Burbidge Capital

CORPORATE GOVERNANCE AND SUCCESSION PLANNING FOR FAMILY BUSINESSES

SEPTEMBER 2022

In collaboration with:

IN THIS ARTICLE

EDITORIAL TEAM

EDWARD BURBIDGE, CFA
Chief Executive Officer

VIRAJ SHAH,
Associate

KEVIN KURIA,
Associate Vice President

DIPNA SHAH, CFA
Associate Vice President

FOREWORD

Edward Burbidge, CFA

Welcome to the latest I&M Burbidge Capital Ad-Hoc publication, which explores and identifies the importance of Corporate Governance and Succession Planning for Family Businesses.

We believe the timing is right to publish this, given the number of businesses in East Africa that are either currently considering governance and succession issues, or need to! Several high-profile corporate failures in recent years have been caused by lack of governance, and there are an increasing number of family businesses where the lack of clear succession plan is beginning to lead to drastic value destruction.

We have partnered with other market institutions - the International Finance Corporation (IFC), PKF Kenya and IKM Advocates (DLA Piper Africa); and provided case studies on the development of corporate governance within Glacier Products Limited and I&M Group Plc, outlining their experiences on the growing importance of corporate governance and adequate succession planning strategies.

We therefore feel this publication can be used as a comprehensive initiation guide for companies improving their corporate governance or looking at succession planning.

I very much hope that you enjoy and gain useful insights from this publication.

Edward Burbidge, CFA
Chief Executive Officer
I&M Burbidge Capital Limited

What is Corporate Governance?

Corporate governance is a system that guides the conduct of the people within an organization, as well as the direction of the organization itself. It refers to the way in which companies are governed and to what purpose. Corporate governance identifies the leadership teams, decision makers and those accountable. It is, in essence, a toolkit that enables the management and the board to deal more effectively with the challenges of running a company.

What is Succession Planning?

The term succession planning refers to a business strategy that companies employ to pass leadership roles down to another employee or group of employees. Succession planning ensures that businesses continue to run smoothly and without interruption, after key people move on to new opportunities, retire, or pass away. It is the process of identifying the critical positions within your organization and developing action plans for individuals to assume those positions. Taking a holistic view of current and future goals, this type of preparation ensures that you have the right people in the right roles today and in the future.

1 GOOD CORPORATE GOVERNANCE IS ESSENTIAL FOR ALL BUSINESSES

INTERNATIONAL FINANCE CORPORATION (IFC)

GOOD CORPORATE GOVERNANCE IS ESSENTIAL FOR ALL BUSINESSES

INTERNATIONAL FINANCE CORPORATION (IFC)

The Author:

Rose Lumumba is a corporate governance specialist working with the International Finance Corporation Corporate Governance Advisory Program in Africa. She is experienced in development of corporate governance legal frameworks and practice, Investment Banking, capital raising and restructuring advisory, corporate governance reform and capacity building for Boards.

Good corporate governance helps companies operate more efficiently, improve access to capital, mitigate risk, and safeguard against mismanagement. It makes companies more accountable and transparent to investors and gives them the tools to respond to stakeholder concerns.

Corporate governance provides the structures and procedures which, when applied, direct and control companies. It also outlines the processes used by boards of directors to monitor and supervise management in discharging the board's accountability to the owners and stakeholders.

The fundamental question often asked is what constitutes good corporate governance practices. More than 70 countries around the world have adopted codes or guidelines that spell out the principles that directors and managers should follow to achieve good corporate governance goals. These codes are not usually mandated by law but are designed to encourage voluntary compliance. The codes provide definitions of best practices, which aim to define specific policies and procedures that foster good governance. In some jurisdictions, the corporate governance requirements are enshrined in law, and compliance is required especially for companies seeking a listing on stock exchanges. In these instances, companies are required to provide continuous reporting on corporate governance compliance.

GOOD CORPORATE GOVERNANCE IS ESSENTIAL FOR ALL BUSINESSES

INTERNATIONAL FINANCE CORPORATION (IFC)

Corporate governance is often and erroneously regarded as important only for large companies, or when it is required by regulators and stock exchanges for listed companies and other investors. However, the need for good business governance is important for all businesses. This includes small and medium-sized businesses and family run companies.

IFC has developed a Corporate Governance Methodology that it uses to encourage companies to enhance or start good corporate governance practices. IFC's Corporate Governance Methodology supports companies to evaluate and improve their corporate governance - including the governance attributes of key environmental and social policies and procedures - to identify, reduce, and manage risk. Its use can help a company confirm its commitment to demonstrate leadership and promote effective environmental, social, and corporate governance throughout the company. This includes applying a set of tools to promote good corporate governance practices around shareholder rights, accountability for the board of directors, environmental, social issues, and disclosure and transparency practices.

IFC was the first development finance institution to undertake corporate governance analysis of every investment transaction as part of its standard due diligence process. This focused approach has been implemented for many years and was formalized in July 2011. This has helped IFC identify relevant corporate governance risks its partners face and suggest appropriate solutions to address the risks and take advantage of improvement opportunities. Through this work, IFC has learned the following, which we believe will help other companies strengthen their corporate governance and therefore their operations.

