

# Let's chat

Improving family dynamics through stronger family governance

April 2022

## Family governance

Family businesses are the backbone of most economies and PNG is no exception. However, historically most family businesses have few, if any, formal governance procedures and structures in place for either the business or the family. One of the themes from our [2nd PNG Family Business Survey](#) was that the barriers of resistance to change appear to have been lowered and the journey has started to professionalise family businesses in PNG.

This is based on our findings that showed:

- 44% of respondents now have a documented vision and purpose statement
- 41% have succession plans
- only 9% say there is resistance to change.

In this issue we talk about what we mean when we talk about family governance and why it is important for family businesses.

### What is a family business?

Michael Collins, our Entrepreneurial and Private Business Director, explains how we typically see a family business:

"When I look at a company, I look for four factors that make it a family business. Firstly, there must be an active business or group of businesses. Secondly, there must be a dominant owner. Thirdly, that dominant owner must be a family. And finally, that family should typically take a multigenerational approach that sees the current generation as trustees for the future generations."

### What can success look like for a family business?

At PwC PNG, we have worked with PNG family businesses for over 60 years and we have a team dedicated to working with the owners of these family businesses to achieve success.

Based on our experience working with family business owners, we understand that success in a family business can mean different things to different people and families.

"Success in a family business can be put into four buckets," says Collins.

"These are economic value, emotional attachment, family cohesion and personal happiness. These goals can often be a source of conflicting priorities and personal interests between family members, but it is important to recognise that a successful family business requires the family to also be cohesive and aligned in its goals and vision whilst still allowing flexibility for the needs of individual family members."

Unfortunately achieving long term success can be difficult.

Studies have shown that for every 100 private businesses that commence, only 30 make it into the hands of the second generation, only 13 will go into the third generation, and just three out of the starting 100 will make it into the fourth generation.

In PNG, a lot of our family businesses are in their first or second generations. We are currently working with many of these family businesses to help them with their transitions of management or ownership and establishing strategies to help them meet their business and family goals.



A few challenges that we see are:

- The current owner wanting to spend more time with family that may be based outside PNG, but they don't have the next generation willing to become involved in the family business, or a management team in place, that allows them to spend an extended period of time outside the business.
- The next generation feeling ready and willing to take a bigger role in managing or becoming an owner of the business, but the current generation is not yet ready or planning for that transition.

These are just some of the current challenges that family businesses face in PNG, many of which have been exacerbated by the recent pandemic and economic upheavals. However, these are not the only challenges for a family business to be successful. As Collins says, "Our experience shows that most of the challenges and conflicts can be traced to the areas of **money, power, love and happiness**."

### What are some of the challenges?

#### Money

There can be disputes over dividend payments, investments and remuneration of family members working in the business. Given family members may be resident in two or more different countries, disputes can also arise over tax optimisation, private use of the family business' assets and potential retirement arrangements.

#### Power

The ability to exercise control or influence, and access to information, is a common source of conflict. There can also be disputes over selection, suitability and performance of the next generation, particularly within sibling or cousin consortiums. There may also be disputes over distribution of competences, freedom of action, powers of attorney, rights of instruction and responsibility.

#### Love

Is there never a favoured child or favourite grandchild in the family? How should the family treat spouses and in-laws in the family and the family business? There is often rivalry and disputes over preferential and equal treatment between family members and over the appreciation, gratitude and acceptance for new family members.

#### Happiness

When does the stability of the family and the family business take precedence over individual happiness and freedoms? There can be disputes over behavioural norms and life models and the conflicts between duties and freedom of choice and action.

In between these areas there can be challenges in relation to leadership, rights and duties, compensation and exit. Given these challenges, we focus on the owner's perspective of how to address them - partitioning ownership issues from business issues, setting up good corporate governance mechanisms, establishing the family rules, establishing a conflict resolution mechanism and having an overriding commitment to fairness within the family.

#### The Owner's Agenda

"When we talk about the owner's perspective we look at both the family strategy and the business strategy to align these as one owner's strategy," says Collins.

"This helps to better understand what the owner is wanting to achieve, and how they will achieve it, so that it will be in the best long term interests of both their family and the business. Once the owner's strategy is in place, it will help influence both the family strategy and the business strategy moving forward."



## So what is our approach?

### Family

From the family perspective we need to understand who comprises the family and what are the respective family members' roles in the family and in the family business (if any). The family structure gets larger, and the issues more complex, as the business moves through generations. This helps us get a basic understanding of each family member, understand their relationship status and personal goals as well understanding what their aspirations are for their family and the business.

Some of the questions that generally get asked as a result of these discussions include:

- Who can be a shareholder, what does the transfer of shares look like, when does it take place and according to what principles?
- How many, and who, should have key roles with the family and the family business?
- For family members working in the family business and for family members not yet working in the family business - what are their plans?
- Does the family remain as one or do they form family branches?

