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Corporate Governance In Family Owned Businesses: A New Paradigm Shift In Management

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ABSTRACT

Globally, family-owned businesses are the cornerstones of economic growth and improved standards of living. Empirically it has been proven that more than two thirds of all businesses in the world are estimated to be family businesses. Worldwide family owned businesses have proven beyond any reasonable doubt to contribute significantly towards employment creation, poverty reduction and wealth creation. However, majority of family owned businesses in the retail sector in Zimbabwe have remained miniature compared to other listed counterparts. A crucial question to pose is whether their stunted growth, high death rates and bankruptcy be attributed to their failure of implementing corporate governance principles or to other factors? Traditionally corporate governance has been associated with listed companies. This research sought to investigate the extent to which family- owned businesses practice succession planning, determine the extent to which they businesses implement separation of management from control and establish the extent of transparency in family businesses. Both exploratory and descriptive research designs were employed. Desk research, questionnaires and interviews were used as data collection instruments. Research findings confirm that most family owned businesses hardly implement corporate governance principles despite its widely acclaimed benefits.

Keywords: Corporate Governance, Family-Owned Businesses, Retail Sector

1.0 INTRODUCTION

Corporate governance is also defined as the system by which business corporations are directed and controlled (Kajola, 2008, p. 16). Family business is a company in which two or more key individuals linked by kinship, close affinity or solid alliances hold a sufficiently large share of financial capital (full ownership) or board control (controlling ownership/governance) to enable them to make decisions regarding strategic management and overall business goals. (Gubitta and Gianecchini 2002). In fact, a number of professionally managed, multidivisional enterprises such as Michelin, Armani, Wal Mart, Home Depot, and IKEA were founded and are still controlled by families (Miller and Le Breton Miller, 2005). According to Astrachan and Shanker (2003), family owned businesses are the backbone of many economies around the world. Previous studies have confirmed the weight these businesses carry in national economies. In the Middle East region, they account for 95% of all private sector companies. About 90% of all United States businesses are family -owned and controlled, constituting 50% of the employment and Gross National Product (GNP). The economic and social importance of family enterprises has now become more widely recognized. The manner in which family firms are governed (the way in which they are directed and controlled) is therefore crucial to the contribution which they can make to their national economies as well as to their owners.

The growth of an enterprise whether family or non- family –owned business is widely regarded as key to economic development , creation of wealth and employment. Family businesses are a driving force in economic development, and their success affect the well-being of economies and society as engines of job creation, encourage growth and innovation. According to Kets De Vries et al (1993), despite having a close network of owner/director relationship and the ability to make decisions quickly, family- owned companies are generally unable to sustain growth and have a shorter life-cycle. One of the major problems family businesses face is the transfer of ownership and management

to the next family generation. Like other businesses, family-owned businesses face the challenge of adapting successfully to changing economic and industry conditions. In Zimbabwe these entities were adversely affected by the deterioration and collapse of the Zimbabwean economy coupled with dynamic changes in political, legal, socio-cultural and technological spheres between 2006 to 2009. This resulted in the eventual closure of businesses and those which resisted the micro and macroeconomic instability drastically downsized their operations. The advent of the multicurrency regime in 2010 and related dollarisation of the economy brought a reprieve in thwarting the skyrocketing hyper-inflation thereby restoring stability and confidence in the business environment. However, the liquidity crunch prevalent in the market, low disposal incomes of consumers due to paltry remuneration, high labor and operational costs among other factors still stifle the growth of family owned businesses

According to Klein, Astrachan, and Smyrniotis (2005), ownership of family owned businesses can be a source of competitive strength. Family involvement in the ownership, governance and management makes family businesses different from non-family businesses. Family members can add resources to the businesses in various ways, through financial, labour, intellectual, cultural, facilitating decision-making and governance processes, thereby providing family business with an edge over its competitors. Families are characterized by long-term relationships and trust. Families are thought to bring these characteristics to the business resulting in ease in communication, faster decision making, creativity, innovation and flexibility which is expected in dynamic global village of today.

On the other hand, there is empirical evidence pointing to the potential negative effects of family influence in terms of nepotism, jealousy and entrenchment leading to lower performance of family businesses (Lester & Cannella, 2007). According to Pieper, (2007) consistent family values and a synthesis between family and business values are crucial for maintaining family ownership in the long-run. Strategies for establishing family values, sharing them between family and business and transmitting them from one generation to the next remain under-researched.