IFC Corporate Governance Methodology

Commitment to Good Corporate Governance Practices Starts at the Board: The foundation of good corporate governance is the commitment of the board of directors and management to be aware of the importance of good corporate governance practices and to apply them in the day-to-day activities of the organization. This commitment fosters a business environment where decision making is driven in the best interests of the company, its employees and its shareholders. Hand-in-hand with this commitment is the need for the board to adopt good environmental and social practices. Adoption of good environmental, social and governance practices improves the sustainability of businesses.

Invest in People Who Can Provide Strategic Guidance: Leadership is key in providing strategic guidance. Every company needs the right people, team and processes in place to guide the company on its growth trajectory. The board has the important task of setting a common understanding of the purpose of the company, the values that drive the business and who the important stakeholders are, amongst other duties. The board must also identify the sustainability issues which are pertinent to the business of the company. There is no recommended standard size for boards: Issues such as the size of the company, industry, and turnover are examples of factors companies should consider when determining the size of their boards. Boards need to be qualified and adequately structured to oversee the strategy, management, and performance of the company.

As the highest governing authority within a company, the board of directors also needs to ensure that the company structure is able to broadly protect the company's interests, stakeholders and shareholders assets and to ensure a return on investment. All strategic decisions originate with the board or must be approved by the board. More specifically the board hires and fires top executives, monitors company performance, approves financial statements, decides executive compensation and benefits, assesses, and plans for potential risk and makes major decisions including whether to approve mergers or acquisitions.

Above all, the board sets the tone for the entire company ensuring that it acts ethically, legally and responsibly.

To prevent the concentration of power and information in one or a few individuals, companies are advised to have a balance of executive and non-executive directors, some of whom are independent. Experts differ over the number of independent directors a board should have but it is generally acceptable that a third to half of the board's directors should be independent. An executive director is also an executive of the company such as the CEO or CFO. A non-executive director is not part of management and is valued for external perspectives and unique expertise.

Good Corporate Governance Facilitates a Good Work Environment: A third parameter of good corporate governance practice is to facilitate a good working environment. To support a company's good corporate governance, boards should ensure that a company's internal control systems, internal audit functions, risk management systems (including an environmental and social management system), and compliance functions are sufficient to ensure sound stewardship of the company's assets, effectiveness of operations, accuracy in reporting, and compliance with policies, procedures, laws, and regulations. Non- effective internal control systems that are either weak or limited contribute to business mismanagement, poor financial performance and often to business failure. Businesses are advised to adopt control systems that are suitable to support their stage of growth and development.

Invest in Disclosure and Transparency: Systems that systematically enforce disclosure and transparency ensure that not only is the company's story told appropriately, but that timely, relevant and accurate information is shared with shareholders, prospective investors, regulators and other stakeholders. When boards report appropriately, information on key issues such as products, financial performance, governance structures and sustainability is readily available.

The board should put in place policies and practices that ensure that the company's financial and nonfinancial disclosures are a relevant, faithful, and timely representation of material events of the company to shareholders and other stakeholders.

Disclosure and transparency fill information gaps for customers, investors, and employees and, as a result, can have a positive effect on a company's revenues and its access to human capital or financial capital. Their use also promotes more efficient capital markets by ensuring "fair disclosure" to all investors and preventing asymmetric information. These benefits are amplified when companies consider wider sustainability concerns, such as environmental, social, and governance issues.

Protect Minority Shareholders: Ensuring that the company's minority shareholders' rights are not abused, and that other stakeholders are treated equitably, is critical for good corporate governance practice. Businesses should pay close attention to this especially when legal frameworks are not strong, in family businesses, and in companies with controlling shareholder risk. The board should have in place policies on key issues such as voting, board nomination, and all other rights of minority shareholders, including those related to change of control and related- party transactions. It should also disclose information on how to exercise such rights.

Governance of Stakeholder Engagement is also a key parameter of good corporate governance practice. Boards are advised to map out all stakeholders and develop strategies for engaging with each stakeholder. The strategies should provide for stakeholder identification, analysis to identify the needs and interests of diverse stakeholders; differentiated approaches for priority groups; iterative disclosure and consultation; grievance mechanism and reporting and management level mechanisms to raise and resolve consistent stakeholder issues.

Conclusion

Good corporate governance frameworks protect the interests of stakeholders and reinforce the fiduciary duties of boards and management. It also widens the purview of management to focus on the long-term sustainability of the business ecosystem.

The IFC Corporate Governance Methodology is available for six different kinds of companies - listed, family-owned or founder-owned, financial institutions, state-owned enterprises, funds, and small and medium-sized enterprises. It emphasizes the importance of continually improving a company's governance practices.

The practice of good corporate governance should always take a front seat in the activities of companies. Companies and institutions are unique and corporate governance frameworks should be adopted to fit the business needs to properly govern the relationships between the institution/company's owners, board, management, shareholders and stakeholders in a sustainable manner.

