

Family Business Empires: Planning to Avoid Disputes and Managing the Unavoidable

Family businesses in the Middle East are often complex, multi-faceted, multi-million dollar enterprises yet they maintain the essential elements of the family business, being family owned and family managed, through one or more generations. In the modern day, family businesses face a number of critical risks in particular: lack of corporate governance, fraud and family war. Proper structuring of the enterprise, and effective planning for succession to ownership and succession to management, are crucial in avoiding these risks and ensuring the survival of the family business in the future.

This article discusses these risks and the structuring and planning steps necessary to avoid them.

Au Moyen-Orient, les entreprises familiales sont souvent des conglomerats complexes, aux multiples facettes, valant plusieurs millions de dollars, tout en maintenant cependant la caractéristique principale de toute entreprise familiale, celle d'être détenue et gérée par une ou plusieurs générations. Aujourd'hui, les entreprises familiales sont menacées par un certain nombre de risques au titre desquels se trouvent l'absence de gouvernance d'entreprise, la fraude et les luttes familiales. Une structuration idoine de l'organisation, un plan efficace de transmission de la propriété et du management une fois l'heure de la succession arrivée, sont indispensables à fin d'assurer la pérennité de l'entreprise familiale. Cet article propose d'analyser les risques menaçant les entreprises familiales ainsi que les moyens de les éviter.



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The Family Business

Within industrial Europe the notion of a family business conjures up a relatively modest enterprise, usually in the "mom and pop" category, typically involved in the services sector, trade, or light engineering. Whatever the sector, the family business will most commonly comprise a single business, run by one or both parents, possibly employing one or more children who may or may not be interested in the business other than as a form of employment or status.

In the Middle East, the family business presents a fundamentally different picture. Here we will be looking at a multi-million-dollar enterprise, comprising several business streams, often spanning all the above: trade, services and manufacturing, and employing hundreds, if not thousands, of people. The family (it might be in the first or second generation, and may comprise several related families) are, first and foremost, the owners of the enterprise but, nonetheless, will occupy most senior executive positions.

In common with its more modest European equivalent, the family connection will be of great importance. In addition to being a source of family wealth the family business will also be a reflection of the family ethos: a projection of values, trust, quality (of services and products) and loyalty (both to employees and customers). The business can, in turn, be a source of identity and family pride and provide substantial careers and a purpose in life for family members. And, by being family owned, long term financial and commercial planning is possible to the enormous advantage of the enterprise.

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How to Lose a Fortune

Against this picture of vibrant commercial and familial success, what is the problem? What could possibly go wrong?

In short, if the present is unstructured and the future is unplanned, the family enterprise is exposed to three key areas of risk:

- lack of corporate governance;
- fraud;
- family war.

A. CORPORATE GOVERNANCE

One of the most common problems in family enterprises is a lack of corporate governance, almost always as a result of family control.

All too often the enterprise is a generational fiefdom with the head of the family, sometimes a few leading members, controlling the entire enterprise. All key decisions, policy and commercial direction rest in the hands of one person, with minimal effective delegation. Decision making itself becomes problematic. Delays are inevitable, there being simply too much for one person to handle. The adoption of new ideas and approaches becomes progressively more difficult with limited scope for learning and experimentation. The

management of change, whether of methods and procedures, new products and services, or lines of business, is always difficult and all the more so when carried on the shoulders of one person.

This concentration of power and decision making and the absence of delegation often results in there being no effective lines of communication or control within the enterprise. This, inevitably, leads to substantial inefficiencies in the flow and analysis of crucial management information and increases the risk of fraud (discussed below).

Equally common within family enterprises is amateur management – management by family members chosen because they are family members and not as a result of any relevant training, experience, managerial knowledge or ability. Amateur management tends to be defensive and exclusionary leading, again, to restricted and inadequate communication and delegation. It is unsurprising that insolvency practitioners regularly confirm that one of the most common causes of business failure is second and third generation management. The failure to prepare family members for management, particularly succession to management, is also a prime source of family disputes (discussed below).

This lack of corporate governance can also be reflected in the corporate, legal and accounting procedures adopted within the enterprise which are frequently found to be inadequate, sloppy, or simply ignored. The notion that the enterprise "belongs", not to the family but to the reigning head of the family, carries with it the notion that he or she can do whatever they want with the business and its assets. This tends to lead, among other things, to the business being treated as the patriarch's personal bank account or money box, creating yet another source of family disputes.

