

Private Sector Opinion

When Grandpa is Also the CEO—Resolving Differences in Family-Owned Businesses

28

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Barney Jordaan

Some of the same aspects of family-owned businesses that can give them a competitive advantage are also the factors that contribute to the high levels of destructive conflict that often occur in them. For example, close family ties can contribute to strong bonds of trust and cooperation, but they also can add emotional fuel to the fire when conflicts arise. Barney Jordaan argues that the best cure for these conflicts is prevention—through establishing basic family governance structures and, failing that, dispute resolution processes that are sensitive to the distinctive dynamic and singular needs of a family-owned business.

Foreword

Corporate governance is often, and wrongly, regarded as the exclusive domain of large corporations with shares that are traded in global stock exchanges. Perhaps this is because the data of those corporations are public and available for scrutiny by investors, journalists, and academics. However, the need for better governance is even more important for smaller, nonlisted family businesses. Listed companies are as visible as the tip of an iceberg, but below the waterline we find a much larger number of companies, mostly family-controlled. In Brazil, for example, about 400 companies are listed on BM&F Bovespa Stock Exchange, whereas 55,000 medium and large (more than 100 employees) companies are not listed. In the United States, unofficial statistics show that 5.6 million family businesses produce 57 percent of the gross domestic product and employ 63 percent of the workforce. Financially, they outperform listed companies and are a perpetual source of much-needed innovation and entrepreneurship.

Listed companies must comply with an extensive set of laws and regulations and are under permanent supervision. Nonlisted family businesses, by contrast, are less subject to external controls and are notoriously light



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The Forum is a multi-donor trust fund facility located within IFC, co-founded in 1999 by the World Bank and the Organisation for Economic Co-operation and Development (OECD).

in their use of bureaucracy, as noted in Barney Jordaan's paper. Yet they have the same governance needs of listed companies, and a few more needs of their own.

One of the biggest strategic advantages a family business can have is its bloodline. Family corporations, when run by a few tightly knit family members, can almost always move far faster than corporate bureaucracies can. In case of conflicts, relationships between family members must be preserved, and judicial solutions must be regarded as a last, not first alternative.

On the other hand, the nature of family relationships adds several degrees of complexity to such issues as related-party transactions, employment of family members, private use of company assets, and dividend decisions, just to mention a few. These problems are aggravated by ownership and managerial succession issues as well as by the participation of different generations.

Corporate governance conflicts in family businesses often involve corporate and family law. Corporate legal advice will often destroy family relationships, and it is practically impossible for judicial decisions to be constructive in both areas, all of which builds a positive case for nonjudicial approaches.

Jordaan describes the financial and nonfinancial consequences of conflicts and typical responses. He makes a strong case for mediation as a cost-saving and relationships-repairing mechanism between family members, either by involving a trained professional mediator in the dispute or by having ongoing involvement of the mediator to facilitate family council meetings.

How to manage dispute resolution should be embedded in every director training and corporate governance awareness-raising session, especially for members of family businesses. For example, the toolkit, Resolving Corporate Governance Disputes¹, makes an essential contribution to the improvement of family businesses. Strengthening corporate governance by introducing adequate dispute resolution policies and practices will have a positive impact on companies and society.

Leonardo Viegas

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¹ Available for download at www.gcgf.org/publications

When Grandpa is Also the CEO—Resolving Differences in Family-Owned Businesses

Barney Jordaan²

Family businesses are notoriously light in their use of bureaucracy. It is one of their appealing characteristics, and an aspect of their speed and flexibility in problem solving. Their informality and intimacy makes elaborate decision-making methods unnecessary. However, it is a common failing of all growing businesses that they do not recognize how growth is changing them. They are like a child who stays in short pants even when they're splitting at the seams.³

INTRODUCTION

Jimmy North and his wife Susan⁴ had worked hard to establish a thriving business with interests in property, a chain of restaurants, a game farm, and—the jewel in the family crown—a hotel in a prime location on South Africa's beautiful east coast. Jimmy, Susan, and their two children, Sarah and Paul, had many a happy family holiday on the farm and on the coast.

Jimmy, who ruled the business with an iron fist, was never one for paperwork; in fact, many deals were closed with a simple handshake. Jimmy and Susan groomed the children to take over the family business one day, although they had no specific plans for how to go about this: Should the children run the businesses jointly? Or should the business interests be separated and each child be given a portion of the business to run?

As things happened, Paul showed an interest in the hospitality industry and naturally took charge of the hotel business. When he later married Josephine, she started a major redecoration process at the hotel, which helped lift the hotel's grading a notch or two. Sarah became a lawyer and took over the running of the administration and legal affairs of the total family business.

