on luck, Govt rules and regulation, connections, financial resources and then business acumen. So if a family business is successful in first generation it qualifies for transition to next generation.

It would be wrong to imagine that next generation family members join family business at their own choice. We know selecting a career of choice for Pakistanis is a farfetched idea. Not only that family elders force their young ones to join family business, the young ones too have no other idea except to join family business. In pursuit to put in or to join family business at times even proper education of young ones is compromised. However where there is emphasis on education the sole purpose is to make young ones better equipped for family business. So when family elders effort to put in and young ones desire or to join family business combines every family member from next generation is destined to join family business.

However where a systematic approach is taken transition not only is smooth the family business also benefits and grow. The transition approach is best illustrated

Preparing for the challenge

It is essential that family children apart from involvement in family business activities are given proper education and preferably should have gained experience in working with outside businesses. Working with outside business enhances the horizon and approach towards family business.

Entering the family business system

The family members destined to be managers should only join the business when they possess the ability to work at the position. In this way not only they would command the respect of employees their own self belief would be improved.

Working together as a business family

Once put in business, family members should take responsibilities and share authorities. **A** proper feedback on their performance provides opportunity to improve performance.

Dealing with newcomers

As family businesses usually lack written defined procedures and plans it is necessary to provide coaching to family members as is provided to new comers.

Passing the baton

It is always difficult to relinquish the positions held by older members however in transition period ranging from months to years the baton should be passed at appropriate time.

Passing the baton

Taking the baton forward with vision and future foresight always ensure continuity and success for the business[4].

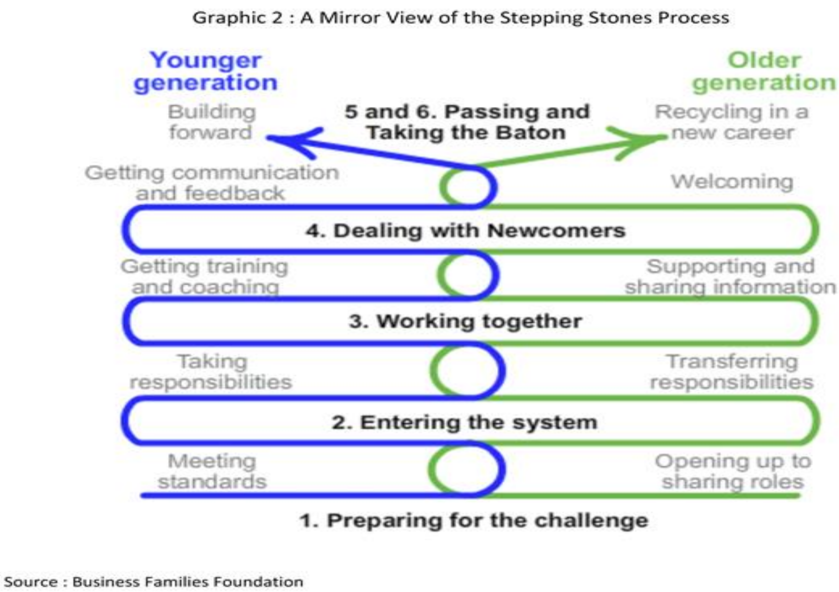

Figure 1 Mirror View of Stepping Stone Process

Challenges Faced by family businesses in Pakistan

Every business is faced with challenges. However, as a family business owner, you are faced with unique threats to your business that, if not recognized and addressed quickly, will drastically affect your success in the market place. Every type of business has its own peculiar challenges. However, in case of a family owned business, it is imperative that the threats are timely identified and effectively addressed. Otherwise, their success in the free market economy is at stake. Most of the businesses are faced with five threats. Their nature, intensity and tips for their timely aversion are discussed here under.

Incarnation of family disputes in family business:

Family businesses often face internal disagreements that typically occur from the incapability to detach your personal lives and business.

At times family disputes arise on account of individual idiosyncrasies and the same cast shadow on business settings. In such situations, not only cause is to be recognized but timely efforts are also required to attain harmony in and achieve the business objectives as one unit. . Additionally, extreme disagreements in your business can lead to high employee turnover and form an unfriendly work atmosphere.

Family Biasedness:

Running family business is a delicate matter, and it is imperative to be alert that the best way to make business run successfully is to create a company culture free from family biasness and nepotism.. The best way a family business can be protected and promoted is to separate personal affiliations while making employments for a job. Merit should be the watch-word. Otherwise non-family employees may feel disgruntled on discrimination and lack motivation to work for achieving the objectives of the business. Besides, family workers might underperform due to their sense of job security and feeling free from sanctions. Eventually, biasedness fails to make your employees powerful; consequently, outcome business performance suffers.

