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Death, dementia or disaster - The importance of succession planning under adverse circumstances

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"There are very few men - and they are the exceptions - who are able to think and feel beyond the present moment," - Carl Von Clausewitz (1780-1831)

The fall of a company founder is always big news, especially when this is a larger-than-life character, such as with Vernon Hill who was deposed as chairman of Metrobank or the untimely death of V G Siddhartha, the Coffee King of India.

Founders play such a vitally important role in their business, instilling pride and emotional commitment from employees, and adding to brand value. But, it is not unusual for a firm's market value to decline when a descendent takes over as the chief executive, even if the founder remains chairman.

This is one of the conclusions of a paper by Wharton professor Raphael (Raffi) Amit and Harvard Business School professor Belen Villalonga in their paper "How Do Family Ownership, Control and Management Affect Firm Value?". Their research suggests that family-owned corporations perform better than non-family firms when the founder serves as the chief executive or as its chairman with a hired chief executive.

While non-family companies suffer from conflict between management and shareholders over returns, management pay and governance; in a family-run company, the manager and owner are the same and so the conflict does not exist.

However, the flip side of this is that family businesses may struggle to recruit high quality management who can see no career path, and a company will be more adversely affected when something unexpected happens to the founder and there is no succession plan.

Also, a founder-led business needs to watch out for the cult of the superhero. Famous name founders can acquire disproportionate influence, in some cases achieving god-like status. There is a risk of bad decisions going unchallenged, especially when someone has the arrogance to hide in plain sight, like Robert Maxwell with his intimidatory tactics.

Proper business planning includes addressing risks and weaknesses in a business. This includes ongoing governance to ensure the effective transfer of the founder's values to the next generation, alongside contingency planning for the worst-case scenarios.

A good example of values transfer is Warren Buffet's decision to appoint his son Howard to succeed him as a non-executive unpaid chairman of Berkshire Hathaway with no responsibility for day-to-day operations. Buffet emphasized that his son's role is to serve as "guardian of the culture" because he knows the values of the firm.

Contrast this with the apparent lack of supportive governance which is believed to have contributed to the very sad death of Café Coffee Day founder VG Siddhartha, who is

suspected to have jumped off a bridge after having been missing for two days. He is reported to have written a letter (as yet unverified) discussing pressure from banks, investors and tax authorities, and intimating that there were certain transactions of which the company and the family were unaware.

Running a company is a wide-ranging and stressful job, especially when the founder has to act as the face of the business and attracts regular attention from the media. With many public calls on his or her time, it should not be a surprise that one person could become overwhelmed or unable to deal with proper scrutiny of the finances.

Good governance of family businesses is essential and should be seen as a supportive safety net for the founding family. It needs to be much more than a tick-box exercise or a set of written constitutions that sit on a shelf.

Director appointment letters and shareholder agreements should foresee adverse circumstances such as sudden death, ill-health, dementia, financial fraud, or potential conflicts between company and family financial needs.

Key issues to consider include: Where family members are employed, do they have clear roles? Are too many family members fighting over few key roles? Is infighting distracting from the business agenda? Is there proper separation of family needs from business needs? Is there enough scrutiny over related party transactions? Has the founder become reliant on someone with undue influence?

Family-owned companies need to put in place an effective board with independent directors who are not afraid to speak truth to power or to ask for clarification. It can be much easier for an independent director to address sensitive issues such as workload or mental health with a founder than it is for another family member.

Experienced independent directors and professional advisers have an important role to play, although the family should ensure that they each adviser is not overly dependent on the one family business and is able to maintain objectivity.

No-one can prevent death, dementia or every disaster, or the impact on the family and the business. But, with forward thinking, good governance, succession and contingency planning, a board can do much to mitigate the financial loss that can ensue for family, employees and other family business stakeholders.