# Family-owned biz under scrutiny

Cheah Chor Sooi


*Institutional shareholders should raise questions if there are many family members in senior management or on the board, says Wee*

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THE time has come for investors in listed family-owned businesses (FOBs) to voice their discontent should they feel that archaic management culture has taken a toll on the companies' profit margin or share price.

Otherwise, it will be an arduous task to break ingrained beliefs even as the better educated second or third generations are more receptive to power sharing and control, according to Wee Hock Kee, managing partner of CG Board Asia Pacific, a provider of learning and leadership development in governance, risk management and internal control.

"Institutional shareholders should exercise powers to raise questions if there are many family members in senior management or on the board [signs of excess baggage], and especially so when financial performance has been lacklustre or below industry benchmarks," he tells ***FocusM***.

**Core competencies**

Although meritocracy in terms of hiring the right talent is desirable, Wee says that it is still sensible to have family members within a large and well-qualified management team so long as there are sufficient core competencies to run the business well while minimising conflict of interest.

"As long as family members have control over the board decision within the realm of a well-delegated authority, there will be a check and balance between family members and professional management team," he points out. "Hence, FOB governance structure and framework requires ongoing assessment and fine-tuning to get the right chord for long term value creation."

Wee recently completed a study commissioned by the Malaysian Directors Academy (Minda) to evaluate the performance and behaviour of FOBs in relation to their corporate governance (CG) practices, leadership and management style, including the evolution of these FOBs over time.

Entitled Perception Meets Reality: Malaysian Family-Owned Businesses, the study covered data analytics of 368 FOBs which made up 41% of the 903 listed companies on Bursa Malaysia as of end-December 2015.

They companies fell within Minda's study definition of FOBs, namely (i) at least 10% of the total issued and paid-up shares were held by family members, and (ii) at least two family members sat on the respective boards.

Two significant findings from the study are that 75% or 278 out of 368 FOBs have boards that comprised 30% to 70% of family members. Moreover, the perception from 60% of 101 respondents that independent directors are controlled by the owning family, raises serious questions on the credibility of appointed independent non-executive directors – and by extension – the credibility of the entire board when it comes to serving the interests of all stakeholders.

In terms of business aspirations, the FOBs can be divided into two categories: (i) those which strive to remain competitive (ie eager to undertake global expansion), and (ii) those whose business growth have stagnated (ie not keen to broaden their investor base).

**Preserving impartiality**

While there is nothing wrong to appoint a familiar person to be an independent director given such tendency is natural, the onus nevertheless lies on the independent director to abide by the CG code by ensuring impartially for the benefit of all shareholders, according to Grant Thornton Malaysia country managing partner Datuk NK Jasani.

"He should also ensure good internal control and the company's compliance with the division of duties and the separation between company and family matters," he tells says. "On the contrary, a fully independent-minded director may cause unnecessary issues by not recognising the company's vision, hence the old cliche of 'better the devil we know than the one we do not'."

On the same note, Jasani holds the view that listed companies should encourage their independent directors to not only focus on the CG code and good internal controls per se but also the growth, profitability and sustainability aspects of the business.

"For companies to succeed requires dedication, team work, vision and focus on growth and profits," asserts Jasani. "Perhaps, the Securities Commission needs to further deliberate on the CG Code to include attention of independent directors in these key matters."

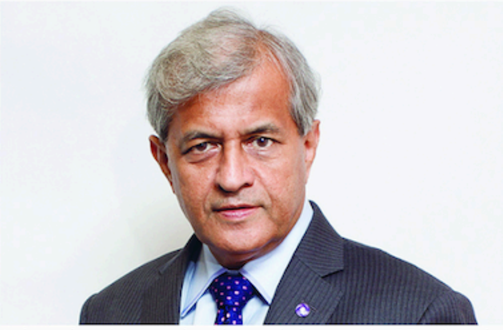
**Transparent nomination**

While it is difficult to perceive independent directors of FOBs as impartial or fully independent-minded, CG Board Asia Pacific's Wee cautions that it is unfair to apply such perception across the board.

He stresses the need for a robust and transparent nomination process with independent directors who are willing to demonstrate their impartiality and courage at all times to mitigate such negative perception.

"The issue of remuneration which elicits a 'give and take' attitude can be minimised by recruiting independent directors who are financially stable and have high professional reputation," reckons Wee.

In fact, there has been suggestion for independent directors to be paid from external sources/funds (capital market contribution by listed companies) to make them “truly” independent although this is still a long shot to get the buy in from the various CG stakeholders.


*Independent directors should not only focus on the CG code and good internal controls but also the growth, profitability and sustainability aspects of business, says Jasani*

According to Grant Thornton’s Jasani, the ultimate hiring of external talent into FOBs is of vital importance despite facing resistance from founders and other family members who are both in the senior management or play a key role as main shareholders/financiers.

“Meritocracy should be allowed time to prevail,” he reckons. “The founding family, who could be the major shareholders, can steer by way of their control of the board of directors.”

As for CG Board Asia Pacific’s Wee, given FOBs have their own dynamics to balance with their other family members, outside talent roped in must be able to “jive” with family values apart from their professional contributions.

Among key issues that need to be ironed out include age hierarchy with older FOB members having to compromise with relatively green upstarts in addition to matters pertaining to trust and integrity.

This may require the second or third generation successors to coax and influence the founders to open the gate for professionals who can bring changes and create value for the FOBs without jeopardising family core values.

Elsewhere, the risk of moving away from the traditional business and re-inventing a new business model is another lingering concern in the mind of FOB founders. “This is something that needs to be managed during the transitional phase especially when we are in the destructive technology era,” adds Wee.

**Top four concerns plaguing FOBs**

1. Lack of confidence in orderly succession planning and in the abilities of younger generation: Concern is valid as values and motivations of younger generation can change. Not seen as a major issue for those that invest in talent to build a high performance team to sustain organisational longevity. Quite a few FOBs have successfully navigated the transition by bringing in the right talent to complement the competencies of the family members.

2. Tendency to intensify management control: Astute founders recognises the fallibility and limitations of family members and believes in hiring the best management team. However, a relatively significant number of family members in leadership positions in many FOBs perpetuates this perception.

3. Influence over key management appointments and priority given to family members for key positions: Hiring is largely merits based. Understandable that preference is given to family members who are equally qualified. Hard to escape perception of favouritism as a number of FOBs have several family members on the board/leadership team.

4. Independent directors are controlled by family members: Negative perception deemed unfair as the appointed independent directors complied with the regulatory requirements. The challenge is for independent directors appointed by the controlling shareholders to be seen as impartial and independent-minded at all times.