At some point at a family meeting, Sarah raised her concern about the total lack of formalized policies, procedures, and systems in the business, which was by now

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Acknowledgement: the author would like to thank Sanaa Abouzaid, Marie-Laurence Guy, Karl Mackie, and Alexey Volynets for their feedback on early drafts of this publication.

³ Grant Gordon and Nigel Nicholson, *Family Wars: Classic conflicts in family business and how to deal with them* (London and Philadelphia: Kogan Page, 2008): 243.

⁴ The case study is based on a matter I am currently involved in. Names have been changed to preserve the identities of the parties.

becoming extremely successful. Jimmy laughed off her concerns, commenting that the business had got to this point without much paperwork and that's the way he prefers to do things. Paul took Sarah's statement as a sign of mistrust in him and Josephine. Pretty soon an argument erupted that led to Sarah leaving the meeting in tears.

The following day, Sarah's husband Peter wrote an e-mail to Paul and Jimmy in which he took both of them to task for humiliating his wife. He also demanded an unconditional apology. Susan felt caught in the middle between her husband and her two children. Relationships deteriorated sharply: family holidays were a thing of the past, and communication between Sarah and her father and brother was kept to a minimum.

Out of the blue, Paul demanded that the hotel business be split from the rest of the family business and be given to him and Josephine to run as their own. That's when the letters from the lawyers started coming. . . .

It is indeed an ironic aspect of family-owned businesses that the self-same characteristics that can give them a competitive advantage are also the factors that contribute to the high levels of destructive conflict that often occur in them. In particular, while their general lack of bureaucracy (formalized rules and systems) can create an atmosphere of informality and also facilitate quick decision making, it can also be an obstacle to the introduction of good corporate governance. Similarly, although close family ties in family-owned businesses can contribute to high levels of trust and cooperation, those very same ties can add emotional fuel to the fire when conflicts arise.

Conflict⁵ in the sense of perceived differences in needs, concerns, or interests is universal and unavoidable whenever people are interdependent, that is, the one needs the cooperation of the other. In workplaces, managers need cooperation not only from their subordinates but also from their directors; directors need cooperation from their subordinates and from other members of the board; shareholders rely on boards of directors to ensure that the enterprise remains profitable and sustainable, and so on. Where people are reliant on one another, there is always a possibility that differences can arise and serve as potential causes of conflict.⁶ If not managed well, these differences can escalate and be aggravated to become time-consuming, distracting, costly, and potentially relationship-destroying disputes.

⁵ Conflict may be latent, i.e. hidden under the surface, or it may be overt, i.e. it manifests or presents itself in actions such as declaration of a dispute, legal proceedings, fighting etc.

⁶ Christopher Moore, *The Mediation Process: Practical Strategies for Resolving Conflict* (San Francisco: Jossey-Bass, 1986), suggests that there are five basic kinds of conflict. Data conflicts are caused by lack of information, misinformation, different views on what is relevant, different interpretations of data, and different assessment of procedures. *Interest conflicts* are caused by perceived or actual competitive interests (whether those are substantive or are procedural or psychological concerns, or a combination thereof). *Relationship conflicts* are caused by strong emotions, misconceptions or stereotypes, poor communication or miscommunication, or repetitive negative behavior. *Value conflicts* are caused by different criteria for evaluating ideas or behavior, exclusive intrinsically valuable goals, different ways of life, ideology, and religion. *Structural conflicts* are caused by destructive patterns of behavior or interaction; unequal control, ownership, or distribution of resources; unequal power and authority; environmental factors that hinder cooperation; and time constraints. Knowing what usually causes conflicts and disputes helps in determining what kinds of interventions might be useful.

For many businesses, including family-owned ones, emphasis on good corporate governance requires a culture shift and results in increasing formalization, or “bureaucratization,” of a business. Culturally, the need for transparency, succession planning, and adherence to ethical business principles runs counter to the secrecy, nepotism, and lack of board independence one finds in many family-owned businesses. Further, the introduction of formalized systems, policies, and procedures can negatively affect levels of trust in the organization, if it is not managed well.

THE CONSEQUENCES OF CONFLICT

A 2006 study conducted by the Centre for Effective Dispute Resolution (CEDR) in the United Kingdom reveals that 80 percent of disputes have a significant impact on the smooth running of business.⁷ The same study estimated that conflicts cost British business an estimated £33 billion per year, of which £6 billion was spent on legal fees.⁸ What accounts for the balance?

