1. General

Pakistan has been experiencing low to moderate economic growth in the past few years with a sizeable increase in the number of unlisted companies, particularly family owned organizations. Securities and Exchange Commission of Pakistan (SECP) has reported that the total number of non-listed companies has now surpassed the 50,000 mark as against 5,000 registered companies.

Families have a number of unique attributes that serve to strengthen a family business including love, care, unconditional acceptance, generational hierarchy, informality, loyalty, commitment, relationships, support and tradition. But they 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. Both positive and negative qualities are reflected into business ownership methods and styles and can support or harm a company.

Surveys show that family-owned companies' shorter lifespan is mainly due to the following attributes:

- Clear lines of succession do not exist or are complicated by relationships.
- Next generation is not willing to run business in the old original way.
- Loose organizational structures do not attract and retain quality human resources.
- Personal interest in the success of the business leads to an unwillingness to take risks of expanding and diversifying into new business ventures.
- Weak understanding of accepted norms of Corporate Governance.

It is very important that all involved in family business understand the dynamics of family businesses and learn from global experience to be successful.

2. Challenges of Family Business

As a family business moves along its generational timeline more family members start taking interest in its activities with varying objectives and expectations. Access to the broader family has many benefits but also brings with it potential challenges. Some of the more common challenges include:

- **Conflicting Goals / Values**
  Family members, especially between generations, can have different personal and business goals / values leading to operational conflicts. These goals / values need to be debated, rationalized and understood by all to avoid unnecessary stress & potential conflict.

- **Personality Conflicts**
  Different personalities can lead to sibling rivalries and intergenerational conflicts. Left unattended or unmanaged, they can destroy family & business harmony, and in some cases, the business itself.

- **Contrasting Expectations**
  Family members have different expectations from family and business. Expectations with respect to employment, management, ownership, compensation, work assignments, training, use of business assets, etc. vary among family members.

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- **Work Ethic Perceptions**
  Work ethic tends to change as the family business moves through generations. New generations tend to be less prepared to invest the kind of time their parents invested in the business. This can cause considerable stress and disaccord between generations and can also unnecessarily delay the transition of both management and ownership.

- **Employment of Family Members**
  "Who gets to work in the family business" almost always is a contentious issue and leads to several questions - Who gets what job? Can spouses and in-laws work in the business? Will employment be based on what the families want (bloodline) or what the business needs (competencies)? How are these employment decisions made? If not effectively addressed, these issues turn into hostility and liability for both the family and business.

- **Compensation**
  Compensation and inappropriate use of compensation to achieve family or personal goals instead of business goals continues to be one of the most challenging issues facing family businesses. It is sometimes difficult for family members to accept that there are no special perks or birth rights when holding working positions in the organization.

- **Reluctance to Plan**
  Generally, family business owners (especially the founders) are not very good at articulating and sharing their vision for the family business or their long-term business goals. Business planning, succession planning and financial planning are often viewed as an ineffective use of time instead of a necessary business process.

- **Reluctance to follow Corporate Governance**
  Family businesses by virtue of their nature are sometimes averse to implementation of a strict corporate governance code which runs contrary to the informal management style used by many family businesses.