One problem that forms the core of the family business literature is intergenerational management succession. Succession planning in the family-owned business is defined as “the explicit process by which the management control is transferred from one family member to another (Sharma et al 2000:233). Succession planning appears to be the major cause of most family business failures. On the other hand, successful succession can provide a family-owned business with a competitive edge over a non-family owned business by enabling the continued use of accumulated idiosyncratic knowledge of family members (Bjuggren and Sund, 2001). It should be realized that as the business grows and markets evolve, finding sufficient management talent and experience within the family becomes harder. In situations where the family alternatively hires an outside manager, failure to motivate and monitor him or her eventually damage or destroy the business. Families need corporate governance both to operate the business and to promote family harmony. Family run business represents the work and the wealth of several generations. If Zimbabwean businesses want to preserve, enlarge and pass on this legacy, they need to make corporate governance a family affair.

2.0 LITERATURE REVIEW

According to Philip Han et al, (2005), family businesses carry the weight of economic wealth creation in most economies. A good governance practice enables family businesses to face risks and to prosper in an environment of intense competition and globalization of business. According to Adjasi (2007), family owned businesses have few employees who are mostly relatives of the owner and thus no separation of ownership and control, there is no need for corporate governance in their operations. Also the question of accountability to the public is non-existent since they do not depend on public funds as they do not necessarily need to comply with any disclosure. In spite of these arguments, there is a global concern for the application of corporate governance to family –owned businesses. Family owned businesses were neglecting it. They tended to believe that the principles of good corporate governance do not really concern them. This is a mistaken view. The principles of good corporate governance are useful for non-listed companies just as they are for listed companies. The call for organizational and managerial

adjustments of family owned businesses in the age of globalization has increasingly been made. Carney and Gedajlovic (2002), suggests that changes in family businesses behaviour are equally important to the adoption of governance rules and regulations in shaping the more modern institutional environment for family firms.

Historically corporate governance has been associated with listed companies According to Smyrnios et al (1997), many families fail to appreciate that preserving wealth is a dynamic process. Each generation must maintain the wealth-generating spirit of the first founding generation. In a similar vein, a famous saying about family owned businesses in Mexico is “Father, founder of the company, son rich and grandson poor” (Pordre noble, hijo Rico, nieto Prodre). The founder works hard and builds a business, the son takes it over and is poorly prepared to manage and make it grow, but enjoys the wealth and eventually the grandson inherits a dead business and an empty bank account. It is estimated that approximately, 86 percent of family- owned businesses expect their businesses to continue on the next generation in the family even after their death. However, evidence from recent surveys worldwide suggests that only 15% of family owned enterprises continue to survive on to the third generation. Of those that do last, 85% either disintegrate or completely vanish before the fourth generation takes the reins.

2.2 SUCCESSION PLANNING

Rothwell (2001:p7) defines succession planning as “a deliberate and systematic effort by an organization to ensure leadership continuity in key positions, retain and develop intellectual and knowledge capital for the future and encourage individual advancement”. A significant number of studies on family business have focused on intergenerational succession (Bigliardi and Dormio, 2009; Howorth et al., 2010; Kimhi, 1997; Miller et al., 2003; Mitchell et al., 2009; Royer et al., 2008; Sharma et al., 2003; Wang et al., 2004), owing to strong evidence that the majority of family businesses fail to make it to the second generation (Beckhard and Dyer, 1983; Dascher and Jens, 1999; Henning, 2004; Le Breton-Miller, 2004; Royer et al., 2008; van der Merwe, 2009; Janjuha-Jivraj and Spence, 2009).

One of the most pressing problems for family owned businesses is planning to pass control of the business to the next generation. Succession planning appears not to be practiced where most family businesses fails. Handler et al (1989) says, indeed failure to plan for succession has been cited as a fundamental human resource problem as well as the primary cause for the poor survival rate of family firms. In the context of family owned businesses, the ability to ensure competent family leadership across generations may be even complex. Research shows that failure to provide for succession is the primary cause for the demise of family owned businesses. Succession decisions many often be based on the family’s needs rather than own business requirements, which cause serious problems when the two are not compatible. The choice of a successor may also have more to do with family’s values than with the chosen successor’s capabilities (Ward, 1992 et al). The role professional management is particularly important when it comes to succession which often is the most critical issue for family controlled businesses.