At the helm of most companies is a board whose responsibility is to provide the company with leadership in prosperous times as well as in challenging conditions, such as the recent COVID-19 pandemic. Perilous times do not remove or reduce the responsibilities of a board. On the contrary, boards are expected to step-up their duties to help companies navigate difficult situations. Boards should consider good corporate governance practices as essential for sustainable leadership. Being committed to good corporate governance practices, having structures that can support the running of the company, ensuring the internal controls and audit support that are sufficient to sustain financial accounting, operations control and compliance are some essential corporate governance parameters for sustainability.

2 THE ROLE OF CORPORATE GOVERNANCE IN THE GROWTH OF I&M GROUP PLC

I&M GROUP PLC

The Author:

Gauri Gupta heads I&M Group's Corporate Advisory function. She holds a B.Com degree and is a Chartered Accountant from the Institute of Chartered Accountants of India. Her experience of over 25 years in Banking covers Credit, Risk Management, Product Development, Finance, and Strategic Planning. Under Corporate Finance, Gauri's forte lies in M&A transactions including transaction structuring and negotiation of legal documentation. Gauri successfully executed I&M's regional expansion and growth strategy which has seen the Kenya based Group become a significant regional banking Group with presence in Mauritius, Tanzania, Uganda and Rwanda. She has also been instrumental in the enhancement of the corporate governance framework at I&M for over 15 years and oversees governance matters for I&M Group Plc, the parent entity for I&M Bank Group, listed on the Nairobi Securities Exchange. Gauri is a Director on the board for several companies under the I&M Bank Group including Bank One Limited in Mauritius, I&M Capital Limited, a Fund Management company licensed by CMA and I&M Burbidge Capital Limited, an East African Corporate Advisory firm.

I am delighted and honored to pen this article recounting my experience and insights of I&M Group's governance journey and how it transformed itself from its humble beginnings as a family-run finance company to a leading financial services Group in East Africa and a Tier I bank in Kenya.

As I reflect and muse over my last two and half decades at I&M, there is no doubt that there were several factors instrumental in its transformational journey. The defining one, however, was the principal shareholders' vision to professionalize the Bank and lay the foundation of its growth on strong corporate governance practices within and across all levels at the Group. The tone from the top was indeed very clear and without this, it would not have been possible to even drive the governance requirements that came about from the regulators or those necessitated by I&M's growth and expansion.

An insight into I&M's history and background would be key to understanding how the Bank and the Group have evolved over the last 48 years. I&M was incorporated in 1974 to provide personalized financial service for Nairobi's business community before gradually evolving into a licensed financial institution in 1980 and later into a commercial Bank in 1996. It is remarkable to note that even before I&M became a Bank in April 1996, it had started its journey of institutionalizing the business and initiating sound corporate governance principles with the appointment of independent Directors on its Board.

I&M commenced its inorganic growth and expansion in 2002 with the acquisition of Biashara Bank in Kenya, followed by the acquisition of several banks in East Africa. This started with the acquisition of Bank One in Mauritius in 2008 and progressed with other acquisitions such as Tanzania in 2010, Rwanda in 2012, Giro Commercial Bank Ltd in Kenya in 2017 and Uganda in 2021. Non-banking acquisitions included Burbidge Capital in 2016 & Youjays Insurance Brokers in 2018.

From around 40 employees and one branch in Kenya in 1996 to over 2500 employees and a network of 83 bank branches spread across 5 countries presently, I&M Group has grown by leaps and bounds. Today it boasts of a consolidated balance sheet (Total Assets) of over USD 3.7 billion, Shareholders' Funds of close to USD 600 million, and a loyal and growing customer base of over 350,000 across the region.

The Journey Begins

It was during the period 1999-2000 that the Central Bank of Kenya issued several prudential guidelines under the Banking Act (including those for corporate governance) coming on the heels of five bank failures in Kenya in 1998. The message was loud and clear, the Central Bank was seeking to transform the Banking sector in Kenya, forcing the licensed banks to implement and uphold high standards of corporate governance.

I&M's first acquisition in December 2002 was a major turning point in its corporate governance journey. Having taken over the banking business of the erstwhile Biashara Bank of Kenya in exchange for its shares, I&M changed overnight from being a closely held entity to one with c. 1,180 shareholders. In addition to the changes that had been brought about by the newly issued guidelines by Central Bank, this meant putting in place the necessary systems and structures for accountability and responsibility for the stewardship of the Bank's assets to maintain and increase shareholder value simultaneously with the satisfaction of other stakeholders.

2003-2007

The next significant milestone in I&M's journey of enhancing corporate governance was the coming on board of Proparco, the French DFI, first as a senior debt lender and thereafter as a shareholder following an equity injection, jointly with DEG, the German DFI, in 2007.

