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Issues Facing Family Companies: Critical Situations and How to Handle Them

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Issues Facing Family Companies: Critical Factors and How to Handle Them

Mr. Talal Abu-Ghazaleh

I am happy to be able to talk to you about management of family businesses, which plays a very significant role in the global economy. The Arab world is known for its dependence in particular on the model of the family business. Despite this, it would be inaccurate to say that family business is more common here than in the USA or Canada. About one third of the companies on the Fortune 500 list are family companies and about two thirds of companies listed on the New York Stock Exchange (NYSE) are as well. Undoubtedly family businesses are very large with many sensitive related topics involved in them. Discussing these topics is undesirable, and some of them are emotional which make them removed from reality. Yet this issue carries its own importance due to its emotional aspects and its close connection to the home and family. Actually, there are not many things in one's life (after one's family) that have a great deal of personal significance more than a person's family business.

We know of course that we are mere mortals, and some of us may be meeting our maker soon. Survival for long periods of time is not common for some people. Actuarial statisticians who employ their skills to make life insurance companies profitable are the same people who provide us with a positive picture on our deaths in their actuarial schedules. For those who are unfamiliar with actuarial schedules, I tell them that they are statistical tables that tell people how many years you will live during any particular phase in your life if your lifestyle is largely similar to many other people. So in general, if you are now 57 years old, you'd have about 20 years and three tenths of a year left. But if you are now 67, then you have 13 years and eight tenths of a year left in your lives. Of course we must not forget despite all that is said, that we believe lives are in the hands of God alone.

We are passing on one day, but our lives continue through our families and what we inherit our children, which means the business that we build from scratch and spend our lives caring for as we do our own children until these businesses become huge successful projects. The dream of most of those who have successful family businesses is that their inheritances remain a long time after they are gone. Unfortunately this is not the case, because about 70% of family businesses fail and do not survive the transition to the next generation, with only about 15% reaching the third generation. It is truly sad that the image reflected by actuarial schedules for family businesses is not more optimistic.

Despite all this, there is a bright side. Although none of us can postpone his/her date with destiny, there is a chance to increase the lifespan of the company you own and save the inheritance you leave behind.

There are a number of topics related to inheritance and children and planning that linger around for many years that everyone knows about, yet these are very rarely discussed frankly. Of course we are talking about family issues in family businesses. In other words, we're talking about family "luggage". Family "luggage" comprises a group of emotions, feelings of jealousy,

disappointments, disputes, hopes, mistakes, weaknesses, love and abandonment, as is common in human families. If we carefully study the meaning of 'luggage', we see that it is the things you carry with you because you didn't finish your work or need for it or handle it or process it adequately. This luggage contributes in increasing in some families what I call "familial dysfunction". When this dysfunction in family relations reaches the workplace, then this will undoubtedly lead to a malfunction in the proper conduct of work.

Dysfunction...Money....Fame...Wealth

It is wrong to believe that due to the volume of business and the profits resulting from it, no harm can come to it. So you might think that you are making large amounts of money and your company is reputable throughout your country and so everything must be ok, correct? Of only things were so simple. Do any of you remember popular TV series such as Dallas or Dynasty or the Bold and the Beautiful? The stories behind all these programs were about family businesses that were very successful despite the existence of a huge family dysfunction. This alone was enough to draw the attention of the world to watch the episodes one season after the next. Money, fame and wealth are not distant from family luggage. Actually, families suffer from dysfunctional relationships do everything they can to hide this dysfunction. It is amazing to see what is thought of in most instances as the "model family" or the "model company" when looking at it from the outside. A classic example of this situation is the marriage of Prince Charles and Princess Diana. It was a royal legend, yet that's all it was: a legend with an unhappy ending.

All of us at this gathering today are businesspeople. I expect that we are happy when we review the most recent numbers given to us by our accountants and when we are dealing with the issues that face us. I'm confident in my belief that a few of us here have a special interest in dealing with psychological pressures and relations that are prevalent in our family and company environments. Most of us realize, when thinking about this, that there are different conflicts and problems in our families and companies, yet you do not find these to be big issues. We are completely in control of the situation, as if we are in a strong ship where no one dares to argue with our orders. Of course there are problems underneath the surface, yet we all know these are normal matters. If anything is out of the ordinary, then we address it with the utmost strictness, and herein lies the problem. There is usually one thing that we cannot deal with which is not dealing with items on our own. Yet this is exactly what we need to confront when we start thinking about how to achieve success for our companies and placing them in the category of companies that continue to the second and third generations. At the end, our companies should be able to survive without us, the founders. The problem is that as the head of the family, you are considered the safety valve not only for the organization but also for the family. So if you do not exert the effort required to confront the matters going on underneath the surface in the family, then the family will collapse when the safety valve is removed, accompanied by the collapse of the institution.