According to Bjuggren and Sund (2001), succession can provide a family owned business with a competitive edge over a non-family business by enabling the continued use of accumulated idiosyncratic knowledge of family members. In professionally managed firms, boards of directors often make succession decisions by utilizing professional recruitment consultancy. According to Brown et al (1999) , the problem of finding a successor is not limited to the person with the most suitable track record and abilities, but has the added complications, networks and family expectations. The normal practice in western countries can be described as male primo-geniture that is the eldest male heir is chosen for succession. Again this phenomenon is prevalent in African context including Zimbabwe. The girl-child is often not considered in succession battle since she will get married.

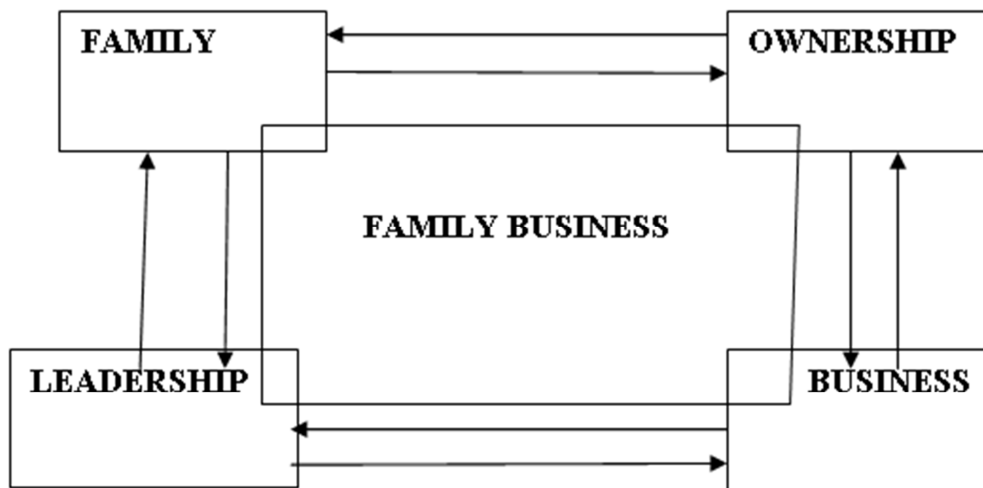
2.3 SEPARATION OF MANAGEMENT AND CONTROL

Researchers worldwide generally agree that family involvement in the business is what makes the family business different. Therefore they may be a complicated phenomenon, (Lansberg et al, 1988; Neubanner and Lank, 1988). This complication is due in part of family businesses being a culmination of two interacting systems, the family and the business. This interaction can have both negative and positive consequences. In family businesses, the family,

ownership, and management are extricable intertwined. According to Ward (2007), family firms, by virtue of the institutional overlap which characterize them, may have competitive advantages and disadvantages over publicly held companies.

THE FOUR DIMENSIONAL FAMILY BUSINESS MODEL

Fig 2.2



Source: Klein (2000)

According to Handler (2003), as the business grows and markets evolve, finding sufficient managerial talent within family owned businesses becomes hard. Ultimately what the family does at least is to hire an experienced manager, but failure to motivate and monitor him or her destroys a businesses. Family owned businesses are characterized by concentration of ownership and control. This is particularly true in firms that require highly specialized knowledge of technology and markets. The restricted nature of the human resource pool supplied by the family means the family may not have adequate qualified personnel to run the business efficiently. At that point, there is need to separate management from control of the business through establishment of the board of directors thereby introducing creativity, innovation and continuity of family businesses. The board should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity for the corporation and to act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility.

2.4 TRANSPARENCY

Transparency “is the ability of firms to signal or provide adequate and relevant information timely and effectively to their shareholders, stakeholders or to other principal parties such as policy makers who motivate and constrain them to behave within the principal’s interest and in an acceptable way to society” Tarek Ibrahim et al (2007). Willard Report, (1998) defines transparency as “a process by which information about existing conditions, decisions and actions is made accessible, visible and comprehensible” The OECD Principles of Corporate Governance (1999), clearly state that the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including financial situation, performance, ownership, and governance of the company. There is a belief that family businesses don’t have public accountability and therefore are not mandated to disclose their financial dealings. Transparency leads to better financing and investment decisions as the market-based mechanism use price signals to efficiently allocate resources and monitor market trends.

