

ROLE OF GOOD FAMILY GOVERNANCE ON FAMILY'S FIRM SUSTAINABILITY (A CASE STUDY ON COMPANY X)

Andrew Setiono¹

Universitas of Ciputra, Surabaya
INDONESIA

Emails: andrew_setiono@hotmail.com

ABSTRACT

Along with the growth of a family's firm and the number of family members who joined the firm, succession issues and conflicts within the family firm is one of the topics that requires a special attention. With the aid of a good family business governance, a family firm can balance family's interest and business' interests so as to reduce friction created due to conflict. Implementing a good governance system will have a positive impact on the performance of the family's firm. The purpose of this study was to analyze the role of good family governance on family's firm sustainability. The method used in this study is one that is qualitative. This is done by conducting interviews with several parties who have different employment background. The number of sources used in this study are four person who have a deep knowledge about the succession, conflict management, and governance. The result of this research is that the application of governance has a widespread role for the sustainability of the family firm.

Keywords: Family Business, Succession, Conflict, Policy, Governance, Accountability, Transperancy, Fairness, Consensus Oriented.

INTRODUCTION

Family business is a company that is owned, controlled and run by members of one or several families, or managed by family members. Nevertheless, that does not mean that all employees in the company must a family member. Many family businesses, especially the smaller ones, employ non-family members to occupy low positions, while members of the family who owns the company hold higher position (i.e. top manager).

In the terminology of the business, family business is defined as family owned enterprise (FOE) and family business enterprise (FBE).

Family consolidation in a business gives huge impact for the company, since the company has strong financial strength as supported by the shares of all family members. This high capital of a company will enable the company to survive competition with other family businesses in similar business field. Yet, in conjunction with the growth of family businesses in Indonesia, sustaining the family business is not as easy as building it. There has been an assumption that working with people who are as close as our family is easier than working with new and unfamiliar people. In fact, business demands professionalism from all members of the family in a family enterprise and requires the members to separate between family matters and business matters in order to face challenges and problems in running their business. Fact has shown that almost 40% of total family businesses will face business split when reaching the second generation and about 80% will face business split when reaching the third generation.

The researcher's family owns a sole trader company (addressed as Company X), Company X, as a family business founded by the researcher's parents under the initial HS. This company has been in business in these recent three years, engaged in supplying raw materials for food for local market (for factories, grocery stores, or end user) and other markets outside Java (for the region of Central Indonesia and Eastern Indonesia). Prior to building Company X, HS became one of the shareholders in a family enterprise of Company SMA (later is addressed as Company Y) as the second generation in his family enterprise. Founded by TKL, the father of HS, Company Y later became a legacy to his three out of fourteen children. The company at that time was led by an older brother, GP (in marketing), HS himself (in marketing), and his younger brother RS (in accounting).

Conflict in Company Y began to rise since the last 10 years, when the children of the second generation started to enter the company to participate in the company's business activities. Conflicts in PT.Y were actually triggered by suspicion among family members, that the real reason behind the breakup of the company that was built and operated for 55 years was the imposition of bad-debts incurred by the sale of HS family, as caused by inability of payments of customers of HS, by GP's family, and was assisted by RS family. Consequently, this led to conflicts happened in Company Y, resulted in the company's performance in past few years, where each family member, without doubt, removed their assets from parent company and made investments to other things such as properties, deposits, gold, to invest in other things such as property, deposits, valuable metals, and others.

Problem Formulation

Regarding the background discussed in previous section, the researcher formulates the statement of problem as this research focus "How is the role of good family business governance to the sustainability of Company X as family business?"

Research Objective

To answer the research problem, objective of this research is to explore the role of *good family business governance* in the sustainability of Company X as family business.

LITERATURE REVIEW

Genogram

Poza and Daugherty (2014:38) describe *genogram* as a chart of a family tree that will provide useful information on name of family members, ages, lineage, and other critical events such as history of divorce and quality of relationships across family members.