I&M continued to step up its corporate governance standards during the 5 years 2003-2007. Some of the more notable ones were:

- the institution of the 1st set of Board Committees
- the introduction of a formal Board Evaluation process
- strengthening of, and diversification of the Board by the appointment of additional independent non-executive directors at the apex level
- formalization of its 5-year Strategy with clearly defined strategic (medium term) and corporate (annual) objectives and KPIs
- strengthening of management oversight and control through several functional management committees
- enhancement of management information and reporting systems,
- strengthening of its Internal Audit function
- setting up of independent Risk Management and Compliance functions

in addition to several others.

2008-2012

As part of its 5-year strategy drawn up in 2007, I&M worked tirelessly to bring to fruition its aspiration of becoming a regional player, establishing its presence in Mauritius, Tanzania, and Rwanda during the next 5-year period between 2008 and 2012. Part of this entailed increasing its capital base to support this strategy and saw the Bank further open its shareholding to high net-worth individuals as part of a private placement exercise undertaken in 2010.

This was accompanied by further strengthening of its corporate governance practices by embracing international best practices.

A few, worthy of mention here, include:

- an increase in the number of Board Committees covering areas such as Risk, Procurement, Strategic matters, Nomination and Remuneration, and Transfer of shares;
- formalization of the Group Corporate Social Responsibility structures,
- deepening of relationships with various stakeholders aimed at making a sustainable difference in the community in the areas of education, health care, environment, and general well-being especially of HIV affected and orphaned children,
- review and strengthening of its Anti-Money Laundering policy and procedures,
- implementation of the social and environmental risk management system,
- revamp of critical policies and procedures to beef up Enterprise risk management, including strengthening of the Treasury and Asset Liability Management framework.

On the Management front, the Group redesigned its organizational structure and set the foundation for a Group Management Centre to focus on strategic management and oversee operations in the subsidiary banking entities and launched an employee share ownership scheme.

2013-2017

The listing of the Group on the Nairobi Securities Exchange (NSE) in June 2013 through a reverse take-over of City Trust Limited and the simultaneous creation of I&M Group Plc saw I&M take the next leap towards further bolstering its corporate governance framework. It is noteworthy that I&M Group Plc was the first non-operating holding company licensed and regulated by the Central Bank of Kenya. This was in addition to its being regulated by the Capital Markets Authority (CMA) and NSE.

The 5-year period from 2013-2017 witnessed the Group moving to a formalized group reporting structure with each subsidiary reporting to the holding company. Having an independent Chairperson and several independent Directors at the holding company level went a long way in further enhancing the governance framework.

Other governance initiatives included improvements in financial reporting standards and enhanced public disclosures through the Bank's website, annual reports and periodic investor briefings. More importantly, I&M launched its Transformational strategy aimed at digitizing its business model in readiness for creating long-term sustainable value for stakeholders.

In 2017, the Group subjected itself to a governance audit undertaken by an independent firm. This would then pave the way to determine the adequacy and effectiveness of the organization's governance policies, structures, and practices and the further improvements that it would require to make.

2018-2022

Any expert on corporate governance would attest that strengthening the governance framework in any entity is a continuous and unending process and I can vouch for this based on my own experience at I&M.

I&M continued to grow across geographies and expanded its presence in the wider financial services. Over the next five years the Group implemented several initiatives to drive performance, nurture talent, and build capacity through skills training. The Group put in place an online e-learning platform to make it easier for the growing number of staff to access relevant training materials in their own time and at their own pace. In 2018, the Group also set up its digital factory, dubbed 'iCube'. This was a significant milestone aimed at developing transformative digital financial solutions keeping in mind the Group's strategic focus on improving operational efficiencies and enhancing customer delivery standards.

As part of its digital strategy, the Group continues to invest significantly in platforms to support innovation and remain relevant to its stakeholders amidst alleviated volatility, disruptions, and uncertainties in its operating environment

It was during this period that the Group set up I&M Foundation to spearhead and deliver on its vision and strategy with the hope of creating shared value and a positive impact. It has adopted a collaborative approach that facilitates its participation in more impactful activities and drives the Group's environmental and sustainability agenda reflecting the Group’s vision.

Steadfast on its commitment to enhancing corporate governance in line with global best practices, I&M has significantly enhanced disclosures through its revamped website as well as the introduction of its first Integrated Report in 2019. It has subjected itself to external, independent Governance Audits as well as Legal & Compliance audits every 2 years which provided the required assurances to our stakeholders. At the same time, the few gaps and recommendations from the auditors were comprehensively addressed to ensure a process of continuous improvement in the corporate governance framework.

The Group is now working on implementing its climate risk management framework to leverage climate opportunities for the Group’s long-term sustainable growth.

Recognition

It is encouraging to note that I&M’s efforts have been publicly acknowledged. I&M, a few years ago, was awarded the Best Bank in East Africa on Corporate Governance by Banker Africa. The award, recognized the Bank as a benchmark for high ethical standards, transparency, and accountability across all levels of operation, was a significant achievement coming against the backdrop of the recent bank failures in the Kenyan banking industry around the same period.

