Good argumentative essay on corporate governance in family business

Business, Company

Business

corporate governance in family business

Introduction

Corporate governance is an indispensable factor for the advancement of family-owned businesses. According to Pedersen & Partners (2015), globalization and rapid growth of commercial transactions resulted to several obstacles for family businesses. In fact, family-owned businesses have to keep up with the requirements of corporate governance to strengthen their foundation. These family-owned businesses learned that practicing good governance enables will allow them to create healthy business processes in preparation for their expansion in the future (Pedersen & Partners, 2015). Recent studies conducted by Credit Suisse showed that modern day family businesses had been successful in overcoming the challenge of having a hostile environment based on the 60 percent reporting revenue growth of 5 percent or higher in the past year (Credit Suisse Research Institute, 2012, p. 3). The strength of the family corporations was supported by the long-term, " quality first approach" that is being practiced in the longer generation firms (Credit Suisse Research Institute, 2012, p. 3). The secret to the success of these types of corporations is by having a long-term payback approach to investment and focusing on the internal rather than external financing model in creating funds for future expansion (Credit Suisse Research Institute, 2012, p. 3).

Some of the family corporation that have become successful over the years in creating a valuable family-based brand include BMW, Samsung, LVMH and

L'Oreal (Credit Suisse Research Institute, 2012). These family-based brands are only a few of family companies that had been able create a higher level of customer loyalty that became a valuable intangible asset (Credit Suisse Research Institute, 2012).

It is through corporate governance that the family firms have become transparent in their operations to ensure that their businesses are on the right track. It also makes them more accountable to their actions and decisions to open the opportunities for growth, financing and better performance (Pedersen & Partners, 2015). Family firms believe that increasing the awareness on the value of corporate governance must be the strategic priority of these types of corporations. The goal of these family firms is to pass their ownership from one family generation to another. Thus, it is imperative to invest on the key drivers to develop robust and efficient family organizations for the future generation (Pedersen & Partners, 2015).

Advantages of Corporate Governance

According to the report the Pricewater Coopers (2012), the family firm has been regarded as the embodiment of " patient capital" since these businesses are enthusiastic to invest for the long term (Pricewater Coopers, 2012, p. 5). Family firms and companies are exempt from the limitations imposed on their competitors since they have to comply with the reporting cycle on a quarterly basis (Pricewater Coopers, 2012, p. 5). Family businesses add to economic stability globally in countries such as U. K., Asia and North America, compared to other businesses that take longer time when making corporate decisions (Pricewater Coopers, 2012, p. 5). It is an advantage for family companies to maintain family relationships since it helps in the mitigation and resolution of conflicts (Siebels, 2012, p. 292). Another advantage of family corporations is that they are respond faster and more flexible in decision-making (Pricewater Coopers, 2012, p. 5). These types of businesses believe that they are more swift and flexible than their multinational competitors since they have the ability to bridge the gaps in the current market and act swiftly in business acquisitions compared to other companies (Pricewater Coopers, 2012, p. 5). Family businesses have the ability to reinvent themselves with each new generation by having an entrepreneurial mindset (Pricewater Coopers, 2012, p. 5). These companies also have a sense of accountability and transparency in the creating jobs for their employees. These community efforts and initiatives are important to the family firms to ensure that the business is passed on to the next generation. It also bears to stress that managers of family firms have to understand and appreciate the unique set-up and environment that they are into and being able to adapt to their working style according to the rules on corporate governance (Pricewater Coopers, 2012, p. 13).

However, the relationships between the managers, employees and family owners become more complicated when the family firms grow. The good corporate governance system means implementation of correct policies to resolve the issues confronting the family corporations (Pedersen & Partners, 2015). It is through corporate governance that establishes a solid organizational structure to delegate responsibilities and define the roles of the members of the organization (Pedersen & Partners, 2015). The rules on corporate governance delineate the distinction between ownership and management as well as the internal policies that are needed for the daily operations of the company.