Conflict and disputes have several economic effects on organizations:

- First-order effects are usually quantifiable, such as lost revenue, employee severance payment and replacement, and legal costs.
- Second-order effects are harder to quantify, such as missed opportunities, increased supervision and management, reduced quality of decision making.
- Third-order effects are impossible to truly quantify, such as passive-aggressive behaviors exhibited by disgruntled employees, staff turnover, the poor image of the organization within the industry or community, impact on family relations, and so on. These can be the real business killers.

A tragic example of the cost and consequences of unresolved conflict in a family-owned business involved a father, his two sons, and a boutique wine farm. One son, Peter,⁹ was an opera star of international repute. He bought a small wine farm but, knowing nothing about viticulture, asked his brother and father to develop and run the business. For a number of years things went very well: the business flourished, and the red wines they produced received local as well as international accolades.

⁷ These are conflicts within as well as between businesses.

⁸ CEDR further estimated that a dispute worth £1 million typically burned up three years of a line manager's productive time. An OPP/Chartered Institute of Personnel and Development report (“Fight, flight or face it?” July 2008) found that the average U.K. employee spends over two hours a week dealing with conflict, which means in total more than 370 million working days were lost in a year. The “Second Annual Litigation Trends Survey Findings” (Fulbright & Jaworski LLP, 2005) reported that 43 percent of corporate lawyers are unable to budget adequately for litigation costs.

⁹ Not his real name. This example is based on an actual event that shook the South African wine industry in the Western Cape.

The father and brother always had the understanding that they would at some point become co-owners and partners in the business and not remain merely paid employees, although no written agreement was ever entered into. When relationships started deteriorating, Peter reneged on what the father and brother understood to be a binding agreement—despite the lack of anything in writing—to make them co-owners.

Peter's father subsequently instructed his lawyers to institute legal proceedings against Peter to enforce the agreement he believed they had. Peter consulted his own lawyers, who indicated that they would fight the claim. The business started suffering, with the father and brother becoming less and less inclined to invest effort into it.

As the litigation began to gain momentum, the father started having second thoughts about the wisdom of litigation and suggested, through his lawyers, that the parties should rather try mediation, because the family was being torn apart. The suggestion was rejected by Peter's lawyers, on Peter's instructions. It happened that Peter was at home on the farm the day his father received news of the rejection of his proposal. That night Peter's father shot Peter dead and committed suicide.

Yet conflict, if it is brought into the open and is managed properly, can contribute to better understanding and fresh insights, and it can bring closure.

Yet conflict, if it is brought into the open and is managed properly, can contribute to better understanding and fresh insights, and it can bring closure. In his book, *Good to Great*, Jim Collins mentions the ability to work through healthy but difficult dialogue as a key factor in what makes companies great:

All the good-to-great companies had a penchant for intense dialogue. Phrases like “loud debate,” “heated discussions” and “healthy conflict” peppered the articles and interview transcripts from all the companies.¹⁰

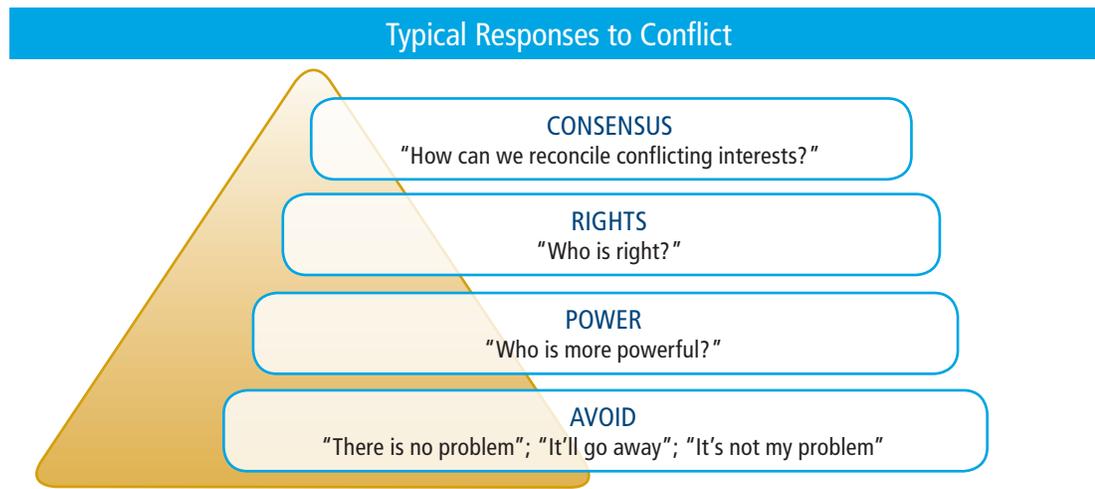
TYPICAL RESPONSES TO CONFLICT

In most situations, including in the business environment, we tend to respond to conflict in one of four ways: *avoidance*, *power*, *rights*, and *interests or consensus*. (See Figure 1.)