As we forge ahead, taking each step forward with renewed vigor and confidence, we look back with humility and pride seeing where we came from and what we have achieved on this incredible journey over the last few decades. It would be remiss not to spotlight the support received in this journey from the Group's board members especially its independent directors, DFI partners, correspondent banks, professional service providers, consultants, regulators, and peer banks both locally and internationally.

Challenges

Walking down memory lane recollecting some of these significant milestones, I realize that this journey has not been an easy one with several road bumps and hurdles along the way but as a wise man once said, "if you find a path with no obstacles, it probably doesn't lead anywhere!"

I&M's story is a testimony to its success in overcoming these obstacles, and yet some remain unaddressed to date. Endemic corruption, a frustrating "one-size fits all" approach often adopted by regulators coupled with an attitude of "ticking boxes" and a lack of a level playing field remain some of the key challenges. In Kenya, listed companies are undeniably disadvantaged as compared to the vast majority of other corporate entities and organizations that are not required to follow similar or even any of the basic corporate governance principles. This has resulted in a disparate situation leading to too much information, unwarranted media attention bordering on sensationalism, and over-analysis for the handful of listed entities.

Going Forward

There is an urgent need to introduce legislation and guidelines to enhance corporate governance in private companies whether through an amendment to the Companies Act or a code applicable to private companies. It is only when private companies start adopting corporate governance standards that it will lead to a wider understanding of the many benefits of doing so. For sure, the key benefit of doing so remains one of creating sustainable high-value entities which can withstand and survive the test of time and economic cyclical fluctuations.

3 WHY AND WHEN TO DIVEST THE FAMILY BUSINESS

PKF KENYA LLP

The Author:

Darshan Shah is a Partner in PKF Kenya LLP and Head of Assurance for PKF in Eastern Africa. He is an expert in Succession Planning and heads PKF's service offering in this area. Darshan has over 20 years' experience in providing professional services in the East African region. Darshan has led audit and assurance engagements, has been involved in financial due diligence, tax re-structuring and family succession planning engagements. He has significant transaction advisory experience in mergers and acquisitions.

Succession planning in the context of family businesses is not merely about passing on businesses to subsequent generations - it involves more of a holistic preservation of wealth for future beneficiaries. However, based on multiple studies, more than 60% of family businesses do not have a succession plan in place and over 50% of business owners over the age of 60 years do not have a documented plan to facilitate inevitable transition anticipated upon their exit from active involvement. Unfortunately, the beginning of such a transition period is more often triggered by ill-health or even worse it is marked by sudden death; both of which render the original owner's incapable of any further executive involvement.

Even where the founders are actively working on a succession plan, a decision on whether to retain ownership of the business within the family or to sell it to third parties is an agonizing financial and emotional challenge. Further, the decision on the appropriate timing of a family business divestiture is convoluted because of the many social considerations that have to be factored into the process.

This article explores a few factors that may tilt the scale in favor of a decision to either hold or divest the business and the implications that may inform the timing of such a decision.

Risk of Losing Bequeathed Wealth

Economist Adam Smith is credited with the observation that great fortunes are seldom extended and are often lost by children and grandchildren. His observation is validated by recent research indicating that only 30% of family businesses make it past the second generation of leadership, while 10% to 15% make it past the third generation with a mere 3% making it to the fourth generation.

A decision on whether to hold onto or sell a family business may therefore be better informed through careful assessment of the beneficiaries including their perspectives and interests in life, their areas of passion and overall ability to carry on the business.

A founder whose heir has an unfettered pursuit of grossly divergent goals may find it better to divest from the business and invest the funds for future wealth preservation. This ensures the beneficiaries benefit from the wealth created by founders and use it in a way that benefit subsequent generations.

Lack of a Successor

Succession planning within the family is also affected by lack of family member (s) to take over the business. In such a case, the decision to divest is inevitable. It is also becoming increasingly common to find situations where heirs do not wish to undertake the business because they either lack the intellectual flexibility required to steer the business through turbulent economic times and ultimately catapult it to greater heights or simply lack the founder’s zeal, passion and skill for the specific line of business. In such situations, an exit strategy in the form of divesting is necessary so that the funds realized can be applied in an area aligned to the heir’s competencies and interests, thus retaining wealth within the family.

Many times, a successor’s perceived lack of passion and ability to take over a family business emanates from factors that could have been controlled from the onset. Inability of founders to trust, mentor, grow and delegate authority to their successors plays a big role in the inability to hand over the baton to the next generation. Family businesses that have spanned generations have mastered this and continuously mentor and guide successors with an aim that they will eventually take charge and grow the business to new heights.

Effects of the Internet Revolution

New forms of technology driven business have been a threat to the traditional ‘brick and mortar’ enterprises in terms of direct competition. Further, existence of fast-growing technology related entities increase the opportunity cost of being in a traditional business because the latter have slower financial returns and lower general appeal to the younger generation. This is compounded by the fact that there is a generational divide between founders and beneficiaries; a divide that was accelerated by the internet revolution. In such cases, it may be important for the founders and their beneficiaries to jointly decide on the future of the business, part of which may include hiring of external professionals to run the business on behalf of the family or changing business models with a view to adapting to current trends that beneficiaries can identify with.

