Corporate Governance in a family company – an Introduction

FAMILY GOVERNANCE ASSOCIATES

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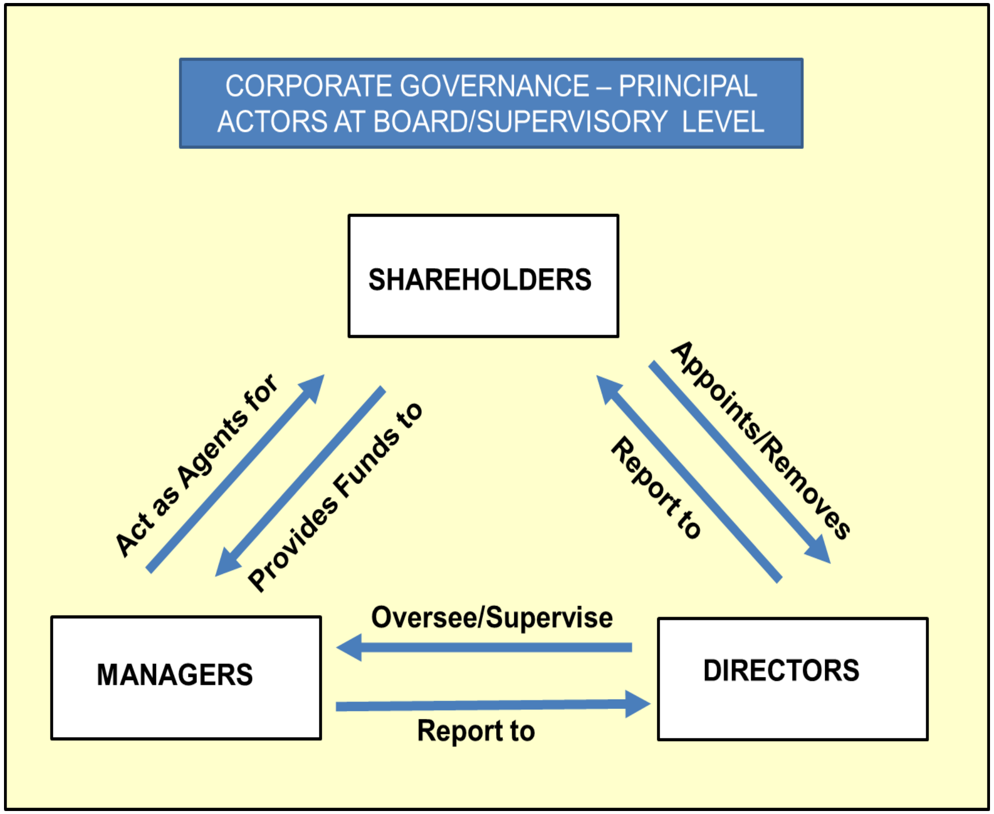
OECD defines Corporate Governance as the system by which business corporations are directed and controlled.

- Corporate Governance specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders
- Corporate Governance, spells out the rules and procedures for making decisions on corporate affairs.
- Corporate Governance, provides the structure through which the company objectives are set, and the means of attaining these objectives and monitoring performance.

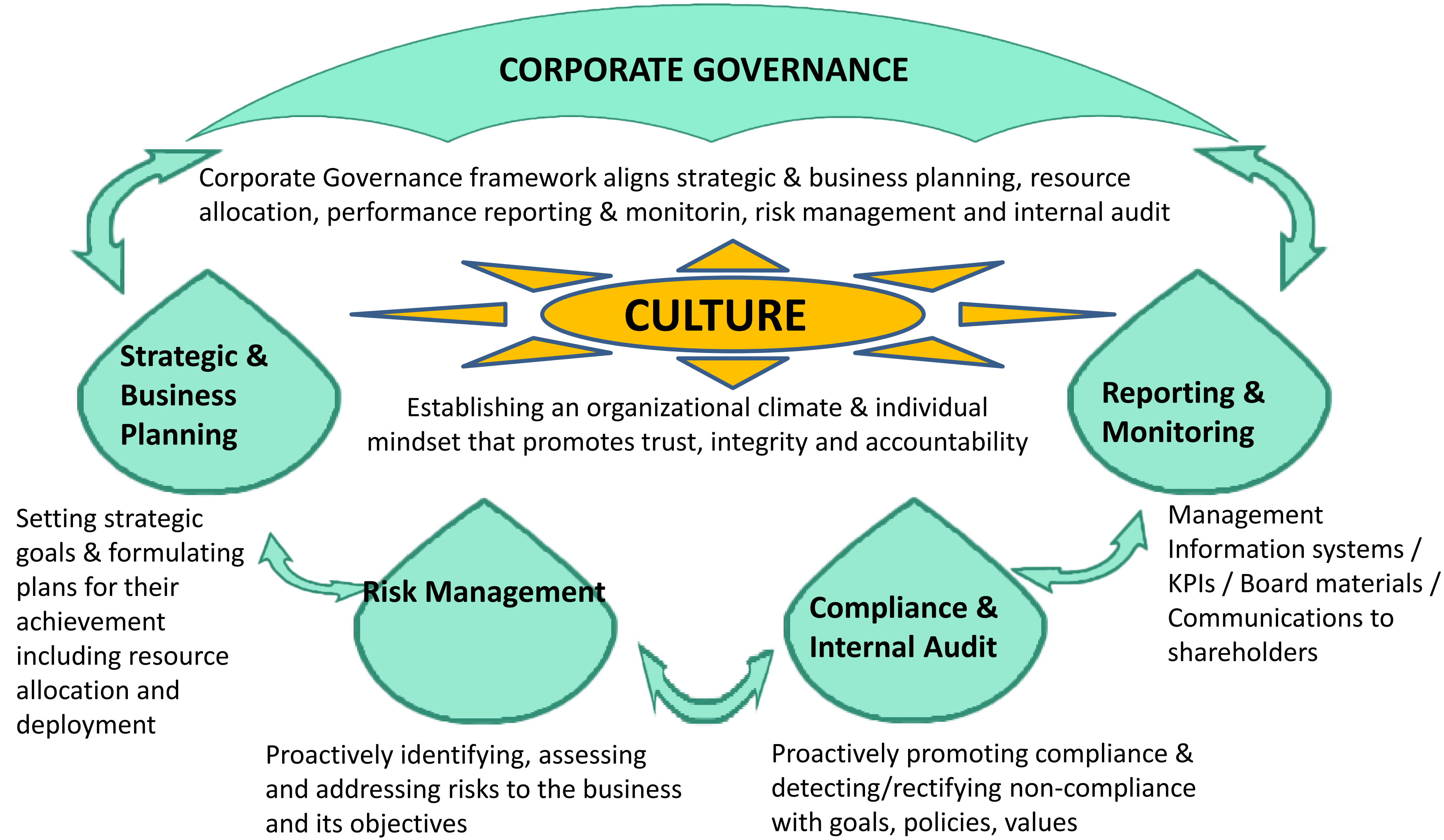
Governance including shareholder level tends to be associated with agency issues