### Business

From the business perspective we need to understand the challenges in the ownership, investment and governance structure that the family business is facing. We do this by not just looking at today, but also the strategy for the future.

We use discussions with the owners and the management of the family business to understand the ownership structure, investment structure and governance structure and this helps identify the challenges they currently face and prepare them for future challenges.

As Collins says, "We currently have a number of family businesses in PNG that are in the second generation with a sibling partnership, however, they will become a cousins' consortium when the current sibling owners pass their shares to their children."

Collins continues, "Obviously the challenges that the current generation of owners faced and overcame will be different to the challenges that the next generation of owners will face. As well as that the cousins will naturally have a different way of working together than their sibling parents."



For example, typical issues when looking at a sibling partnership include sibling rivalry, ownership competency and entrepreneurial spirit. However, once the family business moves to a cousin consortium the typical issues are around the diversity, old rivalries, entrepreneurial spirit, reduced owner identification and maintaining cohesion."

Once you have an understanding of the family ownership structure, the governance structure and the business lifecycle, you are in a position to help the family put together their owner's strategy.

Typically the owner's strategy process comprises a series of meetings with the family members to workshop family members' views on the following areas:

- goals and values
- membership
- owner business model
- business governance
- family governance
- roles and people.

The goals and values workshop helps everyone express their understanding of the goals that the family wants to achieve; which values they want to set for the family; the importance of the family's history and identity; and the family's culture.

Collins adds, "As a result of the COVID-19 pandemic we have seen a distinct change in priority for a lot of PNG family business culture's from being business first to family first."

The membership workshop allows discussion on issues such as: how and when does the family pass on ownership; how the family will deal with the implications of increasing fragmentations of ownership; and how will the role of the family's branches evolve in the future.

Collins adds, "We have a number of clients who have run very successful family businesses for several decades. While some of these family business owners are able to pass the business to their children who are already working in the family business, there are other children who have no interest in the business and are looking to do their own thing. We also see the impact of marriage break ups and family conflicts on keeping the family business membership together."

Typical matters discussed around the owner business model include: the economic and emotional value derived from the business; whether the family all agree on a clear set of economical boundary conditions for the family business and the principles for future business strategy and financing.

Collins adds, "It can be difficult to agree on a clear set of targets related to growth and profitability or risk management, but having an agreed and documented strategy and policies around business diversification, risk comfort, dividend policy, and debt tolerance helps to ensure all family members understand and support the business model."

The business governance workshop focuses the family on how they keep or organise control in the family business; how they deal with power-related issues; and the trade-off between compensation of those working in the business and the dividends to the wider family group.

Discussions on family governance helps identify the overall goals and values of the family, the rules for how the family deal with each other and how conflicts are resolved.

Collins adds, "It is important the family can agree on how they deal with each other, especially in the event if there is conflict. Having a properly documented conflict resolution mechanism discussed and agreed before it is needed is very useful for the long term success of both the family and the family business.

The final stage is to identify the governance roles within the family and the family business required from family members and who is best placed, and willing, to take up those roles.

Collins adds, "Not everyone can be a senior executive or director in the family business, but there are many other ways all family members can contribute and be committed to the success of the family. Having clear understanding on the roles and people in the business and the family are vital to the long term success of the family and business especially as the family business passes from one generation to the next.

My own family's business is a good example. When I was a child it was expected that the oldest son inherited the farm and the daughters would be looked after by their husband's family. In the last 30 years, that has changed significantly and we now see a lot more equity and fairness to all family members."

The owner's strategy is a process and should lead to further steps. Typically this may include a family constitution, establishment of an advisory board for the company, legal implementation of strategies and structures, action lists, family activities and family education.

"One of the most important things about this process is to remember that it evolves, and as time passes and things change, it is important to review and revisit this process," says Collins.



## Join us for an Owner's Agenda session

If you would like to find out more about family governance and how PwC can help you better understand your owner's strategy and business strategy, we invite you to attend a complimentary owner's agenda session with us.

### Built around you

In a two to three-hour Owner's Agenda session, the conversation and talking points are built around you, since we know how important your business is to you and your family. It's built on your ambition, grows with your potential, and shapes your legacy.