Family owned businesses, being characterized by secrecy, concentrated ownership and relationship- based systems are obstacles to corporate governance reform (Tony Shieh et al 2002). The incentive to hide information from the

public is further enhanced by the entrenchment- effect of ownership concentration. Transparency is the heart of corporate governance which minimizes information-gap and promotes greater efficiency in capital allocation across firms. Other things being equal, this development should bring about developed capital markets which lead to higher economic growth and improved social welfare. The application of corporate governance transparency by family owned businesses also helps reduce corruption and misuse of resources.

3.0 METHODOLOGY

The study adopted descriptive survey research design to take advantage of the design's ability to employ different of data collection techniques such as personal interviews, questionnaires and documentary analysis as form of triangulation .According to Newman (1977) triangulation significantly improves both reliability and validity of gathered information. Therefore a significant number of respondents with diverse experience were consulted, eliciting both convergent divergent responses.

3.1 INSTRUMENTS

A combination of desk research, questionnaires and personal interviews were used to gather to pertinent information about the awareness of family businesses to basic principles of corporate governance. The drop and pick method was used in distributing questionnaires since it allowed respondents to fill in their responses without undue influence. Besides being one of the cheapest methods of surveying several people it has high likelihood of soliciting accurate and truthful answers. Follow –up interviews were carried out in administering open –ended questions which required elaboration.

3.2 SAMPLE

The target of the study was mainly owners of family owned businesses in grocery retail sector .During the peak of the meltdown of the Zimbabwean economy from 2007 to 2009 a majority of these enterprises were either closed or operated under capacity .They undoubtedly represent the ideal sample since they have relatively a shorter life span . A total of 600 respondents participated in this study using purposive sampling in the town of Chinhoyi in Zimbabwe. The shops were selected on the basis of accessibility and possibility of having the traits under investigation. Stratified sampling was used in the classification of shop owners, managers and employees. Furthermore, managers and employees were selected to provide more insights into clandestine issues like transparency, separation of management from control.

3.3 DATA COLLECTION PROCEDURE

Before commencing on data collection, permission was sought from the Ministry of Small to Medium Enterprises and the respective shop owners. Pilot-testing of questionnaires was done to ascertain their relevance, content, language suitability elimination of ambiguity and precision of findings.

4.0 INTRODUCTION

The major thrust of this chapter is to present, analyze and interpret data that was gathered through questionnaires and personal interviews respectively. Information gathered was utilized to recommend effective corporate governance principles to be implemented by family owned businesses. Data shall be presented in the form of tables, pie –charts and graphs.

4.1 CATEGORY OF RESPONDENTS

In the process of carrying out the research, questionnaire response rate from grocery retail sector was 38%, 29% in clothing sector and 33% in hardware sector. Family business is a complicated phenomenon. This complication is due to family business being a culmination of two interacting systems. The family and the business and the two can have both positive and negative consequences. Furthermore the overlap between business and family creates unique human resources issues which may hinder the development of an effective human resource strategy such as successor's selection and training. Family firms tend to avoid forward strategic planning for its human resources.

The introduction of corporate governance structures is often advocated to improve professionalism of the family business. This becomes more pronounced when the family business has evolved through multiple family generations and there are numerous family stakeholders who have an interest in the business. As part of the corporate governance thrust, there is general acceptance of the view that family business need outside board members in order to obtain more varied and objective advice. The findings of the research confirm that 80% of family –owned businesses performs these multiple roles and responsibilities and this cause conflicts and confusion.

4.2 SUCCESSION PLANNING

The main objective of the study was to determine the extent to which family owned businesses practice succession planning. This researcher reveals that 60% of the respondent businesses are first generation, 25% are second generation, and 15% constitute third generation businesses. Lamenting on lack of succession planning on family owned businesses, Professor John Ward (1987) concluded “The first generation builds the business, the second generation “milks” or “harvest it” and the third generation must either auction what is left to the highest bidder, or start all over again.” Handler et al (1989) being cited by Fahed-Sreih (2009), says, indeed failure to plan for succession has been cited as a fundamental human resource problem well as the primary cause for the poor survival rate of family firms

Failure in succession planning represents a serious problem, not only to family businesses and their employees, but also to the prosperity of the economy because of resultant loss in employment creation and national revenue. 60% of respondents concurred that family owned businesses do not plan for succession. Personal interviews with Chinhoyi businesswoman owning a hardware shop confirmed that premature selection of a successor and the subsequent grooming process causes family feuds, hatred or at its worst death due to witchcraft.

