Edge Weekly The Edge Billion Ringgit Club: Plan early by using effective mechanisms

Business & Markets 2014
Written by Tho Li Ming of the edge malaysia.com

EFFECTIVE structures and mechanisms must be put in place to ensure smooth transitions in family businesses. Joseph Fan, professor with the department of finance and school of accountancy at The Chinese University of Hong Kong, says this is even more important for Asian Chinese families as there is often a clash of cultures between the generations.

"The older generation is traditional and follows Confucius' philosophy. There is a hierarchy in the family where the father is the head of business and the authority. Many members of the next generation receive Western education, particularly the wealthy children," he tells The Edge.

"They prefer discussion and democracy whereas the older generation prefers command and order. This creates a value gap between the old and new generations. Chinese families are less able to communicate, discuss issues and make decisions together largely because of this value gap."

Fan says conflict is common as families do not typically make decisions through voting or effective communication, unlike their peers in the West.

"More often, we see conflict and separation among siblings. If they don't get along, they split or separate. All these are roadblocks. This doesn't mean that Western families do not have value gaps, but they do have governance so that families can sort things out among themselves as they are less dependent on family hierarchy."

In his presentation "Lessons from Asian Families", Fan cited the examples of two family conflicts and his advice to them going forward. The first example involved Yung Kee, a restaurant specialising in roast goose and which was once given a single-star rating in the Michelin guide. It was founded by the late patriarch Kam Shui-fai, who worked closely with his sons Kinsen Kam Kwan-sing and Ronald Kam Kwan-lai in running the business. Upon his passing in 2004, his sons received 45% share of the company each. His daughter Kam Mei-ling received 10%. Fan says the two brothers had different ideas for the business going forward.

"Subsequently, the younger brother acquired the 10% stake from their sister, effectively making him the controlling shareholder with 55%. He then introduced his son and daughter to the board, who took over financial control of the company.

"The older brother negotiated with the younger brother to sell his 45% stake so that he could exit the company and start something else. But the younger brother could not agree on a price. Eventually, they took the case to the Hong Kong court, which ruled in favour of the older brother. Just before the verdict, the older brother passed away," narrated Fan.

An important lesson to be learnt from this episode is not to create a critical minority in the ownership of one's business.

“In a political competition, the winner depends on the minority, not the right or the left wing. Here, the middle minority comprises family members who hold the key to the future of the family business. They create a balanced family structure in your family ownership,” said Fan.

Using a second-generation Chinese family business based in Taiwan as an example, he showed how family governance and ownership designs can be done.

“The siblings were not happy at how the older brother was controlling them and the company while the brother felt that they were ungrateful and that he had taken care of their finances throughout the years. So, in order to help solve these issues, I came up with a Western family governance structure but with a Chinese twist.”

A family constitution was created with a family decision-making platform at the centre of it. Fan tells The Edge that it is a method of harmonising family communication and making decisions and sharing values together.

“The idea is to unify value opinion at family level instead of bringing the problem to corporate level. We spent six months to see how this family could communicate and eventually came up with a voting system that could be agreed upon. Every family needs to come up with a way to communicate and a decision mechanism that has to be respected by the family.”

The other method is to use a family trust to hold controlling ownership. However, Fan stresses that it is important not to allow third parties to be in charge of the family trust structure.

“Do not let your lawyer or banker be in charge of your family trust structure. You need to be responsible to plan your own family wealth and wills, especially if you use the trust to hold complicated operating assets, such as company and controlling shares. This structure should also include how family members make decisions and how this mechanism can be transferred across the generations. A well-organised family trust contract is more complicated than you think and your bankers won’t be able to do it for you.”

Fan recommends planning for this transition to be done at least two decades in advance. “We encourage family businesses to plan for retirement 20 years ahead. If you want to retire by 70, you need to start the process when you are 50.

“This is because as Asian Chinese businesses, our core assets are not factories or equipment. They are intangible assets like relationships, be it family, business, employee, political or financial. So, transferring these relationships across the generations takes a long time.”
- By Tho Li Ming.