Organization/Ownership Chart

Sharma *et al.* (2013:14) describe *organization/ownership chart* as chart that outlines the internal structure of a company, including the roles and responsibilities between the individuals in the company. The main function of this chart is to help understanding the authority of each individual in a company and in its departments.

Succession Issue

Aronoff *et al.* (2011:27) explain that the primary goal of succession process is to build and develop family business and to ensure that the business can run and develop smoothly after the incumbent leader is no longer in control or contributes to the business.

Types of Conflict

Sharma *et al.* (2013:18) explain in their article that conflict in family business can be categorized into three: *task conflict*, *process conflict*, dan *relationship conflict*. *Task* and *process conflict* often happen as resulted by working problems in the company, where *task conflict* arises more because of disagreement in a group with the means of achieving the expected target or goal while *process conflict* arises more because there are individuals or groups who disagree with the means of achieving the target that has been previously discussed and agreed. On the other hand, *relationship conflict* arises not because of running the business, but due to negative feelings or negative emotions happen between individuals in family business.

Governance of Family Firm

Sharma *et al.* (2013:5) define *governance* as a system established to lead multi generation family business in managing all processes in a company that consists of strategies to achieve the set target, maintain the relationship among individuals in the company, keep the good health of individuals in the company, and sustain well performance and achievement.

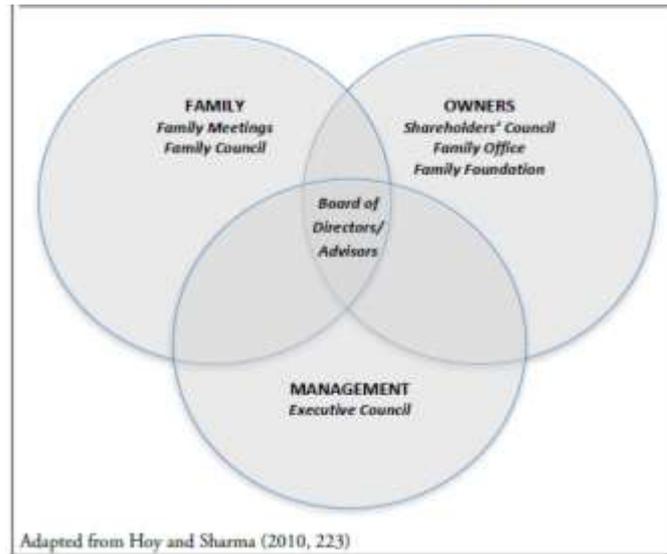


Figure 1. Davis's 3-Circle Model

Effective governance also requires agreement in determining the family policies that must be established first before building the company, in order to anticipate processes or decisions that can destabilize the health of the company. These policies include participation of family members in the company, liquidity for shareholders, information and education to the shareholders, responsibility for asset owners, succession for the company's leadership, and other potential problems that may arise in the future. These policies and procedures, after being understood and approved by members of the family, must be executed consistently and equally.

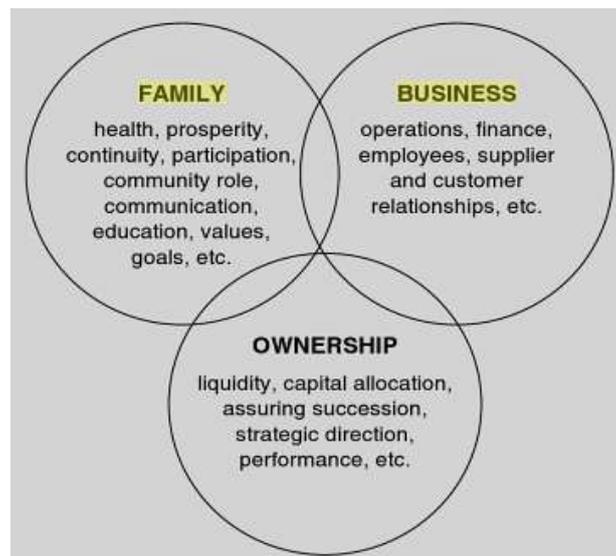


Figure 2. Dimensions of Family Business Governance

Elements of Governance

1. Accountability
2. Transparency
3. Fairness
4. Participatory
5. Consensus Oriented / Consensus Building

Accountability

Accountability refers to obligations and responsibilities of giving reasons or explanations of all activities in the company and all decisions made by the company.