Are business owners authoritarian and risk-takers?

Mr. Kenton J. Fleming, the consultant on family businesses, says that “there are two sayings about people who establish businesses: that they have authoritarian personalities and that their work totally controls them.” In general, he states that business founders have a tendency for control and in most cases have a strong emotional connection to their business. This tendency, as with many things in life, has both positive and negative consequences. In actuality, it is these qualities that exclusively help business founders erect their empires and which make the vast majority of them subject to failure when these are transferred to following generations. Founders are characterized as independent, confident and risk-takers, who have ideas they know how to execute and can be very strict. They are keen to know everything that goes on in their business corridors.

Because of these qualities, the family head acts as a strong wall (or as a strong sedative for pent-up tension). If the family head is removed suddenly, then this will lead to emotional chaos. Please note the word “suddenly”. The abruptness in removing the valve is what leads to the flare-up of confined issues. From here we conclude that we should not be surprised if we realize that the key to success lies in sound planning for the transfer process, preparing the successors and starting years ahead in the preparation of the company for the day that the founders will retire. While we do this, we must remember that problems at work will not be our stumbling blocks but rather family problems will.

The opinion that family business experts agree on is that the best method to deal with family matters in family businesses is the systems approach. What distinguishes the systems approach from others is that it looks at the big picture instead of the particulars in order to reach a correct understanding of the matters that take place in the family. Usually, when founders/leaders exert what they believe are fruitful attempts to keep family affairs away from work, they find that separation of the two issues is not that easy. Family can make managing work a difficult task, and conversely work can make the conduct of family affairs difficult as well.

Family dysfunction...and failure

To avoid any misunderstanding, I would like to make a clarification here. The clarification is that family dysfunction is a quite common issue and does not mean complete failure in the required performance. Rather, it is merely a matter relating to the failure in conducting a certain role in a sound and healthy fashion. In reality, if you do not come from a family that has some kind of dysfunction, then you are not considered to be among “normal” people. According to the highly reputable management consultant and author Mr. John Bradshaw, 96% of all families are to some degree emotionally impaired. So there is a direct correlation between systems that are dysfunctional which most families suffer from and the failure experienced by most family businesses in completing the transfer process to the second and third generations.

As with all systems, family systems are dependent on communication mechanisms to perform their duties. Think of any system at all, whether related to the entire nation or the Arab League

or even the human body, and then you will realize that when the circuits for the transmission of signals or data or feedback do not properly work, then the system is not ok. When there is a miscommunication between the brain and the nerves underneath the skin or these nerves malfunction for even a second, you find that quite simply you have been harmed in a short period of time. Therefore, sound feedback circuits represent the most important element in the system and its proper conduct of functions. This truth leads us towards a significant portion of improved performance of a certain system: recognition of bad communication patterns and recovery of integration in communication channels.

Communications can be impaired in the family work system for countless reasons. One of the most common reasons and something that at the same time represents the most difficult challenge is what is related to the founder and his/her personality. The qualities that can make you successful are the same qualities that may blind you at a later date from realizing the need for change and being open to new ideas.

Ability to Confront Difficulties

Major investors in projects are considered people with a broad long-term vision who have realized that their insight is not enough to face large unexpected problems. In many instances the insight fails in assisting them to overcome extreme resistance. That ability to overcome resistance may lead –when they succeed in establishing their businesses- to their refusal to face new ideas from other persons. This might lead them to consider any opinion –other than their own- undesirable. Consequently they surround themselves with “yes-men”. So if are not used to your primary managers disagreeing with you and if you do not change your decisions at least once in a while based on the consultation of your management team, then it is more than likely that you are of a limited horizon that will lead to a destabilization of your works. Even if you were indeed open to new ideas that differ from your opinions, and the challenges you created for yourself, you need to remember the absolute power carried by yourself. It might be often difficult for other managers, including potential heirs, to impose their personalities in confronting you. To be responsible is the most significant privilege the executive director earns, yet you need to establish mechanisms and there should be no objection to the creation of official mechanisms that enable others to express their opinions honestly. It is also necessary for you and the founder/executive director to acknowledge that there are basic needs for your organization in stages of growth that differ from what it required in the initial establishment period. The pattern of investment projects for the organization in the early phases should provide the opportunity for the creation of work that is administered with a high degree of professionalism.