30% of the respondents agreed that family owned business are aware of succession issue but they acknowledged that it only becomes relevant and topical issue after the death of the incumbent or is incapacitated. They alluded to the fact that succession is considered highly confidential and secretive and therefore does not deserve to be discussed publicly. This explains why it is neither documented, formalised or even strategically planned in advance. 10% of the respondents remained neutral and they said family businesses hardly plan but they are just muddling through.



FIG 4:3

Furthermore the research revealed that whenever succession is discussed, the son is preferred to the daughter. In this regard the predicament of the daughter lies in her marriage and therefore cannot be chosen as a potential successor

even if she possess the ideal skills, experience, knowledge. In family businesses human resources decisions are influenced by family values and personality traits than by objective decision making. Family values and culture create a filter in decision making process that complicates human resources issues such as selecting and training of success. As a result family owned businesses tend to have a limited organizational capacity.

Furthermore family members' involvement in the business tends to make human resources issues, in particular, succession highly sensitive. In similar vein, Hofstede's cultural typology mentions of masculinity which is society in which man are expected to be assertive, competitive and concerned with material success while women fulfill the role of nurturer and concerned with issues such as welfare of children. Consequently the major cause of the high failure rate of family firms is lack of effective human resource planning.

4.3 SEPARATION OF MANAGEMENT FROM CONTROL

Personal interviews indicated that 70% of the respondents confirmed that there is concentration of management and decision making within the family. Family owned businesses are immune and highly skeptical to employing non-relatives. Almost 40% of respondents from both questionnaires and personal interviews concurred that inclusion of board of directors bring creativity, innovation and strategic planning in businesses. According to Sir Adrian Cadbury, "the continuing success of a family firm is best assured if it is headed by an effective board. One with competent, independent minded, outside directors on it, who will bring with them outside knowledge and experience. Family firms need to be able to draw on the best independent advice that they can find, in order to complement the strengths which come from the family's expertise and commitment." 60% of respondents confessed noncommittal if not complete ignorance of operations of the board of directors. However, some alluded to the point that as the business expands, there is need to clearly define roles and responsibilities, delegate tasks and include board of directors for risk assessment succession planning and strategic planning.

Family businesses centralize key decision making within the family. However, because of current competition and globalization of business in tandem with changes in social, political, economic, and cultural dynamics, family businesses tend to be rigid and myopic instead of being entrepreneurial, innovative and adaptive to such changes in the business environment. Inclusion of board of directors improves their strategic planning, succession planning and risk assessment among other benefits as afore-mentioned.

Research findings indicated that 55% of respondents were unsure to separation of management from control. That is they prefer centralization of decision making, power and management within the family. 30% of the respondents indicated that they prefer separation of management and control citing the need for risk management, strategic management, easier capital acquisition, succession planning and creativity which is brought about by board management. 15% of the respondents professed lack of knowledge about separation of management and control.