Transparency

Transparency refers to all decisions taken by the board already follow the rules and regulations of the company. This also means that information about company's decisions and their sources are available and accessible for those who are impacted by the decisions.

Fairness

Fairness can be defined as equal profit share among all family members participating in the business. Fairness is also equal treatment of all family members.

Participatory

Participatory is a natural process of involving all family members participated in the family business, whether as a management team, board member, or as a shareholder.

Consensus Oriented/Consensus Building

Consensus oriented requires mediation of various individuals' expectation or group's expectation in order to achieve wide consensus, in order to achieve the best expectation. This also requires comprehensive long-term perspective on what are needed for the sustainability development of a company and for achieving the objective for people's or company's development.

Sustainability

Sustainability not only extends the product lifecycle through global competition, supply chains, and lifespan of a company's product, but also seeks relevant and enduring sustainability of a company beyond multi generations.

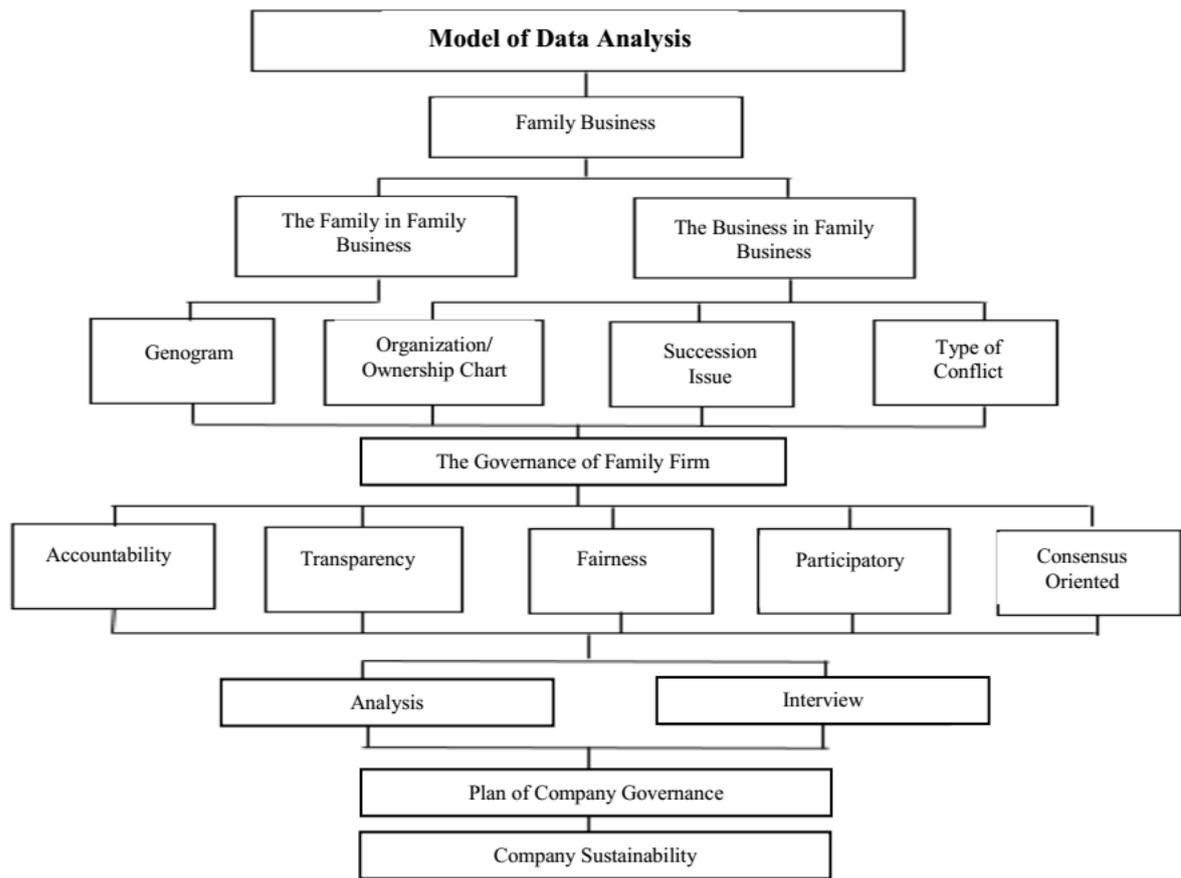


Figure 3. Model of Data Analysis

RESEARCH METHODS

Source of data

