

Corporate Governance in Family Owned Companies

Pakistan has been experiencing phenomenal economic growth in the past few years, leading to a sizeable increase in the number of unlisted companies, particularly family owned organizations. The Securities & Exchange Commission of Pakistan has recently reported that the total number of non-listed companies has now surpassed the 50,000 mark.

The sharp growth in such companies is fueling the growth of Pakistan's private sector, making good governance even more important for businesses. Currently, the Code of Corporate Governance only ensures compliance for companies listed on the stock exchanges. Introducing the concept of good corporate governance is vital for the continuity and sustainability of the unlisted companies that support economic growth in Pakistan.

Family-owned companies are characterized as organizations in which the shareholders belong to the same family and participate substantially in the management, direction, and operation of the company. It is widely recognized that each family has its own unique unwritten rules, values, histories, and communication methods. As the family structure shrinks or expands, the company changes, particularly with the advent of the second and third generations. Changes instigated by new generations can improve or harm the business. A recent survey suggests that only 15% of family owned enterprises continue to survive to the third generation. Of those that do last, 85% either disintegrate or completely vanish before the fourth generation takes the reins.

Families have a number of unique attributes that serve to strengthen a family business, including love, care, unconditional acceptance, generational hierarchy, emotion, informality, closeness, loyalty, commitment, stability, relationships, growth and development, safety, support, and tradition. Families can also have a number of negative traits such as anger, tension, confusion, competitiveness, and strangled communication, which can affect a company to the detriment of all. These qualities are reflected into business ownership methods and styles, and can support or harm a company. Good governance mechanisms can alleviate some of the problems that arise when family characteristics become a driving force behind company action.

Despite having a close network of owner/directors and the ability to make decisions quickly, family-owned companies are generally unable to sustain growth and have a shorter lifecycle than a privately owned company. In Pakistan, amongst the so-called 22 families identified in the Ayub era, only a few have managed to retain their prestigious position. Research shows that family-owned companies' shorter lifespan is mainly due to the following attributes:

1. Clear lines of succession do not exist or are complicated by the importance of familial relationships.
2. Loose organizational structures do not attract and retain quality human resources.
3. Personal interest in the success of the business leads to an unwillingness to take risks like expanding and diversifying into new business ventures.

It is internationally recognized that good governance has a positive impact on the performance of companies and enables them to move into the next phase of the business lifecycle. As companies grow and become more conversant with good governance, their ability to attract capital from external sources also improves, allowing them to expand, diversify, and acquire other businesses in a sustainable manner.

Good governance directly addresses the above issues for family-owned companies by:

- Integrating the strengths of family and business.
- Improving shareholder relationships through effective communication and conflict management.
- Systemizing wealth distribution mechanisms.
- Supporting growth and business diversification.
- Managing ownership and leadership transitions.
- Developing the next generation of managers, shareholders, and family members.
- Improving credibility.
- Attracting lower-cost debt and equity capital.

The principles of good corporate governance are as useful for non-listed companies as for listed companies. In countries like Pakistan, where a corporate governance code has been established for listed companies, these principles can be practiced by family-owned and nonlisted companies as well. Some countries – including Egypt, Turkey, Belgium, and Finland – have also developed indigenous, voluntary corporate governance guides for non-listed, family owned companies.

In Pakistan, family-owned companies are often private limited companies. Shares are held by a small group of people and there are limits on transferability. When this small group of people, however, is a family in conflict, the company suffers from a lack of objective analysis on the part of independent directors. Creating mechanisms like family constitutions and family councils can manage corporate governance apart from the family so the business does not suffer. Additionally, good governance practices can assist in creating a more sustainable organization by delineating methods for generational transitions and succession planning.

Family-owned, listed companies are the backbone of Pakistan's economy. However, these companies are traditionally either unaware of the general principals of good corporate governance, or work in a relatively less open environment. Promoting basic principles of good governance for family-owned companies is crucial in supporting the development of a strong economic sector.

In early 2008, Center for International Private Enterprise (CIPE), Pakistan Institute of Corporate Governance (PICG) and Institute of Chartered Accountants Pakistan (ICAP) worked extensively with the stakeholders and developed a Corporate Governance Guide for Family owned Companies. The guide can be downloaded from <http://www.cipepk.org/CG%20Guide.pdf>

The Guide provides a corporate governance framework, based on the OECD's internationally recognized principles, that is practical and adaptable for both listed and unlisted companies. Moreover, this guide addresses some of the peculiarities of family owned businesses in Pakistan. It is hoped that in addition to family-owned companies, other unlisted companies will benefit from this guide as well.

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