Economic Considerations

In some cases, offers to divest are plainly irresistible due to the potential cash value. Although emotional and social factors may transcend economic considerations, it is important for the family business to carefully evaluate such opportunities because this could mean higher wealth growth and preservation for the family in the longer term.

Impact of Debt

Some family businesses are gravitating towards increasing debt, where they have to continually borrow to survive. The owners may have a blurred vision of the future regarding how exactly this debt situation will pan-out thus providing a compelling reason to divest with a view to safeguarding family wealth.

Life After Sale

Founders have to factor in the effects of the divestiture on their post-sale preoccupation. For people who have been fully engaged in building their business on a daily basis for decades, life outside the demands of the business may be daunting. There would be need to determine what they will be engaged in since this may inform the need to leave themselves a few roles in the business as they ease themselves out, as opposed to an outright sale.

Whatever the circumstances, family businesses should carefully review their succession plans and revisit them regularly with a view to ensuring the wealth maximization and preservation objective is met. Often such businesses and families would benefit from the involvement of an independent outsider who can help analyze and map out the family dynamics, intentions and objectives and the state of the family business in providing clarity on the benefits of various options.

4

SHARPENING THE FAMILY BUSINESS EDGE BY ENHANCING GOVERNANCE STRUCTURES

IKM ADVOCATES (DLA PIPER AFRICA)

IKM ADVOCATES

The Author:

Kamami Christine Michira is a highly regarded corporate lawyer with over 25 years post qualification experience in financial markets. Before going into private practice, she led the legal teams at the Nairobi Securities Exchange (NSE), the Capital Markets Authority (CMA) in Kenya and two investment banks. She also spent four years with the Centre for Corporate Governance developing governance frameworks and guides and training directors. She is a much sought-after trainer in the areas of legal duties and liabilities of directors, strategy, board effectiveness and reporting.

Kamami's 360-degree experience of financial markets has given her deep and valuable insights into matters of corporate governance and conviction of the importance of good corporate governance to profitability and sustainability.

. . . company value is what unites shareholders, irrespective of whether these are family members, institutional shareholders or investors who are external to the controlling groups.

Roque Benavides, Buenaventura, Chief Executive Officer

IKM ADVOCATES (DLA PIPER AFRICA)

Family: The Foundation of Enterprise

Family in its many shapes and forms is recognized universally as the basic unit of social organization. It is in families that we are born and nurtured. Through families that cherished values are imparted to successive generations. It is only natural that many enterprises start life as family-owned enterprises (FOEs). This is true in Africa as it is in Europe, the United States, or Asia. FOEs make up over 90 per cent of the world's companies. In Kenya, family businesses are responsible for production of goods and delivery of services across the country. They account for significant revenues in some cases higher than those earned by some public companies. Good governance of FOEs is therefore key to sustainability of economic activity and the country's well-being.

The Family Business Edge

Family ownership of business has often been depicted as inimical to good governance and commercial success. This is not necessarily so. While the close control that comes with family ownership does present certain challenges, it also posits benefits. There are attributes of FOEs that if effectively leveraged can anchor and sharpen the competitive edge of these enterprises for increased profitability and sustainability. The competitive advantage that is drawn from these attributes of FOEs is what has been described as the family business edge.

Value Driven Culture

FOEs are almost always founded upon and driven by the values of the family that establishes the enterprise. Values are concepts or beliefs pertaining to desirable behaviors that transcend specific situations. Values of FOEs tend to be more humane, emotional and fundamental. Those of other businesses are on the contrary typically more transactional, impersonal and focused on economic outcomes.

The nature of values determines the kind of behaviours that are acceptable in an enterprise. This is the reason why FOEs enjoy stronger corporate cultures. Their value system drives key decisions in strategy, organizational structure, culture, governance and leadership style. The values inform their approach to the stewardship of assets and shape the desired legacy. All these work to establish a strong sense of identity and commitment to the business. Much of the family business edge is drawn from the centrality of values in an FOE. Effective culture cannot be fabricated. Neither can it be designed and imposed for current commercial needs. Effective culture must have deep roots. Its advocates have to be sincere. It must be natural and consistent.

Wholesome work environment and committed work force

Value led corporate culture in FOEs tends to be reflected in the work environments. Work environments in FOEs tend to be more wholesome and accommodating. Family members working in the business are flexible and demonstrate strong loyalty and a deep commitment to success. This is seen especially across generations where successive generations seek to build on the achievements of their predecessors.

In FOEs, employees are treated like extended family. As a consequence, they develop a strong bond with the family demonstrating a similar level of commitment and loyalty to the business. Years of working together builds a strong sense of belonging and interdependency beneficial to both the family and the business. Such environments facilitate the full expression of creativity and foster hard work. Their output is superior and sustainable.