This research is qualitative in nature. The respondents are chosen by implementing purposive sampling technique, as a strategy to select group of respondents as the informants based on the defined criteria. The size of informants, who are probably or improbably selected, must be set before collecting the data, depends on sources and time available, and research objective. The basic key of purposive sampling is the knowledge of information by the informants, since logically all key figures in social research always have direct access or master the information needed for the research matter.

The researcher uses structured interview technique to interview four informants who are selected based on the criteria that they master the knowledge of information on family business governance. The informants selected are leaders or CEO who are believed to run good family business governance in the companies they handle. The researcher also interviews expert in human resources management. Another informant selected for this

research is an expert in handling conflicts in family business or known as consultant of family business.

Research Result and Discussion
Genogram

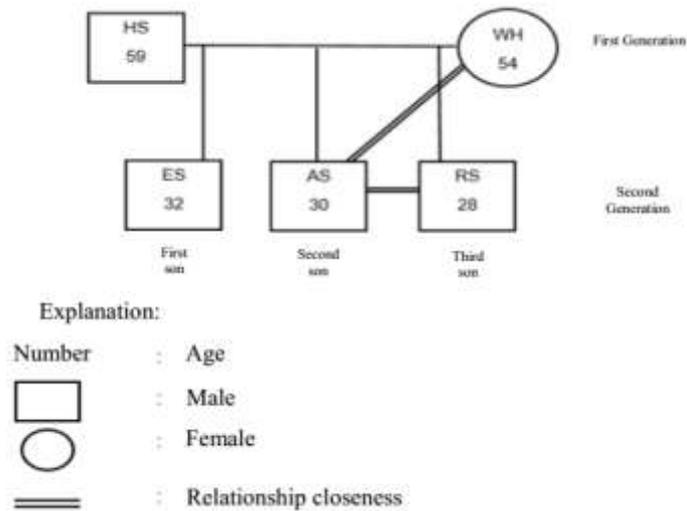


Figure 4. Genogram of Company X

Image 4 shows the family tree structure of Mr. HS as the owner of Company X. The image shows that Mr. HS is recently 59 years old and his wife, WH is 54 years old. Mr. HS has three sons. The firstborn is recently 32 years old, the middle son is 30 years old, and the third son is 28 years old. All Mr. HS's sons are active employees of Company X. These three sons are the second generation of Company X who are prepared to replace Mr. X after his retirement from the company.

