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What Is The Cost Of Ineffective Governance?

(Measurable Cost & Also, Immeasurable)

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Family business history contains many examples of what can happen without an effective governance.

Emotions among even a handful of shareholders can erupt into clashes that disrupt future goals & planning, tie up families in court for years and drain all tangible and intangible value.

Case:

The scenario: One of the family businesses, in 2014, from Mumbai had a third-generation minority shareholding in a family business. She was denied any information about the performance of her investment. She was refused the opportunity to work in the business, as well.

Her attempts to exercise her shares were rebuffed, and her request for a board seat was denied.

The result: Her relationship with other shareholders, her brothers, had been ruined with bitterness. In frustration, she took the help of family advisors who advised her to get legal counsel. And the matter reached court.

Her brother's reaction further aggravated her, making her litigate and further damage by a media campaign.

The response: We were asked by them and had the whole situation explained. To my surprise, the family seniors explaining the case were furious, stating that this should have never happened if there was a constitution in place already.

Upon asking them about how the constitution was enacted. The answer was silence and nothing much. Further asking again, they mentioned no enacted version of a constitution.

The reason: I gasped on learning that such a large family business only decided to create the constitution guide without the process that creates living-ness by heart for all shareholders and families.

Furthermore, I was told they shied away from investing money in the governance system. The excuse was that family governance was unnecessary as we were too sorted in love and didn't need a complex system.

Another excuse I learned they made was: Oh! We do not have so much time to investing with experts in creating governance.

How could effective governance processes have averted this problem?

Firstly, effective governance requires accountability between shareholders and business. When enacted, the governance processes and its constitutional policies should have completely stopped the brothers from taking things this far.

Secondly, effective governance is ultra-mindful of various capitals the family uses to thrive in its business. A correct governance process and system would have prevented the seemingly arbitrary decisions the sister found so damaging.

Such policies govern family members' participation in the business, liquidity for shareholders, information and education for shareholders, responsible stewardship of shareholder's assets, family succession on board, and other potentially contentious and sensitive matters.

Policies and procedures, once accepted and understood, provide for shared expectations and a sense of consistency and fairness.

In the absence of these processes, as the example of the alienated sister shows, shareholders' needs denied do not go away - they fester, grow and turn dangerously malignant.

For family governance to run smoothly, helping the family navigate through several high-stakes situations requires supporting systems to enable the family to enjoy true, long-lasting success and love.

There are three areas effective governance focuses on:

1. The Family,
2. The Ownership,
3. The Business & Management

Each area is accountable to the other two areas. The business and management area must have its business governance for large family business enterprises.

Hence, I am touching the other two here for you to understand - The Family and Ownership.

Ownership area of Governance:

The concerns that ownership governance processes and systems resolve are the following:

- Liquidity issues
- Allocation of capital
- The survival of business through ownership and management succession.
- The performance of shareholders' investment
- The strategic direction

(..and much more specialise to business of the family)

Family are of Governance:

Family concerns are an equally important but more often neglected dimension of family business governance, such as:

- Family members shared interest in the health, prosperity, and continuity of family
- Family participation in business
- The role and image of the business in the community
- Information and education of family members
- Family communication
- Manifesting family values and goals in business

(…and much more specialised to family)
Each of these and many specifically developed as per family business constitutional development. They warrant special attention.

Each has tremendous potential as a positive force in the family business.

And if neglected, each has vast destructive power.

Accountability in family business governance doesn't mean turning the business into a democracy. It merely means setting up the processes that ensure respect for the interests of both business and family.

Governance design is affected severely by hidden assumptions of the family, in which leaders must choose one set of interests over another – embracing a family first or business first philosophy of governance.

Some family business leaders put ‘family first’ and operate on the premise that family members have a right to be heard under any circumstances – no matter how disruptive their self-expression may be to the business.

They assume that family members' ideas should always be considered seriously and that business leaders should report back to the family. In this line of thinking, the business should compromise to avoid potential family conflict and ensure family harmony.

Another set of beliefs in some other family businesses suggests ‘business first’. They discriminate against family members who lack skills, knowledge, and proven experience.

They assume some family members' comments on the business are always inappropriate and disrupts management. In this line of thinking, shareholders must be passive.

Over time, a ‘business first’ or ‘family first’ mode of operation can cause serious problems.

A ‘business first’ perspective allows family concerns to fester and usurp or erupt into disputes that can threaten the future of the business. A ‘family first’ view can distract and drain management and undermine the competitiveness of the business. Either will increase sharply the conflict between non-family leaders and shareholders.

Both family and business domains are crucial to long-term family business prosperity. Both require equal care. Neither needs to assume a dominant role. Instead, respect for the needs of the business must be balanced with legitimate family concerns if the family business – and the family – are to endure.

Rightly designed governance can provide this balance responsive to all needs of continuous growth and family harmony.

The governance design is complex and an expert's job, especially those who hold a deeply human-centric design for constitution development.

When the constitution is developed from the lens of "living it and living on", the governance design needs to juxtapose such that it produces decisions through various bodies of governance completely aligned with the constitutional frame.

One major thing we guide our clients when designing the governance is to view this in a completely overarching way. This means family owners are educated to realise that they are living on the constitution in such a way using governance that it produces a wave of confidence to all stakeholders – employees, customers, suppliers, and the community at large building confidence in the business and its future.

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