Access to capital

In the early and critical stages of enterprises, it is to family that entrepreneurs turn for capital. This is regardless of the form be it debt or equity. Capital from family is more flexible. Need dictates its structure. It is also less complicated in terms of process and less expensive. Capital from family is typically stable and patient allowing better alignment of resources with strategic objectives.

This is particularly important during difficult periods and when urgent opportunities present themselves.

A value-driven culture, committed workforce and ease of access to necessary capital are some of the unique attributes of FOEs that if leveraged can sharpen their competitive advantage enabling them to dominate their markets for successive generations. Where FOEs are successful, the rewards are high, and the benefits shared not only within the family but throughout the community.

Governance Challenges for FOEs

Governance is the framework through which owners of a business set goals, manage risk, and optimize the performance of the business. It involves creation of rules, practices, and processes to guide the management of the business and to balance the interests of stakeholders including management, customers, suppliers, financiers, and the community.

Objectives of FOEs include strengthening of family values, creation of family investments, reputation building, contributing to community, protection of family legacy and creation of employment opportunities for the family. An effective governance system provides the framework within which FOEs can meet their objectives.

FOEs face certain unique governance challenges. The biggest of challenge is the interface between the family and the business. Where decisions are made around not only the business but also the family and the intersection of the two. In the early stages, the company and the family are not clearly distinguished particularly as regards finances and assets. Reliance is often placed on people rather than on structures and processes. As a consequence, internal controls, audit and risk management tend to be weak. This becomes apparent as the business grows larger and more complex.

Getting Governance Right in FOEs

Strong governance frameworks in FOEs provide consistency in the decision-making process. They create the best possible environment for engagement so that the considered decisions are made as quickly as they are required.

Strong governance frameworks also encourage transparency making communication more effective by ensuring that family members and critical stakeholders have the opportunity to contribute to the process and at the same time are on the same page about important aspects of the business. They ensure continuity and the promotion of the family's culture.

To sharpen the family business edge, FOEs must be deliberate in adopting organized structures appropriate to their circumstances. Such structures should be considered from the perspective of both the family and the business.

From the perspective of the family, the structures should provide a formal forum for discussion of routine family and business matters; provide transparency into the business, its operations, performance and strategy; communicate key issues, both within and outside the enterprise and foster the development of new ideas.

From the perspective of the business, the structures provide a link between the family and the FOE and vice versa ensuring adherence to the values, mission, vision and strategy of the firm and the family. They facilitate communication of values and vision, generation of new ideas and approval of significant initiatives. They avoid unnecessary conflicts among or misunderstandings and provide a means for resolution when such conflicts occur.

FOE governance structures

The organized structures that may be adopted by families range from informal family assemblies to highly structured family offices.

The Family Assembly is a meeting of the family that discusses issues relating to it ranging from the family enterprise to vacations, philanthropy and financial literacy. These are suited in the very early stages where the founder of the enterprise (often the matriarch or patriarch) is actively involved. Regular family assemblies facilitate the discussion of critical issues relating to the family and the enterprise without the wait of intimidating structures and processes. They are an excellent way of easing FOEs into a governance framework.

Family Councils are more formal set ups where select members of the family usually the more senior members sit to consider and take decisions on critical family issues. They are empowered to articulate expectations of the family vis-à-vis the enterprise and to develop policies that safeguard the family's long-term interests. They develop policies and make decisions on issues at the intersection of the family and the business. These issues include matters such as employment of family members, liquidity, succession, conflict resolution and communication. Directors of the FOE often serve on the family council. Family councils report to and are accountable to the broader family assembly.

Family Advisory Boards are external to the family. They may be permanent or ad hoc and provide objective advice to the board of directors and management of the FOE. They are usually used when FOEs are considering strategic decisions such as external investment. Successful advisory boards are those that can remain independent and communicate openly with the family. Such boards work with the family councils.

Family Offices on the other hand are formal investment and administrative centres also overseen by a family council through which boundaries between family and business matters are managed. They also provide personal investment planning, insurance coverage, tax and estate planning, career counselling and other topics of interest to family members. They develop the skills and knowledge of family members into responsible owners.

Governance solutions for FOEs depend to a large extent on the stage of the FOE. Some are suited to the founder stages and others to those of successive generations. Over time, the structures facilitate formalization of critical issues into written policies. The policies are ultimately put together in a family constitution that also codifies core values, vision, and mission of the business. The family constitution defines the roles, composition, and functions of family governance institutions vis-a-viz the company's governance bodies such as the shareholders' meeting, the board of directors and senior management.

Family governance structures such as family assemblies, councils and family offices can play an important role in managing the divergent interest of family members who work for the family business and those who are only owners and rely on dividend income. Within these governance structures, sensitive issues can be discussed, and solutions developed. These include sound dividend policies that consider the needs of the business and the family members and liquidity funds, which can be used to redeem the shares of family members who wish to pursue interests outside of the family business.