B. FRAUD

The level of personal and corporate fraud is enormous. A brief review of the financial press demonstrates just how prevalent fraud is today: the misappropriation of funds, diversion of business and opportunities, skimming of profits, receipt of bribes, and self dealing by officers and agents.

This is often a result of the lack of corporate governance discussed above. The concentration of decision making and control in a few hands, insufficient information reporting and analysis, and inadequate corporate and legal procedures, creates the very environment in which fraud is not only facilitated, but encouraged.

C. FAMILY WARS

We are concerned here with battles between family members for ownership or control of the family enterprise, often following the death of the patriarch or head of the family. The subject matter of such disputes can include obtaining or retaining a share of the family business, obtaining managerial control over the enterprise (and influencing business strategy and methods), and securing an income, position, or job.

These are not just ordinary commercial disputes where the issue, ultimately, is simply financial. Family disputes expose most human weaknesses and unleash powerful emotions. It is crucial to understand the catastrophic consequences on the enterprise and on family members should the family become locked into battles of this nature, most especially if the matter ends up in court:

- the business may not be able to function as injunctions will fly to prevent assets being moved (with the risk of cash resources being blocked), shares being transferred or voted, and directors being appointed, often resulting in the board being unable to operate;
- such disputes will be a massive distraction for the family members

involved in the management of the business, the business inevitably suffering and opportunities being lost. Family members may be called upon to explain/justify past actions, very often hopelessly out of the context in which the actions took place. Actions, even though undertaken with genuine, *bona fide* intentions, may be called into question on the basis of some technical defect, often arising from the inno-cent informality typical in family businesses;

- family disputes are all too often played out in public, especially if they end up in court, leading to significant reputational and commercial damage to the family enterprise;

- enormous damage to family relationships can be caused by these disputes, often irreparable, making peaceful resolution all but impossible;

- finally, even if the war ends and peace breaks out, a settlement of the dispute can result in a non-commercial division of the enterprise: a splitting up of the business without regard to commercial interests. Any division of a family enterprise is almost always bad news: the sum of the parts is rarely as great as the whole, and a forced division of a business to bring about peace will rarely reflect the most sensible commercial division of the business assets.

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How Not to Lose a Fortune

Avoiding the family war. – The key to preserving the family fortune lies in avoiding the family war in all its forms: organise and structure the present; plan and provide for the future.

Organising and structuring the present. – It will be apparent from what has been said above that the overall goal at the outset will be the introduction of effective corporate governance across the enterprise. This will involve the adoption of professional management, whether of people or methods, the institution of proper controls, communications and delegation throughout the organisation, and the development of business strategies and policies reflecting the family's needs, aspirations and ethos. Fundamental to this will be the need to understand and clarify the role of the family within or in relation to the enterprise, whether as owners, executive management, or employees.

Planning and providing for the future. – Planning for the future means planning for generational succession – succession not just to ownership of the enterprise but also to its management and control. The latter involves preparing family members for managerial succession enabling them, by education and experience, to assume these roles – in short – avoiding the amateur "second generation" management problem noted earlier. Far too little consideration tends to be given to this aspect. Equipping each generation for ownership, control and management requires long-term planning, education, training and experience.

Underlying both aspects is a need to understand the cause of so many family disputes, in particular the highly personal motivations which produce them and the emotions generated by them. These disputes are, so often, the result of disappointment, broken promises, misunderstandings, misplaced pride, jealousy, greed and stubbornness among family members. Avoiding these is a multifarious process, with the management of expectations often the most important element. This can be key to avoiding the disappointments and misunderstandings just mentioned and to exposing the misplaced pride, jealousy and other potential failings of the next generation at

a time when it is still possible to address them. For those willing to do so, much can be achieved by simply engaging family members in the planning process (so that they know what is happening and what to expect in the future) and, going forward, by providing for effective communications and ensuring the involvement of family members in decision making.

It can sometimes be worthwhile to establish a family council or other forum to facilitate efficient communications and involvement in decision making among family members and to formulate a family charter, constitution or protocol articulating the family's principles, values, objectives, expectations and governance in relation to the enterprise, each of varying degrees of sophistication and detail.

The difficulties of engaging in a succession planning process are considerable. It is perfectly natural to put off difficult decisions for as long as possible. It is equally natural for the present generation to be reluctant to contemplate the future and especially to consider relinquishing control. Exceptionally difficult decisions may need to be faced. Who should succeed to management? How should the less capable or the less motivated be provided for? What if there are no suitable successors? Can management be successfully separated from ownership? Once the necessary decisions have been made, managing the transition from single controlling ownership to the multiple ownership and control of the next and ensuing generations, is itself a complex and difficult process.