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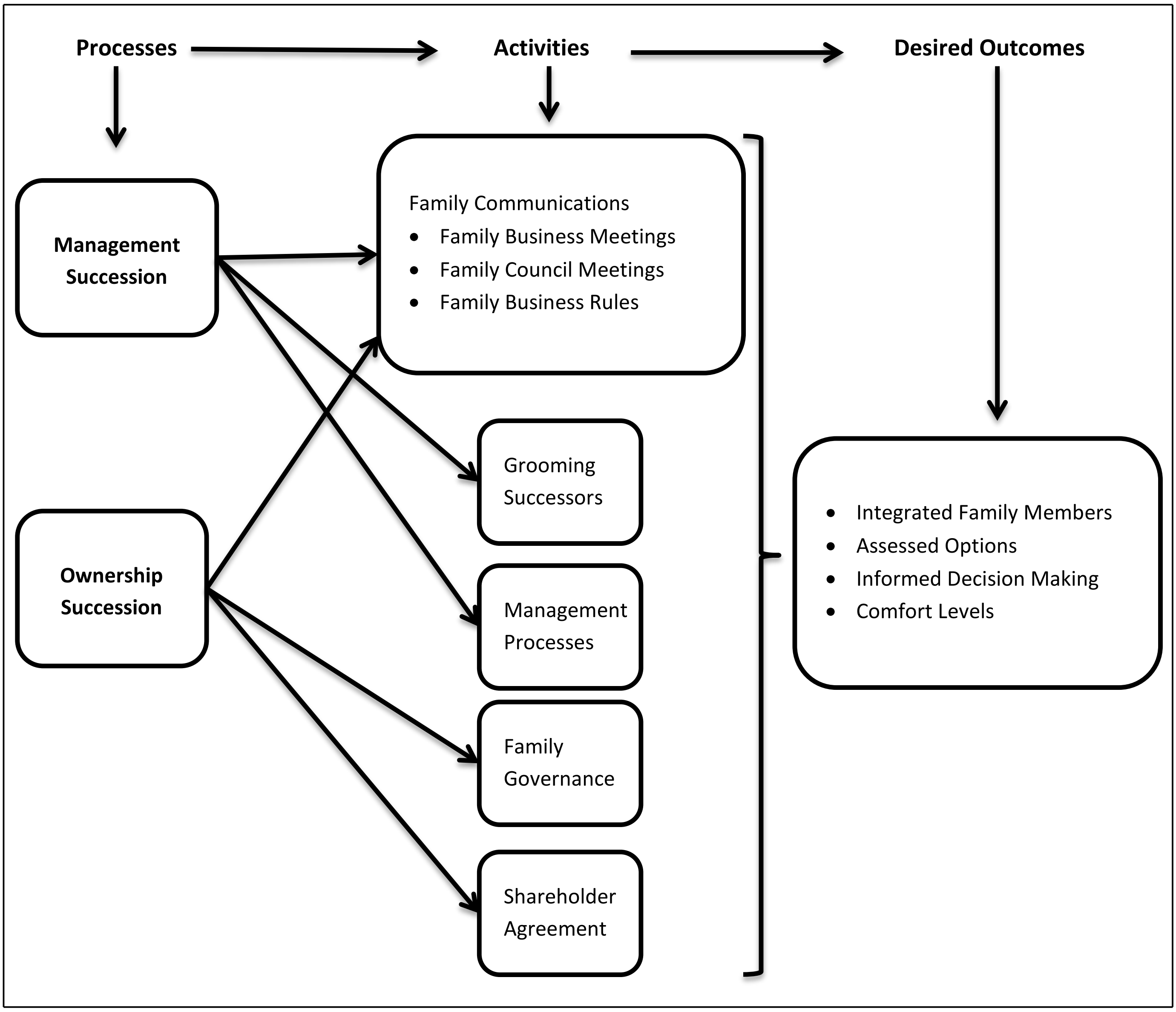
3. Succession Planning

Following is a typical model to illustrate effective management of family circle during the succession process.



A Typical Model for Family Business Succession Planning

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Family business succession plan comprises two processes, the "management" succession process and the "ownership" succession process. Numerous activities are required for each of the two processes to achieve the desired succession outcomes. It is preferable that the management succession process be carried out first so that the ownership succession plan reflects and supports the management succession. Regardless of which of the management or ownership succession processes are undertaken first, family communication activities should be the first step.

The model shows a number of family business succession activities intended to integrate family members into the management and ownership succession processes. The activities are also intended to make family members feel comfortable with both the succession process and its outcomes. The ultimate goal is to allow family members to make informed decisions about their individual and collective future in the management and ownership of the family business. By integrating family members into the process and by providing sufficient comfort to the current and future owners of the family business, informed decisions can be made. It is these informed decisions that ensure a smooth and effective family business transition.