Keys to Improve Performance of Family Work

It is a complex task, because you need to address issues of work and family affairs in a somewhat complementary manner. Probably the best thing you can do as an executive director is do your utmost to be a good listener. Be a good listener and open up to hear what others say

at the level of the organization. In order to succeed in this area, you need to work seriously to inveigle ideas you disagree with. Believe me there are a number of persons around you who do not agree with many things you do, and this is a fact. But if you do not listen to what they are saying, then you are not conducting the job with the possession of all the information, which means you are disconnected from the circle surrounding you. People will tell you only what you want to hear. This happens at very high rates in a surprising way in the final stages of business empires created by the first generation.

You must reward people and compliment them openly for supporting ideas even if you may disagree with some of these ideas. You need to show your acceptance and welcome people who speak openly and communicate freely. Reward those who communicate well and are characterized by their integrity. By doing so, you enrich communications and enliven them, and improve the flow of information you are receiving and therefore, improve the performance your family business and the projects it executes.

Make sure to conduct family business meetings and grant a chance to every individual to speak and record everything that is said and talk with all family members. Try to write the meeting minutes on a display device so that everyone can see them, such as a paper board or whiteboard or a projector, so that every person feels he/she is a part of the process and his/her ideas and comments have value. Affirm the fact that these meetings are open for discussion of the difficult issues, and that it is better to address these now than to leave them for a later time.

One of the common mistakes among project creators is failure to discuss financial matters with possible heirs. It is important to begin at an early stage in being open and discussing the financial aspects of the administration of family business with potential heirs. Keep an open mindset with sons and especially with those who have an interest in getting involved in the midst of work, if any. If none of them is truly interested in managing the business, it may be better to use managers from outside the family. Usually founders are late in declaring who they chose to succeed them in management. So if a person is over 50, then this probably is a suitable time to start planning for the transfer of responsibility, and it is better not to delay announcing who will succeed you. So announcing the successor(s) in advance assists in dispelling rumors and in-fighting that takes place in many instances. Further, this allows managers to focus more on what they should be focusing on, in relation to the businesses conducted by the company that draw expected profit.

In any case, prior to announcing the successor(s), it is probably a good idea to give the opportunity to every person to discuss his/her interests in the work, and to convene meetings with the group and with members -who hold administrative positions whether from inside or outside the family- individually. It is also important that these meetings are of a dual path with give-and-take such that the participants in them feel that they can express their feelings and concerns freely.

Work and Family ...Two Different Entities

Exhibiting interest and appreciation in the feelings and desires of your family members at work, can go a long way in minimizing tension that usually destroys family businesses during the succession process. Despite this, it is also important that you do not cause any chaos in the sensitive feelings of your family by taking unsound decisions. Here I would like to affirm that work and family are two completely different entities. In most cases there is an overlap between them that causes more than the rewards it reaps. The best way to be fair and responsible towards both your family and work is to maintain the distinction between the two as much as possible.

So you need to run your business like it is a business and manage your family affairs like it is a family and no doubt you will be the winner in both cases. If one of your children or your family members is the potential successor, then be sure that the preferential status of this successor ends as soon as you leave the institution.

It is good to express interest and concern to feelings, yet business owners usually make bad decisions relating to succession due to their worries about being fair and considering the feelings of their families. As a business owner, you need to do what's right for the company. So for example, as far as family members who do not intend to be active in this work, they should not leave a burden upon the company. Usually, inactive owners try to get the money while knowing little about the institution's operational needs. In this case, it is better to leave the inactive family members other possessions (such as life insurance for example).