Given these difficulties, the quicker the succession planning process is commenced, the better. Leaving it to the next generation does them no favours. On the contrary it bequeaths to them a potentially incapacitated enterprise and the perfect environment for a destructive family war.

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Managing the Unavoidable

Despite the most sensible planning, human nature being what it is, family battles are sometimes unavoidable. Recognition of this adds an additional element to the succession planning process: the need to manage the (sometimes) unavoidable and the consequent need to put oneself in the best position to do so.

Dispute management is begun well before any dispute arises. The process of managing expectations, and providing for communications and family involvement, discussed above, should go a long way to preventing the conditions arising which are so often the cause of family dissatisfaction.

Family disputes rarely manifest themselves as head on demands for greater ownership or control. Instead they appear in the form of seemingly tangential attacks on some aspect of the enterprise or its past management: a derivative action based on a complaint about corporate funds having been paid away without corporate justification; challenges to the validity of directors' appointments or share transfers; or an unfair prejudice claim.

The implementation of effective corporate governance procedures substantially cuts down the scope for such complaints. In many cases, organising the present will result in new ownership structures and arrangements being implemented. Where this occurs, it is crucial to ensure that the solutions do not themselves cause the problems. Ill thought out or sloppily implemented arrangements will cause more

problems than they solve and provide powerful ammunition for those minded to challenge them.

When, despite everyone's best efforts, a dispute does arise, the most significant stage is often at the outset, before positions are taken and battle lines are drawn. At this stage, there are usually real opportunities to defuse the situation and to prevent it escalating into open warfare. It is beyond doubt that a great number of disputes are caused as much by the reaction to a complaint as by the complaint itself. Time and again I see mistakes made, positions weakened, and opportunities lost at this early stage: anger, disappointment, offence taken, bravado, and stubbornness quite naturally come to the fore at this point and are the very emotions which result in reckless actions being taken and statements being made which can come to haunt the parties throughout a dispute.

The dispute that escalates into a battle in open court has all the problems discussed earlier: the business cannot function, the management are massively distracted, reputations are scarred, the business is damaged, and enormous legal costs are incurred. Sensible dispute management requires careful evaluation of the opportunities to arbitrate confidentially, rather than to litigate publicly. Most corporate and other ownership structures offer the means to impose arbitration of disputes but achieving this requires forward thinking. It is normal to consider dispute resolution in, say, a commercial contract, but the same consideration is rarely given in the context of ownership structures.

Jaw jaw is better than war war, as the saying goes, and a mediated resolution to a dispute is almost always better than a litigated or arbitrated one. By their very nature, family disputes lend themselves to mediation and other forms of alternative dispute resolution. The fact there are no obvious winners or losers in a mediated settlement can so often promote a resolution, and the mediation process itself can provide the opportunity to expose misunderstandings, to enable parties to draw back from offensive positions and statements, and to understand the enormous consequences of failing to reach a negotiated settlement. In addition to requiring arbitration of disputes, ownership structures can sometimes impose pre-arbitration dispute resolution procedures, including mediation.

The manifold advantages of the family business were noted in the introduction - they offer a source of wealth, income, family pride, continuation of family values, involvement in the community, careers and status. The key to all of this is continuity; continuity of family ownership and, crucially, of family management. Family enterprises rarely survive major family disputes and planning to avoid them, and to manage the unavoidable, should be a primary goal of modern family business planning.

BIOGRAPHY

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Family Business – Middle East – Business Management
Entreprise familiale – Moyen-Orient – Gestion des affaires

تتميز المقاولات العائلية في منطقة الشرق الأوسط بكونها تكتلات معقدة ومتعددة الأوجه، تساوي ملايين الدولارات لكن مع الحفاظ على الخاصية الأساسية لكل مقولة عائلية وهي كونها مملوكة ومسيرة من طرف جيل أو عدة أجيال. تتهدد اليوم هته المقاولات العائلية مخاطر عدة من قبيل غياب الحكامة، الإختلاسات والنزاعات العائلية. وللحفاظ على ديمومة المقولة العائلية يتوجب لزاماً تنزيل الهيكل المناسبة للتنظيم، وجدولة فعالة لانتقال ملكية المقولة وإدارتها، حين بلوغ ساعة الخلافة في الإرث.

يقترح هذا المقال تحليلاً للمخاطر التي تواجه المقاولات العائلية، وسبل الحد منها.