Organization Chart

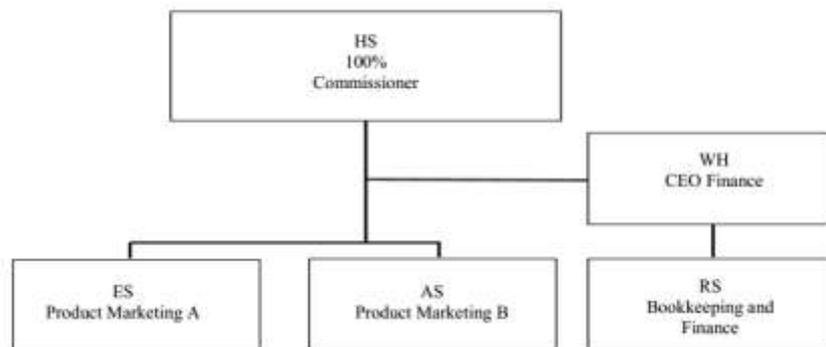


Figure 5. Organization Chart of Company X Before Research

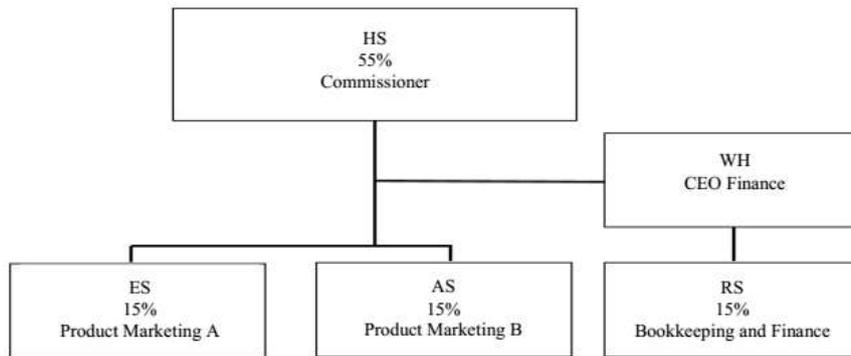


Figure 6. Organization Chart of Company X after Research

In establishing the working divisions in Company X, all members have their own tasks and responsibilities based on their experience and abilities. There are three primary objectives of share dividends from the first generation to the second generation, which are as follows:

1. Share dividends or the amount of a person's ownership to a company is a process of inheriting the company from a first generation to its second generation (succession process).
2. Record all individual's revenue properly and in accordance with each portion. This is to ensure that no individual expenses, including possible irresponsible expenses, will harm the company. Besides getting basic salary and bonus, all children also get their dividends each year. The dividends can be used either for personal needs or for investments such as land property, gold, stock for new business, and many more.
3. Reduce excessive feelings of distrust and envy among family members in a company.

Table 1 . Informants

Name	Workplace	Status	Code
Himawan Wijanarko	Jakarta Consultant Group	Consultant	HW
Denny Bernadus	Ciputra Group	Director	DB
Yuntoro Effendy	ABIN Group	Owner	YE
Astrid Wiratna	Siloam Hospital	Psychologist of Family Business	AW

Succession Issue

Criteria of successor

The followings are several primary conditions that must be considered when looking for a future successor for inheriting the family company founded by preceding generation:

1. Future successor must have interest and passion in family business.

2. Capable to manage family business, both in terms of educational background and management ability of managing, governing, and leading employees of the family company.
3. Future successor must have strong commitment.
4. Future successor must truly know and understand the condition of the family company that is handled.
5. Future successor must have excellent quality and capability of a leader.

Strategies to determine and improve the successor

It is important to remember that the firstborn or the oldest son do not automatically have the competencies needed to continue their family company. Therefore, one way to find out the capabilities and competencies of a prospective successor is to deploy them to the lowest level based on their recent educational background and capabilities. This can be used to prepare prospective successors for their next responsibilities, as well to predict who will become the future successor based on the highest performances and competencies shown in their position. In addition to this, a future successor must be a trustworthy since that person will receive a great responsibility, which is to develop the family company to become bigger than the first generation already achieved.

The role of the founder to assist the successor

The founder or first generation has a very significant role in the family company, especially when conflict happens among the members of the family. Thus, it is expected that the first generation must maintain their neutral position and not to take side with even their favorite child.

Types of Conflict

Conflict management

Conflict in a family business is almost impossible to avoid, since there have been differences of opinion, ways of thinking, capabilities of each member, and many more differences. Thus, the best way to minimize conflicts in a family business is to implement good communication among family members in the company.

The role of the founder to conflict in a family business

The founder or first generation has important role in managing the conflicts that happen. They are expected to be in a neutral position and do not take side.

Policy

Company policy is an absolute necessity needed to minimize frictions that may occur among members of the family, among employees, and as caused by problems faced by the company due to decrease of company's productivity. Hence, the business wisdom is also required to adjust the company development with the situation or problems, to enable the sustainability of the company.