Avoiding conflicts and other difficult conversations might be an appropriate strategy for issues that are of low importance to all parties involved, or if the timing is not right to deal with them. But in most situations, avoidance merely tends to escalate the conflict, particularly if the issues are important for one or all parties involved in an ongoing relationship, such as a family-owned business.

¹⁰ Jim Collins, *Good to Great: Why Some Companies Make the Leap. . . and Others Don't* (Harper Business, 2001).

Figure 1: Dispute Resolution Options



Sources: Based on William L. Ury, Jeanne M. Brett, and Stephen B. Goldberg, *Getting Disputes Resolved: Designing Systems to Cut the Costs of Conflict* (Jossey-Bass Management Series, 1988): 3–19.

We typically use the *power* and *rights* options—often after a period of avoidance—when deciding to confront and deal with a dispute. The most common rights procedure is adjudication by courts or arbitrators, with a neutral third party handing down a binding decision. The *power* option uses unilateral action to resolve a conflict. Ironically, the most sensible and cost-effective approach—trying to reconcile *interests* through consensus-seeking processes such as negotiation and mediation—is least often used.

The decision as to which approach to take to deal with a conflict or dispute will have an impact on the costs of conflict resolution, the outcome, the relationship between the parties to the dispute, and the possible recurrence of disputes. Using the criteria of transaction costs, satisfaction with outcome, effect on relationship, and recurrence, the *interests* approach is clearly the most effective. It focuses on achieving consensus on how to reconcile conflicting economic, emotional, and other interests, compared to focusing on rights or power to resolve differences. Therefore, it tends to produce higher satisfaction with outcomes, better working relationships, and less recurrence, with good potential to incur lower transaction costs.

The *rights* approach, usually adjudication,¹¹ involves delays, expense, limited legal solutions, and unpredictable outcomes. It is backward-looking, produces win-lose outcomes, and usually harms relationships: the focus is on who is right, not on what is the best business solution in the circumstances.

Power, apart from its potential to harm relationships, has one major downside for the powerful: they cannot accurately predict or control the reaction of the person or people at the receiving end of their power; the victim so often becomes the aggressor.

¹¹ Adjudication here refers to decision making by a third party, primarily litigation in the courts and arbitration.

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In summary, it is human nature to try to avoid disputes and conflicts as far as possible—even more so in family businesses, where it is especially difficult to confront a more senior family member or a patriarch, and still more difficult for nonfamily employees to do so with powerful family members. Consequently, the conflict is often denied or simply wished away instead of being dealt with as soon

as possible. Then, when we do decide to tackle the conflict or are left with no other option, we tend to use our position, authority, or power to do so, or we defer to the legal process to resolve the dispute for us. All the while, we might be unaware of the actual and hidden costs, including relationship costs, of dealing with the problem in this way.

Of the several options for dealing with conflict and disputes, the prime one is collaborative negotiation, where the parties learn to resolve their differences by putting heads together, rather than by knocking heads, in searching for a solution. Adjudication and arbitration remain important for the resolution of certain disputes—for example, where a precedent is needed, an urgent injunction has to be obtained, or consensus is simply not possible. But, given the relationship issues that often bedevil conflicts in family-owned businesses, mediation offers the best alternative.

MEDIATION AS A PROCESS FOR RESOLVING DISPUTES

Mediation is a voluntary and confidential process in which an independent third party (the mediator) helps the parties to a dispute arrive at an agreed (consensual) solution. It is increasingly becoming a preferred method of resolution for disputes both within and between businesses. It offers particular benefits for family-owned businesses.

Compared to traditional methods of dispute resolution, mediation is quicker and less costly than litigation. Most importantly, it leaves the decision about the solution in the hands of the disputing parties. Instead of having an outsider, such as a judge or arbitrator, making a decision for the parties, mediation enables them to make their own decision, with the assistance of the mediator.

Mediation leaves the solution in the hands of the disputing parties. Instead of an outsider such as a judge or arbitrator making a decision for the parties, in mediation the parties make their own decision, with the assistance of the mediator.

Mediation is also confidential and without prejudice. The parties to the process as well as the mediator typically commit themselves contractually to maintain absolute confidentiality about the fact that mediation happened, the nature of the discussions that occurred, and the outcome. Even though participation in the process is voluntary, any agreement entered into during mediation is enforceable as a binding contract. The process is also without prejudice

in the sense that admissions or proposals made in the course of the mediation process are off the record and cannot be used in future legal proceedings against a party if mediation fails to resolve the dispute. Failing resolution, the parties to the dispute still remain free to pursue whatever legal remedies they might have available.