Along the same lines, a number of business owners harm their companies when they try to be completely "fair" and give all children "equal" shares of the business. This is obviously not fair for those children who work hard and shoulder the largest and most active role in the company. Here, a person should realize that the solution to these problems lies in: A) Following well-known practices (dictated by the market) that justify giving a greater reward in this case to the more productive persons, and B) Avoiding hurting feelings and the flare-up of afflictions between family members, through a discussion of all issues at a very early stage, good communication and ensuring that everyone understands the bases upon which decisions are made.

Role of External Consultants

It is easy for me to stand here and advise you extensively, yet it is quite difficult to execute these matters. This is because it is truly difficult to get rid of the resistance, inaction and patterns that developed and became ingrained over time. This is not the first or last conference on the management of family businesses. I am not sharing a number of my private original thoughts but rather what I am telling you are general well-known ideas and some are selected deep thoughts that some family business consultants would like to exchange with others. It is useful to listen to these items repeatedly, since what we repeat here and now is what we believe in, and what we believe in is what we hope to act upon. Yet the secret lies in implementation.

One of the important issues in family businesses is the utilization of external consultants. When I say “external”, I mean outside the family. Usually family companies work within a broad network of friends and professionals with longstanding connections with the family. Usually there are overlapping relationships of a social and professional nature such that we find that “external” consultants are actually a part of the extended family. So we cannot really describe these persons with the term of objectivity. In general, any person who has an interest at a particular institution is incapable of being truly objective.

External consultants should not have had any tie to the company in the past or a future relationship with it, because they are expected to bring about two main benefits to the company. The first is that they bring about new expertise to management. The second issue however, which is more important, is that they bring the objectivity that the company affiliates lack. They are in a better position to see the family ‘baggage’ and recognize it and assist in the development and application of solutions that deal with it. What is particularly vital is that the objectivity of these consultants be guaranteed. Remuneration for their services must be paid in advance and there should not be any discussion on the possibility of them returning in the future, and this is in your interest. If however, you did not want the objective reality, it is very easy for you to get “the same old story” from your present administration. What you really need is new insight into the dynamic facts of your family, management and businesses. You must be ready to give your consultants complete freedom to contact all employees and talk to them, including yourselves, and they must attend all meetings.

A number of private companies have adopted, according to their nature, a degree of confidentiality in their operations. It has not been easy for them to grant outside consultants complete freedom in attending the meetings of the board of directors, communicating with individuals or reviewing their internal communications. Without this kind of freedom of access to what they need, consultants cannot undertake their job completely for your interest. Confidential issues can be addressed through dealing with a reputable company that is willing to sign off on non-disclosure agreements prior to embarking in any engagement.

The consultants sector at my own company; Talal Abu-Ghazaleh & Co. Consulting has a unit dedicated to work on issues specific to businesses owned by families. It has helped many Arab companies in conducting their activities better over 25 years, and I suggest that you call them and ask them to give you an offer. But don’t stop there. You should contact three different companies at least and compare their offers and choose the best. All I ask is that you give Talal Abu-Ghazaleh & Co. Consulting a chance to be one of the companies that presents you with an offer, because I know their ability in helping you and supplying you with the direction and guidance you need to attain success.

How to Choose an External Consultant

Allow me to humbly present some advice based on expertise and professional experience on when you make a decision to choose a consultant:

- 1- Excellent analytical capabilities: Your consultants should have the ability to diagnose the root-cause of your problems. Remember also that problems can be hidden and you are aware of them. So these problems could be of the dormant type that awaits the absence of the manager who is able to keep things in their place and prevent/settle disputes.
- 2- Quick wittiness: Much of what is conveyed is not verbal; many times what is not said is much more important than what is said. Here, the consultant needs to be able to read between the lines. So a good consultant will realize what's really going on and will understand both the verbal and non-verbal gestures.
- 3- Comprehensiveness of the approach: As I mentioned earlier, real problems are not work problems but rather those of a psychological nature related to the family's baggage. There are solutions from a commercial standpoint for these issues, but these solutions are composed of aspects of sensitivity towards relations and the needs of work and the overlapping of the two. A good consultant is one who understands that there is overlapping between these matters and takes this into account.
- 4- Ability to manage knowledge: The consultant receives a vast amount of information and should adopt a comprehensive approach. This means that there are a large number of issues, people and feedback from communications that need to be taken into consideration. The consultant needs to know how to integrate these in a complete manner.
- 5- Integrity: You cannot reach any conclusion whatsoever if you do not trust your consultants, since they need to reach you, your employees, your meetings and communications and even access your secrets. Deal with a reputable organization and make sure to ask for confidentiality guarantees and non-divulgence of information.