Entry of non-family shareholders into FOEs presents additional challenges to governance including ensuring fairness and accommodation of divergent views as well as access to company information. This is more easily achieved within clear governance structures through which FOEs are able to appoint an empowered board that oversees and assists management define and pursue the company's strategic direction in a manner that aligns the interests of all investors. Inclusion of independent directors is helpful in this regard as it provides objective perspectives.

As does a formal organizational structure that clearly defines the roles and responsibilities of all senior managers and that decentralizes decision making. The lack of well-designed decision-making guidelines can ultimately negatively impact the FOE's success as well as family relations.

The ability to rope in non-family professionals is core to sustainability of FOEs. As is a good succession process. In this regard, clear employment policies, internal training programs and a remuneration system that incentives the right behaviour are invaluable.

Succession planning is particularly critical in family businesses. Effective succession planning in FOEs should ensure that changes in ownership have no material effect on how the business is governed.

The governance framework for FOEs is a delicate affair. It is prudent for FOEs to retain professional advisers such as lawyers and corporate finance professionals to assist them in designing the structures that are balanced with processes that are simple and disciplined. Where feasible, non-family members such as external investors should as much as is practically possible be part of the deliberations.

5

INDUSTRY INSIGHT

GLACIER PRODUCTS LIMITED

The Author:

Sunil Shah is the current Chairman of the Board of Directors at Glacier Products Limited, where since 2013 he held the position of Finance Director for the business and oversaw the Finance and Credit Management Departments.

Sunil started his career at Le Stud Limited, a Garment Manufacturing Company where he held the position of Managing Director for the period May 1987 to December 2007. He later moved to Vajas Manufacturers; a promotional services business as an Executive Director in January 2008 and held the position until December 2012.

Sunil has a background in Software Engineering from Manchester University, United Kingdom.

1. What are the reasons behind the Company putting in place structured corporate governance procedures? How has the Company worked towards achieving the goals put in place through these procedures?

Corporate governance has assisted the Company in the following ways:

- Segregation between shareholders and directors; allowing for newer ideas and innovation.
- Ensuring each individual's objectives are aligned with the overall objectives of the business hence driving the growth strategy.
- Assisted in attracting better financial terms from investors and lenders, as well as increasing marketability of the company.

2. Was there resistance in family shareholders to any of the changes towards governance? If so, how did you overcome that?

There was largely no resistance from family members to implement this change, however, there were differing views as to the extent of change, in particular, the level of involvement of each shareholder. At the end of the day, the shareholders shared the common goal to expand the business and therefore the discussions on the change towards corporate governance were driven with a uniform intent.

3. The Board of Directors play a key role in corporate governance. How has the Company ensured that the Board and Management have differing roles, ultimately with the unified goal in growing the business?

- Implementation of strong internal processes and controls has ensured that each individual is sufficiently positioned to carry out their duties and accountable for their respective actions.
- Clearly set out policies informing of the objectives, processes and procedures.
- Hiring of competent management and workforce.

4. What are some of the obstacles faced along the way as the Company sought to put in corporate governance and planning procedures?

- Cost and time associated with putting in place these procedures.
- Ensuring buy-in from the Management and workforce.
- Changing the hands-on approach by Shareholders to taking a step back approach.

5. What have been the benefits of corporate governance you have noticed? Have there been any negative results?

Benefits

- Each individual is more accountable/responsible for their duties.
- Structured approach to decision making.
- Less time spent in conflict resolution.
- Reduced key-person risks associated with the family while ensuring business sustainability.

Negative

- Costs and time associated with initial set up of corporate governance procedures. This is expected to be a one-off investment.

6. Has having a Private Equity investor onboard helped you implement the governance changes?

Yes. AgriVie has been very instrumental in bringing about this change. They have brought on board their expertise and understanding of governance to provide key insights for change. AgriVie has a vast number of years of experience in the market and has brought on board a wide network of avenues.

ABOUT US

I&M Burbidge Capital Limited is a corporate finance advisory firm operating across Sub-Saharan Africa and a subsidiary of the I&M Group Plc, creating long-term value and solutions for its clients across the region.

Advisory Services:

Originating and Structuring Equity and Debt Capital Raising, IPOs, M&A Transactions, Strategic Options Advisory, PE Advisory and Independent Research Services.

DISCLAIMER

This document has been prepared based on information in the public domain. None of the information on which the document is based has been independently verified by *I&M Burbidge Capital Limited* nor its affiliate bodies and associates, who do not take responsibility for the content thereof and do not accept any liability with respect to the accuracy or completeness, or in relation to the use by any recipient of the information, projections, opinions contained in this document.

This document is purely for information purposes only and should not be relied upon to make any investment decisions or any other decisions. Any liability is disclaimed, including incidental or consequential damages arising from error or omission in this document.

Head Office
3rd Floor, 1 Park Avenue
1st Parklands Avenue, Parklands
P.O. Box 51525-00100
Nairobi, Kenya
Tel: +254 (0) 719 088 160

Kampala Office
Orient Plaza
Kampala, Uganda
Tel: +256 (0) 794 476 967