Corporate Governance and Family Business Performance

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A sound governance structure helps family businesses to improve strategy and control mechanisms, as also organize communication and relationship between family owners and business executives. In this article, the authors assess the impact of governance structures on family business performance.

Corporate Governance Structure and Family Firms

Corporate governance is a guidance and management structure that aligns and organizes ownership and business management. It comprises three distinct components -

(1) ***The shareholder's assembly*** - It is the general body of shareholders that has the final authority on the company's decisions.

(2) ***The board of directors*** - It is the body of directors that approves and monitors the decisions of top management team and is the link between the top management team and the shareholders and

(3) ***The top management team*** - The group of top executives who make the organization's strategic decisions. These three entities need to operate systematically with a balanced power structure. While top management seeks short-term value and growth, shareholders aim to get long-term value and growth. The board has to align the business strategy with shareholder interests.

In family firms often the board is largely comprised of family members that assures effective control on decisions. It affects the objectivity of corporate governance. Family businesses tend to be complex and undergo transitional changes when successive generations take leadership positions. In the first generation, firms managed by the founder, boards exist and operate to meet minimal legal requirements. As the second generation takes charge, the board becomes more formal and operational. By the time another generation takes lead and the firm becomes a cousin consortium the board becomes a proper professional body that sets up other bodies, councils and committees for effective corporate governance. Most family businesses usually setup two additional bodies termed the family council and the business council. In this study based on a survey of 22 Latin American business families, the authors examine the determinants of effective corporate governance.

Key Findings

The major findings of the study are the following –

1. ***Board Performance*** – The qualities of directors of the most successful family firms

that turned to be significant were – *Clear and Shared Strategic Direction, Objective Decision-making, Business Knowledge and Experience*. On the other hand, the boards of the least successful companies lacked committees on relevant issues, pointing to their governance deficit.

2. ***Family versus Non-Family Board Member's Performance*** – While family members on the board of most successful companies scored the highest on *Management Advice and Support, Active Participation and Business Knowledge*, the non-family board members scored high on – *Provision of Missing Dimensions, Strategic Vision and Objective Decision-making.*

3. ***Business versus Family Council Performance*** – The Business Council scored high on *Organizing decision-making process for family-business issues, Solving family-business conflict* and *Identifying potential leaders*. On the other hand, the Family Council was rated high for *Developing family/business agreements, improving communication and information and solving business-family conflicts. Conveying values* and *promoting family/business fellowships* were the other contributions for which family council was rated high.

Implications for family businesses

An important implication of this research for a family firm is that all the three components of corporate governance need to be properly inculcated with appropriate norms and mechanisms. Boards must be diversified to build adequate capabilities and skills in the firm. Another learning is that while family members bring in business knowledge, experience and active participation, non-family members must be brought on board to bring in the missing dimensions or capabilities in the business. They bring an objective vision to the firm and help improve corporate governance. Yet another implication is the importance of setting up supportive governance structures of family and business councils, which act as bridges between the family and the business. While business council becomes a governance platform to discuss business issues and resolve family-business conflicts, family council serves as an important forum for building consensus on family agreements, sharing and communication and perpetuating family values. Thus, effective utilization of these councils can hugely improve family business governance.

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