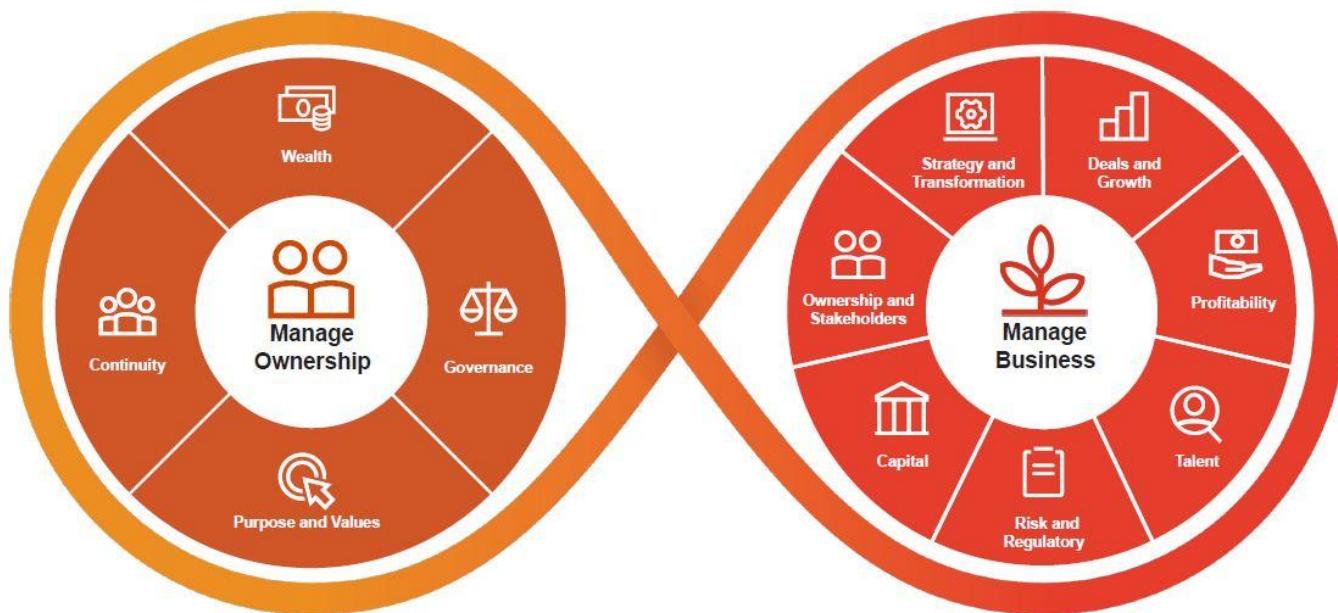
Against the backdrop of a world in constant flux, you need the perspective to stay focused on today's goals and the confidence to set new ones to keep pace and evolve your growth.

That's where we come in. For us, your success is personal – we're dedicated to understanding what matters most to you and your business, every day. From strategy planning to governance, we use our deep expertise to create the right approach for your goals. We call our approach The Owner's Agenda.

No matter where you are on your business journey, your PwC team is at your side translating our unique vantage point and perspective into real insights that can help you succeed.

Contact us to arrange a free meeting with us.

## The Owner's Agenda



### Manage Ownership

Using the Manage Ownership wheel, we can help you to identify and address the key challenges relating to your Owner Strategy.

### Manage Business

Using the Manage Business wheel, we can help you to evaluate the right strategy for innovative, sustainable growth, and to develop an approach for systematically managing profitability.

## 2nd PNG Family Business survey: Key findings

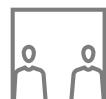
The responses of the PNG family business owners and executives who participated in the second PNG family business survey reveal important insights into how family businesses operated in 2020, their outlook for 2021 and beyond, and the issues high on their agendas. The key findings presented below are specific to family governance based on the results of this survey. You can download a copy of the survey report by clicking [this link](#).



**Family members communicate regularly about the business**

**62%**

Almost two-thirds (62%) of respondents report that family members communicate regularly about the business (66% globally and 63% in Asia Pacific), but nearly one fifth (18%) say they have no formal mechanisms in place to deal with potential areas of disagreement (21% globally and 31% in Asia Pacific).



**Conflict within family members is prevalent**

**15%**

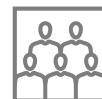
Some form of conflict in a family business is unavoidable, but there appears to be more conflict in PNG family businesses than in family businesses outside PNG. Only 15% of PNG family businesses say that they have never had a disagreement (compared to 23% globally and 25% in Asia Pacific). Disagreements that occur from time to time are experienced by 53% of PNG family businesses (33% globally and 32% in Asia Pacific).



**Last wills and testaments are in place**

**53%**

Interestingly, PNG appears to be ahead of every country in Asia Pacific other than Australia in having last wills and testaments in place (53% compared to 34% globally and 22% in Asia Pacific), but that still seems far too low given the disruption to a family and a family business that can result from an intestate estate.



**Succession planning is critical**

**22%**

In our previous 2018 survey, about one quarter (23%) of PNG family businesses expected that the NextGen family members should be majority shareholders within five years (24% globally and 17% in Asia Pacific). In the 2020 survey, this number rises to just over one fifth (22% which is lower than the 32% globally and 30% in Asia Pacific). Succession planning is therefore a looming issue for these businesses.

Whilst there may be a next generation of family business owners who are willing, and able, to take on a much larger role, the current generation also need to be in a position where they are ready to start letting go and to give the next generation increased responsibility and this may also require choices between who is to be given those opportunities. This can result in conflict due to the misalignment between family members' expectations.

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