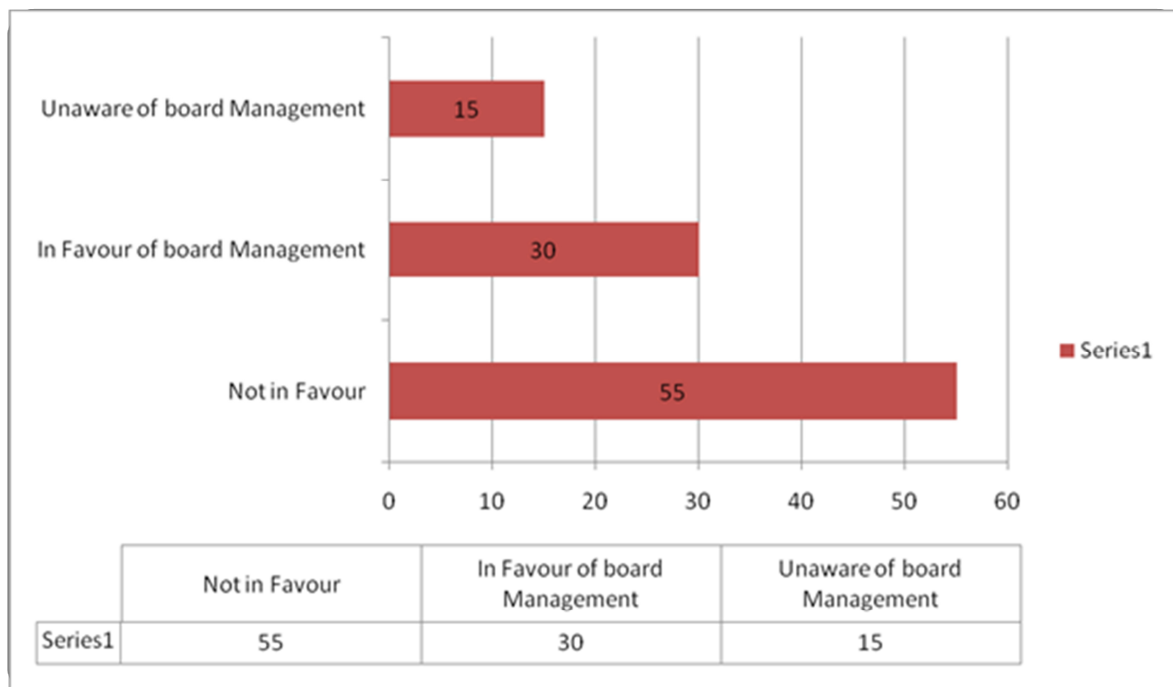


FIG 4.4

4.4 TRANSPARENCY

Most family owned businesses tend to believe that transparency and information disclosure pertaining to business issues should circulate and consequently benefit the business owner and family inner circle since they do not depend on funding from nobody. However, in today's competitive environment, transparency and information disclosures benefit several business stakeholders including the central government. Family owned businesses get funding for business expansion from investors through that. This clearly shows that the majority of family owned businesses are neither aware nor committed to implementation of corporate governance principles.

45% of respondents replied in favor of transparency. 50% of respondents alluded to the fact that family owned businesses should not publish or disclose their financial results because they do not depend on public funds. 5% of respondents were not willing to disclose their position. Some respondents said disclosure of financial transactions in family owned businesses will make them vulnerable to witchcraft.

Research findings from personal interviews indicate that 55% of respondents confirmed that implementation of corporate governance is not beneficial to family businesses' growth. While 20% remained neutral. 25% acknowledged that corporate governance is beneficial to family owned businesses. This clearly shows that the majority of family owned businesses are neither aware nor committed to implementation of corporate governance principles.

4.6 CONCLUSION

From the research findings it can be concluded that family owned businesses in Zimbabwe hardly practice principles of corporate governance. This was supported by majority of respondents who portrayed complete lack of knowledge of the subject under discussion. Contributing factors were complete absence of corporate governance code in Zimbabwe and general lack of awareness.

5.0 RECOMMENDATIONS

5.1 The study recommended that communication is essential in succession process especially between predecessors and potent successor. Furthermore, a formal succession plan should be prepared in time to avoid disputes over who is entitled to take over and that plan deserves to be communicated to all concerned. Also utilization of professional management especially legal advisors is also recommended.

5.2 The findings suggested that ownership in family owned businesses should be integrally separated from the other dimensions in the governance of the family business in order to be able to achieve fairly good performance and ensure the survival and longevity of the family businesses Other aspects include ,family relationships have to be managed in addition to business relationships ,picking and promoting the right members of the family ,providing attractive opportunities to managers from outside the family, demonstrating even-handedness in training, promoting, compensation and benefits. The formation of a proper structure provides the basis for establishing clear lines of authority and responsibility.

5.3 The board of directors should be composed of independent-minded outside directors who will bring much needed outside knowledge, creativity, innovation and experience. Family companies can position themselves for the future by investing in leadership development and succession planning processes, adapting succession planning best practices to the unique characteristics of family-owned businesses.

5.4 Family businesses need to practice transparency and information disclosures to key stakeholders. Transparency is considered one of the determinants of corporate governance success.

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