Increase desire to follow the existing policies

Policies of a company will influence the sustainability of that family business, which is why it is very important to involve all family members when formulating the policies. When involving all members to formulate the policies, consequently, the members are willing to follow all policies that are formulated in consensus. Good communication is

required between the first generation and the next generation, when they are required to implement policies that were already formulated by the first generation.

Governance of Family Firm

Accountability

The role of accountability to company sustainability

Accountability of family company is highly needed for sustaining the company. Akuntabilitas dalam perusahaan keluarga tersebut sangatlah penting bagi kelangsungan dari perusahaan keluarga itu. Selain itu apabila setiap anggota keluarga memiliki akuntabilitas yang tinggi maka kegiatan perusahaan keluarga dapat berjalan secara optimal.

Responsibility of second generation and next generation

The main responsibility of next generation in a family business is to continue the business that has been run by the previous generation. It is also important to consider that the next generation must be able to develop the company more than the previous generation already did.

Risk Management

All that is vital and involve the life of a family company must be discussed with all members, including the strategic planning, risk and return, and many more. This is to minimize mistakes in making a decision and to avoid blaming between the family members when the decision made has negative impact to the company.

Transparency

The role of transparency to company sustainability

Transparency in a family business has significant influence to company sustainability. Transparency in a family business can affect future successor to make decision whether to join the family business or not. In addition to that, transparency among family members can reduce the feelings of distrust among others.

Aspects that need transparency

Financial is the main aspect of a family business that requires transparency, since this aspect shows whether the family business gain profit or less in a certain year. Transparency of cash flow of a family company will reduce the feelings of distrust among the members. However, we have to consider that there are certain levels for information distribution of a company. Some information can only be shared to the CEO members but not to other departments, such as the amount of employees' salary, amount of employees' bonus, and other information.

Fairness

The role of fairness to company sustainability

Business split is mainly caused by feelings of distrust, envy, suspicion, and dissatisfied with other members. The seeds of those feelings can also cause relationship conflict among the family members. To anticipate this, fairness can be promoted in order to

avoid or minimize relationship conflict. Fairness means fair in treating all members without taking side, fair in coping with problems, and fair in benefit sharing over profit and revenue of a family company. Relationship conflicts can be minimized when the aspect of fairness is promoted and established. As for its long-term effect, business activities of a company can be more optimized in order to ensure the family business sustainability.

Aspects that need fairness

All aspects related to family business matters need fairness, including fairness in treating all members, in coping with problems, and in benefit sharing.

System of compensation in family business

Systems of sharing compensation that implements fairness among passive shareholders and active shareholders certainly have differences. Passive shareholders have right to their dividends, while active shareholders who are also actively working in family business have right to dividends, basic salary, and bonuses as regulated by the company policy. Therefore, contributions and competencies of a member are things to be considered in sharing the bonuses in order to minimize envy among other members.

Participatory

The role of participatory to company sustainability

Family company is a company founded and raised by all family members. For that reason, all members should have role and contribute in formulating a business strategy and decision in a company meeting. Each member surely has different way of thinking with positive values. Therefore, if all positive values as contribution of all family members can be well collaborated, it will give maximal result to the process of formulating strategy and decision for the company.

Parties who can participate

Family members who actively participate in a family business, active in operational activities of the company, and possess sufficient knowledge and understanding of the company, must be involved in a family meeting and their voice need to be listened to and considered when discussing company's strategic planning. On the other hand, family members who are less active in the family company do not need to be involved in order to make the meeting time more efficient and to avoid conflict that can happen during decision-making process.

Consensus Oriented

The role of consensus oriented to family business sustainability

Consensus has significant roles to the sustainability of a family company. As a main and basic aspect, consensus consolidates commitments of all family members to continue and develop the business founded by their first generation. Without commitments of family members in a family business, the business will not survive long. Consensus comprises vision and mission of a company that must be achieved and reached by all company members. Consensus will also minimize conflicts of each individual.