Allowing sentiments in running the Business:

If is famous saying, “It’s not personal, it’s business.” Well! it is always personal in a family business. Where you are managing a family member in a business setting, it is any easy task to separate emotions from business considerations. People take critical feedback from boss and peers with difficulty and they receive it with even more difficulty from their loved ones. Emotions interference with business makes you appear weaker to your customers, employees and harshly has an effect on your capability to take sound business decisions. In contrast, if you are not sensitive, you may be perceived as unreachable and cold. Lack of sensitivity in business can also cause problems at family also. Right balance of emotion needs to be determined on the basis of dynamics of your business culture.

Leaving of Non-Family Employees:

There are two main causes of leaving of non-family employees: restricted growth prospects and family disagreements. Mostly employees want to move ahead within the same company. Unluckily, there are often restricted chances for progressions in most family businesses, because all leadership positions are occupied by family members within the company. Without chances of advancement and having no opportunity in sight to take a top position, many brilliant and ambitious employees will leave the business. Another problem is that non-family employees feel as if they are always sandwiched when a family feud breaks out and feel comfort only in leaving the business.

Therefore as a family business manger your job is to realize that every business requires a good blend of people to help the business grow. Non-family employees view the business from an unemotional position and thus add equilibrium to the organization because they have an ability to take unbiased decisions. They can provide valuable input on how to put the company in further progress if given the chance. Ignoring the positive influence that non-family employees have on a family business is a massive error.

No Plan of Succession:

A time will come when an owner will leave, retire, or perhaps pass away. If there is no succession plan, then the business will end up as a failure.

According to Nancy Bowman-Upton in the Small Business Administration publication "*Transferring Management in the Family-Owned Business",* it is projected that only less than 33% of family businesses move from one generation to the second generation. Sometimes this happens as the family is not interested in running the business, but most of the time, is it is the consequence of a lack of a succession plan. A succession plan is sine qua non for running business in successive generations [5].

Risk management in family-owned business:

- Describe the objectives of the company in a clear manner.
- Outline every family employee’s tasks and responsibilities and hold them answerable.
- Job description of each family employee be mentioned cleared and held accountable for their performance.
- Establish and maintain a free flowing two-way communication between the owners and employees.
- Attend to all concerns promptly and in an objective way. Establish a merit based remuneration and promotion system.

- Obtain management education and acquire skills to separate emotions from management of the business. Provide equal promotion chances to non-family employees in your family business.
- Formulate a succession plan to make sure your business succeeds to your next generation[5].

Different Types of Owners of a Family Business

Three important sub-systems in a family enterprise system: 1) the Family, 2) the Business, and 3) the Ownership.

Types of family business owners

The ownership component is the most important sub-system where authority, control, and influence over the businesses are usually concentrated. The owners substantial impact over family dynamics and verdicts.

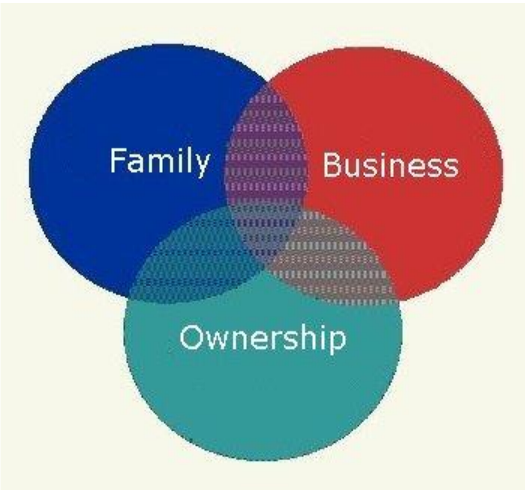

Figure2: Family Enterprise Subsystem Tagiuri and Davis, 1982

Ownership can be: personal, private, emotional:

In small and medium size family companies, owners may put their houses up as guarantee or make additional major sacrifices for their business. It might also be hard to institute what a family asset is compared to a business asset. Ownership can also be somewhat centralized. It is ordinary that an entrepreneurial business initiates with only one owner. Ownership can be transferred or shared later on with siblings or more generations.

Most importantly, ownership requires stewardship:

Stewardship is the duty to handle assigned resources in the best feasible way. It is necessary to educate family members who are current or future owners to be stewards of the family business legacy and the family businesses, which includes integrating personal requirements and broader family objectives and goals[6].