Corporate governance will ensure that there is a solid foundation in choosing the members of the board among family corporations. A well-functioning board of directors will guarantee that all major decisions and operations of the company will run smoothly. The board is the foundation of good corporate governance that will serve as the mediator between the family members and the company (Pedersen & Partners, 2015). The appointment of independent directors is favored by most family firms since these directors will provide strategic and fair decisions that are within the bounds of law. The legal and finance skills of independent directors is recognized as vital factors in the operations of the family businesses (Pedersen & Partners, 2015). The nomination of independent directors will cause a significant impact in the improving the planning and discipline of the other members of the board. At the same time, there a high probability that strategic focus and organized structure will be achieved during the board meetings and will result in making key decisions of the corporation through majority vote of the board of directors (Pedersen & Partners, 2015).

For the past decades, those family corporations with independent directors has been considered as causing a big improvement in the board dynamics and beneficial to the corporation. Corporate governance among family firms in every country in the world target the objective of strengthening the board because it is the cornerstone of the corporation. Thus, the board has to meet regularly to discuss the daily operations and affairs of the business, strategy and profitability and the expansion plans. The attainment of these goals cannot be made possible without providing support and guidance to the management by the board. It is imperative that the duties and responsibilities of the family shareholders and the members of the board should be made clear and well-defined. Another option of the company is to create an executive management that will support the major decisions of the board. However, there had been only a small number of firms which have fully implemented such decision (Pedersen & Partners, 2015).

Appointment of Independent Directors

The board of directors is often required to include a number of independent members, regardless of the fact that they are professionals with no management role, no business and ownership ties to the company (Prencipe & Bar-Yosef, 2011). These independent directors are expected to hold institutional affiliation and expertise for the purpose of preserving their professional reputation to the public. The inclusion of a certain number of independent directors in a family corporation will reduce the business risks. With such board structure, the risk of collusion with top management is minimized since the independent directors will see to it that the law is respected and also limit agency problems (Prencipe & Bar-Yosef, 2011).

Internal Governance of Family-Owned Corporations

Siebels (2012, p. 291), the systems approach which is being followed to ensure the internal governance of a family firm has been defined as two interacting subsystems which are: the business governance system and the family governance system. Under the business governance subsystem, it has been defined as the organization of administration and control of the business that compose of the top-management team (TMT), board of directors and shareholders’ meeting (Siebels, 2012, p. 291). The primary task of the TMT is the strategic management of the company where the board of directors is tasked to supervise the company and the top-management team. On the other hand, the goal of the family governance subsystem is to secure and organize the cohesion within the family which comprises of a family council and the shareholders’ meeting (Siebels, 2012, p. 291).

The board of directors and the family council had been considered as the core elements of the governance structure. The instances of overlapping of the family and business systems indicates the interaction and reciprocal influence between and among the family members (Siebels, 2012, p. 291). This only shows that as opposed to public companies where both systems are treated separately, internal governance in family firms demands both systems to be treated in equal footing (Siebels, 2012, p. 291).

Common Issues Encountered by Family-Owned Corporations

Just like ordinary corporations, these family-owned corporations also deal with management issues since the board is composed of family members. While many of the companies have created monitoring mechanisms to ensure that managers do not take excess risks by providing compensation mechanisms that will assure the managers that they will be given proper compensation and reward, the same is not the case of family-owned corporations (Credit Suisse Research Institute, 2012, p. 21). Most of the family businesses avoid giving the managers the authority to decide on the compensation since the manager often has a substantial stake in the business. There had been reported cases when the family firms encounter self-control problems due to the owners-managers' favoritism towards other family members (Credit Suisse Research Institute, 2012, p. 21). As a result, it can lead to the manager's free-riding at the expense of the firm. It is important to instil discipline among family members but the end result often led to strained relationships among family members (Credit Suisse Research Institute, 2012, p. 21). Hence, these companies have to put up governance mechanisms that will resolve with these eventualities (Credit Suisse Research Institute, 2012, p. 21).

