Core values and governance vital for transition of HNW family businesses

Transition planning for ultra-wealthy Asian families and family businesses is as much an art as a science. Lee Wong, Head of Family Services at Lombard Odier, contemplated this diverse universe at the Singapore Asian Wealth Solutions Forum event on November 2.

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WHATEVER THE ASSET - whether financial, collectible or property - the transition of such assets from the founder to the second generation and beyond is an area fraught with difficulty. For example, Lee explained, moving ownership of a family owned business to a broader family grouping can severely impact the management team's ability to formulate and execute a business strategy. It can also expose the family to the risk of a hostile takeover if a listed company is involved. Share valuations are also fraught with potential disagreement, leading to disillusion and trouble in the family group.

LEE WONG
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Is a family a business?

Splitting financial benefit from management and control can be key. In families there is generally clear and unconditional belonging while in businesses, conditional belonging is given based on competence. "A family is inward looking," Wong expounded. "Its role is to maintain harmony. A business is outward looking. Its role is to achieve productivity."

She continued: "Roles within families are based on relationships and power is based on generational status. Roles within business are based on functions and power is based on performance. Fairness in a business is meritocracy. While a family tends to minimise change, and adhere to how things are typically done, a business exploits change."

Deciding priorities

This implies, said Wong, that the two conflicting drivers behind these two arenas, family and business, can create tension and vulnerability to disputes. "A family business has to decide which comes first," she added, "Family or business. This affects the principles behind how decisions are made."

Management succession

Wong discussed the potentially delicate topic of leadership succession. The family must decide whether the most essential element for this is skill and competence, in which case a dispassionate decision will be made. Or whether inclusiveness and trust are the core drivers for future leadership, whereby decisions are generally determined by the need, or want, for harmony.

"There is no right or wrong way forward," said Wong. "The answer is what reflects the realities in the family so that when decisions are made there is understanding why they are being made in that way."

A business manager focuses on the wellbeing of the business, seeing the business as a career and livelihood. A shareholder focuses on investment return as represented by the dividend yield and capital return. But a family member who is neither a shareholder nor a business manager is concerned about maintaining a lifestyle, viewing the business as a rightful inheritance. "Such a family member who has neither control nor benefit access may be seething in anxiety and trying to find all avenues for their voice to be heard."

Natural governance

Adding complexity is the generational question as the businesses grow more mature. Within the founder or early generation, there may not be an accepted family hierarchy and siblings may consider themselves as equals, regardless of the age difference or birth order. "At this stage," said Wong, "natural governance may prevail given that they grew up together and they may share a mutual understanding of how things are done."

But for later generations with more family members involved, the complexity of decision making increases exponentially. Third generation cousins are unlikely to accept anything but equality amongst themselves, particularly across family branches. "Given the different family and educational background and work experiences and exposures, natural governance is unlikely to exist," Wong added. "Without such an agreed governance framework it will often be very challenging to make decisions together."

Family governance

Family governance can help address many of these issues, if clearly elucidated, agreed and communicated. This creates a framework to make decisions and for the extended family to reach agreement on key issues. Often it is set out in the family charter or family constitution, sometimes reinforced in a shareholder's agreement, a trust deed or enhanced articles of association.

"But," said Wong, "the writer Ernest Hemingway once said, it is good to have an end to journey toward, but it is the journey that matters, in the end."

Financial advisors to the wealthy can help with the journey by advising on the principles that represent the family values and objectives, by helping draw out the policies that the family can work with and helping to implement the practices that will facilitate the survival of the family business to the third generation and beyond.

"Family governance is important because it provides a mechanism for a family to manage differences," Wong concluded. "It facilitates open communication and transparent decision making and thereby enables the family to build trust. It helps to avoid individuals' personalities from getting in the way, and it clarifies the relationships between family members and the business." ■