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Corporate Governance

Institutionalization of Family-Owned Companies

2018

"Corporate governance involves
a set of relationships between
a company's management, its board,
its shareholders and other stakeholders.
Corporate governance also provides
the structure through which the objectives
of the company are set, and the means
of attaining those objectives and monitoring
performance are determined".

OECD Principles of Corporate Governance

Context

There is no shortage of privately held companies in the CIS. Most of them emerged with the rise of private ownership that followed the Soviet Union's collapse, and throughout their brief corporate histories, the personalities of the founders have typically played a dominant role. Today, the involvement of owners in day-to-day management often remains substantial at private companies, and the decision-making process tends to be largely informal.

As private businesses mature, founders may want to move away from close involvement in operations and pass the helm to the next generation, or to outside executives. Founders and their families would then typically retain board membership after the succession, thus remaining involved with the company at the strategic level.

Regardless of any plans for an IPO, any business will face the necessity to establish a corporate governance system that is able to support its advancement toward its long-term goals. One important objective of corporate governance is to facilitate a smooth transfer of executive functions from the founder to successors to ensure business continuity and progress without its founder at the helm. Yet another critical objective is to draw a clear distinction between private and corporate assets in order to determine the role of each family member in the running of the business and to coordinate the decision-making process among family members.

Common issues of private family-owned companies

Introducing robust corporate governance practices

It takes a consistent approach to implementing robust corporate governance practices to overcome the issues commonly observed at private family-owned companies. Among other things, this typically involves setting clear delegation principles for the governing bodies, documenting their responsibilities, institutionalizing a solid decision-making process within each body's mandate and setting up a proper internal audit function.

Corporate governance challenges at private family-owned companies

Take care of the Company assets and keep growing without losing control of the business

Separate the family roles from the organizational ones by keeping the harmony and the family ties

Answer to real market and competence pressures

Anticipate the incorporation of future generations to the business and / or succession of key positions in the organization

Create transparency and confidence for external investors, family shareholders and to the general public

Deloitte services

As a general rule, corporate governance codes are drafted with a public company in mind, yet some of their recommendations may apply to other organizations as well. The Russian Corporate Governance Code, for example, contains detailed guidance on the board nomination process, executive appointments, compensation practices, risk management, internal audit and the internal control function that we find to be generally applicable to family-owned companies as well.

However, private family-owned companies have their unique governance traits that call for dedicated guidance. With support from Deloitte, the British Institute of Directors (IoD) and the European Confederation of Directors' Associations (EcoDa) released "Corporate Governance Guidance and Principles for Unlisted Companies in the UK" (the "Guidance"). The document contains 14 principles designed to promote the long-term success of private family-owned companies, their continuity and sustainability. As noted in the Guidance, in private family-owned companies good corporate governance, "...is not primarily concerned with the relationship between boards and external shareholders (as in listed companies). Nor is it mainly about compliance with formal rules and regulations. Rather, it is about establishing a framework of company processes and attitudes that add value to the business, help build its reputation and ensure its long-term continuity and success".

Stage 1.
Corporate Governance Review

Our standard approach is to start our engagement with a family-owned company by reviewing the existing corporate governance arrangements. Depending on the specific goals of the engagement, the scope may range from covering one legal entity to an entire group of companies held by the family. This exercise allows to achieve the following objectives:

- Assessing the extent and specifics of the involvement of the founders and their families in the company's (or the group's) management and providing recommendations that are aligned with relevant best practices;
- Identifying gaps and grey areas in the decision-making process of the company's (or the group's) governing bodies;
- Tracking the escalation procedures for key decisions to the level of the board of the holding company and/or beneficiaries;
- Based on the results of the review, developing recommendations for a target corporate governance architecture of the company (group).

Based on the results of the review, we formulate recommendations that represent concrete steps toward developing a robust corporate governance system and present them to the project's sponsors. Our recommendations account for the applicable local and international regulations on corporate governance and are grounded in relevant best practices. At the same time, our recommendations take into account the specifics of the business and the company's corporate culture.