For a family-owned business, mediation offers the disputing parties the best opportunity to repair relationships that might have been damaged or broken as a result of an internal conflict. Failing settlement, relationships are likely to be further damaged or destroyed altogether by litigation.

Mediation is also considerably less expensive than litigation. A 2011 report compiled for the Policy Department of the European Parliament looked at the savings that can be realized by choosing mediation over litigation. The data show that, even with a low success rate, mediation can still save time and costs. The breakeven point for time savings (when compared to the length of litigation) is only a 19 percent mediation success rate, and the breakeven point for costs is only 24 percent. In other words, mediation has to fail 81 percent of the time to be as time-inefficient as litigation; similarly, it has to *fail* 76 percent of the time to be as costly as litigation. Compare this to an average success rate in mediation of 80 percent in some jurisdictions, and the advantages of mediation become obvious.¹²

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It was also found that, while the average cost to litigate in the European Union is €10,449, the average cost to mediate (inclusive of the cost of the mediator and legal representation during mediation) is €2,497—an average saving of €7,952 per dispute!

The researchers conclude that the use of mediation should be encouraged as a matter of public interest. They suggest that, given its potentially positive impact on business, people, and government, mediation merits a campaign such as those against smoking and teenage alcohol abuse and for the wearing of seat belts.

WHAT MAKES FAMILY BUSINESSES DIFFERENT?

From a conflict perspective, several factors distinguish family businesses from other businesses. As stated at the outset, perhaps ironically, the same features that can make family relationships lasting and strong and promotive of a healthy business can also create

¹² The 2006 CEDR report referred to earlier notes that approximately 80 percent of civil and commercial disputes get resolved at mediation or shortly after conclusion of the process. Therefore, although there is a risk of additional mediation fees if the dispute is not settled at mediation, the statistics show that mediation results in most disputes being settled, which means that the risk of double payment (mediation and additional litigation costs) is relatively low.

mistrust and produce dysfunctional governance. Such factors include the following, which is not an exhaustive list:¹³

- Co-ownership by a kinship group means that there is no rigid divide between work and family. Those involved are bound together not only by business but also through emotional, social, economic, and legal relationships. When conflict arises, it can threaten one or more of these relationships.
- Decision-making (and dispute-resolution) authority is initially vested in the founder, who makes decisions based on his or her authority and ownership of the business. But new generations do not enjoy the same authority among each other, which leads to contestation.
- Coherent and transparent internal decision-making processes often are absent.
- Teamwork is required between kin and nonkin. If relationships among “insiders” and between them and “outsiders” are not healthy, decision making becomes difficult.
- Lines between ownership, management, and control are blurred.
- Differences often go beyond business conflict because of the intertwined business and personal relationships. Sibling rivalry, especially in the absence of a clear succession strategy, is a key contributor to conflict. Conflicts in the business can affect family relations in the same way that conflicts between members of the family can have an adverse effect on the smooth running of the business.
- There is sometimes a clash between the “old” culture of the founders and new values and norms that later generations want to import.
- The power division is usually different from that in other businesses. Apart from the power of the founder (who may no longer be active in the business), the presence of passive shareholders (other family members) means that power is often fragmented and therefore difficult to manage.
- Those involved in the challenges of keeping the business afloat are sometimes not appreciated by noninvolved family members (passive shareholders), which causes resentment. Unequal access to information about the business among family members who work in it and those who don’t further magnifies this factor.
- Leaders are expected not only to manage the business but also to deal sensitively and generously with family concerns. They are caught in the dual pressures of assuring competitive survival of the business while also maintaining family harmony.
- A poor, or absent, succession strategy compounds conflict. The problem often arises because the founder’s focus is on growing the business and not on planning for its future.¹⁴

¹³ See, for example, C. E. Aronoff and J. L. Ward, “Run the business like a business,” *Nation’s Business* 95, 83, no. 11 (1995): 49–51; J. M. Haynes and T. M. Usdin, “Resolving family business disputes through mediation,” *Family Business Review* 10, no. 2 (1997): 115–127. See, for example, C. E. Aronoff and J. L. Ward, “Run the business like a business,” *Nation’s Business* 95, 83, no. 11 (1995): 49–51; J. M. Haynes and T. M. Usdin, “Resolving family business disputes through mediation,” *Family Business Review* 10, no. 2 (1997): 115–127.