4. Family Business Succession Guiding Principles

In working towards the desired succession outcomes, the process or discussions may become stalled or challenged due to the number & sensitivity of management and ownership issues. Decisions made affect not only the future of the business but in many respect the future of the family as a unit.

Family business practitioners have learned that the succession process is greatly facilitated if the family business owners and / or their successors steer the process and their decision making based on proven family business succession guiding principles, some of which are as follows:

4.1 Family Harmony

Research on family business indicates that too much attention is allocated to the technical components (cost savings, tax, insurance, market share, etc.) of the succession process and too little attention paid to the abstract non-technical components (i.e., wishes and aspirations of the family members, family harmony, family legacy, family dynamics, preparing the next generations, etc.).

4.2 Creating a Legacy

Most successful family businesses adopt the concept of creating a lasting legacy. Applying this guiding principle to the succession process means that the family wants the business to stay in the family and, as such, all future generation of owners should act as "stewards" of the family business. As "stewards" they are given the responsibility to safeguard the family business and grow it for the generations to come.

4.3 Opportunity versus Entitlement

Successful family businesses ensure that future generations clearly understand what the family business can do for them. In applying this guiding principle, future generations are constantly informed / reminded that the family business can provide them with an

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opportunity to work in the business as well as an opportunity to be an owner in the family business after meeting agreed criteria in order to eliminate the notion of "entitlement".

4.4 Ownership based on Wealth Creation

This guiding principle could well be the most important in support of creating the legacy. Research clearly indicates that those family businesses that only allow active senior family members to own shares have fared much better in the succession process. This is based on the premise that those family members who have generated the business wealth should be allocated the business wealth.

4.5 Business Exit Strategies

It has been established over the years that the best exit strategies for a family business are those for which the terms and conditions of the exit (death, disability and voluntary exit) are pre-determined and agreed upon in the shareholders' agreement. This has proven to reduce much of the family conflict that can and does arise when a family member exits the ownership ranks of the family business.

4.6 Taking the Lead

It is recommended that the next generation of leaders / owners take the lead in the succession process by addressing all the management and ownership issues (preferably facilitated by a family business practitioner)

4.7 Working Compatibility

It is believed that just because family members are part of different family they are compatible to work together. It should be accepted that the next generation will be different than their parents and that there will also be differences among siblings.

4.8 Accommodating Family Members in Business

The principle is based on the premise that most family business owners want their children in positions of leadership and ownership even if there may be other more competent non-family members to lead the business.

4.9 Informed Decision Making

Success in succession is the ability of each family member to make an informed decision about one's individual and collective future in the management, leadership and ownership of the family business.

5. Family Governance Structure

The major constituents of a family governance structure are:

- A "family constitution" that clearly states the family vision, mission, values and policies regulating family members relationship with the business.
- "Family institutions" which can have different forms and purposes, e.g., family assembly, family council and other family committees.

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5.1 Family Constitution

Family constitution is also referred to as "Family Creed", "Family Protocol", "Family Rules and Values", "Family Rules and Regulations" and "Family Strategic Plan". It is a statement of the principles that outlines the family commitment to core values, vision and mission of the business. It defines the roles, compositions and powers of key governance bodies of the business family members - shareholders, management and board of directors.

Family constitution should be used as a living document that evolves as the family and its business thrive. It is thus necessary to regularly update the constitution to reflect changes in the family and / or the business.

A typical family constitution covers the following elements:

- Family vision, mission statement and values.
- Family institutions like the family assembly, the family council, the education committee and the family office, etc.
- Board of directors (and board of advisors, if used).
- Authority, responsibility and relationship among the family, the board and the senior management.
- Policies regarding important family issues such as family members' employment, transfer of shares, CEO succession, etc.

5.2 Family Business Meetings

The purpose of family business meetings is to provide active family members with a dedicated communication forum to discuss family and business issues pertaining to the succession process and plan. These meetings are used to address the interaction between the family and the business (the family component) as it relates to the management and ownership succession. These are meetings for family members working in the business not other employees.

