ON GOVERNANCE & GROWTH

Frederic Chemaly
Managing Partner, Chemaly & Company and Company Secretary, Malia Group

Consider this case

A second generation family transitioning into the third generation owns and operates a family business. In 2015, the total turnover of the business is 4 million per year and the dividends distributed from net profits amount to USD 540,000 per year.

The 2nd generation is formed of 3 brothers. They share the company equally. They are all married with 3 children each. Under this scenario, each family of the 2nd generation earns USD 15,000/month, leaving the per capita at USD 3,000.

Discarding the inflation rate, which may be as decisive as stagnancy in returns from the company, each 2nd generation family member earned USD 3,000/month and got used to this amount for their way of life.

If the family business remains at its own volume when the 3rd generation takes over management, we will be having 9 siblings married with 3 children each, all sharing the USD 45,000/month return. By a simple calculation, we get the following figure:
9 siblings * 5 family members = 45 family member in total

USD 45000 / 45 family member =1000$ per capita.

Now let's factor in the inflation at 3% per year, which is a conservative figure.
A generation is 30 years.

With 30 years of inflation at 3%, you would need 2,36 times the amount of money in 2045 to buy you the same item you could have bought in 2015, which cuts your purchase power by 2,36. In other words, the USD 1000 per capita has a purchasing power of USD 423. In more words, to sustain the same living standard of the 2nd generation, the 3rd generation has to earn USD 7080 per capita.

Based on this scenario, the family business has to grow by 7 folds in 30 years in order to sustain the same living standards for all the family members.

This brings us to governance and the many questions raised on the relation between governance and growth.

First, on family governance and growth

Experts in family governance plan the sustainability and wealth of families for the coming 100 years. To do so, they focus mostly on financial sustainability amongst other criteria, such as culture, organization, legal matters, philanthropy, etc. Given the above case study, the growth of the family business is the first concern they raise to the family members considering that said growth fuels the sustainability of the family through generations.

Second, on growth and family governance

The growth of the family business is a prerequisite for the sustainability of the family within the family business structure, otherwise family members would have to grow outside the family business. An application of the above case, should the family business stagnate when the 3rd generation gets on the market, a USD 1000 of income per capita, equivalent to USD 423 in purchasing power, would push many members of the family to seek business or employment elsewhere, if the market offers a bit more, especially if the family business is saturated, if the outlook is not promising, if the family sense of belonging is weak, if…, if…

Third, on corporate governance and growth

Unlike sales, growth is not a direct consequence of implementing sound governance inside the family business. However, the corporate governance framework is a control and management style that may, if well implemented, improve the efficiency of the business and lead it to growth. In other words, when it comes to sales, the more you sell, the more you grow. When it comes to governance, the dynamic differs: you have to first implement a corporate governance framework starting from the top to the bottom. This already takes time and effort since it is a change in culture and management. Sound governance will improve transparency, control and efficiency. Investors, lending institutions, suppliers and consumers then will gain better confidence in the well governed business. Growth follows.

Fourth, on growth and corporate governance

Growth encourages business owners to implement corporate governance frameworks within their business due to the positives it bears on transparency, efficiency, oversight, accountability and other important principles, which, as explained above, attracts in turn new investments, markets and businesses, and fuels consequently further growth.

Whether a family owned business or not, governance is an essential for growth.

Results of a survey published by the IFC[1] show that the premia to be paid by investors in a company with better governance is substantially higher compared to companies with average governance. In developing markets it can increase by 57% and in emerging markets it can double. Additionally, investors are more inclined to study investing in companies in countries with improving governance. This is strengthened by the volatility of markets and the recurrent financial crises.

For all of the above, governance should be considered a priority to be implemented in companies, and in families where applicable.

---

http://www.ifc.org/wps/wcm/connect/dbfd8b004afe7d69bcb6bdb94e6f4d75/IFC_EMI_Survey_web.pdf?MOD=AJPERES