¹⁴ See the Forum’s CG Insights Series interview with Joseph Fan, “Good governance of family-owned businesses is critical to emerging markets,” at http://www.gcgf.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/global+corporate+governance+forum/news/j_fan_interview. . . [I]n the five years after the company founder turns over the reins to the next generation, companies in the sample declined in value by an average of nearly 60 percent. 60 percent!”

In light of these factors, those administering mediation in family-owned business disputes need to be alert to what makes family businesses different from other commercial enterprises. It is necessary to understand the different relationship patterns. In these businesses, the line between business issues and interpersonal issues is not clearly defined: the former affect the latter and vice versa. A further complication is that the conflicts often concern not only those immediately involved in them, but also extended family. Leaving out important players might mean that any agreement reached at one level will simply be rejected at another level.

For example, in the family dispute mentioned at the outset, the siblings and parents did not want the daughter's and son's spouses to be involved in the process. This proved to be a big mistake, because the siblings experienced enormous pressure from their spouses to vote in favor of proposals that would benefit their own families and not necessarily the bigger family business. Their interests being very different, each side supported proposals directly opposed to the interests of the other side. The noninvolvement of the spouses allowed them to be powerful influences operating outside the controlled environment of the mediation process.

RELATIONSHIP PATTERNS IN FAMILY BUSINESSES

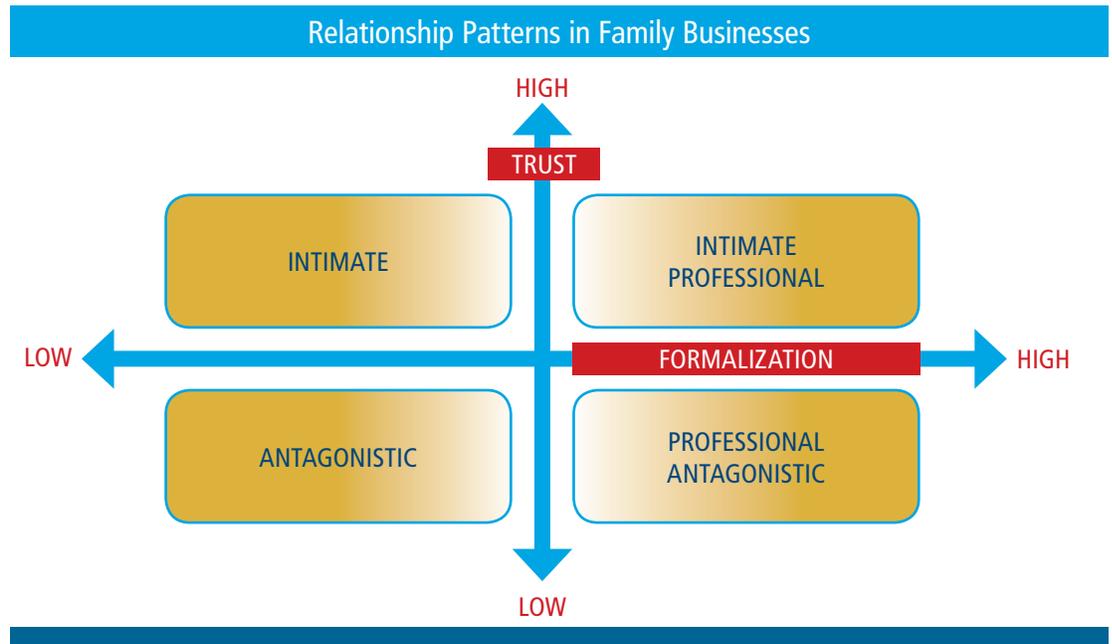
As in most relationships, the nature and quality of relations in family businesses are to a large degree dependent on two factors: the level of *trust* between members of the family directly or indirectly involved in the business and the level of *formality*, or bureaucratization, of the business. Trust, in this context, refers to the level of communication, transparency, credibility, and collaboration between the various stakeholders in the family-owned business. Formalization refers to the extent to which the relationships between the stakeholders are governed by clear rules and policies, such as shareholders agreements, succession plans, and so on.¹⁵

The combination of trust and formalization in the context of a family business establishes four kinds of relationships (also see Figure 2):

1. ***Intimate***—characterized by high levels of trust and low levels of formality. On the positive side, differences tend to be resolved early, and high levels of collaboration occur. The absence of formalized systems and processes tends to be an obstacle in a business environment that is increasingly becoming regulated. There is a danger that the introduction of policies, rules, and systems can affect trust levels, leading to a *professional antagonistic* culture (see below), if not managed with care.