Corporate Governance

Corporate governance can be visualized as a system of directing and controlling a company through implementation of prior defined rules, policies, and procedures. It consists of a balancing interests of different stakeholders of a business, for example, shareholders, management, clients, revenue authorities, and society as general. In practice, it covers every sphere of business activity ranging from action plans to internal controls and corporate reporting and measurement of achievement of its set targets[7].

Impact of Corporate Governance in Family Owned Businesses (FOB)

Pakistan has experienced substantial economic development in the past years. Consequently, the number of unlisted companies has increased enormously. The majority of them are family owned companies. According to a recent report of SECP Securities & Exchange Commission of Pakistan the total figure of non-listed companies has exceeded the 50,000 mark. This sharp growth in such companies has fueled Pakistan’s private sector growth making excellent corporate governance vital for businesses. Good corporate governance is essential for the sustainability and continuity of the non-listed companies which are supporting economic growth in Pakistan. Family-owned companies are characterized by shareholding and management are concentrated in the same family. Every family has its own distinctive unrecorded rules, traditions and methodology of communication. As the family structure contracts or expands , the company experiences changes usually in the second or third generation in the succession stage. These changes can either be beneficial or damaging. Recently, a survey indicated that out of family owned businesses, only 15% survive to the third generation. Out of these, in the fourth generation, 85% fail again.

Families have distinctive characteristics that serve up to build up a family business, including: tradition,support,safety,development,growth,relationships,stability,commitment,loyalty,closeness, Informality, emotion, generational hierarchy, love, care and unconditional acceptance. Families can have a number of negative characteristics as well such as tension, anger, confusion, strangled communication and competitiveness, which can affect a company to the detriment of all. These qualities are reflected into business ownership styles and methods, and can sustain or harm a company. Good governance methods can ease some of the harms and challenges faced by family businesses and can provide solutions for business sustainability[8-9].

Family-owned companies' shorter lifespan is mostly owing to the following characteristics:

- No clear lines of succession exist or are complexed by the significance of family relationships.
- Organizational structures are loosely enforced and do not draw and retain quality human resources.
- Personal interest in the accomplishment of the business guides to an reluctance to take risks like expanding and expanding into new business projects.

It is globally documented that good governance has an optimistic influence on the performance of companies and allows them to go into the next stage of the business lifecycle. As companies develop and become more aware with good governance, their capability to draw capital from outside sources also progress, letting them to enlarge, diversify, and obtain other businesses in a sustainable way[10].

Advantages of Integrating good Corporate Governance in Family Businesses:

- Integrates the powers of family and business together.
- Strengthens relation between different stakeholder through effective communication and prompt conflict resolution.
- Systemizes wealth allocation to different kinds of assets.
- Results in sustainable development and diversity in the business areas. Manages successive ownership and transition of managerial leadership
- Helps to develop next generation of shareholders and managers including those from the family.
- Improves trustworthiness.
- Attracts lower cost funds.

Case study: Maryam Memorial Hospital

Mr.Daud having 30 years experience of working in Saudi Arabia in accordance with wishes of his father embarked upon establishing a progressive and affordable hospital in Rawalpindi in the year 1990.He was joined by his son, Dr.Shamail, who took specific foreign education in hospital management. The aim of both father and son was to create a professionally run outfit not entirely dependent on family members. While other family members are owners of the hospital, Dr.Daud and his son are involved in the management. They however have hired a team of professional management and doctors to run affairs of the hospital. They believe in corporate governors and have formulated strict ethical and operational policies and guidelines for everyone to follow the same. The result is that the hospital has earned a reliable name in the city and is not dependant on family members and is properly geared for expansion and transition to the third generation. It has already started taking steps by purchasing adjacent land for expansion of the hospital[8].

Case Study: The Sheikh Family Business

The Sheikh family's business has a number of units under its umbrella, including a large-sized flour mill, poultry farms and hatcheries, a wholesale agency, a brokerage firm, a commodity exchange company, and a compressed natural gas (CNG) station. The business is in its third generation. The philosophy is to establish small business units to be run by increasing numbers of family members independently. This is to have at the same time a common interest and a type of independence to allow to excel in entrepreneurial skills. A close-knit family bond strengthened by interfamily marriages has restricted incidents of conflict within the family. They believe in overall policy decisions by elders and trust reposed in younger generation for running those businesses. They also believe in allowing some freedom for private business by family members not affecting the joint ventures. The sheikh family does not believe in outside family partnerships or bank borrowings. In the joint ventures they have adopted a system of corporate governors and audits. The strategy has worked towards a sustained growth and transition to generations avoiding conflicts and providing individual satisfaction[8].