Many of the family businesses have regarded the skills shortages to be an issue and address it by hiring external managers that will complement or replace family members in the key positions of the company (Pricewater Coopers, 2012, p. 12). The hiring of professional managers will be able to settle any of the commercial issues that may hinder the success of family business and add to inadequate home-grown skills of the members (Pricewater Coopers, 2012, p. 12).

Privacy within Family-Owned Corporations

There should be a strong culture of privacy that governed several of the family corporations in the world based on the annual reports submitted each year. However, these annual reports have not been made public by some of the family firms and were only viewed by a limited number of internal stakeholders (Pedersen & Partners, 2015). The current relationships between and among family shareholders and non-family investors create a huge challenge for many family firms.

There are many non-family external investors which provide considerable influence in the instilling governance among family businesses and corporations. Due to economic globalization and the growth of global investors, the biggest challenge in the governance of family-owned businesses is the fact that the family is owned by members who are relatives and creates added complexity in managing the business (Pedersen & Partners, 2015). The interconnections between and among the members of the owners who represent the controlling family members must be well-explained to all its stakeholders.

Succession Planning

The absence of family governance structures within family corporations can create conflicts in terms of succession planning within the organization. In order to resolve this, there should be clear criteria that will implement the selection of the family members to the respective positions in order to ensure that the business is well-taken cared for. The structure of the family business must comply with good governance and transparency in all its dealings. Over the years, many of the family firms’ board members get sick and deteriorate. Hence, succession planning is also important in order to transfer the business to the third generation. It is through meticulous succession planning of family businesses that will ensure that the present generation will pass on to the third generation the values of hard work and dedication. By doing this will mean that there is a greater possibility that the family firms will stand firm over the years (Pedersen & Partners, 2015).

Passing on the success of the company should made part of the culture among family firms and corporations. By instilling corporate governance as an essential factor among family firms will create a culture of discipline and dedication. A succession plan will move the company toward the development and prosperity. Facilitating the leadership of the key officers and board members will lead the company to a progressive and well-planned family business. It also guarantees the continuity of operations that will assure the shareholders, investors, clients and their employees that they are in good hands. The reputation of the family companies should be the aim of the family-owned business in order to ensure the longevity of the corporate brand value (Pedersen & Partners, 2015). It is through succession planning that will help in maintaining the proper balance of skills and experience among the officers and members of the board within the organization (Pedersen & Partners, 2015). According to Siebels (2012, p. 290), many family firms follow long-term investment strategies in their desire to perpetuate their business and to pass it on to future generations.

Conclusion

The corporate governance advances the perception that the structure of the board of directors will enhance the monitoring of managerial decisions (Prencipe & Bar-Yosef, 2011). Some of the important managerial decisions include the policies on the management of investments and earnings of the family companies. The past studies reveal that there is minimal evidence that will explain the effectiveness of board independence on earnings management in family-controlled companies. Such issue shall only matter if the affected family companies are susceptible to various types of agency concerns (Prencipe & Bar-Yosef, 2011). Thus, one of the advantages of corporate governance is to ensure proper earnings management inside the family-controlled companies. The recent studies show that corporate governance advances the potentially lower board independence and a higher risk of collusion (Prencipe & Bar-Yosef, 2011). Board independence can affects the reliability of financial reporting since the family-owned corporations may be exposed to an environment of weak internal control that may result to accounting fraud and manipulation (Prencipe & Bar-Yosef, 2011, p. 203).

The main thrust of corporate governance is to ensure that the board is both part of the internal control environment that will be held responsible to establish other control systems among its members. Hence, the creation of a more independent board is to lessen the opportunity for accounting manipulation and enhance the reliability of financial reports (Prencipe & Bar-Yosef, 2011, p. 203). The recent studies had shown through empirical evidence support the theory that board independence lessens earnings management and fraudulent accounting (Prencipe & Bar-Yosef, 2011, p. 203). Therefore, managers of family firms have to understand and appreciate the unique set-up and environment that they are into and being able to adapt to their working style according to the rules on corporate governance (Pricewater Coopers, 2012, p. 13).

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