¹⁵ For an application of trust and formalization in the context of workplace relations generally, see J. Purcell, "Mapping management styles in employee relations," *Journal of Management Studies* 24, no. 5 (1987): 533–548.

Figure 2: Relationship Patterns



2. **Antagonistic**—the culmination of low trust and low levels of formality. When trust is low, the absence of clear policies, procedures, and agreements on how to manage the business and the differences within it merely aggravates the conflicts. Legal action, or family warfare, tends to be the only process available to the parties.
3. **Professional antagonistic**—signifying a situation where rules, policies, and agreements are in place, yet trust levels are low, which results in a rule- and compliance-driven, formalistic environment. The business tends to lose the advantage of being a closely knit, family-orientated concern, but it also tends to operate in a more professional way. Conflicts are generally dealt with through formal, agreed procedures.
4. **Intimate professional**—a situation where the business has in place policies, agreements, and procedures that are necessary for its effective operation and governance. Relationships between the key stakeholders are generally characterized by high levels of trust and collaborative decision making and dispute resolution. Conflicts are dealt with proactively, and a high premium is placed on conflict prevention.

In summary, although good governance (and for good reason) requires that policies, procedures, and agreements are formalized, their introduction may have an adverse impact on trust if the process of formalization is not managed properly. Instead of merely adopting standard-form policies and procedures from other organizations, it is advisable for family-owned businesses—possibly with the aid of a reputable business consultant—to develop

and design policies and procedures that are appropriate to their own circumstances. These policies should also be adaptable, to change as the business and the family continue to grow and evolve.

A SUGGESTED WAY FORWARD

To keep from losing their key competitive advantages, family businesses need to ensure that there are adequate systems and rules in place not only to resolve conflicts and disputes but also to prevent conflict from happening in the first place.

Preventive Measures

The following points of agreement ahead of time can help avert or defuse conflicts:

1. Agree on where to resolve family-business conflicts. For example, decide which conflicts are to be resolved at family meetings (family councils) and which are to be resolved at management board meetings. The idea is to separate business and interpersonal issues as much as possible. Business-related issues can be addressed at management and board meetings, whereas any family member who feels that he or she is being opposed or frustrated by another family member can raise that concern at a family council (or family meeting, for smaller families).
2. Agree on a deadlock-breaking mechanism to be used in the event that consensus cannot be achieved. For example, the views of the founder or majority shareholder, or the votes of the majority, will prevail.
3. Agree on an internal communication mechanism and protocol. It is advisable to encourage face-to-face communication wherever possible. An effective communication protocol establishes some ground rules, such as the following:
 - Normal meeting procedures apply whenever formal meetings are held.
 - Interpersonal issues should be addressed in person and not, for example, by e-mail.
 - All should make a commitment to listen to and understand the views of others before responding.
 - Postpone discussions when any party is too emotional to continue with them.
 - Have private discussions in private.
4. Agree on rules (a kind of social contract or family constitution) regarding the following:
 - Family employment: For example, appointment to any position in the business is subject to the normal competency requirement for the position in question, and family appointments are limited to those who fully qualify.

- **Career development:** Nonfamily members in the business can find it very demotivating for their experience and qualifications to be ignored while the appointment to a senior position goes to a family member who is not as qualified. It is also hard for the business to achieve and maintain excellence if such appointments are taking place.
- **Succession planning:** This is probably the single most important consideration in ensuring the survival and growth of the business. It is advisable to enlist professional help in developing a succession plan for the business.
- **Compensation for management:** Decide how compensation, rewards, and benefits are determined, and what performance measures apply.
- **Payment of dividends.**
- **Financial and other contributions to the business:** There should be clarity about what is expected not only from those actively involved in or running the business, but also from beneficiaries who do not play an active role. The latter's expectations often exceed the value of their contributions!
- **Ownership:** Where does it vest—in a partnership, corporation, trust or foundation, or individual owners? Each of these possibilities has its own legal consequences for which proper advice is required. It is also important to ask: When does ownership pass? Does the founder remain a residual owner, and for how long? How are shares in the business acquired—merely because of familial bonds, or is some consideration (for example, money or services) required? What responsibilities are attached to ownership, and what rules apply to the alienation of shares? How must the relationship between internal and external owners—and accordingly also decision making—be regulated?
- **Retirement:** For new thinking and modernization to occur, it is not advisable for founders to continue to have an overriding influence after they have ceased to have an active role in the business. The introduction of a mandatory retirement age for all employees, including family members, can resolve this problem.

Such agreements should be *formalized* to remove uncertainty about their terms, because uncertainty merely generates more disputes. It is useful not only to include the actual terms of these agreements but also to record the spirit in which they are entered into.