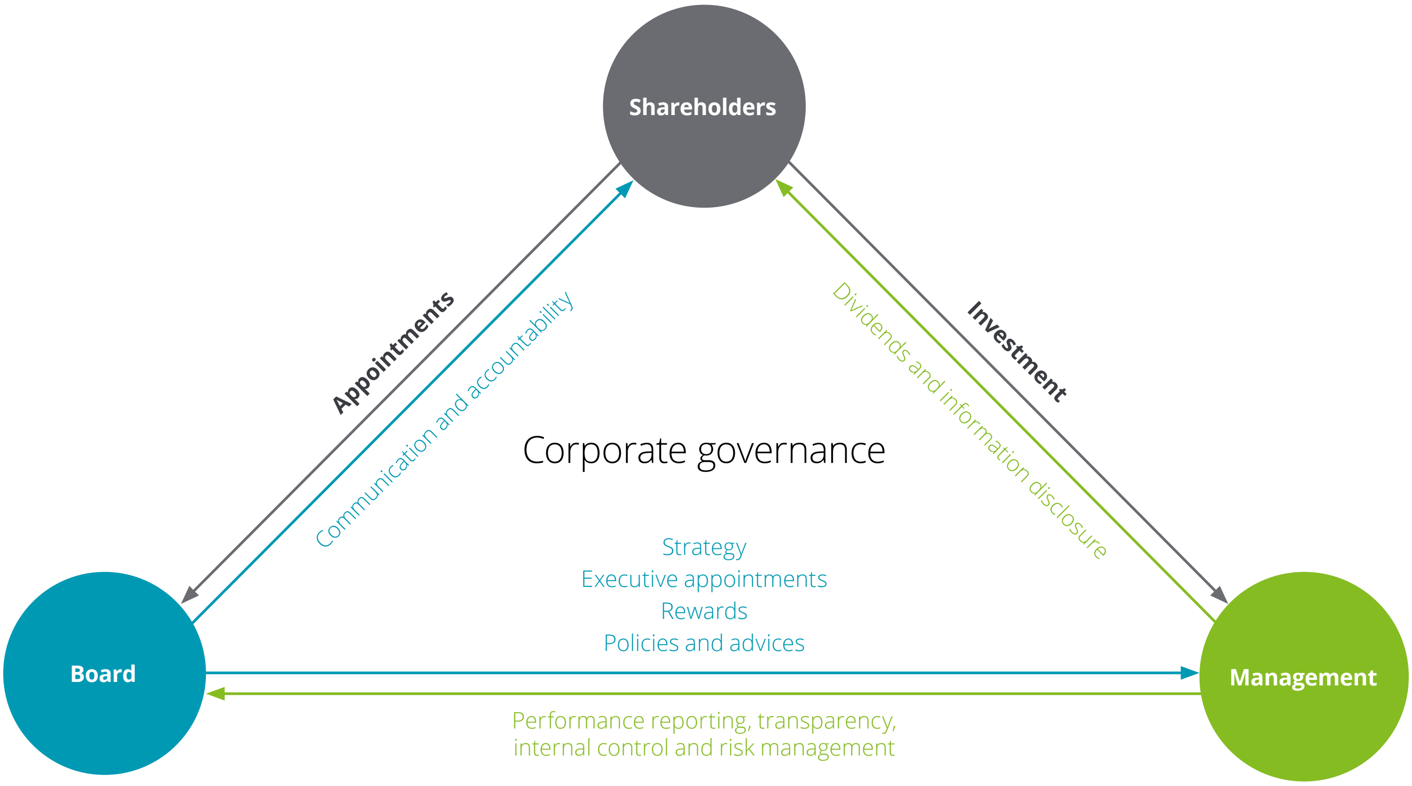
Stage 2.
Implementing changes to corporate governance policies

In order to enable improvements to the corporate governance system, some recommendations need to be reflected in the company's internal documents. We would typically assist our clients in amending the charter and internal policies of the company (or the group) in line with the accepted recommendations, or develop these documents from scratch. In this way, specific recommendations would be implemented in full, paving the way for a balanced corporate governance system, with clearly defined responsibilities of governing bodies.

Stage 3.
Implementing changes to corporate governance practices

Corporate governance improvements are unlikely to succeed if they are not properly understood and embraced by all the parties involved in the corporate relations of the family-owned business. Deloitte has developed a number of training sessions for shareholders, board members and executives, designed to facilitate a broader understanding of corporate governance principles and practices as well as the specific recommendations provided by consultants and accepted by the project's sponsors.

Parties to corporate relations



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