The role of good governance to family business

Governance enables a company to have a smooth decision-making process, solid family members, and minimum internal conflict, where those are the main foundation of shaping the sustainability of a healthy family and business.

Good governance means shaping two differences become one goal. In practice, the critical success factor of governance process is to seek for consensus against the owners' desires, and to provide all family members with shared sense of identity and mission. Shared vision and mission among family members will also shape family policies that regulate all behaviors and decision-making process of a company.

CONCLUSION

Preparing the business transfer from one generation to its next generation is one of the most difficult and crucial challenges faced by a company in facing the ownership issue of the company. This is a responsibility of active leaders in managing the succession process. One of the most important steps to conduct is to prepare the future successor as early as possible by introducing and guiding the future successor to the company, in order to enable the successor to lead the company later as well as expected.

One of the problems happens in a family business is a conflict between the family members. The conflicts can be *task conflict*, *process conflict*, and *relationship conflict*. Thus, it is very important to shape and develop company policies in order to minimize the conflicts possibly happen. Since family business is dynamic in nature, conflicts can happen repeatedly and can damage the effectiveness of a family company, therefore policies development can be used to resolve the conflicts that happen.

Good governance is an abstract concept which aims to balance the needs of family and of business. Through governance, company can have smooth decision-making process, solid family members, and minimum internal conflict which are the main foundation of shaping the sustainability of a healthy family and business.

Good governance shapes two differences into one goal. In practice, the critical success factor of governance process is to seek for consensus against the owners' desires, and to provide all family members with shared sense of identity and mission. Good governance functions dynamically and needs modifications to adjust with the growth number of family members and the development of the family company itself.

REFERENCES

- Aronoff, Craig E., Astrachan, Joseph H., Ward, John L. 2011. *Developing Family Business Policies : Your Guide to The Future*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E., McClure, Stephen L., dan Ward, John L. 2011. *Family Business Compensation*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E., McClure, Stephen L., dan Ward, John L. 2011. *Family Business Succession: The Final Test of Greatness*. First Edition, United States : Palgrave Macmillan.

- Aronoff, Craig E dan Ward, John L. 2011. *Family Business Governance : Maximizing Family and Business Potential*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E dan Ward, John L. 2011. *Family Meeting : How to Build a Stronger Family and a Stronger Business*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E dan Ward, John L. 2011. *Making Sibling Teams Work : The Next Generation*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E dan Ward, John L. 2011. *Preparing Successors For Leadership : Another Kind of Hero*. First Edition, United States : Palgrave Macmillan.
- Aronoff, Craig E dan Ward, John L. 2011. *Preparing Your Family Business For Strategic Change*. First Edition, United States : Palgrave Macmillan.
- Bungin, H. dan M. Burhan. 2011. *Penelitian Kualitatif : Komunikasi, Ekonomi, Kebijakan Publik Ilmu Sosial Lainnya*. Edisi Kedua. Jakarta : Kencana Prenada Media Group.
- Collin, Ahlberg .2012. *Family Governance of Family Firm*. Jurnal Ekonomi.
- Dana, Leo Paul dan Ramdani, Veland. 2015. *Family Business in Transition Economic : Management, Succession, and Internationalization*. Switzerland : Springer International Publishing.
- Denis, Diane K dan McConnell, John J. 2001. *International Corporate Governance*. Purdue CIBER Working Papers. Paper 17. :
- Economy Building. 2011. *Fairness in Corporate Governance*. <https://economybuilding.wordpress.com/2011/03/01/fairness-in-corporate-governance/>.
- Economy Building. 2011. *Transperancy in Corporate Governance*.
- Fudda, Moin. 2014. *Corporate Governance in Family-Owned Companies in Pakistan*. CIPE : Center For International Private Enterprise.
- Graziano, Anthony M, dan Raulin, Michael L. 2010. *Research Methods : A Process of Inquiry*. New York : Pearson Prentice Hall.
- Hoy, F dan Sharma, P. 2010. *Entrepreneurial Family Firm*. New York : Pearson Prentice Hall.
- Ilyas, Muhammad dan Rafiq, Muhammad. *Impact of Corporate Governance on Percieved Organizational Success (Emirical Study on Consumer Banks in Lahore, Pakistan)*. Jurnal Ilmu Bisnis dan Sosial. Vol.3 , No.13.
- Juwitasari, Ratih. 2008. *Pengaruh Independensi, Frekuensi Rapat, Dan Remunerasi Dewan Komisaris Terhadap Nilai Perusahaan Yang Terdaftar Di BEI Tahun 2007*. Jakarta: Universitas Indonesia.