Family business meetings are not intended to replace regular business / management meetings or meetings of the Board of Directors (even if they involve the same players).

The owners should assign an active family member to coordinate or chair the family business meetings. They should also consider the benefits of using an outside family business practitioner to facilitate these meetings, especially the first few.

It's a good idea to keep records / notes of the outcomes of the family business meetings. The participants will need to decide on what is to be recorded and to whom the notes are to be distributed.

5.3 Family Business Rules

Family business "rules" are intended to guide family members in their personal, business and family relationships. They reduce the chance of having to deal with conflicts that challenge personal relationships, business relationships and therefore the family business.

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Family business rules are developed for three categories of issues - General, Management Succession and Ownership Succession. They are the foundation upon which the overall succession process is based and will determine the approach and the direction to use for succession process.

- **General Issues**
  - Rationale for having "family business rules"
  - Family business meetings and family council meetings (Why? Who? When? Where?)
  - Family disagreements / conflict resolution process
- **Management Succession Issues**
  - Timeline for management succession
  - Communication to family, managers and employees
  - Employment of family members (criteria)
  - Employment of spouses and in-laws (criteria)
  - Compensation philosophy / approach for family members
  - Grooming / training management successors
  - Performance reviews of family members
  - Role of current owners during and after the management succession
  - Leadership (co-leadership and management team)
  - Role of non-family employees in senior management
  - Leave of absence for family members
  - Conflict resolution process (resolving management succession issues among active family members)
- **Ownership Succession Issues**
  - Timeline for the ownership succession
  - Communication to family, managers and employees
  - Who can own shares (active, non-active, direct and indirect family members) and why?
  - How will the shares be acquired? (method and funding)
  - Will the ownership transfer be gradual / partial or all at once?
  - Does the ownership succession support the management succession?
  - Role of current owners during and after the ownership succession
  - Compensation for the owners (salary, bonuses, annual distributions, etc.)
  - Exit strategies (fair and equitable)
  - Minority shareholders (expectations and how to manage them)
  - Role of non-family employees in ownership
  - Nuptial and prenuptial agreements for future owners
  - Loans to family members (terms and conditions)
  - Public relations (Who speaks for the family business?)
  - Philanthropy and community activities (Which ones? How much?)
  - Conflict of interest for family members (guidelines)
  - Shareholders agreement that reflects / supports the succession objectives

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- Conflict resolution process (resolving ownership succession issues among family members)

5.4 Family Councils Meetings

The purpose of family council meetings is to provide a communication forum that allows all family (direct / indirect and active / non-active family members) to learn more about the family business and to provide them with an opportunity to express their views on family issues that impact the business & business issues that impact the family.

Family councils typically comprise the broader family, which can include spouses, in-laws, children, grandparents and grandchildren, whether active or non-active in the family business. Given the potential size and composition of the family council, family council meetings are typically held annually or every couple of years unless the business is in succession / transfer mode, where these meetings may be required more frequently. The meetings are most effective when they focus on keeping family members informed of the "big picture" issues. They are not intended to be used as a decision-making forum for day-to-day business issues or succession issues. They are intended to inform, educate and obtain feedback from the broader family on specific issues of interest to all family members.

Following is a sample of what the first family council meeting agenda might cover:

- Review of the purpose of the family council and the rules. These should be approved at the first family council meeting.
- Overview of the role of the family business meetings and how they differ from the family council meetings.
- Overview of how the business is performing (summary of overall performance).
- Overview of the short, mid and long-range plans for the business (expectations / vision of the owners).
- Overview of the current thinking with respect to management and ownership succession.
- Discussion of employment and career opportunities for family members.
- Review and discussion of all or some of the family business rules developed by the active family members at their family business meetings. (A dedicated family council meeting to review and discuss the family business rules may be warranted).
- Questions or concerns about the family business in keeping with the overall objectives of the family council.
- Brief evaluation of the meeting by each participant.

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