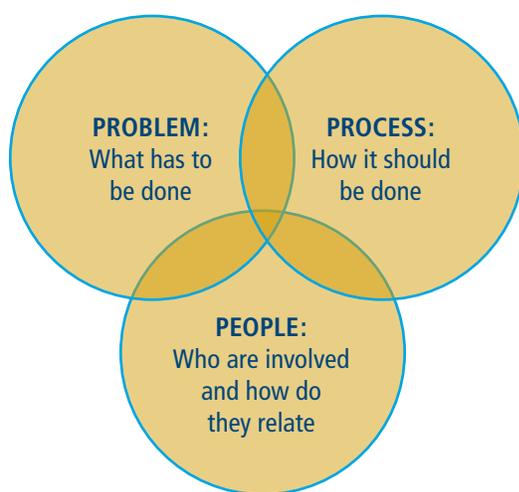
As the example of Jimmy and Susan demonstrates, the lack of structure in the business served a useful purpose many years ago when the young entrepreneur and his wife established their business. However, in a changing regulatory environment and with the involvement of family members who have a different vision for the business and who are motivated by very different concerns, the absence of formal policies, rules, and procedures is a recipe for disaster.

Choosing Appropriate Dispute Resolution Processes

In any conflict or dispute situation, three elements are always present: the *problem*, the *process*, and the *people*. (See Figure 3.) The last one includes the feelings, desires, assumptions, fears, and concerns of the parties involved. The people issues are what usually stand in the way of a rational discussion about the problems facing the business. If the wrong process (for example, litigation or open family warfare) is chosen in an effort to resolve the conflict, both the business and the family relationships will suffer.

Figure 3: People, Problem, and Process

All People-related Business Issues Display the Same Structure



Because of the interpersonal issues, many family members tend to pursue the litigation option to resolve disputes, regardless of the consequences. As the litigation progresses and the stakes climb, it becomes increasingly difficult to stop the litigation train, and before long the parties are engaged in a process of mutual and self-destruction.¹⁶

It is highly recommended that family-owned businesses commit to using mediation by a trusted and independent third party whenever they are unable to resolve their differences themselves. Mediation is an ideal mechanism for the resolution of such disputes. As pointed out earlier, it provides a cost-effective and quick way to resolve disputes, particularly where future-oriented solutions need to be found. It is also capable of restoring and maintaining ongoing business and family relationships.

The mediator uses collaborative-process skills to help the parties find a mutually acceptable solution to their problem. The mediator also manages the interaction between the parties, their emotions, fears, anger, and mistrust—of one another, of the mediator, and of the

¹⁶ For example, see a discussion of Friedrich Glasl's model of conflict escalation at <http://www.breakthrough.ie/articleissues/escalationstagesvol3no1.htm>.

process. The ability to skillfully manage the people dimension is critical in mediating disputes in family-owned businesses.¹⁷

Another dispute resolution option (depending on the nature of the dispute and causes of the conflict) is a team intervention, in which a mediator, business consultant, and family mediator or therapist work together. This option would be appropriate in situations where, besides business-related disputes, there is within the family dysfunctional conflict that adversely affects the growth or success of the business.

Another option, especially after a mediation intervention, is the ongoing involvement of the mediator beyond the immediate dispute. For example, the mediator might facilitate family council or other meetings where potentially difficult conversations are likely to occur.

POSTSCRIPT

At this writing (summer 2012), the mediation between Susan, Jimmy, and their children is ongoing. What complicates matters is that Jimmy in the meantime has had a stroke and is not capable of participating in attempts to resolve the issues. His having previously ignored good advice from others about the importance of ensuring that his paperwork is in good order—including the terms of his will and clear guidance on how the business is to be run if he is no longer capable of running it himself—has made the current situation all the worse. In the absence of the preventive measures alluded to earlier, the conflict has become a free-for-all battle, involving lawyers and the extended families, that threatens to destroy what Jimmy and Susan had built up over many hard years. Susan herself, now approaching her 75th year, is but a shadow of her former self as she watches the family disintegrate.

Perhaps this story can be a cautionary tale for families whose businesses have not started down that road—or at least have not gone very far—toward irrevocable conflict. Those families still have time to choose a course that can help their businesses deal with inevitable conflicts in healthy ways and survive for many generations.

¹⁷ See Bernard Liebowitz, "Resolving conflict in the family owned business," at http://www.liebowitzassoc.com/index.php?option=com_content&view=article&id=37:resolving-conflict-in-the-family-owned-business&catid=8:the-family-owned-business&Itemid=10.

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