- Khan, Mahfooz Ali. 2014. *Governance*.
<http://www.hec.gov.pk/InsideHEC/Divisions/LearningInnovation/MUGUA/Documents/Material>.
- Lunix, Luvichan. 2011, *Good Corporate Governance*.
<http://gcgbyicha.blogspot.co.id/2011/08/empat-prinsip-utama-corporate.html>
- Kodrat, David Sukardi. 2010, *Manajemen Eksekusi Bisnis*, Yogyakarta : Graha Ilmu.
- Kuncoro, M. 2013. *Metode Riset Untuk Bisnis & Ekonomi "Bagaimana meneliti dan Menulis Tesis"*. Jakarta: Penerbit Airlangga.
- Moleong, Lexy J. 2010. *Metode Penelitian Kualitatif*. Edisi ke -28. Bandung: Remaja Rosdakarya.
- Monks, Robert A.G., dan Minow, Nell. 2014. *Corporate Governance*. Fifth Edition. United Kingdom : John Wiley & Sons, Ltd.
- Poza, Ernesto J., dan Daugherty, Mary S. 2014. *Family Business*. Fourth Edition. United States : South Western Cengage Learning.
- Ritchie, Jane dan Lewis, Jane. 2009. *Qualitative Research Practice : A Guide for Social Science Students and Researchers*. London : Sage Publications Ltd
- Sarbah, Alfred dan Xiao,Wen. 2015. *Good Corporate Governance Structures : A Must For Family Business*. Jurnal Ilmu Bisnis dan Manajemen. Vol.3, pp. 50-57.
- Sharma, Pramodita., Blunden, Robert., Labaki, Rania., Tsabari, Nava., dan Algarin, Juan O. 2013. *Analyzyng Family Business Cases : Tools and Techniques*. Jurnal Ilmu Ekonomi.
- Silva, Paulino dan Silva,Rui. 2014. *Family Business Transfer :The Importance of Continuing The Business*. Jurnal Ilmu Ekonomi dan Bisnis , Vol. 2, No. 5, pp. 184-190.
- Soegijono, Angela Nathania dan Haryadi, Bambang. 2014. Peran Pendiri Dalam Proses Sukses Kepemimpinan Pada Perusahaan Keluarga Di PT.BTS. Jurnal Ilmu Ekonomi Agora, Vol. 2, No. 2.
- Sudibyoy, Yonathan Popo. 2014. *Tahapan, Faktor Pendukung dan Faktor Penghambat Perencanaan Sukses Kepemimpinan Generasi Ketiga Pada Perusahaan Keluarga PT. Lubrical Suga Sejahtera Di Pasuruan*. Jurnal Ilmu Ekonomi Agora, Vol. 2, No. 2.
- Susanto,A.B., Wijanarko, Himawan., Susanto, Patricia., Mertosono Suwahjehadi. 2008.*The Jakarta Consulting Group On Family Business*. Edisi ke-2. Jakarta: The Jakarta Consulting Group.
- Tricker, Bob. 2015. *Corporate Governance : Principles, Policies, and Practices*. Third Edition. United Kingdom : Oxford University Press.

Whiteside, Mary F., Aronoff, Craig E dan Ward, John L. 2011. *How Families Work Together*.
First Edition, United States : Palgrave Macmillan.

Wright, Mike., Siegel, Donald S., Keasey, Kevin., Filantotchev, Igor. 2013. *The Oxford Handbook of Corporate Governance*. United Kingdom : Oxford University Press.