Case study: National foods

National Foods is a family business that has maintained an annual growth rate of at least 20 percent since its founding in 1971. At first, the company confined itself to the spice business, but has since grown into a company supplying more than 700 food products. Two friends, Mr. Waqar Hassan and Mr. Abdul Majeed, launched National Foods as a partnership. Soon thereafter, the partners invited Mr. Khawar Butt, CEO of English Biscuits, to invest in the company and join the board of directors. The two friends were already in the import business when they decided to enter into the business of providing clean and packed spices to the public. The philosophy is to run the business through professional management and for this purpose they promoted one of their experienced employees as CEO. They are always in pursuit of hiring and training of new professionals so as to provide a regular succession of working team. Family members only sit on board and provide vision and attend to policy matters. They believe in expansion through outside participation but still retaining control within the family. Therefore they have got listed for inviting public money to their venture. They believe in extensive corporate governance policies to be placed in their organizations and they have also established a tight system of check in balances in the organization. The result of such approach is that the business has seen such transition through second to third generation and is geared for future large expansion not to be affected by unnecessary family interference[8].

Case study: Ismail industries

Following Mr. Ismail's death in 1983, a separation of ownership became inevitable. The family eventually agreed that the late brother's offspring would receive their shares in the form of cash. Ismail Industries Limited was founded when members of the Ismail family received a cash settlement for their inherited shares in Union Biscuits (Private) Limited. Brothers Mohammad, Maqsood, and Miftah Ismail risked everything to start anew. In just 22 years, Ismail Industries has become an established business in Pakistan, and it continues to grow and diversify. Although the family had business experience in the past, the correct venture may be termed as a first generation business. The brothers have developed a corporate governance mechanism in the company; they brought in independent directors and always encouraged professional team management. The company has ultimately been converted into a listed company. The family has tried to avoid family conflicts through transparency and understanding .It has in the meantime, acquired certain similar business companies and established its own brand products for example especially Candy land. The result is that the company is geared for expansion and transition into second generation without any conflict and difficulty[8].

Findings of the Research

The founder of Maryam Memorial Hospital Mr Daud created a professional business which did not solely rely on family members they hired external help as well skillful and experienced managers from outside they believe in corporate governance and have strict rules and regulations as a result they are very successful and are now in the third transition of family business.

Sheikh Family Business owner has developed independent business units that are solely governed by family members. This gives the family members pride of workmanship and they can show their interpersonal skills properly and in order to resolve family issues family members are married to one another in order to have a more proper bonding with less family clashes. They don't believe in outside borrowings and have a small system of corporate governors who do regular audits.

National foods believe in proper corporate level strategies. They have hired experienced CEO to handle business affairs. the family members sit in the board of directors they just provide the company with vision and look at policy matters family members do not interfere in the management affairs. The business has a proper accountability system as a result the business has expanded so much and is in transition from the second to third generation.

Ismail Industries had a lot of clashes after the death of Mr. Ismail his offspring were given their share in the form of cash. Brothers Mohammad, Maqsood, and Miftah Ismail started new business from the scratch and risked everything. By developing a proper corporate governance framework and family conflicts are resolved through transparency as a result they are in the second phase of family business transition[11-12].

Limitations

The major limitations of this research study were time constraints, cost and research culture. The time to conduct this research was short and a thorough research could not be carried due to shortage of funds. The researcher has done analysis using existing previous knowledge and secondary data.

This research was conducted in Pakistan and people of the organizations are reluctant to cooperate and were unwilling to participate during the survey.

Business cases and examples are taken from businesses in Pakistan which existing researches have highlighted before or they were highlighted in the news papers or the law agencies. Limited numbers of organizations were considered as all cannot be included in the research due to the time and budget constraints [13-15]

CONCLUSION

The principles and instruments of good corporate governance are as helpful for un-listed companies as they are for listed companies. Some countries have developed their own domestic corporate governance codes for voluntary adoption by family owned business operating in their jurisdiction. Such countries include Egypt, Turkey, Belgium, and Finland. In countries like Pakistan, although only listed companies are required to implement a corporate governance code by regulatory agencies, these principles can be implemented by un-listed and family-owned companies with advantage.

In Pakistan, family-owned companies are mostly non-listed companies falling in the category of SMEs. Number of shareholders in such companies is usually very small and transfer of shares is not easy. Against this backdrop, even small conflicts can result in damage to the survival and growth of the companies. Mediation mechanisms through such institutions like family councils and constitutions can be channelized to devise and implement corporate governance principles for effective management of the businesses. Ensuing to good corporate governance practices, succession planning can be smooth and friction free.

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