When contracting with a consulting company, do not insist that they must have specific expertise in the area of your activity. This is because in 99% of cases, the problems you face will not have anything to do with the nature of your works. Let your minds be open about problems. So you might have an idea about the problems you have and it is better to discuss those with your consultants, but remember you contracted with the consultant. It is because he/she is an external and objective party and because he/she can reach conclusions that people on the inside cannot see or say.

Allow me to warn also from following the latest consultative gimmicks and head directly towards fundamental improvement. The basics are always the foundation upon which issues are built. Do not be surprised by the costs of professional consulting services, because are worthwhile to invest in for your businesses. Remember that the matter is no longer limited to being an investment in your businesses, but rather is a contribution to the success of your families and the inheritance you will leave for the future generation.

Finally, I ask you to recall the risks, since only 10% of family businesses withstand the test of time. So will your company be one of these? I hope that my comments drive you to take the measures needed to fulfill your purposes. If I can offer any help whatsoever to anyone, or if any of you has any questions on what I discussed with you today, please do not hesitate to ask me during the break period. My sons Luay and Qusay are here who have worked their way up the corporate ladder by working for two decades under my supervision. They can affirm that we succeeded together in moving the organization forward.

Conclusion:

A) The three relations between a family member and the family institution:

1. As an individual in the family: He/she should not have anything to do with the work.
2. As a shareholder or owner: does not have any executive powers.
3. As an executive director: Deserves to be rewarded based on his/her accomplishments, and should have clearly defined authorities.

B) The three rules that the family members working in the institution need to follow:

1. All rules used shall be applied upon the family members who occupy executive positions; everyone is equal under the rules and regulations.
2. Continuity of the family business and its success should be the goal, and not bringing satisfaction and joy to the family members.
3. When more appropriate for the work's interest, a professional management should be appointed instead of the family members, since there could be a need that the family business be run by people other than the family members themselves.

C) The three mistakes in planning the professional future of the family members:

1. Should we hand over the reins of power to close relatives who are unready for this merely because we need to give them a chance to learn? (Wrong), because they learn better if they work under the supervision of officials who are responsible, qualified and able to train them. They must work their way to managerial positions just like other employees.
2. Should family members get special privileges and pay just because of their family status? (Wrong). They need to be like others. Their privileges should be limited to the profits they earn as owners of privileges granted to them outside the framework of the company.
3. Is it a mistake to employ family members? (Wrong), so if they are conducting the job correctly then this will be more productive. So an effective administration with complete levels contributes to success. There are economic and non-economic reciprocal values created through combining the systems of family and work.

D) The three pieces of advice on sound performance:

1. You must run the family business (even if it is a company that is individually owned by law) as an institution as is the case in any commercial entity. You need to build an institution and not a commercial activity and you need to establish an official institutional structure.
2. After the latest scandals such as those that took place at Enron and the issuance of new legislations such as the Sarbanes-Oxley Act, sound institutional performance is going through a phase of reform and restructure. The basis of most of the reform work is usually attributed to the requirements defined by the Sarbanes-Oxley Act and revolved around the demand for strengthening the structures for sound performance and enhancing the independence of management boards. The same concept should be applied to family businesses, especially in relation to management boards.
3. Let your tendency be global. Be global, think globally, behave globally and abide by global requirements (and national ones as well).

E) Three advantages of family business:

1. Family businesses can excel more than public shareholding companies. The family has ethical interests in addition to regular commercial interests. A recent study (by Anderson and Reeb, 2003) has shown that the performance of companies subject to the influence of the families that established them surpasses those companies that are not subject to such influence.
2. Family businesses enjoy the privilege of continuous ownership. This means that they enjoy a long-term interest. Remember that there is no business that is not subject to the influence of a certain family. So even the decisions taken by an executive director at a public shareholding company which is not controlled by a single shareholder can be influenced by the family of that director.
3. Family businesses can be more lively and active than public companies and better able to adapt to the needs of change and development. Adam Smith (1796) believed that the manager who does not have his own business cannot be expected to be more hardworking than the owner of such business.

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