Corporate Governance prescribes rules of engagement between

- owners as providers of capital
- managers as executors of business strategy with owners' capital and
- directors as formulators of strategy and supervisors of managers but answerable to owners

Governance below shareholder level focuses inter alia on interaction of planning, allocation and monitoring



Good Corporate Governance ("GCG") benefits

- GCG underpinned by and promotes culture of transparency and openness
- GCG creates value as external finance providers perceive GCG companies as being lower risk
  - Equity investors will attach higher valuation
  - Lenders will attach more favorable terms/pricing
- GCG has benefits in multiple dimensions
  - Improved strategic planning and prudent business risk taking
  - More efficient and timely capital allocation
  - Better succession planning and leadership development
  - Fair and transparent performance measurement culminating in loyalty inducing terms of employment

Finance providers' interest in corporate governance is business driven

- Good Corporate Governance is considered a vital ingredient for a well functioning business/financial environment/market place
  - Agency issues mitigated within rules based and best practice standards framework
- Finance providers consider corporate governance as a vital indicator of the prospects of any transaction and counterparty they are involved with
  - Good corporate governance signifies lower risks for finance providers, including lower reputational risks

⇒Companies interested in accessing external financing are assessed by finance providers **<u>inter alia</u>** on their corporate governance arrangements and their commitment to appropriate standards in this area

A family's interest in corporate governance needs to be both values and business driven

- Corporate Governance makes a very important contribution in the transition from managing owners to governing owners as iit facilitates the professionalization of management through recruitment of non-family members in senior management positions
- Corporate Governance can facilitate access to external finance and help accelerate growth and improve a company's long term prospects.

⇒ The longevity of the business is improved by Good Corporate Governance and a family controlling the business benefits from that

- Corporate Governance also aims to transmit and protect values

⇒ A family introducing Corporate Governance needs to recognize and be comfortable with the fact the corporate governance of a business it controls, WILL ultimately reflect its own values

Introduction of corporate governance by a family in their business requires certain initial building blocks

- Values and purpose of being in business articulated across the business(es)
- Competence taken into account in management selection
- Willingness to call on qualified external assistance
- Practice of corporate planning in relation to expansion
- Dynamic business portfolio with innovation and risk taking in controlled manner
- Family able to make decisions in relation to ownership matters in context of the needs of the businesses
- Recognition that corporate governance combines culture, structure, people, systems and needs to match the different stages of development of a business

Good corporate governance in family business context

- An oversight body is a vital ingredient in a Corporate Governance

=> A Board of Directors or a Supervisory Board which includes non-family members contributes to Good Corporate Governance in a family business

- Good corporate governance in a family business provides the same benefits as for companies in general plus
  - Contributes to the long term survival and prosperity of the business as a multigenerational family business
    - Most family businesses are 3rd generation or younger
  - Ensures family interaction with the business and minority shareholders (if any) remain constructive and value creating
    - Family's stabilizing influence as a long term owner is achieved within clear parameters that do not destabilize management and the business

Board of Directors in a family company

Required by law and regulation

- Role of board
- Composition of board
- Duties of board directors
- Attributes of board directors
- Independent directors

Recommended for good corporate governance

Nature and function of board of directors in a family company reflects size/complexity of business and development of family ownership