Best Practices for the Future of East Asia Family Businesses

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East Asian business is so identified with its family ownership that businesses are referred to as extensions of the family "houses." These business houses are an overwhelmingly important component of the East Asian business landscape. Research conducted by the Asian Development Bank (ADB) suggests that most companies started as family businesses and are still under the control of the founders or their offspring[1] resulting in the continuation of significant family holdings which is usually achieved through holding companies and/or nominee accounts.[2]

It is a rich tradition, but the current forces of globalization in business pose some significant challenges to sustaining family influence in major businesses. Each business family must struggle continuously between loyalty to family tradition, and the need for major innovation and professionalization to compete on a world stage.

Much has been written about the future of South and East Asia family businesses and the inherent weakness of a family enterprise as compared to a "professionally" run company. Some commentators have also talked about the value discount that is accorded to family enterprises in the Indian context.

It is our conviction that companies managed by non-owners are not inherently superior to those managed by owners. Further, there is no evidence to show that non-family firms survive longer than family enterprises. There are family controlled and managed companies around the world that have thrived for many generations. For instance, Beretta, the Italian arms manufacturer, is currently managed by the thirteenth generation of the founding family. In other instances, the extended family gives up day-to-day management to outside managers, yet retain ownership. For instance, close to 80 family members share an 80% interest in the German company Henkel. However, the family members are part of the shareholders' committee and not responsible for the management of the company.

In the East Asian context, family businesses would continue to be overwhelmingly important for the foreseeable future. However, there is tremendous pressure to sell large stakes in the enterprise either to raise necessary capital or conform to regulatory policy. So, while it may be both personally meaningful and financially so for a family to remain at the helm of its business, global market pressures put pressure on the family to raise outside capital and to professionalize to compete. This means two things happen:

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[1] Zhuang, Juzhong, Edwards, David, Webb, David, Capulong, M.V. (2000) *Corporate Governance and Finance in East Asia. Volume 1*. Manila, Philippines. Asian Development Bank.
[2] Ibid

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1. The family has to go public and sell a minority stake to raise capital and enable the family to diversify its holdings, then as a consequence of that, or just general heightened competition, the family must:

2. Place professional management in the company, with family members moving from management to governance roles. They must learn to select good managers, compensate them appropriately, give them proper authority but exercise proper oversight to make sure they are accountable, and work with them as partners.

The issue that faces them is how to thrive in the increasingly competitive marketplace. In our work with major family businesses around the globe, we have identified several factors that must be resolved in order for them to meet this challenge. While the specifics would vary by family, these issues usually group themselves into two areas: the "business of the family" and the "business of the business".

The business of the business is easy to understand. What must be resolved are the ways that the demands of family—rivalries, the need to develop a next generation of leaders, and a sense of entitlement, can undermine the strength of the business. Further, in India and throughout South and South East Asia, a lot of family members obtain their "identity" by being part of the business and involved in managing operations.

Within the family, as more and more family members are involved in each generation, the family faces its own issues of organization, communication and governance. Is there room for every son in the business? Should female family members be included? How do family members qualify for work in the family's various businesses? How can the family diversify its investments? How can it motivate its wealthy heirs to develop their skills and capabilities to help the family succeed in the future? Traditionally, the elders would resolve it, and young family members would dutifully defer to them. As a family has more branches, who do not live together or feel the traditional sense of family connection, different family heirs will have different ideas of what is "fair" and how things should be done.

The only way for families to resolve issues about compensation, about precedence, or about employment is by developing what we call "family governance structures" – rules, policies, agreements and understandings that define clearly what the family will do for each family member, and how they will be treated. What could be done informally with fewer people and stronger links to tradition now must be done by explicit agreement.

In this context, we want to suggest some best practices that Indian family business can adopt, to meet these multiple challenges:

1. Appreciate that different family members would have different opinions, ranging from personal development to how the business should be run. Hold family meetings to talk about the future of the family and its businesses. A multi-generational family in business should consider creating a formal family council, to deal with the future of the family and its business issues. In addition, they should create a formal, documented "family constitution" to guide the activities of the family

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2. The family must take into account the desires and abilities of each member of its next generation. It also must create a forum to resolve conflicts before they affect the business.

3. Institute a mechanism where employment is by competence rather than blood. Family members who work in the business should have their performance evaluated, and should work toward clear business goals. They should be paid for performance.

4. Evaluate the family business portfolio – there are no sacred cows. There are good reasons for a family to have diversity, but it should focus on business performance and weed out ventures in which it does not have a competitive advantage.

5. Develop professional Boards of Directors, and make sure that outside directors are allowed to function as advisors who challenge the family to develop the effectiveness of their business.

6. Help each young family member to develop a positive identity, by professional education, by finding employment outside the family in their early career, and by finding a path in life where they can make their own contribution.

Most South and East Asian business families have a long way to go in implementing the above practices. However, it is important that they start thinking about these issues – waiting for a crisis to happen before being goaded into action maybe too late. Each family has to decide for itself the raison-d-etre of the business – is it an institution for creating and sustaining shareholder value or is it a "welfare society" for family members? Ultimately, on the answer to this question will rest the family's approach to these practices.

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